

**TAX CONSIDERATIONS FOR
INDIVIDUAL CHAPTER 11 DEBTORS**

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Tax Considerations for Individual Chapter 11 Debtors

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Tax Considerations For Individual Chapter 11 Debtors

I. Outline

Tax Considerations for Individual Chapter 11 Debtors

- A. Timing Issues – Separate entity created
1. Election to Terminate Tax Year (“1398 Short Year”)
 - a. Tax attributes into bankruptcy estate are measured on January 1 in the year of bankruptcy **unless an election is made by the individual debtor.**
 - b. Election allows individual to divide tax year and utilize NOL and other tax attributes to reduce income, tax, etc. in the short period prior to bankruptcy when a tax is anticipated.
 - c. Make election by due date for filing individual debtor’s short period return. **(If the short period tax return is extended the election must be made with the extension.)**
 - d. Election is irrevocable.
 - e. Election not available if debtor has only “exempt assets”.
 - f. Taxable income must be annualized in both short period tax returns.
 2. Dismissal of the bankruptcy case
 - a. Bankruptcy never existed – debtor reports all activity.
 - b. Separate entity rules do not apply therefore **debtor** reports all transactions.



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B. Transfers between Debtor and Estate - Debtor's property and interests in property become property of the estate.

1. Post-petition wages and other compensation (SE tax is responsibility of individual debtor.)
2. Interests in partnerships and S corporations including suspended losses and post-petition distributions of capital.
3. Rights to inheritance, bequest or devise acquired either prior to or within 180 days of commencement of the case belong to the estate.
 - a. Debtor may have obligation to pay inheritance tax even though estate receives inherited property.
4. Joint Tenancy and Community Property
 - a. Non-debtor spouse in Community Property State may suffer tax when Trustee disposes of property. (Community property is property of the bankruptcy estate taxable on date of transfer to estate.)
 - b. Non-debtor co-owner may suffer tax when Trustee disposes of property. (Jointly-held property is not taxable until sold by Trustee.)
5. Causes of Action
 - a. Personal injury, discrimination, etc. (personal physical injury settlement is not taxable).
 - b. Collection matters

C. Death of the Debtor

1. Does not affect the bankruptcy estate.
2. Property does not receive a step-up in basis to FMV

D. Debtor's Tax Attributes



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1. NOL is often the most significant tax attribute. Affect of waiver of carry back period. Estate property (UNITED STATES of America, Appellant v. Soneet R. KAPILA, Appellee. No. 08-60723-CIV. Aug. 18, 2008 – (2008 WL 5612316 (S.D.Fla.)).
 2. Carryback of NOL creates tax refund for estate not individual debtor.
 3. Capital losses
 4. Charitable contribution carryovers, suspended passive activity losses and suspended at-risk losses are included as attributes under IRC Section 1398 to which the estate is entitled. (Not reduced by IRC Section 108(b)(2)).
 5. Attributes include individual debtor's method of accounting, basis, holding period and character of assets.
 6. Attributes that are affected by COD adjustment of IRC Section 108(b)(2) are reduced accordingly. Unused attributes at conclusion of bankruptcy belong to debtor except for administrative expenses of the estate.
 7. Ability to accrue future earnings/deductions to facilitate preparation of final tax return.
- E. Abandonment of property
1. Trustee may abandon property that is burdensome to the estate, shifting accompanying tax consequences to the debtor. (*See below - H. Planning*)
 2. Abandonment is not an exchange of property by the estate.
- F. Dischargeability of Tax Claims
1. Burden of proof – Debtor
 2. Automatic stay not applicable
 - a. Audit
 - b. Notice of tax deficiency
 - c. Demand for tax returns



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Assessment of tax, issuance of notice and demand for payment

d. Lien – Does property revert to Debtor?

3. Exceptions to discharge

a. Priority

i. Three-year rule (Due date including extension to Petition date.)

ii. 240 Day rule (Assessment date to Petition date)

iii. Tax not assessed but still assessable under statute

b. General

i. Tax return not filed

ii. Late return within 2 years of bankruptcy

iii. Fraudulent return

G. Income from Discharge of Indebtedness (COD Income)

1. When does discharge occur?

a. Debt forgiven

b. Debt satisfied for discount

c. Property for Debt exchange – recourse vs. non-recourse

d. Debt for Debt exchange

e. Material Modification of instrument (Yield, Timing, Amount of Payment, Obligor, Collateral)

2. Bankruptcy or Insolvency Exceptions

a. Bankruptcy – Title 11 of U. S. Code

- b. Insolvency - Exempt assets included in calculation of insolvency (e. g. homestead), unclear whether contingent liabilities are included in calculation.
 - 3. Reduction of tax attributes – Ordering rules: 1) NOL 2) General business credits 3) Minimum tax credits 4) Capital losses 5) Tax basis of assets 6) Passive activity losses 7) Foreign tax credits
 - 4. Qualified Farm Indebtedness
 - 5. Qualified Real Property Indebtedness (not for a C corporation)
- H. Planning
- 1. Filing Chapter 11
 - a. Foreclosure
 - b. Property with liabilities in excess of basis
 - c. Choice of year-end
 - d. Cooperation with bankruptcy Trustee
- I. Other
- 1. Offers in compromise

Tax Considerations For Individual Chapter 11 Debtors

II. Practice & Planning Points

Tax Considerations for Individual Chapter 11 Debtors

Practice and Planning Points

Timing Is Everything

There are a number of ways the bankruptcy estate can be affected by the timing of certain actions by the Debtor or by the creditors. Consider the following:

Section 1398(d) Short Period Election Of The Debtor

If the Debtor makes a 1398(d) election to file a tax return with a short year ending on the day before the Petition Date, any tax liability for the short period constitutes a priority claim against the bankruptcy estate. Absent the election federal income tax liability incurred in the year of commencement is a post-petition debt for which bankruptcy assets are not utilized. In addition, tax attributes will be available in the short year prior to passing to the bankruptcy estate. That means any net operating loss, suspended passive loss, capital loss carryover, etc. that exists on January 1 of the petition year may be utilized by the Debtor for the short year prior to passing to the bankruptcy estate.

A valid 1398(d) election must be made on or before the 15th day of the fourth month following the commencement date of the case. For example if a case commenced on May 10th, the short period election must be made no later than September 15th of the same year. **If an extension of time to file the return is sought the election must accompany the extension request.**

In the event the Chapter 11 estate is administered by a bankruptcy trustee, knowledge of a 1398(d) election is important information when tax planning for the disposition of estate assets and managing tax claims.

Foreclosure actions

A foreclosure can often result in adverse tax consequences so filing a bankruptcy petition prior to the issuance of a Sheriff's deed but after a foreclosure sale can present a dilemma regarding whether the foreclosure occurred pre- petition or post- petition.

Abandonment of property

The bankruptcy estate is tasked with providing a “fresh start” for the debtor and maximizing the distribution to creditors. Properties in default that may be foreclosed during the bankruptcy proceedings with the potential to create gain or other taxable income. Pass-through entities such as partnerships, LLCs, S corporations, etc. with the potential to generate phantom income should be reviewed carefully. Abandonment results in the property’s ownership reverting back to the individual debtor and any adverse tax consequences arising from foreclosure or triggering of phantom income being the liability of the individual and not the bankruptcy estate.

Federal Income Tax Liability

The Three Year Rule – Income and gross receipts taxes due within the three year period before the petition date are priority and non-dischargeable tax claims. For example if the petition date is January 1, 2011, all tax liabilities for taxable years for which the due date of the tax return (including extensions) occurs BEFORE January 1, 2008 are non-priority, dischargeable general unsecured claims. The 2008 tax year’s liability due on April 15, 2009 would be classified as a priority tax liability because the due date is within three years of the petition date.

The 240-Day Rule – This rule must be satisfied before a tax liability will be discharged. Any income taxes or gross receipts taxes assessed within 240 days prior to the filing of a bankruptcy petition will be classified as priority and non-dischargeable tax claims. When there are multiple assessments for a taxable year the latter deficiency assessment is the date from which the 240 days must be calculated. It is important to note that filing an Offer in Compromise to negotiate a settlement/reduce potential liability prior to the running of the 240 days or during a period in which a waiver of the statute of limitations on assessment is in effect serves as a suspension of the 240 days.

Tax Considerations for Individual Chapter 11 Debtors

Practice and Planning Points

Timing Is Everything

Section 1398 (d) Short Period Election

- Bifurcates the Debtor's tax year
- Short year liability is priority claim against the estate
- Tax attributes available to the Debtor
- Valid election on or before 15th day of fourth month following petition date
- Ability of Chapter 11 trustee to determine if Debtor made such election

Foreclosure actions

- Potential tax consequence post-petition
- Non-recourse debt may create gain versus COD under section 108

Abandonment of property

- Avoidance of foreclosure
- Pass-through entity phantom income
- Fresh-start of debtor versus distributions to creditors

Claims for Federal income Tax Liabilities

- Three Year Rule
- 240 Day Rule (Date of assessment important)
- Offers in Compromise/Extension of Statute suspends running of 240 days
- Failure to file returns – priority and non-dischargeable

Tax Considerations for Individual Chapter 11 Debtors

Practice and Planning Points

Individual Chapter 11 versus Chapter 7

1. Both Chapter 11 and Chapter 7 create a separate taxable entity upon the commencement of the case that is completely distinct from the individual debtor.

2. Estate Property

Chapter 7 Estate consists of property owned at the time the petition is filed. Other than certain property acquired within 180 days of the commencement of the case (e.g. inheritance) "after-acquired" property belongs to the debtor free and clear of all bankruptcy claims.

Chapter 11 consists of property owned at the time the petition is filed as well as the Debtor's post-petition earnings and property acquired after commencement but before closure of the case. (SE income is separately reportable by the debtor and therefore SE tax is liability of the debtor not the bankruptcy estate.)

See IRS Notice 2006-83 for information regarding allocation between pre- and post petition periods and self employment tax on non-employee compensation

3. Liquidation by bankruptcy trustee versus Plan Confirmation.
4. Bankruptcy administration expenses are deductible by both Chapter 7 and Chapter 11 individual estates [Section 1398(h)(1)]

Tax Considerations For Individual Chapter 11 Debtors

III. Tax Forms

Form 982

Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)

OMB No. 1545-0046

Attachment
 Sequence No. **94**

▶ Attach this form to your income tax return.

Name shown on return	Identifying number
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Part I General Information (see instructions)

- 1 Amount excluded is due to (check applicable box(es)):
 - a Discharge of indebtedness in a title 11 case
 - b Discharge of indebtedness to the extent insolvent (not in a title 11 case)
 - c Discharge of qualified farm indebtedness
 - d Discharge of qualified real property business indebtedness
 - e Discharge of qualified principal residence indebtedness
- 2 Total amount of discharged indebtedness excluded from gross income 2
- 3 Do you elect to treat all real property described in section 1221(a)(1), relating to property held for sale to customers in the ordinary course of a trade or business, as if it were depreciable property? Yes No

Part II Reduction of Tax Attributes. You must attach a description of any transactions resulting in the reduction in basis under section 1017. See Regulations section 1.1017-1 for basis reduction ordering rules, and, if applicable, required partnership consent statements. (For additional information, see the instructions for Part II.)

Enter amount excluded from gross income:		
4 For a discharge of qualified real property business indebtedness applied to reduce the basis of depreciable real property	4	
5 That you elect under section 108(b)(5) to apply first to reduce the basis (under section 1017) of depreciable property	5	
6 Applied to reduce any net operating loss that occurred in the tax year of the discharge or carried over to the tax year of the discharge	6	
7 Applied to reduce any general business credit carryover to or from the tax year of the discharge	7	
8 Applied to reduce any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge	8	
9 Applied to reduce any net capital loss for the tax year of the discharge, including any capital loss carryovers to the tax year of the discharge	9	
10a Applied to reduce the basis of nondepreciable and depreciable property if not reduced on line 5. <i>DO NOT use in the case of discharge of qualified farm indebtedness</i>	10a	
b Applied to reduce the basis of your principal residence. <i>Enter amount here ONLY if line 1e is checked</i>	10b	
11 For a discharge of qualified farm indebtedness applied to reduce the basis of: <ul style="list-style-type: none"> a Depreciable property used or held for use in a trade or business or for the production of income if not reduced on line 5 b Land used or held for use in a trade or business of farming c Other property used or held for use in a trade or business or for the production of income 	11a	
12 Applied to reduce any passive activity loss and credit carryovers from the tax year of the discharge	12	
13 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	13	

Part III Consent of Corporation to Adjustment of Basis of Its Property Under Section 1082(a)(2)

Under section 1081(b), the corporation named above has excluded \$ _____ from its gross income for the tax year beginning _____ and ending _____

Under that section, the corporation consents to have the basis of its property adjusted in accordance with the regulations prescribed under section 1082(a)(2) in effect at the time of filing its income tax return for that year. The corporation is organized under the laws of _____

(State of incorporation)

Note. You must attach a description of the transactions resulting in the nonrecognition of gain under section 1081.

General Instructions

Section references are to the Internal Revenue Code unless otherwise noted.

What's New


The exclusion for discharge of indebtedness of a qualified individual because of Midwestern disasters does not apply to discharges after 2009.

Purpose of Form

Generally, the amount by which you benefit from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you can exclude the amount of discharged indebtedness from your gross income.

You must file Form 982 to report the exclusion and the reduction of certain tax attributes either dollar for dollar or 33 $\frac{1}{3}$ cents per dollar (as explained below).

How To Complete the Form

IF the discharged debt you are excluding is . . .	THEN follow these steps . . .
Qualified principal residence indebtedness	<ol style="list-style-type: none"> 1. Be sure to read the definition of qualified principal residence indebtedness in the instructions for line 1e on page 4. Part or all of your debt may not qualify for the exclusion on line 1e but may qualify for one of the other exclusions. 2. Check the box on line 1e. 3. Include on line 2 the amount of discharged qualified principal residence indebtedness that is excluded from gross income. Any amount in excess of the excluded amount may result in taxable income. See Pub. 4681 for more information. If you disposed of your residence, you may also be required to recognize a gain on its disposition. For details, see Pub. 523, <i>Selling Your Home</i>. 4. If you continue to own your residence after the discharge, enter on line 10b the smaller of (a) the amount of qualified principal residence indebtedness included on line 2 or (b) the basis (generally, your cost plus improvements) of your principal residence. <div style="display: flex; align-items: flex-start;"> <div style="margin-right: 10px;">  <p>CAUTION</p> </div> <div> <p><i>If the discharge occurs in a title 11 case, you cannot check box 1e. You must check box 1a and complete the form as discussed below under A nonbusiness debt. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of box 1e and completing the form as discussed below under A nonbusiness debt.</i></p> </div> </div>
A nonbusiness debt (other than qualified principal residence indebtedness, such as a car loan or credit card debt)	<p>Follow these instructions if you do not have any of the tax attributes listed in Part II (other than a basis in nondepreciable property). Otherwise, follow the instructions for <i>Any other debt</i> below.</p> <ol style="list-style-type: none"> 1. Check the box on line 1a if the discharge was made in a <i>title 11 case</i> (see <i>Definitions</i> on page 3) or the box on line 1b if the discharge occurred when you were <i>insolvent</i> (see <i>Line 1b</i> on page 3). 2. Include on line 2 the amount of discharged nonbusiness debt that is excluded from gross income. If you were insolvent, do not include more than the excess of your liabilities over the fair market value of your assets. 3. Include on line 10a the smallest of (a) the basis of your nondepreciable property, (b) the amount of the nonbusiness debt included on line 2, or (c) the excess of the aggregate bases of the property and the amount of money you held immediately after the discharge over your aggregate liabilities immediately after the discharge.
Any other debt	<p>Use <i>Part I</i> of Form 982 to indicate why any amount received from the discharge of indebtedness should be excluded from gross income and the amount excluded.</p> <p>Use <i>Part II</i> to report your reduction of tax attributes. The reduction must be made in the following order unless you check the box on line 1d for qualified real property business indebtedness or make the election on line 5 to reduce basis of depreciable property first.</p> <ol style="list-style-type: none"> 1. Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year) (dollar for dollar); 2. Any general business credit carryover to or from the tax year of the discharge (33$\frac{1}{3}$ cents per dollar); 3. Any minimum tax credit as of the beginning of the tax year immediately after the tax year of the discharge (33$\frac{1}{3}$ cents per dollar); 4. Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year) (dollar for dollar); 5. The basis of property (dollar for dollar); 6. Any passive activity loss (dollar for dollar) and credit (33$\frac{1}{3}$ cents per dollar) carryovers from the tax year of the discharge; and 7. Any foreign tax credit carryover to or from the tax year of the discharge (33$\frac{1}{3}$ cents per dollar). <p>Use <i>Part III</i> to exclude from gross income under section 1081(b) any amounts of income attributable to the transfer of property described in that section.</p>



Certain individuals may need to complete only a few lines on Form 982. For example, if you are completing this form because of a discharge of indebtedness on a personal loan (such as a car loan or credit card debt) or a loan for the purchase of your principal residence, follow the chart on page 2 to see which lines you need to complete. Also, see Pub. 4681, *Canceled Debts, Foreclosures, Repossessions, and Abandonments*, for additional information including many examples and sample forms.

Definitions

Title 11 Case

A *title 11 case* is a case under title 11 of the United States Code (relating to bankruptcy), but only if you are under the jurisdiction of the court in the case and the discharge of indebtedness is granted by the court or is under a plan approved by the court.

Discharge of Indebtedness

The term *discharge of indebtedness* conveys forgiveness of, or release from, an obligation to repay.

When To File

File Form 982 with your federal income tax return for a year a discharge of indebtedness is excluded from your income under section 108(a).

The election to reduce the basis of depreciable property under section 108(b)(5) and the election made on line 1d of Part I regarding the discharge of qualified real property business indebtedness must be made on a timely filed return (including extensions) and can be revoked only with the consent of the IRS.

If you timely filed your tax return without making either of these elections, you can still make either election by filing an amended return within 6 months of the due date of the return (excluding extensions). Write "Filed pursuant to section 301.9100-2" on the amended return and file it at the same place you filed the original return.

Specific Instructions

Part I

The American Recovery and Reinvestment Act of 2009 allows certain businesses to elect under section 108(i) to defer and include ratably over a 5-taxable-year period, beginning with the taxpayer's fourth or fifth taxable year following the taxable year of the reacquisition, any income from the discharge of business debt arising from the reacquisition of certain types of business debt repurchased in 2009 and 2010. For more details, including how to make this election, see section 108(i) and Rev. Proc. 2009-37, 2009-36 I.R.B. 309, available at www.irs.gov/irb/2009-36_JRB/ar07.html.



If you made an election under section 108(i) to defer income from the discharge of business debt arising from the reacquisition of a debt instrument, you cannot exclude on lines 1a through 1d the income from the discharge of such indebtedness for the taxable year of the election or any subsequent taxable year.

Line 1b

The insolvency exclusion does not apply to any discharge that occurs in a title 11 case. It also does not apply to a discharge of qualified principal residence indebtedness (see the instructions for line 1e on page 4) unless you elect to have the insolvency exclusion apply instead of the exclusion for qualified principal residence indebtedness.

Check the box on line 1b if the discharge of indebtedness occurred while you were insolvent. You were insolvent to the extent that your liabilities exceeded the fair market value (FMV) of your assets immediately before the discharge. For details and a worksheet to help calculate insolvency, see Pub. 4681.

Example. You were released from your obligation to pay your credit card debt in the amount of \$5,000. The FMV of your total assets immediately before the discharge was \$7,000 and your liabilities were \$10,000. You were insolvent to the extent of \$3,000 (\$10,000 of total liabilities minus \$7,000 of total assets). Check the box on line 1b and include \$3,000 on line 2.

Line 1c

Check this box if the income you exclude is from the discharge of qualified farm indebtedness. The exclusion relating to qualified farm indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified farm indebtedness is the amount of indebtedness incurred directly in connection with the trade or business of farming. In addition, 50% or more of your aggregate gross receipts for the 3 tax years preceding the tax year in which the discharge of such indebtedness occurs must be from the trade or business of farming. For more information, see sections 108(g) and 1017(b)(4).

The discharge must have been made by a qualified person. Generally, a *qualified person* is an individual, organization, etc., who is actively and regularly engaged in the business of lending money. This person cannot be related to you, be the person from whom you acquired the property, or be a person who receives a fee with respect to your investment in the property. A qualified person also includes any federal, state, or local government or agency or instrumentality thereof.

If you checked line 1c and did not make the election on line 5, the debt discharge amount will be applied to reduce the tax attributes in the order listed on lines 6 through 9. Any remaining amount will be applied to reduce the tax attributes in the order listed on lines 11a through 13.

You cannot exclude more than the total of your (a) tax attributes (determined under section 108(g)(3)(B)) and (b) basis of property used or held for use in a trade or business or for the production of income. Any excess is included in income.

Line 1d

If you check this box, the discharge of qualified real property business indebtedness is applied to reduce the basis of depreciable real property on line 4. The exclusion relating to qualified real property business indebtedness does not apply to a discharge that occurs in a title 11 case or to the extent you were insolvent.

Qualified real property business indebtedness is indebtedness (other than qualified farm indebtedness) that (a) is incurred or assumed in connection with real property used in a trade or business, (b) is secured by that real property, and (c) with respect to which you have made an election under this provision. This provision does not apply to a corporation (other than an S corporation).

Indebtedness incurred or assumed after 1992 is not qualified real property business indebtedness unless it is either (a) debt incurred to refinance qualified real property business indebtedness incurred or assumed before 1993 (but only to the extent the amount of such debt does not exceed the amount of debt being refinanced) or (b) qualified acquisition indebtedness.

Qualified acquisition indebtedness is (a) debt incurred or assumed to acquire, construct, reconstruct, or substantially improve real property that is secured by such debt and (b) debt resulting from the refinancing of qualified acquisition indebtedness to the extent the amount of such debt does not exceed the amount of debt being refinanced.

You cannot exclude more than the excess of the outstanding principal amount of the debt (immediately before the discharge) over the net FMV (as of that time) of the property securing the debt reduced by the outstanding principal amount of other qualified real property business indebtedness secured by that property (as of that time). The amount excluded is further limited to the aggregate adjusted basis (as of the first day of the next tax year or, if earlier, the date of disposition) of depreciable real property (determined after any reductions under sections 108(b) and (g)) you held immediately before the discharge (other than property acquired in contemplation of the discharge). Any excess is included in income.

Line 1e

Check this box if the income you exclude is from discharge of qualified principal residence indebtedness. Also, be sure you complete line 2 (and line 10b if you continue to own the residence after discharge). However, if the discharge occurs in a title 11 case, you must check the box on line 1a and not this box. If you are insolvent (and not in a title 11 case), you can elect to follow the insolvency rules by checking box 1b instead of checking this box. For more information, see Pub. 4681.

Principal residence. Your principal residence is your *main home*, which is the home where you ordinarily live most of the time. You can have only one main home at any one time.

Qualified principal residence indebtedness. This indebtedness is a mortgage you took out to buy, build, or substantially improve your main home. It also must be secured by your main home. If the amount of your original mortgage is more than the cost of your main home plus the cost of any substantial improvements, only the debt that is **not** more than the cost of your main home plus improvements is qualified principal residence indebtedness. Any debt secured by your main home that you use to refinance qualified principal residence indebtedness is treated as qualified principal residence indebtedness, but only up to the amount of the old mortgage principal just before the refinancing. Any additional debt you incurred to substantially improve your main home is also treated as qualified principal residence indebtedness.

Amount eligible for the exclusion. The exclusion applies only to debt discharged after 2006 and before 2013. The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately). You cannot exclude from gross income discharge of qualified principal residence indebtedness if the discharge was for services performed for the lender or on account of any other factor not directly related to a decline in the value of your residence or to your financial condition.

Ordering rule. If only a part of a loan is qualified principal residence indebtedness, the exclusion applies only to the extent the amount discharged exceeds the amount of the loan (immediately before the discharge) that is **not** qualified principal residence indebtedness. For example, assume your main home is secured by a debt of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If your main home is sold for \$700,000 and \$300,000 of debt is discharged, only \$100,000 of the debt discharged can be excluded (the \$300,000 that was discharged minus the \$200,000 of nonqualified debt). The remaining \$200,000 of nonqualified debt may qualify in whole or in part for one of the other exclusions, such as the insolvency exclusion.

Line 2

Enter the total amount excluded from your gross income due to discharge of indebtedness under section 108. If you checked any box on lines 1b through 1e, do not enter more than the limit explained in the instructions for those lines. If you checked line 1a, 1b, or 1c, this amount will not necessarily equal the total reductions on lines 5 through 13 (excluding line 10b) because the debt discharge amount may exceed the total tax attributes. If you checked line 1e, this amount will not necessarily equal the total basis reduction on line 10b (which is required only if you continue to own the residence after the discharge).

See section 382(l)(5) for a special rule regarding a reduction of a corporation's tax attributes after certain ownership changes.

Line 3

You can elect under section 1017(b)(3)(E) to treat all real property held primarily for sale to customers in the ordinary course of a trade or business as if it were depreciable property. This election does not apply to the discharge of qualified real property business indebtedness. To make the election, check the "Yes" box.

Part II

Basis Reduction

If you check any of the boxes on lines 1a through 1c, you can elect, by completing line 5, to apply all or a part of the debt discharge amount to first reduce the basis of depreciable property (including property you elected on line 3 to treat as depreciable property). Any balance of the debt discharge amount will then be applied to reduce the tax attributes in the order listed on lines 6 through 13 (excluding line 10b). You must attach a statement describing the transactions that resulted in the reduction in basis under section 1017 and identifying the property for which you reduced the basis. If you do not make the election on line 5, complete lines 6 through 13 (excluding line 10b) to reduce your attributes. See section 1017(b)(2) and (c) for limitations of reductions in basis on line 10a.

Line 7

If you have a general business credit carryover to or from the tax year of the discharge, you must reduce that carryover by $33\frac{1}{3}$ cents for each dollar excluded from gross income. See Form 3800, General Business Credit, for more details on the general business credit, including rules for figuring any carryforward or carryback.

Line 10a

In the case of a title 11 case or insolvency, the reduction in basis is limited to the aggregate of the basis of your property immediately after the discharge over the aggregate of your liabilities immediately after the discharge. However, this limit does not apply to a reduction in basis reported on line 5 pursuant to section 108(b)(5).

Line 10b

If box 1e is checked and you continue to own the residence after discharge, enter the smaller of:

- The part of line 2 that is attributable to the exclusion of qualified principal residence indebtedness, or
- The basis of your main home.

Part III

Adjustment to Basis

Unless it specifically states otherwise, the corporation, by filing this form, agrees to apply the general rule for adjusting the basis of property (as described in Regulations section 1.1082-3(b)).

If the corporation desires to have the basis of its property adjusted in a manner different from the general rule, it must attach a request for variation from the general rule. The request must show the precise method used and the allocation of amounts.

Consent to the request for variation from the general rule will be effective only if it is incorporated in a closing agreement entered into by the corporation and the Commissioner of Internal Revenue under the rules of section 7121. If no agreement is entered into, then the general rule will apply in determining the basis of the corporation's property.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown as follows: **Recordkeeping**, 6 hr., 27 min.; **Learning about the law or the form**, 2 hr., 17 min.; **Preparing and sending the form to the IRS**, 2 hr., 29 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.

Form 656

Form **656**
(Rev. March 2011)

Offer in Compromise

Attach Application Fee and Payment (check or money order) here.

IRS Received Date

Section 1 Your Contact Information

Your First Name, Middle Initial, Last Name

If a Joint Offer, Spouse's First Name, Middle Initial, Last Name

Your Physical Home Address (Street, City, State, ZIP Code)

Mailing Address (if different from above or Post Office Box number)

Business Name

Your Business Address (Street, City, State, ZIP Code)

Social Security Number (SSN)
(Primary)

(Secondary)

Employer Identification Number
(EIN)

(EIN not included in offer)

Section 2 Tax Periods

To: Commissioner of Internal Revenue Service

In the following agreement, the pronoun "we" may be assumed in place of "I" when there are joint liabilities and both parties are signing this agreement.

I submit this offer to compromise the tax liabilities plus any interest, penalties, additions to tax, and additional amounts required by law for the tax type and period(s) marked below:

1040 Income Tax-Year(s) _____

1120 Income Tax-Year(s) _____

941 Employer's Quarterly Federal Tax Return - Quarterly period(s) _____

940 Employer's Annual Federal Unemployment (FUTA) Tax Return - Year(s) _____

Trust Fund Recovery Penalty as a responsible person of (enter corporation name) _____
for failure to pay withholding and Federal Insurance Contributions Act taxes (Social Security taxes), for period(s) ending _____

Other Federal Tax(es) [specify type(s) and period(s)] _____

Note: If you need more space, use attachment and title it "Attachment to Form 656 dated _____." Make sure to sign and date the attachment.

Section 3 Reason for Offer

Doubt as to Collectibility - I have insufficient assets and income to pay the full amount.

Exceptional Circumstances (Effective Tax Administration) - I owe this amount and have sufficient assets to pay the full amount, but due to my exceptional circumstances, requiring full payment would cause an economic hardship or would be unfair and inequitable. I am submitting a written narrative explaining my circumstances.

Section 3

Reason for Offer (Continued)

Explanation of Circumstances (Add additional pages, if needed)

The IRS understands that there are unplanned events or special circumstances, such as serious illness, where paying the full amount or the minimum offer amount might impair your ability to provide for yourself and your family. If this is the case and you can provide documentation to prove your situation, then your offer may be accepted despite your financial profile. Describe your situation below and attach appropriate documents to this offer application.

Section 4

Low Income Certification (Individuals Only)

Do you qualify for Low-Income Certification? You qualify if your gross monthly household income is less than or equal to the amount shown in the chart below based on your family size and where you live. If you qualify, you are not required to submit any payments during the consideration of your offer.

Check here if you qualify for Low-Income Certification based on the monthly income guidelines below.

Size of family unit	48 contiguous states and D.C.	Hawaii	Alaska
1	\$2,256	\$2,596	\$2,819
2	\$3,035	\$3,492	\$3,794
3	\$3,815	\$4,388	\$4,769
4	\$4,594	\$5,283	\$5,744
5	\$5,373	\$6,179	\$6,719
6	\$6,152	\$7,075	\$7,694
7	\$6,931	\$7,971	\$8,669
8	\$7,710	\$8,867	\$9,644
For each additional person, add	\$ 779	\$ 896	\$ 975

Section 5

Payment Terms

Enter the amount of your offer \$ _____

Check one of the payment options below to indicate how long it will take you to pay your offer in full:

Payment Option 1

Check here if you will pay your offer in five or fewer payments:

Enclose a check for 20% of the offer amount (waived if you are an individual and met the requirements for Low-Income certification) and fill in the amount(s) and date(s) of your future payment(s).

20% of the offer amount is \$ _____ leaving a balance of \$ _____ to be paid as follows after the acceptance of your offer:

- Amount of payment 1 \$ _____ date _____
- Amount of payment 2 \$ _____ date _____
- Amount of payment 3 \$ _____ date _____
- Amount of payment 4 \$ _____ date _____
- Amount of payment 5 \$ _____ date _____

Payment Option 2

Check here if you will pay your offer in full in more than five months and pay in monthly installments

Enclose a check for one month's installment (waived if you are an individual and met the requirements for Low-Income certification)

\$ _____ is being submitted with the Form 656 and then \$ _____ on the _____ (day) of each month thereafter for a total of _____ months. Total payments must equal the total Offer Amount.

You must continue to make these monthly payments while the IRS is considering the offer. Failure to make regular monthly payments will cause your offer to be returned.

Section 6**Designation of Down Payment and Deposit (Optional)**

If you want your payment to be applied to a specific tax year and a specific tax debt, please tell us the tax form _____ and Tax Year/Quarter _____. If you do not designate a preference, we will apply any money you send in to the governments best interest.

If you are paying more than the required payment when you submit your offer and want any part of that payment treated as a deposit, check the box below and insert the amount.

I am making a deposit of \$ _____ with this offer.

Section 7**Source of Funds**

Tell us where you will obtain the funds to pay your offer. You may consider borrowing from friends and/or family, taking out a loan, or selling assets.

Include separate checks for the payment and application fee.

Make payable to the "United States Treasury" and attach to the front of your Form 656, Offer in Compromise. Do not send cash. Send a separate application fee with each offer; do not combine it with any other tax payments, as this may delay processing of your offer. Your offer will be returned to you if the application fee and the required payments are not properly remitted, or if your check is returned for insufficient funds.

Section 8**Offer Terms**

By submitting this offer, I/we have read, understand and agree to the following terms and conditions:

Terms, Conditions, and Legal Agreement

a) I request that the IRS accept the offer amount listed in this offer application as payment of my outstanding tax debt (including interest, penalties, and any additional amounts required by law) as of the date listed on this form. I authorize the IRS to amend Section 2 on page 1 in the event I failed to list any of my assessed tax debt.

IRS will keep my payments, fees, and some refunds.

b) I voluntarily submit the payments made on this offer and understand that they are not refundable even if I withdraw the offer or the IRS rejects or returns the offer. Unless I designated how to apply the required payment (page 3 of this application), the IRS will apply my payment in the best interest of the government, choosing which tax years and tax liabilities to pay off. The IRS will also keep my application fee unless the offer is not accepted for processing.

c) The IRS will keep any refund, including interest, that I might be due for tax periods extending through the calendar year in which the IRS accepts my offer. I cannot designate that the refund be applied to estimated tax payments for the following year or the accepted offer amount. If I receive a refund after I submit this offer for any tax period extending through the calendar year in which the IRS accepts my offer, I will return the refund as soon as possible.

d) The IRS will keep any monies it has collected prior to this offer and any payments that I make relating to this offer that I did not designate as a deposit. Only amounts that exceed the mandatory payments can be treated as a deposit. Such a deposit will be refundable if the offer is rejected or returned by the IRS or is withdrawn. I understand that the IRS will not pay interest on any deposit. The IRS may seize ("levy") my assets up to the time that the IRS official signs and accepts my offer as pending.

Pending status of an offer and right to appeal

e) Once an authorized IRS official signs this form, my offer is considered pending as of that signature date and it remains pending until the IRS accepts, rejects, returns, or terminates my offer or I withdraw my offer. An offer will be considered withdrawn when the IRS receives my written notification of withdrawal by personal delivery or certified mail or when I inform the IRS of my withdrawal by other means and the IRS acknowledges in writing my intent to withdraw the offer.

I must comply with my future tax obligations and understand I remain liable for the full amount of my tax debt until all terms and conditions of this offer have been met.

f) I waive the right to an Appeals hearing if I do not request a hearing within 30 days of the date the IRS notifies me of the decision to reject the offer.

g) I will file tax returns and pay required taxes for the five year period beginning with the date of acceptance of this offer, or until my offer is paid in full, whichever is longer. If this is an offer being submitted for joint tax debt, and one of us does not comply with future obligations, only the non-compliant taxpayer will be in default of this agreement.

h) The IRS will not remove the original amount of my tax debt from its records until I have met all the terms and conditions of this offer. Penalty and interest will continue to accrue until all payment terms of the offer have been met. If I file for bankruptcy before the terms are fully met, any claim the IRS files in the bankruptcy proceedings will be a tax claim.

i) Once the IRS accepts my offer in writing, I have no right to contest, in court or otherwise, the amount of the tax debt.

I understand what will happen if I fail to meet the terms of my offer (e.g., default).

j) If I fail to meet any of the terms of this offer, the IRS may levy or sue me to collect any amount ranging from the unpaid balance of the offer to the original amount of the tax debt without further notice of any kind. The IRS will continue to add interest, as Section 6601 of the Internal Revenue Code requires, on the amount the IRS determines is due after default. The IRS will add interest from the date I default until I completely satisfy the amount owed.

I agree to waive time limits provided by law.

k) To have my offer considered, I agree to the extension of the time limit provided by law to assess my tax debt (statutory period of assessment). I agree that the date by which the IRS must assess my tax debt will now be the date by which my debt must currently be assessed plus the period of time my offer is pending plus one additional year if the IRS rejects, returns, or terminates my offer or I withdraw it. (Paragraph (e) of this section defines pending and withdrawal). I understand that I have the right not to waive the statutory period of assessment or to limit the waiver to a certain length or certain periods or issues. I understand, however, that the

Section 8 - (Continued)

IRS may not consider my offer if I refuse to waive the statutory period of assessment or if I provide only a limited waiver. I also understand that the statutory period for collecting my tax debt will be suspended during the time my offer is pending with the IRS, for 30 days after any rejection of my offer by the IRS, and during the time that any rejection of my offer is being considered by the Appeals Office.

I understand the IRS may file a Notice of Federal Tax Lien on my property.

l) The IRS may file a Notice of Federal Tax Lien during the offer investigation. Generally, the IRS files a Notice of Federal Tax Lien to protect the Government's interest on offers that will be paid over time. This tax lien will be released when the payment terms of the accepted offer have been satisfied.

I authorize the IRS to contact relevant third parties in order to process my offer

m) By authorizing the IRS to contact third parties including credit bureaus, I understand that I will not be notified of which third parties the IRS contacts as part of the offer application process, as stated in section 7602(c) of the Internal Revenue Code.

I am submitting an offer as an individual for a joint liability

n) I understand if the liability sought to be compromised is the joint and individual liability of myself and my co-obligor(s) and I am submitting this offer to compromise my individual liability only, then if this offer is accepted, it does not release or discharge my co-obligor(s) from liability. The United States still reserves all rights of collection against the co-obligor(s).

Section 9 Signatures

Under penalties of perjury, I declare that I have examined this offer, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct and complete.

Signature of Taxpayer	Date (mm/dd/yyyy)
Signature of Taxpayer	Date (mm/dd/yyyy)

Section 10 Paid Preparer Use Only

Signature of Preparer

Name of Paid Preparer	Date (mm/dd/yyyy)	Preparer's CAF no. or PTIN
Firm's Name, Address, and ZIP Code		

Include a valid, signed Form 2848 or 8821 with this application, if one is not on file.

Section 11 Third Party Designee

Do you want to allow another person to discuss this offer with the IRS? Yes No

If yes, provide designee's name	Telephone Number
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IRS Use Only

I accept the waiver of the statutory period of limitations on assessment for the Internal Revenue Service, as described in Section 8 (k).

Signature of Authorized Internal Revenue Service Official	Title	Date (mm/dd/yyyy)
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Privacy Act Statement

We ask for the information on this form to carry out the internal revenue laws of the United States. Our authority to request this information is Section 7801 of the Internal Revenue Code.

Our purpose for requesting the information is to determine if it is in the best interests of the IRS to accept an offer. You are not required to make an offer; however, if you choose to do so, you must provide all of the taxpayer information requested. Failure to provide all of the information may prevent us from processing your request.

If you are a paid preparer and you prepared the Form 656 for the taxpayer submitting an offer, we request that you complete and sign Section 10 on Form 656, and provide identifying information. Providing this information is voluntary. This information will be used to administer and enforce the internal revenue laws of the United States and may be used to regulate practice before the Internal Revenue Service for those persons subject to Treasury Department Circular No. 230, Regulations Governing the Practice of Attorneys, Certified Public Accountants, Enrolled Agents, Enrolled Actuaries, and Appraisers before the Internal Revenue Service. Information on this form may be disclosed to the Department of Justice for civil and criminal litigation.

We may also disclose this information to cities, states and the District of Columbia for use in administering their tax laws and to combat terrorism. Providing false or fraudulent information on this form may subject you to criminal prosecution and penalties.



Form 656 Booklet

Offer in Compromise

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IRS contact information

If you have questions regarding qualifications for an offer in compromise, please call our toll-free number at 1-800-829-1040. You can get forms and publications by calling 1-800-TAX-FORM (1-800-829-3676), or by visiting your local IRS office or our website at www.irs.gov.

Taxpayer resources

You may also seek assistance from a professional tax assistant at a Low Income Taxpayer Clinic, if you qualify. These clinics provide help to qualified taxpayers at little or no charge. IRS Publication 4134, Low Income Taxpayer Clinic List, provides information on clinics in your area and is available through the IRS website at www.irs.gov, by phone at 1-800-TAX-FORM (1-800-829-3676), or at your local IRS office.

WHAT YOU NEED TO KNOW

What is an offer?

An offer in compromise (offer) is an agreement between you (the taxpayer) and the IRS that settles a tax debt for less than the full amount owed. The offer program provides eligible taxpayers with a path toward paying off their debt and getting a "fresh start." The ultimate goal is a compromise that suits the best interest of both the taxpayer and the IRS. To be considered, generally you must make an appropriate offer based on what the IRS considers your true ability to pay.

Submitting an offer application does not ensure that the IRS will accept your offer. It begins a process of evaluation and verification by the IRS, taking into consideration any special circumstances that might affect your ability to pay. Generally, the IRS will not accept an offer if you can pay your tax debt in full via an installment agreement or a lump sum.

This booklet will lead you through a series of steps to help you calculate an appropriate offer based on your assets, income, expenses, and future earning potential. The application requires you to describe your financial situation in detail, so before you begin, make sure you have the necessary information and documentation.

Are you eligible?

Before you submit your offer, you must (1) file all tax returns you are legally required to file, (2) make all estimated tax payments for the current year, and (3) make all required federal tax deposits for the current quarter if you are a business owner with employees.

Bankruptcy

If you or your business is currently in an open bankruptcy proceeding, you are not eligible to apply for an offer. Any resolution of your outstanding tax debts generally must take place within the context of your bankruptcy proceeding.

If you are not sure of your bankruptcy status, contact the Centralized Insolvency Operation at 1-800-913-9358. Be prepared to provide your bankruptcy case number and/or Taxpayer Identification Number.

Doubt as to Liability

If you have a legitimate doubt that you owe part or all of the tax debt, you will need to complete a **Form 656-L Offer in Compromise (Doubt as to Liability)**. The Form 656-L is not included as part of this package. To submit a Doubt as to Liability offer, you may request a form by calling the toll free number 1-800-829-1040, by visiting a local IRS office, or at www.irs.gov.

Other important facts

Penalties and interest will continue to accrue during the offer evaluation process.

You cannot submit an offer that is only for a tax year or tax period that has not been assessed.

The law requires the IRS to make certain information from accepted offers available for public inspection and review. These public inspection files are located in designated IRS Area Offices.

A Notice of Federal Tax Lien (lien) gives the IRS a legal claim to your property as security for payment of your tax debt. Generally, if a lien is not already filed, a lien will not be filed during the offer evaluation process. If a lien was filed, it will normally not be released until the payment terms of the accepted offer are satisfied, or the tax debt is paid in full, whichever comes first.

If your business owes trust fund taxes, and responsible individuals may be held liable for the trust fund portion of the tax, you are not eligible to submit an offer unless you pay the trust fund portion of your tax debt first. Trust fund taxes are the money withheld from an employee's wages, such as income tax, Social Security, and Medicare taxes.

The IRS will keep any refund, including interest, for tax periods extending through the calendar year that the IRS accepts the offer. For example, if your offer is accepted in 2011 and you file your 2011 Form 1040 showing a refund, IRS will apply your refund to your tax debt.

The IRS may keep any proceeds from a levy served prior to you submitting an offer. The IRS may levy your assets up to the time that the IRS official signs and accepts your offer as pending. If your assets are levied after your offer is pending, immediately contact the IRS person whose name and phone number are listed on the levy.

If you currently have an approved installment agreement with IRS and are making installment payments, then you may stop making those installment agreement payments when you submit an offer. This will allow you to make your offer payments noted below. If your offer is returned for any reason, your installment agreement with IRS will be reinstated with no additional fee.

PAYING FOR YOUR OFFER

Application fee

All offers require a \$150 application fee.

EXCEPTION: If you are submitting an individual offer and meet the Low Income Certification guidelines (see page 2 of Form 656, Offer in Compromise), you will not be required to send the application fee.

Payment options

Submitting an offer requires the selection of a payment option as well as sending an initial payment with your application. The amount of the initial payment and subsequent payments will depend on the total amount of your offer and which of the following payment options you choose.

Payment option 1: This option requires 20% of the total offer amount to be paid with the offer and the remaining balance paid in five or fewer payments.

Payment option 2: This option requires the first payment with the offer and the remaining balance paid in accordance with your proposed offer terms. Under this option, you must continue to make all subsequent payments while the IRS is evaluating your offer. Failure to make these payments will cause your offer to be returned.

The length of the payment option you choose may affect the amount of the offer we will accept. Generally, an offer paid within five months of acceptance will require a lesser amount. Your offer amount cannot include a refund we owe you.

If you meet the Low Income Certification guidelines, you will not be required to send the initial payment, or make the monthly payments during the evaluation of your offer but you will still need to choose one of the payment options.

If your offer is returned or not accepted, any required payment(s) made with the filing of your offer and thereafter, will not be refunded. Your payment(s) will be applied to your tax debt.

If you do not have sufficient cash to pay for your offer, you may need to consider borrowing money from a bank, friends, and/or family. Other options may include borrowing against or selling other assets. NOTE: If retirement savings from an IRA or 401k plan are cashed out, there will be future tax liabilities owed as a result. Contact the IRS or your tax advisor before taking this action.

Future tax obligations

If your offer is accepted, you must continue to timely file and pay your tax obligations. If you fail to file and pay your required tax returns, before your offer is paid in full, or for five years after your offer is accepted, which ever is longer, your offer may be defaulted. If your offer is defaulted, all compromised tax debts will be reinstated.

HOW TO APPLY

Application process

The application involves filling out Form 433-A (OIC), Collection Information Statement for Wage Earners and Self-Employed Individuals and/or Form 433-B (OIC), Collection Information Statement for Businesses, filling out a Form 656, (Offer in Compromise), attaching an initial payment, and attaching a \$150 application fee for each offer you send in.

If you and your spouse owe joint and separate tax debts

If you have joint tax debt(s) with your spouse and also have an individual tax debt(s), you and your spouse will send in one Form 656 with all of the joint tax debt(s) and a second Form 656 with your individual tax debt(s), for a total of two Forms 656.

If you and your spouse have joint tax debt(s) and you are also each responsible for an individual tax debt(s), you will each need to send in a separate Form 656. You will complete one Form 656 for yourself listing all your joint and separate tax debts and your spouse will complete one Form 656 listing all his or her joint and individual tax debts, for a total of two Forms 656.

If you and your spouse/ex-spouse has a joint tax debt and your spouse/ex-spouse does not want to submit a Form 656, you on your own may submit a Form 656 to compromise the joint debt.

Each Form 656 will require the \$150 application fee and initial down payment unless your household meets the Low Income Certification guidelines (See page 2 of Form 656, Offer in Compromise).

COMPLETING THE APPLICATION PACKAGE

Step 1 – Gather your information

To calculate an offer amount, you will need to gather information about your financial situation, including cash, investments, available credit, assets, income, and debt.

You will also need to gather information about your average gross monthly household income and expenses. The entire household includes spouse, significant other, children, and others that reside in the household. This is necessary for the IRS to accurately evaluate your offer. **In general, the IRS will not accept expenses for tuition for private schools, college expenses, charitable contributions, credit card payments, and other unsecured debt payments as part of the expenses calculation.**

Step 2 – Fill out the Form 433-A (OIC), Collection Information Statement for Wage Earners and Self-Employed Individuals)

Fill out the Form 433-A(OIC) if you are an individual wage earner and/or a self-employed individual. This will be used to calculate an appropriate offer amount based on your assets, income, expenses, and future earning potential. You will have the opportunity to provide a written explanation of any special circumstances that affect your financial situation.

Step 3 – Fill out Form 433-B(OIC), Collection Information Statement for Businesses

Fill out the Form 433-B(OIC) if your business is a Corporation, Partnership, Limited Liability Company (LLC) classified as a corporation, single member LLC, or other multi-owner/multi-member LLC. This will be used to calculate an appropriate offer amount based on your business assets, income, expenses, and future earning potential. If you have assets that are used to produce income (for example, a tow truck used in your business for towing vehicles), you may be allowed to exempt the equity in these assets.

Step 4 – Attach required documentation

You will need to attach supporting documentation with Form(s) 433-A(OIC) and 433-B(OIC). A list of the documents required will be found at the end of each form. Include copies of all required attachments, as needed. Do not send original documents.

Step 5 – Fill out Form 656, Offer in Compromise

Fill out Form 656. The Form 656 identifies the tax years and type of tax you would like to compromise. It also identifies your offer amount and the payment terms.

The Low Income Certification guidelines are included on Form 656. If you are an individual and meet the guidelines, check the Low Income Certification box in Section 4, on Form 656.

Step 6 – Include initial payment and \$150 application fee

Include a check, cashier's check, or money order for your initial payment based on the payment option you selected (20% of offer amount or first month's installment).

Include a separate check, cashier's check, or money order for the application fee (\$150).

Make both payments payable to the "United States Treasury."

If you meet the Low Income Certification guidelines, the initial payment and application fee are not required.

Step 7 – Mail the application package

Make a copy of your application package and keep it for your records.

Mail the application package to the appropriate IRS facility. See page 23 for details, Application Checklist.

IMPORTANT INFORMATION

After you mail your application, continue to:

File all federal tax returns you are legally required to file.

Make all federal estimated tax payments and tax deposits that are due for current taxes.

Reply to IRS requests for additional information within the timeframe specified. Failure to reply timely to requests for additional information could result in the return of your offer without appeal rights.

APPLICATION CHECKLIST

Review the entire application and verify that it is complete.

Forms 433-A (OIC), 433-B (OIC), and 656

- Did you complete all fields and sign all forms?
- Did you make an offer amount that is greater than or equal to the minimum offer calculated on the Form 433-A (OIC) or Form 433-B (OIC)? If not, did you describe the special circumstances that are leading you to offer less than the minimum in the "Explanation of Circumstances" section 3 of Form 656, and did you provide supporting documentation of the special circumstances?
- Did you select a payment option on Form 656?
- If you want to allow the IRS to discuss your offer with another person, did you complete the "Third-Party Designee" section on the Form 656?
- If someone other than you completed the Form 656, did they sign it?
- Did you sign and attach the Form 433-A (OIC) if applicable?
- Did you sign and attach the Form 433-B (OIC) if applicable?
- Did you sign and attach the Form 656?

Supporting documentation and additional forms

- Did you include photocopies of all required supporting documentation?
- If you want a third party to represent you during the offer process, did you include a Form 2848 or Form 8821 unless one is already on file?

Payment

- Did you include a check or money order made payable to the "United States Treasury" for the initial payment? (Waived if you meet Low Income Certification guidelines—see Form 656.)
- Did you include a separate check or money order made payable to the "United States Treasury" for the \$150 application fee? (Waived if you meet Low Income Certification guidelines—see Form 656.)

Mail your application package to the appropriate IRS facility

Mail the Form 656, 433-A (OIC) and/or 433-B (OIC), and related financial document(s) to the appropriate IRS processing office for your state. You may wish to send it by Certified Mail so you have a record of the date it was mailed.

If you reside in:

AK, AL, AZ, CA, CO, HI, ID, KY, LA, MS, MT, NV, NM, OR,
TN, TX, UT, WA, WI, WY

AR, CT, DE, FL, GA, IA, IL, IN, KS, MA, MD, ME, MI, MN,
MO, NC, ND, NE, NH, NJ, NY, OH, OK, PA, RI, SC, SD,
VT, VA, WV; DC, PR, or a foreign address

Mail your application to:

Memphis IRS Center COIC Unit
P.O. Box 30803, AMC
Memphis, TN 38130-0803
1-866-790-7117

Brookhaven IRS Center COIC Unit
P.O. Box 9007
Holtsville, NY 11742-9007
1-866-611-6191

Tax Considerations For Individual Chapter 11 Debtors

IV. Rulings and Pronouncements

Tax Considerations For Individual Chapter 11 Debtors

IV. Rulings and Pronouncements



**Tax and Accounting
Center™**

Source: IRS Documents > Notices > 2006 > NOTICE 2006-83, 2006-40 I.R.B. 596 (10/2/2006)

NOTICE 2006-83, 2006-40 I.R.B. 596 (10/2/2006)

Part III -- Administrative, Procedural, and Miscellaneous

Individual Chapter 11 Debtors

Notice 2006-83

This notice provides guidance for individuals who file bankruptcy cases under Chapter 11 of the Bankruptcy Code (11 U.S.C. section 1101 *et seq.*) on or after October 17, 2005. This notice also provides guidance for (1) employers of these individuals, (2) persons filing Forms W-2, 1099-INT, 1099-DIV, 1099-MISC, and other information returns (including Schedule K-1) that report payments to these individuals, and (3) Chapter 11 trustees in bankruptcy cases filed by these individuals. Upon consideration of the comments received concerning this notice, as requested in section 7, additional guidance may be published.

Section 1 PURPOSE

The bankruptcy estate of a Chapter 11 debtor who is an individual is a separate taxable entity under section 1398 of the Internal Revenue Code. The estate, rather than the debtor, must include in its gross income all of the debtor's income to which the estate is entitled under the Bankruptcy Code, except for amounts received or accrued by the debtor before the commencement of the case. Section 1115 of the Bankruptcy Code was enacted by section 321(a)(1) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Pub. L. No. 109-8, 119 Stat. 23 (2005) and is effective for cases filed on or after October 17, 2005. As a result of the enactment of section 1115, the bankruptcy estate, rather than the debtor, must include in its gross income both (1) the debtor's gross earnings from his or her performance of services after the commencement of the case ("post-petition services") and (2) the gross income from property acquired by the debtor after the commencement of the case ("post-petition property"). I.R.C. section 1398(e)(1). The gross earnings from post-petition services include wages and other compensation earned by a debtor who is an employee and self-employment income earned by a debtor who is a self-employed individual.

Section 2 BACKGROUND AND GENERAL LEGAL PRINCIPLES

.01 The commencement of a bankruptcy case creates an estate, which generally includes all legal or equitable interests of the debtor in property as of the commencement of the case. 11 U.S.C. section 541(a)(1). Specific exclusions apply, however. See 11 U.S.C. section 541(b) (excluded property). See also 11 U.S.C. section 522 (exempt property); 11 U.S.C. section 554 (abandoned property). Exempt property and abandoned property are initially part of the bankruptcy estate, but are subsequently removed from the estate. By contrast, property excluded from the estate is never included in the estate.

.02 Confirmation of a Chapter 11 plan of reorganization generally vests all the property of the estate in the debtor, except as otherwise provided in the plan or in the court order confirming the plan. 11 U.S.C. section 1141(b). If no plan is confirmed and a bankruptcy case is dismissed, the property of the estate generally reverts in the debtor, unless the court orders otherwise. 11 U.S.C. section 349(b)(3).

.03 When a trustee is appointed pursuant to section 1104 of the Bankruptcy Code, the debtor generally must turn over to the trustee control over the assets of the bankruptcy estate. In most Chapter 11 cases, a trustee is not appointed and the debtor (referred to as the debtor in possession) remains in control of the property of the bankruptcy estate. Under section 1107(a) of the Bankruptcy Code, the debtor in possession must perform all the functions and duties of a trustee, except for the duties specified in Bankruptcy Code section 1106(a)(2), (3) and (4).

.04 Because the bankruptcy estate is a separate taxable entity, the trustee or debtor in possession must obtain an employer identification number (EIN) for the estate. I.R.C. section 6109. The trustee or debtor in possession uses the EIN on any tax returns filed for the estate.

.05 Section 1398(e)(1) of the Code provides that the gross income of the estate includes the gross income of the debtor to which the estate is entitled under the Bankruptcy Code. Section 1398(e)(2) provides that the gross income of the debtor does not include any item to the extent the item is included in the gross income of the bankruptcy estate.

.06 In general, the determination of whether or not any amount paid or incurred by the estate is allowable as a deduction or credit to the estate shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case. I.R.C. section 1398(e)(3)(A). The estate is, however, specifically allowed a deduction for administrative expenses allowed under section 503 of the Bankruptcy Code and for any fee or charge assessed against the estate under chapter 123 of title 28 of the United States Code. I.R.C. section 1398(h)(1).

.07 The individual debtor must continue to file his or her own individual tax returns during the bankruptcy proceedings. I.R.C. section 6012(a)(1).

.08 For bankruptcy cases filed *before* October 17, 2005, the property of the estate does not generally include any post-petition property acquired by an individual Chapter 11 debtor. Nor in those cases does the property of the estate include the individual Chapter 11 debtor's earnings from post-petition services, because section 541(a)(6) of the Bankruptcy Code specifically excluded those earnings from the estate. *See, e.g., In re Fitzsimmons*, 725 F.2d 1208 (9th Cir. 1984); *In re Larson*, 147 B.R. 39 (Bankr. D.N.D. 1992). Therefore, in these cases income from post-petition property and earnings from post-petition services are not generally includible in the estate's gross income. Instead, such income and earnings are generally includible in the debtor's gross income.

.09 Section 321 of BAPCPA made several changes to Chapter 11, effective for bankruptcy cases filed by individuals *on or after* October 17, 2005. Although many of the provisions that apply to individual Chapter 11 cases now operate in a manner similar to the provisions that apply in Chapter 13 cases, section 1398 of the Internal Revenue Code has not been amended and continues to apply to individual Chapter 11 cases, but not to Chapter 13 cases. Based on section 1115 of the Bankruptcy Code, read in conjunction with section 1398(e)(1) of the Internal Revenue Code, the debtor's *gross* earnings from post-petition services and *gross* income from post-petition property are, in general, includible in the bankruptcy estate's gross income, rather than in the debtor's gross income. This rule is subject to the exceptions noted below in sections 2.10, 2.11, 2.12, and 2.13.

.10 If a chapter 11 case is converted to a Chapter 13 case, the Chapter 13 estate is not a separate taxable entity and earnings from post-conversion services and income from property of the estate realized after the conversion to Chapter 13 are taxed to the debtor. I.R.C. section 1399.

.11 If the Chapter 11 case is converted to a Chapter 7 case, section 1115 will not apply after conversion and earnings from post-conversion services will be taxed to the debtor, rather than the estate. 11 U.S.C. section 541(a)(6). In such a case, the property of the Chapter 11 estate will become property of the Chapter 7 estate. Any income on this property will be taxed to the estate even if the income is realized after the conversion to Chapter 7.

.12 If a Chapter 11 case is dismissed, the debtor is treated as if the bankruptcy case had never been filed and as if no bankruptcy estate had been created. I.R.C. section 1398(b)(1).

.13 For Chapter 11 cases filed by individuals on or after October 17, 2005, the estate's gross income includes gross income from property held by the debtor when the case commenced ("pre-petition property"), as was the case under pre-BAPCPA law. There are certain exceptions to this general rule, however. The gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, if the pre-petition property is excluded from the estate and the gross income is subject to taxation. Also, the gross income on pre-petition property is included in the gross income of the debtor, rather than the estate, *after* the pre-petition property is removed from the estate by exemption or abandonment.

Section 3 FILING INCOME TAX RETURNS OF THE DEBTOR AND THE ESTATE; NOTIFICATION TO PERSONS FILING INFORMATION RETURNS (OTHER THAN FORM W-2) OF THE STATUS OF THE CHAPTER 11 BANKRUPTCY CASE

.01 The debtor in possession or trustee, if one is appointed, must prepare and file the income tax returns of the bankruptcy estate if required under section 6012(a)(9). I.R.C. section 6012(b)(4). In preparing the income tax returns of the debtor and the bankruptcy estate, the debtor in possession (or the trustee) must follow the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice, and must attach to

the returns the statement discussed in section 6.

.02 A debtor in possession may be compensated by the estate to manage or operate a trade or business that the debtor conducted before the commencement of the bankruptcy case. Such payments should be reportable by the debtor as miscellaneous income on his or her individual income tax return. I.R.C. section 61(a). Amounts paid by the estate to the debtor in possession for managing or operating the trade or business may qualify as administrative expenses of the estate. An administrative expense allowed by the bankruptcy court under section 503 of the Bankruptcy Code will generally be deductible by the estate as an administrative expense when it is paid or incurred. I.R.C. section 1398(h)(1).

.03 Within a reasonable time after the commencement of a Chapter 11 bankruptcy case, the trustee (if one is appointed) or the debtor in possession should provide notification of the bankruptcy estate's EIN to persons that are required to file information returns with respect to the bankruptcy estate's gross income, gross proceeds, or other types of reportable payments. I.R.C. section 6109(a)(2). Since these payments are property of the estate under section 1115, such persons should report the gross income, gross proceeds, or other reportable payment on an appropriate information return using the estate's name and EIN in the time and manner required under the Internal Revenue Code and regulations (*see, e.g.*, sections 6041 through 6049). The trustee or debtor in possession should *not*, however, provide the EIN to the debtor's employer or other person filing Form W-2 with respect to the debtor's wages or other compensation, since section 1115 does not affect the determination of what constitutes wages for purposes of Federal income tax withholding or the Federal Insurance Contributions Act. I.R.C. sections 3121(a) and 3401(a). As provided in section 5, an employer should continue to report all wage income and accompanying tax withholdings, whether pre-petition or post-petition, on a Form W-2 issued to the debtor under the debtor's social security number. See sections 6721 through 6724 for applicable penalties for failure to comply with information reporting requirements, including providing taxpayer identification numbers, and provisions for penalty waivers for reasonable cause.

.04 When a Chapter 11 bankruptcy case is closed, dismissed, or converted to a case under Chapter 12 or 13 of the Bankruptcy Code, the bankruptcy estate ends as a separate taxable entity. The debtor should, within a reasonable time, provide notification of the closing, dismissal, or conversion to the persons that were previously notified of the bankruptcy case under section 3.03 to the extent notification is necessary to ensure that gross income, gross proceeds, and other types of reportable payments realized after the closing, dismissal, or conversion are reported to the proper person and with the correct taxpayer identification number. Gross income, gross proceeds, and other reportable payments realized after the closing, dismissal, or conversion to Chapter 12 or 13 should, in general, be reported to the debtor, rather than the estate.

.05 If the Chapter 11 case is converted to a Chapter 7 case, the bankruptcy estate will continue to exist as a separate taxable entity and gross income (other than post-conversion income from the debtor's services), gross proceeds, or other reportable payments should continue to be reported to the estate if the gross income, gross proceeds, or other reportable payment represents property of the Chapter 7 estate. As section 2.11 notes, income from services performed by the debtor after conversion to Chapter 7 is not property of the Chapter 7 bankruptcy estate. Therefore, within a reasonable time after the conversion to Chapter 7, the debtor should notify payors required to report the debtor's nonemployee compensation on Form 1099-MISC that such compensation earned after the conversion to Chapter 7 should be reported using the debtor's name and taxpayer identification number, rather than the estate's name and TIN.

.06 The debtor is not required to file a new Form W-4 with an employer adjusting the debtor's withholding allowances solely because the debtor has filed a Chapter 11 case and his or her post-petition wages are includible in the gross income of the estate. This is true even though the estate may be taxed at a higher tax rate than the debtor and is entitled to only one personal exemption. A new Form W-4 may be necessary, however, under the applicable regulations when, for instance, the debtor employee is no longer entitled to claim the same number of allowances claimed on the Form W-4 previously provided to the employer, such as for certain deductions or credits that now belong to the estate. See section 31.3402(f)(2)-1 of the Employment Tax Regulations. Furthermore, even where not required, in some circumstances it may be prudent for the debtor to file a new Form W-4 to increase the amount of income tax withheld from the debtor's post-petition wages that will be allocated to the estate in accordance with section 6. Otherwise, estimated tax payments on behalf of the estate may be required in order to avoid a penalty for underpayment of estimated tax. See section 6654(a).

Section 4 APPLICATION OF THE SELF-EMPLOYMENT TAX

.01 Section 1401 of the Internal Revenue Code imposes a tax upon the self-employment income of every individual. The term "self-employment income" means the net earnings from self-employment derived by

an individual. I.R.C. section 1402(b). The term "net earnings from self-employment" means, in relevant part, the gross income derived by an individual from any trade or business carried on by such individual less deductions allowed attributable to such trade or business. I.R.C. section 1402(a).

.02 Under section 1115 of the Bankruptcy Code, the earnings from a Chapter 11 debtor's post-petition services, including the debtor's self-employment income, constitute property of the estate under section 1115. As property of the estate, the income from post-petition services is includible in the income of the bankruptcy estate, rather than the income of the debtor. I.R.C. section 1398(e)(1). However, neither section 1115 of the Bankruptcy Code nor section 1398 of the Internal Revenue Code addresses the application of the self-employment tax to the earnings from the individual debtor's continuing services. Because the debtor continues to derive gross income from the performance of services as a self-employed individual after the commencement of the bankruptcy case, the debtor must continue to report on Schedule SE of the debtor's individual income tax return the self-employment income earned post-petition, which includes the attributable deductions, and must pay the resulting self-employment tax imposed by section 1401.

Section 5 APPLICATION OF EMPLOYMENT TAXES AND OBLIGATION TO FILE FORM W-2

.01 As a result of the enactment of section 1115, post-petition wages earned by a debtor are generally treated for *income tax* purposes as gross income of the estate, rather than the debtor. The reporting and withholding obligations of a debtor's employer, however, have not changed as a result of the enactment of section 1115. Section 1115 has no effect on the determination of wages under the Federal Insurance Contributions Act (FICA), including application of the contribution and benefit base (as determined under section 230 of the Social Security Act). I.R.C. section 3121(a). Similarly, the enactment of section 1115 has no effect on the determination of wages for Federal Unemployment Tax Act (FUTA) tax or Federal Income Tax Withholding purposes. See I.R.C. sections 3306(b) and 3401(a).

.02 Since section 1115 does not affect the application of FICA tax, FUTA tax, or Federal Income Tax Withholding, with respect to the wages of a Chapter 11 debtor in a case commenced on or after October 17, 2005, an employer should continue to reflect such wages and accompanying tax withholdings on a Form W-2 issued to the debtor under the debtor's name and social security number.

Section 6 ALLOCATION OF INCOME AND CREDITS ON INFORMATION RETURNS AND REQUIRED STATEMENT FOR RETURNS

.01 When an employer issues a Form W-2 to a Chapter 11 debtor reporting all of the debtor's wages, salary, or other compensation to the debtor for a calendar year, and a portion of the wages, salary, or other compensation represents earnings from post-petition services includible in the estate's gross income under section 1398(e)(1), an allocation of the amounts reported on the Form W-2 must be made. The debtor in possession, or the trustee, if one is appointed, must allocate in a reasonable manner wages, salary, or other compensation reported in box 1 and the withheld income tax reported in box 2 of Form W-2 between the debtor and the estate. The allocations must be in accordance with all the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice. If reasonable, the debtor and trustee may use a simple percentage method for allocating income and withheld income tax between the debtor and the estate. The same method used to allocate income must be used to allocate withheld income tax. For example, if one-sixth of the wages reported on Form W-2 for the calendar year ending December 31, 2005, was earned after the commencement of the case and must therefore be included in the estate's gross income, one-sixth of the withheld income tax reported on Form W-2 must be claimed as a credit on the estate's income tax return and five-sixths of the withheld income tax must be claimed as a credit on the debtor's income tax return. See I.R.C. section 31(a).

.02 In some cases, persons filing information returns may report to the debtor gross income, gross proceeds, or other reportable payments that should have been reported to the bankruptcy estate using Forms 1099-INT, 1099-DIV, 1099-MISC, Schedule K-1 or other information returns. This may occur, for instance, if the debtor in possession fails to notify the payor of the bankruptcy in accordance with section 3.03. In these cases, the debtor in possession, or the trustee, must allocate the improperly reported income in a reasonable manner between the debtor and the estate. In general, the allocation must ensure that any income (and any income tax withheld) attributable to the post-petition period is reported on the estate's return, and any income (and income tax withheld) attributable to the pre-petition period is reported on the debtor's return. The allocations, however, must be in accordance with all the rules stated in sections 2.09, 2.10, 2.11, 2.12, and 2.13 of this notice.

.03 The debtor must attach a statement to his or her income tax return stating that he or she filed a Chapter 11 bankruptcy case. The statement must reflect the foregoing allocations of income and withheld

income tax and must describe the method used to allocate income and withheld tax between the debtor and the estate. The statement should list the filing date of the bankruptcy case, the bankruptcy court in which the case is pending, the bankruptcy court case number, and the bankruptcy estate's EIN. The debtor in possession or trustee must attach a similar statement to the income tax return of the estate.

.04 The following model statement may be used by debtors, debtors in possession and trustees in complying with the requirements of section 6 of this notice:

Notice XXXX-XX Statement

Pending Bankruptcy Case

The taxpayer, _____, filed a bankruptcy petition under Chapter 11 of the Bankruptcy Code on _____ in the Bankruptcy Court for the _____ District of _____. The bankruptcy court case number is _____. Gross income, and withheld federal income tax, reported on Form W-2, Forms 1099, K-1, Schedule K-1, and other information returns received under the taxpayer's name and social security number (or other taxpayer identification number) are allocated between the taxpayer and the bankruptcy estate (EIN__-____) as follows, using [*describe allocation method*]:

Year	Taxpayer	Estate
1. Form W-2 from _____ Co.	\$____	\$____
Withheld income tax shown on Form W-2	\$____	\$____
2. Form 1099-INT from _____ Bank	\$____	\$____
Withheld income tax (if any) shown on Form 1099-INT	\$____	\$____
3. Form 1099-DIV from _____ Co.	\$____	\$____
Withheld income tax (if any) shown on Form 1099-DIV	\$____	\$____
4. Form 1099-MISC from _____ Co.	\$____	\$____
Withheld income tax (if any) shown on Form 1099-MISC	\$____	\$____

Section 7 REQUEST FOR COMMENTS

.01 The IRS and the Treasury Department are aware that further guidance may be needed as a consequence of the enactment of section 1115 and request comments from the public.

.02 In particular, section 1115 does not address whether, or to what extent, the income earned by the debtor from services performed after confirmation of the Chapter 11 plan is property of the estate or property of the debtor. Nor does section 1115 address whether, or to what extent, property of the estate retains its character as such after it vests in the debtor upon plan confirmation under section 1141(b) of the Bankruptcy Code. Courts have addressed the effects of plan confirmation on the scope and extent of the Chapter 13 estate under the analogous provisions of that Chapter, but the courts have reached varying and conflicting results. See, for example, *Telfair v. First Union Mortgage Corp.*, 216 F.3d 1333, 1340 (11th Cir. 2000) (describing the estate termination approach, the preservation approach, and the transformation approach) and *Barbosa v. Soloman*, 235 F.3d 31, 36, 37 (1st Cir. 2000) (describing a fourth, hybrid, approach). Comments are requested as to the proper treatment of post-confirmation income, given the conflicting holdings under analogous provisions of Chapter 13. Comments are also requested as to whether the terms of the Chapter 11 plan and the order confirming the plan may affect the taxation of post-confirmation earnings of the debtor and post-confirmation income on property of the estate.

.03 Section 3.02 of this Notice addresses the tax consequences of compensation that a debtor in possession receives from the estate for managing or operating a trade or business carried on by the debtor before the commencement of the bankruptcy case. In some cases, however, the estate might not conduct a trade or business because the debtor was the employee of a third party before the commencement of the case and continues as an employee post-petition. Comments are requested on the tax treatment to the estate and the debtor of the portion of the post-petition compensation from a third party employer that the bankruptcy court allows the debtor to retain to pay for the debtor's personal or living expenses. In particular, comments are requested regarding whether such post-petition compensation is subject to double taxation as gross income to the debtor under section 61 and earnings under section 1115(a)(2) of the Bankruptcy Code includible in the estate's gross income under section 1398(e)(1), without a corresponding deduction for the estate.

.04 Comments should be submitted on these and other relevant issues in writing on or before December 1, 2006, to the Internal Revenue Service, P.O. Box 7604, Washington, D.C. 20044, Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to the Courier's Desk at Room 105, First Floor, Internal Revenue Service, 1901 S. Bell Street, Jeff Davis Highway, Arlington, Va., Attn: CC:PA:CBS (Notice 2006-83). Submissions may also be sent electronically via the internet to the following email address: Notice.comments@irs.counsel.treas.gov. Include the notice number (Notice 2006-83) in the subject line. All comments will be available for public inspection and copying.

Section 8 PAPERWORK REDUCTION ACT

.01 The collection of information in the notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-2033.

.02 An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

.03 The collection of information in the notice is in section 6 of this notice entitled "Allocation of Income and Credits on Information Returns and Required Statement for Returns." The collection of information is required for compliance with I.R.C. section 1398. The collection of information is required to comply with the Internal Revenue Code. The likely respondents are individuals and their chapter 11 bankruptcy estates.

.04 The estimated total annual reporting burden is 1,500 hours. The estimated annual burden per respondent is 1/2 hour. The estimated number of respondents is 3,000. The estimated frequency of responses is annually.

.05 Books or records relating to a collection of information must be retained as long as their contents may become material to the administration of the internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Section 9 DRAFTING INFORMATION

The principal author of this notice is William F. Conroy of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice contact William F. Conroy at (202) 622-3620 (not a toll-free call).

Contact us at <http://www.bna.com/contact/index.html> or call 1-800-372-1033

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Tax Considerations For Individual Chapter 11 Debtors

V. Internal Revenue Code

§ 1398



**Tax and Accounting
Center™**

Internal Revenue Code

Subtitle A — INCOME TAXES (Sections 1 to 1564)

Chapter 1 — Normal taxes and surtaxes (Sections 1 to 1400U-3)

Subchapter V — Title 11 Cases (Sections 1398 to 1399)

Sec. 1398. Rules Relating To Individuals' Title 11 Cases

1398(a) Cases To Which Section Applies

Except as provided in subsection (b), this section shall apply to any case under chapter 7 (relating to liquidations) or chapter 11 (relating to reorganizations) of title 11 of the United States Code in which the debtor is an individual.

1398(b) Exceptions Where Case Is Dismissed, Etc.

1398(b)(1) Section Does Not Apply Where Case Is Dismissed

This section shall not apply if the case under chapter 7 or 11 of title 11 of the United States Code is dismissed.

1398(b)(2) Section Does Not Apply At Partnership Level

For purposes of subsection (a), a partnership shall not be treated as an individual, but the interest in a partnership of a debtor who is an individual shall be taken into account under this section in the same manner as any other interest of the debtor.

1398(c) Computation And Payment Of Tax; Basic Standard Deduction

1398(c)(1) Computation And Payment Of Tax

Except as otherwise provided in this section, the taxable income of the estate shall be computed in the same manner as for an individual. The tax shall be computed on such taxable income and shall be paid by the trustee.

1398(c)(2) Tax Rates

The tax on the taxable income of the estate shall be determined under subsection (d) of section 1.

1398(c)(3) Basic Standard Deduction

In the case of an estate which does not itemize deductions, the basic standard deduction for the estate for the taxable year shall be the same as for a married individual filing a separate return for such year.

1398(d) Taxable Year Of Debtors

1398(d)(1) General Rule

Except as provided in paragraph (2), the taxable year of the debtor shall be determined without regard to the case under title 11 of the United States Code to which this section applies.

1398(d)(2) Election To Terminate Debtor's Year When Case Commences

1398(d)(2)(A) In General

Notwithstanding section 442, the debtor may (without the approval of the Secretary) elect to

treat the debtor's taxable year which includes the commencement date as 2 taxable years--

1398(d)(2)(A)(i)

the first of which ends on the day before the commencement date, and

1398(d)(2)(A)(ii)

the second of which begins on the commencement date.

1398(d)(2)(B) Spouse May Join In Election

In the case of a married individual (within the meaning of section 7703), the spouse may elect to have the debtor's election under subparagraph (A) also apply to the spouse, but only if the debtor and the spouse file a joint return for the taxable year referred to in subparagraph (A)(i).

1398(d)(2)(C) No Election Where Debtor Has No Assets

No election may be made under subparagraph (A) by a debtor who has no assets other than property which the debtor may treat as exempt property under section 522 of title 11 of the United States Code.

1398(d)(2)(D) Time For Making Election

An election under subparagraph (A) or (B) may be made only on or before the due date for filing the return for the taxable year referred to in subparagraph (A)(i). Any such election, once made, shall be irrevocable.

1398(d)(2)(E) Returns

A return shall be made for each of the taxable years specified in subparagraph (A).

1398(d)(2)(F) Annualization

For purposes of subsections (b), (c), and (d) of section 443, a return filed for either of the taxable years referred to in subparagraph (A) shall be treated as a return made under paragraph (1) of subsection (a) of section 443.

1398(d)(3) Commencement Date Defined

For purposes of this subsection, the term "commencement date" means the day on which the case under title 11 of the United States Code to which this section applies commences.

1398(e) Treatment Of Income, Deductions, And Credits

1398(e)(1) Estate's Share Of Debtor's Income

The gross income of the estate for each taxable year shall include the gross income of the debtor to which the estate is entitled under title 11 of the United States Code. The preceding sentence shall not apply to any amount received or accrued by the debtor before the commencement date (as defined in subsection (d)(3)).

1398(e)(2) Debtor's Share Of Debtor's Income

The gross income of the debtor for any taxable year shall not include any item to the extent that such item is included in the gross income of the estate by reason of paragraph (1).

1398(e)(3) Rule For Making Determinations With Respect To Deductions, Credits, And Employment Taxes

Except as otherwise provided in this section, the determination of whether or not any amount paid or incurred by the estate--

1398(e)(3)(A)

is allowable as a deduction or credit under this chapter, or

1398(e)(3)(B)

is wages for purposes of subtitle C, shall be made as if the amount were paid or incurred by the debtor and as if the debtor were still engaged in the trades and businesses, and in the activities, the debtor was engaged in before the commencement of the case.

1398(f) Treatment Of Transfers Between Debtor And Estate**1398(f)(1) Transfer To Estate Not Treated As Disposition**

A transfer (other than by sale or exchange) of an asset from the debtor to the estate shall not be treated as a disposition for purposes of any provision of this title assigning tax consequences to a disposition, and the estate shall be treated as the debtor would be treated with respect to such asset.

1398(f)(2) Transfer From Estate To Debtor Not Treated As Disposition

In the case of a termination of the estate, a transfer (other than by sale or exchange) of an asset from the estate to the debtor shall not be treated as a disposition for purposes of any provision of this title assigning tax consequences to a disposition, and the debtor shall be treated as the estate would be treated with respect to such asset.

1398(g) Estate Succeeds To Tax Attributes Of Debtor

The estate shall succeed to and take into account the following items (determined as of the first day of the debtor's taxable year in which the case commences) of the debtor--

1398(g)(1) Net Operating Loss Carryovers

The net operating loss carryovers determined under section 172.

1398(g)(2) Charitable Contributions Carryovers

The carryover of excess charitable contributions determined under section 170(d)(1).

1398(g)(3) Recovery Of Tax Benefit Items

Any amount to which section 111 (relating to recovery of tax benefit items) applies.

1398(g)(4) Credit Carryovers, Etc.

The carryovers of any credit, and all other items which, but for the commencement of the case, would be required to be taken into account by the debtor with respect to any credit.

1398(g)(5) Capital Loss Carryovers

The capital loss carryover determined under section 1212.

1398(g)(6) Basis, Holding Period, And Character Of Assets

In the case of any asset acquired (other than by sale or exchange) by the estate from the debtor, the basis, holding period, and character it had in the hands of the debtor.

1398(g)(7) Method Of Accounting

The method of accounting used by the debtor.

1398(g)(8) Other Attributes

Other tax attributes of the debtor, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purposes of this section.

1398(h) Administration, Liquidation, And Reorganization Expenses; Carryovers And Carrybacks Of Certain Excess Expenses

1398(h)(1) Administration, Liquidation, And Reorganization Expenses

Any administrative expense allowed under section 503 of title 11 of the United States Code, and any fee or charge assessed against the estate under chapter 123 of title 28 of the United States Code, to the extent not disallowed under any other provision of this title, shall be allowed as a deduction.

1398(h)(2) Carryback And Carryover Of Excess Administrative Costs, Etc., To Estate Taxable Years

1398(h)(2)(A) Deduction Allowed

There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (i) the administrative expense carryovers to such year, plus (ii) the administrative expense carrybacks to such year.

1398(h)(2)(B) Administrative Expense Loss, Etc.

If a net operating loss would be created or increased for any estate taxable year if section 172(c) were applied without the modification contained in paragraph (4) of section 172(d), then the amount of the net operating loss so created (or the amount of the increase in the net operating loss) shall be an administrative expense loss for such taxable year which shall be an administrative expense carryback to each of the 3 preceding taxable years and an administrative expense carryover to each of the 7 succeeding taxable years.

1398(h)(2)(C) Determination Of Amount Carried To Each Taxable Year

The portion of any administrative expense loss which may be carried to any other taxable year shall be determined under section 172(b)(2), except that for each taxable year the computation under section 172(b)(2) with respect to the net operating loss shall be made before the computation under this paragraph.

1398(h)(2)(D) Administrative Expense Deductions Allowed Only To Estate

The deductions allowable under this chapter solely by reason of paragraph (1), and the deduction provided by subparagraph (A) of this paragraph, shall be allowable only to the estate.

1398(i) Debtor Succeeds To Tax Attributes Of Estate

In the case of a termination of an estate, the debtor shall succeed to and take into account the items referred to in paragraphs (1), (2), (3), (4), (5), and (6) of subsection (g) in a manner similar to that provided in such paragraphs (but taking into account that the transfer is from the estate to the debtor instead of from the debtor to the estate). In addition, the debtor shall succeed to and take into account the other tax attributes of the estate, to the extent provided in regulations prescribed by the Secretary as necessary or appropriate to carry out the purposes of this section.

1398(j) Other Special Rules

1398(j)(1) Change Of Accounting Period Without Approval

Notwithstanding section 442, the estate may change its annual accounting period one time without the approval of the Secretary.

1398(j)(2) Treatment Of Certain Carrybacks

1398(j)(2)(A) Carrybacks From Estate

If any carryback year of the estate is a taxable year before the estate's first taxable year, the

carryback to such carryback year shall be taken into account for the debtor's taxable year corresponding to the carryback year.

1398(j)(2)(B) Carrybacks From Debtor's Activities

The debtor may not carry back to a taxable year before the debtor's taxable year in which the case commences any carryback from a taxable year ending after the case commences.

1398(j)(2)(C) Carryback And Carryback Year Defined

For purposes of this paragraph--

1398(j)(2)(C)(i) Carryback

The term "carryback" means a net operating loss carryback under section 172 or a carryback of any credit provided by part IV of subchapter A.

1398(j)(2)(C)(ii) Carryback Year

The term "carryback year" means the taxable year to which a carryback is carried.

(Added Pub. L. 96-589, 3(a)(1), Dec. 24, 1980, 94 Stat. 3397, and amended Pub. L. 99-514, title I, 104(b)(14), title XIII, 1301(j)(8), title XVIII, 1812(a)(5), Oct. 22, 1986, 100 Stat. 2105, 2658, 2833.)

BACKGROUND NOTES

Amendments to Part

1980--Pub. L. 96-589, 3(a)(1), Dec. 24, 1980, 94 Stat. 3397, added subchapter V heading "Title 11 Cases" and items 1398 and 1399.

AMENDMENTS

1986--Subsec. (c). Pub. L. 99-514, 104(b)(14)(A), substituted "basic standard deduction" for "zero bracket amount" in heading.

Subsec. (c)(3). Pub. L. 99-514, 104(b)(14)(B), amended par. (3) generally, substituting "Basic standard deduction" for "Amount of zero bracket amount" in heading and substituting "In the case of an estate which does not itemize deductions, the basic standard deduction for the estate" for "The amount of the estate's zero bracket amount" in text.

Subsec. (d)(2)(B). Pub. L. 99-514, 1301(j)(8), substituted "section 7703" for "section 143".

Subsec. (g)(3). Pub. L. 99-514, 1812(a)(5), amended par. (3) generally. Prior to amendment, par. (3), recovery exclusion, read as follows: "Any recovery exclusion under section 111 (relating to recovery of bad debts, prior taxes, and delinquency amounts)."

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 104(b)(14) of Pub. L. 99-514 applicable to taxable years beginning after Dec. 31, 1986, see section 151(a) of Pub. L. 99-514, set out as a note under section 1 of this title.

Amendment by section 1301(j)(8) of Pub. L. 99-514 applicable to bonds issued after Aug. 15, 1986, except as otherwise provided, see sections 1311 to 1318 of Pub. L. 99-514, set out as an Effective Date; Transitional Rules note under section 141 of this title.

Amendment by section 1812(a)(5) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE

Subchapter applicable to bankruptcy cases commencing more than 90 days after Dec. 24, 1980, see section 7(b) of Pub. L. 96-589, set out as an Effective Date of 1980 Amendment note under section 108 of this title.

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§ 108

*Internal Revenue Code**Subtitle A — INCOME TAXES (Sections 1 to 1564)**Chapter 1 — Normal taxes and surtaxes (Sections 1 to 1400U-3)**Subchapter B — Computation of Taxable Income (Sections 61 to 291)**Part III — Items Specifically Excluded From Gross Income (Sections 101 to 140)***Sec. 108. Income From Discharge Of Indebtedness****108(a) Exclusion From Gross Income****108(a)(1) In General**

Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if—

108(a)(1)(A)

the discharge occurs in a title 11 case,

108(a)(1)(B)

the discharge occurs when the taxpayer is insolvent,

108(a)(1)(C)

the indebtedness discharged is qualified farm indebtedness,

108(a)(1)(D)

in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness; or

108(a)(1)(E)

Editor's Note: Sec. 108(a)(1)(E), below, before amendment by Pub. L. 110-343, Div. A, Sec. 303(a), is effective for discharges of indebtedness occurring before Jan. 1, 2010.

the indebtedness discharged is qualified principal residence indebtedness which is discharged before January 1, 2010.

108(a)(1)(E)

Editor's Note: Sec. 108(a)(1)(E), below, after amendment by Pub. L. 110-343, Div. A, Sec. 303(a), is effective for discharges of indebtedness occurring on or after Jan. 1, 2010.

the indebtedness discharged is qualified principal residence indebtedness which is discharged before January 1, 2013.

108(a)(2) Coordination Of Exclusions**108(a)(2)(A) Title 11 Exclusion Takes Precedence**

Subparagraphs (B), (C), (D), and (E) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.

108(a)(2)(B) Insolvency Exclusion Takes Precedence Over Qualified Farm Exclusion And Qualified Real Property Business Exclusion

Subparagraphs (C) and (D) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent.

108(a)(2)(C) Principal Residence Exclusion Takes Precedence Over Insolvency Exclusion Unless Elected Otherwise

Paragraph (1)(B) shall not apply to a discharge to which paragraph (1)(E) applies unless the taxpayer elects to apply paragraph (1)(B) in lieu of paragraph (1)(E).

108(a)(3) Insolvency Exclusion Limited To Amount Of Insolvency

In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(B) shall not exceed the amount by which the taxpayer is insolvent.

108(b) Reduction Of Tax Attributes

108(b)(1) In General

The amount excluded from gross income under subparagraph (A), (B), or (C) of subsection (a)(1) shall be applied to reduce the tax attributes of the taxpayer as provided in paragraph (2).

108(b)(2) Tax Attributes Affected; Order Of Reduction

Except as provided in paragraph (5), the reduction referred to in paragraph (1) shall be made in the following tax attributes in the following order:

108(b)(2)(A) NOL

Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.

108(b)(2)(B) General Business Credit

Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit).

108(b)(2)(C) Minimum Tax Credit

The amount of the minimum tax credit available under section 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge.

108(b)(2)(D) Capital Loss Carryovers

Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.

108(b)(2)(E) Basis Reduction

108(b)(2)(E)(i) In General

The basis of the property of the taxpayer.

108(b)(2)(E)(ii) Cross Reference

For provisions for making the reduction described in clause (i), see section 1017.

108(b)(2)(F) Passive Activity Loss And Credit Carryovers

Any passive activity loss or credit carryover of the taxpayer under section 469(b) from the

taxable year of the discharge.

108(b)(2)(G) Foreign Tax Credit Carryovers

Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the credit allowable under section 27.

108(b)(3) Amount Of Reduction

108(b)(3)(A) In General

Except as provided in subparagraph (B), the reductions described in paragraph (2) shall be one dollar for each dollar excluded by subsection (a).

108(b)(3)(B) Credit Carryover Reduction

The reductions described in subparagraphs (B), (C), and (G) shall be 33 1/3 cents for each dollar excluded by subsection (a). The reduction described in subparagraph (F) in any passive activity credit carryover shall be 33 1/3 cents for each dollar excluded by subsection (a).

108(b)(4) Ordering Rules

108(b)(4)(A) Reductions Made After Determination Of Tax For Year

The reductions described in paragraph (2) shall be made after the determination of the tax imposed by this chapter for the taxable year of the discharge.

108(b)(4)(B) Reductions Under Subparagraph (A) Or (D) Of Paragraph (2)

The reductions described in subparagraph (A) or (D) of paragraph (2) (as the case may be) shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year in the order of the taxable years from which each such carryover arose.

108(b)(4)(C) Reductions Under Subparagraphs (B) And (G) Of Paragraph (2)

The reductions described in subparagraphs (B) and (G) of paragraph (2) shall be made in the order in which carryovers are taken into account under this chapter for the taxable year of the discharge.

108(b)(5) Election To Apply Reduction First Against Depreciable Property

108(b)(5)(A) In General

The taxpayer may elect to apply any portion of the reduction referred to in paragraph (1) to the reduction under section 1017 of the basis of the depreciable property of the taxpayer.

108(b)(5)(B) Limitation

The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

108(b)(5)(C) Other Tax Attributes Not Reduced

Paragraph (2) shall not apply to any amount to which an election under this paragraph applies.

108(c) Treatment Of Discharge Of Qualified Real Property Business Indebtedness

108(c)(1) Basis Reduction

108(c)(1)(A) In General

The amount excluded from gross income under subparagraph (D) of subsection (a)(1) shall be

applied to reduce the basis of the depreciable real property of the taxpayer.

108(c)(1)(B) Cross Reference

For provisions making the reduction described in subparagraph (A), see section 1017.

108(c)(2) Limitations

108(c)(2)(A) Indebtedness In Excess Of Value

The amount excluded under subparagraph (D) of subsection (a)(1) with respect to any qualified real property business indebtedness shall not exceed the excess (if any) of—

108(c)(2)(A)(i)

the outstanding principal amount of such indebtedness (immediately before the discharge), over

108(c)(2)(A)(ii)

the fair market value of the real property described in paragraph (3)(A) (as of such time), reduced by the outstanding principal amount of any other qualified real property business indebtedness secured by such property (as of such time).

108(c)(2)(B) Overall Limitation

The amount excluded under subparagraph (D) of subsection (a)(1) shall not exceed the aggregate adjusted bases of depreciable real property (determined after any reductions under subsections (b) and (g)) held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of such discharge).

108(c)(3) Qualified Real Property Business Indebtedness

The term "qualified real property business indebtedness" means indebtedness which—

108(c)(3)(A)

was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property,

108(c)(3)(B)

was incurred or assumed before January 1, 1993, or if incurred or assumed on or after such date, is qualified acquisition indebtedness, and

108(c)(3)(C)

with respect to which such taxpayer makes an election to have this paragraph apply. Such term shall not include qualified farm indebtedness. The indebtedness under subparagraph (B) shall include indebtedness resulting from the refinancing of indebtedness under subparagraph (B) (or this sentence), but only to the extent it does not exceed the amount of the indebtedness being refinanced.

108(c)(4) Qualified Acquisition Indebtedness

For purposes of paragraph (3)(B), the term "qualified acquisition indebtedness" means, with respect to any real property described in paragraph (3)(A), indebtedness incurred or assumed to acquire, construct, reconstruct, or substantially improve such property.

108(c)(5) Regulations

The Secretary shall issue such regulations as are necessary to carry out this subsection, including regulations preventing the abuse of this subsection through cross-collateralization or other means.

108(d) Meaning Of Terms; Special Rules Relating To Certain Provisions

108(d)(1) Indebtedness Of Taxpayer

For purposes of this section, the term "indebtedness of the taxpayer" means any indebtedness—

108(d)(1)(A)

for which the taxpayer is liable, or

108(d)(1)(B)

subject to which the taxpayer holds property.

108(d)(2) Title 11 Case

For purposes of this section, the term "title 11 case" means a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court.

108(d)(3) Insolvent

For purposes of this section, the term "insolvent" means the excess of liabilities over the fair market value of assets. With respect to any discharge, whether or not the taxpayer is insolvent, and the amount by which the taxpayer is insolvent, shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge.

108(d)(4)

[(4) Repealed. Pub. L. 99-514, title VIII, 822(b)(3)(A), Oct. 22, 1986, 100 Stat. 2373]

108(d)(5) Depreciable Property

The term "depreciable property" has the same meaning as when used in section 1017.

108(d)(6) Certain Provisions To Be Applied At Partner Level

In the case of a partnership, subsections (a), (b), (c), and (g) shall be applied at the partner level.

108(d)(7) Special Rules For S Corporation

108(d)(7)(A) Certain Provisions To Be Applied At Corporate Level

In the case of an S corporation, subsections (a), (b), (c), and (g) shall be applied at the corporate level, including by not taking into account under section 1366(a) any amount excluded under subsection (a) of this section.

108(d)(7)(B) Reduction In Carryover Of Disallowed Losses And Deductions

In the case of an S corporation, for purposes of subparagraph (A) of subsection (b)(2), any loss or deduction which is disallowed for the taxable year of the discharge under section 1366(d)(1) shall be treated as a net operating loss for such taxable year. The preceding sentence shall not apply to any discharge to the extent that subsection (a)(1)(D) applies to such discharge.

108(d)(7)(C) Coordination With Basis Adjustments Under Section 1367(b)(2)

For purposes of subsection (e)(6), a shareholder's adjusted basis in indebtedness of an S corporation shall be determined without regard to any adjustments made under section 1367(b)(2).

108(d)(8) Reductions Of Tax Attributes In Title 11 Cases Of Individuals To Be Made By Estate

In any case under chapter 7 or 11 of title 11 of the United States Code to which section 1398 applies, for purposes of paragraphs (1) and (5) of subsection (b) the estate (and not the individual) shall be treated as the taxpayer. The preceding sentence shall not apply for purposes of applying section 1017 to property transferred by the estate to the individual.

108(d)(9) Time For Making Election, Etc.

108(d)(9)(A) Time

An election under paragraph (5) of subsection (b) or under paragraph (3)(C) of subsection (c) shall be made on the taxpayer's return for the taxable year in which the discharge occurs or at such other time as may be permitted in regulations prescribed by the Secretary.

108(d)(9)(B) Revocation Only With Consent

An election referred to in subparagraph (A), once made, may be revoked only with the consent of the Secretary.

108(d)(9)(C) Manner

An election referred to in subparagraph (A) shall be made in such manner as the Secretary may by regulations prescribe.

108(d)(10) Cross Reference

For provision that no reduction is to be made in the basis of exempt property of an individual debtor, see section 1017(c)(1).

108(e) General Rules For Discharge Of Indebtedness (Including Discharges Not In Title 11 Cases Or Insolvency)

For purposes of this title--

108(e)(1) No Other Insolvency Exception

Except as otherwise provided in this section, there shall be no insolvency exception from the general rule that gross income includes income from the discharge of indebtedness.

108(e)(2) Income Not Realized To Extent Of Lost Deductions

No income shall be realized from the discharge of indebtedness to the extent that payment of the liability would have given rise to a deduction.

108(e)(3) Adjustments For Unamortized Premium And Discount

The amount taken into account with respect to any discharge shall be properly adjusted for unamortized premium and unamortized discount with respect to the indebtedness discharged.

108(e)(4) Acquisition Of Indebtedness By Person Related To Debtor

108(e)(4)(A) Treated As Acquisition By Debtor

For purposes of determining income of the debtor from discharge of indebtedness, to the extent provided in regulations prescribed by the Secretary, the acquisition of outstanding indebtedness by a person bearing a relationship to the debtor specified in section 267(b) or 707(b)(1) from a person who does not bear such a relationship to the debtor shall be treated as the acquisition of such indebtedness by the debtor. Such regulations shall provide for such adjustments in the treatment of any subsequent transactions involving the indebtedness as may be appropriate by reason of the application of the preceding sentence.

108(e)(4)(B) Members Of Family

For purposes of this paragraph, sections 267(b) and 707(b)(1) shall be applied as if section

267(c)(4) provided that the family of an individual consists of the individual's spouse, the individual's children, grandchildren, and parents, and any spouse of the individual's children or grandchildren.

108(e)(4)(C) Entities Under Common Control Treated As Related

For purposes of this paragraph, two entities which are treated as a single employer under subsection (b) or (c) of section 414 shall be treated as bearing a relationship to each other which is described in section 267(b).

108(e)(5) Purchase-Money Debt Reduction For Solvent Debtor Treated As Price Reduction

If—

108(e)(5)(A)

the debt of a purchaser of property to the seller of such property which arose out of the purchase of such property is reduced,

108(e)(5)(B)

such reduction does not occur—

108(e)(5)(B)(i)

in a title 11 case, or

108(e)(5)(B)(ii)

when the purchaser is insolvent, and

108(e)(5)(C)

but for this paragraph, such reduction would be treated as income to the purchaser from the discharge of indebtedness, then such reduction shall be treated as a purchase price adjustment.

108(e)(6) Indebtedness Contributed To Capital

Except as provided in regulations, for purposes of determining income of the debtor from discharge of indebtedness, if a debtor corporation acquires its indebtedness from a shareholder as a contribution to capital—

108(e)(6)(A)

section 118 shall not apply, but

108(e)(6)(B)

such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the shareholder's adjusted basis in the indebtedness.

108(e)(7) Recapture Of Gain On Subsequent Sale Of Stock

108(e)(7)(A) In General

If a creditor acquires stock of a debtor corporation in satisfaction of such corporation's indebtedness, for purposes of section 1245—

108(e)(7)(A)(i)

such stock (and any other property the basis of which is determined in whole or in part by reference to the adjusted basis of such stock) shall be treated as section 1245 property,

108(e)(7)(A)(ii)

the aggregate amount allowed to the creditor—

108(e)(7)(A)(ii)(I)

as deductions under subsection (a) or (b) of section 166 (by reason of the worthlessness or partial worthlessness of the indebtedness), or

108(e)(7)(A)(ii)(II)

as an ordinary loss on the exchange, shall be treated as an amount allowed as a deduction for depreciation, and

108(e)(7)(A)(iii)

an exchange of such stock qualifying under section 354(a), 355(a), or 356(a) shall be treated as an exchange to which section 1245(b)(3) applies.

The amount determined under clause (ii) shall be reduced by the amount (if any) included in the creditor's gross income on the exchange.

108(e)(7)(B) Special Rule For Cash Basis Taxpayers

In the case of any creditor who computes his taxable income under the cash receipts and disbursements method, proper adjustment shall be made in the amount taken into account under clause (ii) of subparagraph (A) for any amount which was not included in the creditor's gross income but which would have been included in such gross income if such indebtedness had been satisfied in full.

108(e)(7)(C) Stock Of Parent Corporation

For purposes of this paragraph, stock of a corporation in control (within the meaning of section 368(c)) of the debtor corporation shall be treated as stock of the debtor corporation.

108(e)(7)(D) Treatment Of Successor Corporation

For purposes of this paragraph, the term "debtor corporation" includes a successor corporation.

108(e)(7)(E) Partnership Rule

Under regulations prescribed by the Secretary, rules similar to the rules of the foregoing subparagraphs of this paragraph shall apply with respect to the indebtedness of a partnership.

108(e)(8) Indebtedness Satisfied By Corporate Stock Or Partnership Interest

For purposes of determining income of a debtor from discharge of indebtedness, if—

108(e)(8)(A)

a debtor corporation transfers stock, or

108(e)(8)(B)

a debtor partnership transfers a capital or profits interest in such partnership, to a creditor in satisfaction of its recourse or nonrecourse indebtedness, such corporation or partnership shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock or interest. In the case of any partnership, any discharge of indebtedness income recognized under this paragraph shall be included in the distributive shares of taxpayers which were the partners in the partnership immediately before such discharge.

108(e)(9) Discharge Of Indebtedness Income Not Taken Into Account In Determining Whether Entity Meets REIT Qualifications

Any amount included in gross income by reason of the discharge of indebtedness shall not be taken into account for purposes of paragraphs (2) and (3) of section 856(c).

108(e)(10) Indebtedness Satisfied By Issuance Of Debt Instrument

108(e)(10)(A) In General

For purposes of determining income of a debtor from discharge of indebtedness, if a debtor issues a debt instrument in satisfaction of indebtedness, such debtor shall be treated as having satisfied the indebtedness with an amount of money equal to the issue price of such debt instrument.

108(e)(10)(B) Issue Price

For purposes of subparagraph (A), the issue price of any debt instrument shall be determined under sections 1273 and 1274. For purposes of the preceding sentence, section 1273(b)(4) shall be applied by reducing the stated redemption price of any instrument by the portion of such stated redemption price which is treated as interest for purposes of this chapter.

108(f) Student Loans

108(f)(1) In General

In the case of an individual, gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of any student loan if such discharge was pursuant to a provision of such loan under which all or part of the indebtedness of the individual would be discharged if the individual worked for a certain period of time in certain professions for any of a broad class of employers.

108(f)(2) Student Loan

For purposes of this subsection, the term "student loan" means any loan to an individual to assist the individual in attending an educational organization described in section 170(b)(1)(A)(ii) made by—

108(f)(2)(A)

the United States, or an instrumentality or agency thereof,

108(f)(2)(B)

a State, territory, or possession of the United States, or the District of Columbia, or any political subdivision thereof,

108(f)(2)(C)

a public benefit corporation—

108(f)(2)(C)(i)

which is exempt from taxation under section 501(c)(3),

108(f)(2)(C)(ii)

which has assumed control over a State, county, or municipal hospital, and

108(f)(2)(C)(iii)

whose employees have been deemed to be public employees under State law, or

108(f)(2)(D)

any educational organization described in section 170(b)(1)(A)(ii) if such loan is made—

108(f)(2)(D)(i)

pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization, or

108(f)(2)(D)(ii)

pursuant to a program of such educational organization which is designed to encourage its students to serve in occupations with unmet needs or in areas with unmet needs and under which the services provided by the students (or former students) are for or under the direction of a governmental unit or an organization described in section 501(c)(3) and exempt from tax under section 501(a).

The term "student loan" includes any loan made by an educational organization so described or by an organization exempt from tax under section 501(a) to refinance a loan meeting the requirements of the preceding sentence. The term "student loan" includes any loan made by an educational organization described in section 170(b)(1)(A)(ii) or by an organization exempt from tax under section 501(a) to refinance a loan to an individual to assist the individual in attending any such educational organization but only if the refinancing loan is pursuant to a program of the refinancing organization which is designed as described in subparagraph (D)(ii).

108(f)(3) Exception For Discharges On Account Of Services Performed For Certain Lenders

Paragraph (1) shall not apply to the discharge of a loan made by an organization described in paragraph (2)(D) if the discharge is on account of services performed for either such organization.

108(f)(4) Payments Under National Health Service Corps Loan Repayment Program And Certain State Loan Repayment Programs

In the case of an individual, gross income shall not include any amount received under section 338B(g) of the Public Health Service Act, under a state program described in section 338I of such Act, or under any other State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by such State).

108(g) Special Rules For Discharge Of Qualified Farm Indebtedness

108(g)(1) Discharge Must Be By Qualified Person

108(g)(1)(A) In General

Subparagraph (C) of subsection (a)(1) shall apply only if the discharge is by a qualified person.

108(g)(1)(B) Qualified Person

For purposes of subparagraph (A), the term "qualified person" has the meaning given to such term by section 49(a)(1)(D)(iv); except that such term shall include any Federal, State, or local government or agency or instrumentality thereof.

108(g)(2) Qualified Farm Indebtedness

For purposes of this section, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if—

108(g)(2)(A)

such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

108(g)(2)(B)

50 percent or more of the aggregate gross receipts of the taxpayer for the 3 taxable years

preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

108(g)(3) Amount Excluded Cannot Exceed Sum Of Tax Attributes And Business And Investment Assets

108(g)(3)(A) In General

The amount excluded under subparagraph (C) of subsection (a)(1) shall not exceed the sum of—

108(g)(3)(A)(i)

the adjusted tax attributes of the taxpayer, and

108(g)(3)(A)(ii)

the aggregate adjusted bases of qualified property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.

108(g)(3)(B) Adjusted Tax Attributes

For purposes of subparagraph (A), the term “adjusted tax attributes” means the sum of the tax attributes described in subparagraphs (A), (B), (C), (D), (F), and (G) of subsection (b)(2) determined by taking into account \$3 for each \$1 of the attributes described in subparagraphs (B), (D) and (G) of subsection (b)(2) and the attribute described in subparagraph (F) of subsection (b)(2) to the extent attributable to any passive activity credit carryover.

108(g)(3)(C) Qualified Property

For purposes of this paragraph, the term “qualified property” means any property which is used or is held for use in a trade or business or for the production of income.

108(g)(3)(D) Coordination With Insolvency Exclusion

For purposes of this paragraph, the adjusted basis of any qualified property and the amount of the adjusted tax attributes shall be determined after any reduction under subsection (b) by reason of amounts excluded from gross income under subsection (a)(1)(B).

108(h) Special Rules Relating To Qualified Principal Residence Indebtedness

108(h)(1) Basis Reduction

The amount excluded from gross income by reason of subsection (a)(1)(E) shall be applied to reduce (but not below zero) the basis of the principal residence of the taxpayer.

108(h)(2) Qualified Principal Residence Indebtedness

For purposes of this section, the term “qualified principal residence indebtedness” means acquisition indebtedness (within the meaning of section 163(h)(3)(B), applied by substituting “\$2,000,000 (\$1,000,000” for “\$1,000,000 (\$500,000” in clause (ii) thereof) with respect to the principal residence of the taxpayer.

108(h)(3) Exception for Certain Discharges Not Related To Taxpayer's Financial Condition

Subsection (a)(1)(E) shall not apply to the discharge of a loan if the discharge is on account of services performed for the lender or any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer.

108(h)(4) Ordering Rule

If any loan is discharged, in whole or in part, and only a portion of such loan is qualified principal residence indebtedness, subsection (a)(1)(E) shall apply only to so much of the amount discharged as exceeds the amount of the loan (as determined immediately before such discharge) which is not

qualified principal residence indebtedness.

108(h)(5) Principal Residence

For purposes of this subsection, the term "principal residence" has the same meaning as when used in section 121.

108(i) Deferral And Ratable Inclusion Of Income Arising From Business Indebtedness Discharged By The Reacquisition Of A Debt Instrument

108(i)(1) In General

At the election of the taxpayer, income from the discharge of indebtedness in connection with the reacquisition after December 31, 2008, and before January 1, 2011, of an applicable debt instrument shall be includible in gross income ratably over the 5-taxable-year period beginning with—

108(i)(1)(A)

in the case of a reacquisition occurring in 2009, the fifth taxable year following the taxable year in which the reacquisition occurs, and

108(i)(1)(B)

in the case of a reacquisition occurring in 2010, the fourth taxable year following the taxable year in which the reacquisition occurs.

108(i)(2) Deferral Of Deduction For Original Issue Discount In Debt For Debt Exchanges

108(i)(2)(A) In General

If, as part of a reacquisition to which paragraph (1) applies, any debt instrument is issued for the applicable debt instrument being reacquired (or is treated as so issued under subsection (e)(4) and the regulations thereunder) and there is any original issue discount determined under subpart A of part V of subchapter P of this chapter with respect to the debt instrument so issued—

108(i)(2)(A)(i)

except as provided in clause (ii), no deduction otherwise allowable under this chapter shall be allowed to the issuer of such debt instrument with respect to the portion of such original issue discount which—

108(i)(2)(A)(i)(I)

accrues before the 1st taxable year in the 5-taxable-year period in which income from the discharge of indebtedness attributable to the reacquisition of the debt instrument is includible under paragraph (1), and

108(i)(2)(A)(i)(II)

does not exceed the income from the discharge of indebtedness with respect to the debt instrument being reacquired, and

108(i)(2)(A)(ii)

the aggregate amount of deductions disallowed under clause (i) shall be allowed as a deduction ratably over the 5-taxable-year period described in clause (i)(I).

If the amount of the original issue discount accruing before such 1st taxable year exceeds the income from the discharge of indebtedness with respect to the applicable debt instrument being reacquired, the deductions shall be disallowed in the order in which the original issue discount is accrued.

108(i)(5)(A) Related Person

For purposes of this subsection—

108(i)(5) Other Definitions And Rules

The term "acquisition" shall, with respect to any applicable debt instrument, include an acquisition of the debt instrument for cash, the exchange of the debt instrument for another debt instrument (including an exchange resulting from a modification of the debt instrument), the exchange of the debt instrument for corporate stock or a partnership interest, and the contribution of the debt instrument to capital. Such term shall also include the complete forgiveness of the indebtedness by the holder of the debt instrument.

108(i)(4)(B) Acquisition

a related person to such debtor.

108(i)(4)(A)(iii)

the debtor which issued (or is otherwise the obligor under) the debt instrument, or

108(i)(4)(A)(i)

of the debt instrument by—

The term " reacquisition" means, with respect to any applicable debt instrument, any acquisition

108(i)(4)(A) In General

For purposes of this subsection—

108(i)(4) Reacquisition

The term "debt instrument" means a bond, debenture, note, certificate, or any other instrument or contractual arrangement constituting indebtedness (within the meaning of section 1275(a)(1)).

108(i)(3)(B) Debt Instrument

any other person in connection with the conduct of a trade or business by such person.

108(i)(3)(A)(iii)

a C corporation, or

108(i)(3)(A)(i)

The term "applicable debt instrument" means any debt instrument which was issued by—

108(i)(3)(A) Applicable Debt Instrument

For purposes of this subsection—

108(i)(3) Applicable Debt Instrument

For purposes of subparagraph (A), if any debt instrument is issued by an issuer and the proceeds of such debt instrument are used directly or indirectly by the issuer to reacquire an applicable debt instrument of the issuer, the debt instrument so issued shall be treated as issued for the debt instrument being reacquired. If only a portion of the proceeds from a debt instrument are so used, the rules of subparagraph (A) shall apply to the portion of any original issue discount on the newly issued debt instrument which is equal to the portion of the proceeds from such instrument used to reacquire the outstanding instrument.

108(i)(2)(B) Deemed Debt For Debt Exchanges

The determination of whether a person is related to another person shall be made in the same manner as under subsection (e)(4).

108(i)(5)(B) Election

108(i)(5)(B)(i) In General

An election under this subsection with respect to any applicable debt instrument shall be made by including with the return of tax imposed by chapter 1 for the taxable year in which the reacquisition of the debt instrument occurs a statement which—

108(i)(5)(B)(i)(I)

clearly identifies such instrument, and

108(i)(5)(B)(i)(II)

includes the amount of income to which paragraph (1) applies and such other information as the Secretary may prescribe.

108(i)(5)(B)(ii) Election Irrevocable

Such election, once made, is irrevocable.

108(i)(5)(B)(iii) Pass-Thru Entities

In the case of a partnership, S corporation, or other pass-thru entity, the election under this subsection shall be made by the partnership, the S corporation, or other entity involved.

108(i)(5)(C) Coordination With Other Exclusions

If a taxpayer elects to have this subsection apply to an applicable debt instrument, subparagraphs (A), (B), (C), and (D) of subsection (a)(1) shall not apply to the income from the discharge of such indebtedness for the taxable year of the election or any subsequent taxable year.

108(i)(5)(D) Acceleration Of Deferred Items

108(i)(5)(D)(i) In General

In the case of the death of the taxpayer, the liquidation or sale of substantially all the assets of the taxpayer (including in a title 11 or similar case), the cessation of business by the taxpayer, or similar circumstances, any item of income or deduction which is deferred under this subsection (and has not previously been taken into account) shall be taken into account in the taxable year in which such event occurs (or in the case of a title 11 or similar case, the day before the petition is filed).

108(i)(5)(D)(ii) Special Rule For Pass-Thru Entities

The rule of clause (i) shall also apply in the case of the sale or exchange or redemption of an interest in a partnership, S corporation, or other pass-thru entity by a partner, shareholder, or other person holding an ownership interest in such entity.

108(i)(6) Special Rule For Partnerships

In the case of a partnership, any income deferred under this subsection shall be allocated to the partners in the partnership immediately before the discharge in the manner such amounts would have been included in the distributive shares of such partners under section 704 if such income were recognized at such time. Any decrease in a partner's share of partnership liabilities as a result of such discharge shall not be taken into account for purposes of section 752 at the time of the discharge to the extent it would cause the partner to recognize gain under section 731. Any decrease in partnership liabilities deferred under the preceding sentence shall be taken into account by such partner at the same time, and to the extent remaining in the same amount, as income

deferred under this subsection is recognized.

108(i)(7) Secretarial Authority

The Secretary may prescribe such regulations, rules, or other guidance as may be necessary or appropriate for purposes of applying this subsection, including—

108(i)(7)(A)

extending the application of the rules of paragraph (5)(D) to other circumstances where appropriate,

108(i)(7)(B)

requiring reporting of the election (and such other information as the Secretary may require) on returns of tax for subsequent taxable years, and

108(i)(7)(C)

rules for the application of this subsection to partnerships, S corporations, and other pass-thru entities, including for the allocation of deferred deductions.

(Aug. 16, 1954, ch. 736, 68A Stat. 32; June 29, 1956, ch. 463, Sec. 5, 70 Stat. 403; June 8, 1960, Pub. L. 88-496, Sec. 1(a), 74 Stat. 164; Oct. 4, 1976, Pub. L. 94-455, title XIX, Sec. 1906(b)(13)(A), 1951(b)(2)(A), 90 Stat. 1834, 1836; Dec. 24, 1980, Pub. L. 96-589, Sec. 2(a), 94 Stat. 3389; Oct. 19, 1982, Pub. L. 97-354, Sec. 3(e), 96 Stat. 1689; Jan. 12, 1983, Pub. L. 97-448, title I, Sec. 102(h)(1), title III, Sec. 304(d), 96 Stat. 2372, 2398; July 18, 1984, Pub. L. 98-369, div. A, title I, Sec. 59(a), (b)(1), title IV, Sec. 474(r)(5), title VII, Sec. 721(b)(2), title X, Sec. 1076(a), 98 Stat. 576, 839, 966, 1053; Oct. 22, 1986, Pub. L. 99-514, title I, Sec. 104(b)(2), title II, Sec. 231(d)(3)(D), title IV, Sec. 405(a), title VI, Sec. 621(e)(1), title VIII, Sec. 805(c)(2)-(4), 822(a), (b)(1)-(3), title XI, Sec. 1171(b)(4), title XVIII, Sec. 1847(b)(7), 100 Stat. 2105, 2179, 2224, 2266, 2362, 2373, 2513, 2856; Nov. 10, 1988, Pub. L. 100-647, title I, Sec. 1004(a)(1)-(4), (6), 102 Stat. 3385, 3387; Nov. 5, 1990, Pub. L. 101-508, title XI, Sec. 11325(a)(1), (b), 11813(b)(6), 104 Stat. 1388-466, 1388-551; Aug. 10, 1993, Pub. L. 103-66, title XIII, Sec. 13150, 13226, 107 Stat. 312; Aug. 20, 1996, Pub. L. 104-188, title I, Sec. 1703(n)(2), 110 Stat. 1755; Pub. L. 105-34, title II, Sec. 225(a), Aug. 5, 1997, 111 Stat. 788; Pub. L. 105-206, title VI, Sec. 6004(f), July 22, 1998, 112 Stat. 685; Pub. L. 107-147, title IV, Sec. 402(a), Mar. 9, 2002, 116 Stat. 21; Pub. L. 108-357, title III, Sec. 320(a), title VIII, Sec. 896(a), Oct. 22, 2004, 118 Stat. 1418; Pub. L. 110-142, Sec. 2, Dec. 20, 2007, 121 Stat. 1803; Pub. L. 110-343, div. A, title III, Sec. 303(a), Oct. 3, 2008, 122 Stat. 3765; Pub. L. 111-5, div. B, title I, Sec. 1231(a); Pub. L. 111-5, div. B, title I, Sec. 1231(a), Feb. 17, 2009, 123 Stat. 115; Pub. L. 111-148, Sec. 10908(a), Mar. 23, 2010, 124 Stat. 119.)

BACKGROUND NOTES

AMENDMENTS

2010 - Subsec. (f)(4). Pub. L. 111-148, Sec. 10908(a), amended par. (4). Before amendment, it read as follow:.

"(4) Payments Under National Health Service Corps Loan Repayment Program And Certain State Loan Repayment Programs.—In the case of an individual, gross income shall not include any amount received under section 338B(g) of the Public Health Service Act or under a State program described in section 338I of such Act."

2009 - Subsec. (i). Pub. L. 111-5, Div. B, Sec. 1231(a), added subsec. (i).

2008 - Subsec. (a)(1)(E). Pub. L. 110-343, Div. A, Sec. 303(a), amended subpar. (E) by substituting "January 1, 2013" for "January 1, 2010".

2007 - Subsec. (a)(1). Pub. L. 110-142, Sec. 2(a), amended par. (1) by striking "or" at the end of subpar. (C); by substituting ", or" for the period at the end of subpar. (D); and by adding subpar. (E).

Subsec. (a)(2)(A). Pub. L. 110-142, Sec. 2(c)(1), amended subpar. (A) by substituting "(D), and (E)" for "and (D)".

Subsec. (a)(2)(C). Pub. L. 110-142, Sec. 2(c)(2), added subpar. (C).

Subsec. (h). Pub. L. 110-142, Sec. 2(b), added subsec. (h).

2004 - Subsec. (e)(8). Pub. L. 108-357, Sec. 896(a), amended par. (8), which formerly read:

"(8) Indebtedness satisfied by corporation's stock.--

"For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock."

Subsec. (f)(4). Pub. L. 108-357, Sec. 320(a), added par. (4).

2002 - Subsec. (d)(7)(A). Pub. L. 107-147, Sec. 402(a), amended subpar. (A) by inserting ", including by not taking into account under section 1366(a) any amount excluded under subsection (a) of this section".

1998 - Subsec. (f)(2). Pub. L. 105-206, Sec. 6004(f)(1), amended par. (2) by adding the sentence at the end.

Subsec. (f)(3). Pub. L. 105-206, Sec. 6004(f)(2), amended par. (3) by striking "(or by an organization described in paragraph (2)(E) from funds provided by an organization described in paragraph (2)(D))" after "paragraph (2)(D)".

1997 - Subsec. (f)(2). Pub. L. 105-34, Sec. 225(a)(1), amended subpar. (B) by striking "or" at the end; struck subpar. (D); and added a new subpar. (D). Prior to amendment it read as follows:

"(D) any educational organization so described pursuant to an agreement with any entity described in subparagraph (A), (B), or (C) under which the funds from which the loan was made were provided to such educational organization."

Subsec. (f)(3). Pub. L. 105-34, Sec. 225(a)(2), added par. (3).

1996 - Subsec. (d)(9)(A). Pub. L. 104-188, Sec. 1703(n)(2), struck "paragraph (3)(B)" and inserted "paragraph (3)(C)".

1993 - Subsec. (a)(1). Pub. L. 103-66, Section 13150(a) struck "or" at the end of subparagraph (B), struck the period at the end of subparagraph (C) and inserted ", or", and added at the end a new subparagraph (D).

Subsec. (a)(2)(A). Pub. L. 103-66, Section 13150(c)(1) struck "and (C)" and inserted ", (C), and (D)".

Subsec. (a)(2)(B). Pub. L. 103-66, Section 13150(c)(2) amended subparagraph (B), which formerly read:

"(B) Insolvency exclusion takes precedence over qualified farm exclusion

"Subparagraph (C) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent."

Subsec. (b)(2). Pub. L. 103-66, Section 13226(b)(1) redesignated subparagraphs (C), (D), and (E) as subparagraphs (D), (E), and (F) and added after subparagraph (B) a new subparagraph (C).

Subsec. (b)(2). Pub. L. 103-66, Section 13226(b)(2) amended section 108(b)(2), as amended by Section 13226(b)(1) of Pub. L. 103-66, by redesignating subparagraph (F) as subparagraph (G) and by adding after subparagraph (E) a new subparagraph (F).

Subsec. (b)(3)(B). Pub. L. 103-66, Section 13226(b)(3)(A), amended subparagraph (B), which prior to amendment read as follows:

"(B) Limitation for period after change

"For purposes of applying the limitation of subsection (a) to the remainder of the taxable income for such year, the section 382 limitation shall be an amount which bears the same ratio to such limitation (determined without regard to this paragraph) as--

"(i) the number of days in such year after the change date, bears to

"(ii) the total number of days in such year."

Subsec. (b)(4)(B). Pub. L. 103-66, Section 13226(b)(3)(B) struck "(C)" in the text and heading and inserted "(D)".

Subsec. (b)(4)(C). Pub. L. 103-66, Section 13226(b)(3)(C) struck "(E)" in the text and heading and

inserted "(G)".

Subsec. (c). Pub. L. 103-66, Section 13150(b) amended section 108 by inserting after subsection (b) a new subsection (c).

Subsec. (d). Pub. L. 103-66, Section 13150(c)(3) amended subsection (d) as follows:

by striking "subsections (a), (b), and (g)" in paragraphs (6) and (7)(A) and inserting "subsections (a), (b), (c), and (g)",

by striking "SUBSECTIONS (a), (b), AND (g)" in the subsection heading and inserting "CERTAIN PROVISIONS", and

by striking "SUBSECTIONS (a), (b), AND (g)" in the headings of paragraphs (6) and (7)(A) and inserting "CERTAIN PROVISIONS".

Subsec. (d)(7)(B). Pub. L. 103-66, Section 13150(c)(4) added at the end of subparagraph (B) the following new sentence: "The preceding sentence shall not apply to any discharge to the extent that subsection (a)(1)(D) applies to such discharge."

Subsec. (d)(9). Pub. L. 103-66, Section 13150(c)(5) inserted "or under paragraph (3)(B) of subsection (c)" after "subsection (b)".

Subsec. (e)(6). Pub. L. 103-66, Section 13226(a)(2)(B) substituted "Except as provided in regulations, for" for "For".

Subsec. (e)(8). Pub. L. 103-66, Section 13226(a)(1) amended paragraph (8), which prior to amendment read as follows:

"(8) Stock for debt exception not to apply in de minimis cases

"For purposes of determining income of the debtor from discharge of indebtedness, the stock for debt exception shall not apply--

"(A) to the issuance of nominal or token shares, or

"(B) with respect to an unsecured creditor, where the ratio of the value of the stock received by such unsecured creditor to the amount of his indebtedness cancelled or exchanged for stock in the workout is less than 50 percent of a similar ratio computed for all unsecured creditors participating in the workout.

"Any stock which is disqualified stock (as defined in paragraph (10)(B)(ii)) shall not be treated as stock for purposes of this paragraph."

Subsec. (e)(10), (11). Pub. L. 103-66, Section 13226(a)(1) struck paragraph (10) and redesignated paragraph (11) as paragraph (10). Prior to being struck, paragraph (10) read as follows:

"(10) Indebtedness satisfied by corporation's stock

"(A) In general

"For purposes of determining income of a debtor from discharge of indebtedness, if a debtor corporation transfers stock to a creditor in satisfaction of its indebtedness, such corporation shall be treated as having satisfied the indebtedness with an amount of money equal to the fair market value of the stock.

"(B) EXCEPTION FOR CERTAIN STOCK IN TITLE 11 CASES AND INSOLVENT DEBTORS. --

"(i) IN GENERAL. -- Subparagraph (A) shall not apply to any transfer of stock of the debtor (other than disqualified stock) --

"(I) by a debtor in a title 11 case, or

"(II) by any other debtor but only to the extent such debtor is insolvent.

"(ii) DISQUALIFIED STOCK. -- For purposes of clause (i), the term 'disqualified stock' means any stock with a stated redemption price if --

"(I) such stock has a fixed redemption date,

"(II) the issuer of such stock has the right to redeem such stock at one or more times, or

"(III) the holder of such stock has the right to require its redemption at one or more times."

Subsec. (g)(3)(B). Pub. L. 103-66, Section 13226(b)(3)(D) amended subparagraph (B) as follows:

by striking "subparagraphs (A), (B), (C), and (E)" and inserting "subparagraphs (A), (B), (C), (D), (F), and (G)",

by striking "subparagraphs (B) and (E)" and inserting "subparagraphs (B), (C), and (G)", and

by inserting before the period at the end the following: "and the attribute described in subparagraph (F) of subsection (b)(2) to the extent attributable to any passive activity credit carryover".

1990 - Subsec. (e)(8). Pub. L. 101-508, Sec. 11325(b)(2), inserted provision at end that any stock which is a disqualified stock, as so defined, not be treated as stock for purposes of this paragraph.

Subsec. (e)(10)(B). Pub. L. 101-508, Sec. 11325(b)(1), substituted heading for one which read: 'Exception for title 11 cases and insolvent debtors' and amended text generally. Prior to amendment, text read as follows: 'Subparagraph (A) shall not apply in the case of a debtor in a title 11 case or to the extent the debtor is insolvent.'

Subsec. (e)(11). Pub. L. 101-508, Sec. 11325(a)(1), added par. (11).

Subsec. (g)(1)(B). Pub. L. 101-508, Sec. 11813(b)(6), substituted 'section 49(a)(1)(D)(iv)' for 'section 46(c)(8)(D)(iv)'.

1988 - Subsec. (a)(1)(C). Pub. L. 100-647, Sec. 1004(a)(1), added subpar. (C).

Subsec. (a)(2). Pub. L. 100-647, Sec. 1004(a)(2), amended par. (2) generally. Prior to amendment, par. (2) read as follows: 'Subparagraph (B) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.'

Subsec. (b). Pub. L. 100-647, Sec. 1004(a)(3), struck out 'in title 11 case or insolvency' after 'Reduction of tax attributes' in heading and substituted 'subparagraph (A), (B), or (C)' for 'subparagraph (A) or (B)' in text of par. (1).

Subsec. (d). Pub. L. 100-647, Sec. 1004(a)(6)(B), which directed amendment of subsec. (d) heading by substituting 'subsections (a), (b), and (g)' for 'subsections (a), and (b)', was executed by making the substitution for 'subsections (a) and (b)' as the probable intent of Congress.

Subsec. (d)(6). Pub. L. 100-647, Sec. 1004(a)(6)(A), (C), substituted 'Subsections (a), (b), and (g)' for 'Subsections (a) and (b)' in heading and 'subsections (a), (b), and (g)' for 'subsections (a) and (b)' in text.

Subsec. (d)(7)(A). Pub. L. 100-647, Sec. 1004(a)(6)(A), (C), substituted 'Subsections (a), (b), and (g)' for 'Subsections (a) and (b)' in heading and 'subsections (a), (b), and (g)' for 'subsections (a) and (b)' in text.

Subsec. (g). Pub. L. 100-647, Sec. 1004(a)(4), substituted 'indebtedness' for 'indebtedness of solvent farmers' in heading and amended text generally. Prior to amendment, text read as follows:

'(1) In general. - For purposes of this section and section 1017, the discharge by a qualified person of qualified farm indebtedness of a taxpayer who is not insolvent at the time of the discharge shall be treated in the same manner as if the discharge had occurred when the taxpayer was insolvent.

'(2) Qualified farm indebtedness. - For purposes of this subsection, indebtedness of a taxpayer shall be treated as qualified farm indebtedness if -

'(A) such indebtedness was incurred directly in connection with the operation by the taxpayer of the trade or business of farming, and

'(B) 50 percent or more of the average annual gross receipts of the taxpayer for the 3 taxable years preceding the taxable year in which the discharge of such indebtedness occurs is attributable to the trade or business of farming.

'(3) Qualified person. - For purposes of this subsection, the term 'qualified person' means a person described in section 46(c)(8)(D)(iv).'

1986 - Subsec. (a)(1)(C). Pub. L. 99-514, Sec. 822(a), struck out subpar. (C) relating to exclusion from gross income if the indebtedness discharged is qualified business indebtedness.

Subsec. (a)(2). Pub. L. 99-514, Sec. 822(b)(1), substituted 'Subparagraph (B) of paragraph (1)' for 'Subparagraphs (B) and (C) of paragraph (1)' in subpar. (A), struck out subpar. (A) designation and heading, and struck out subpar. (B) providing that insolvency exclusion takes precedence over qualified

business exclusion.

Subsec. (b)(2)(B). Pub. L. 99-514, Sec. 231(d)(3)(D), substituted 'General business credit' for 'Research credit and general business credit' in heading and amended text, as amended by this Act (Pub. L. 99-514, Sec. 1171(b)(4) (see below)), generally. Prior to amendment, text read as follows: 'Any carryover to or from the taxable year of a discharge of an amount for purposes of determining the amount allowable as a credit under -

'(i) section 30 (relating to credit for increasing research activities), or

'(ii) section 38 (relating to general business credit).

For purposes of this subparagraph, there shall not be taken into account any portion of a carryover which is attributable to the employee stock ownership credit determined under section 41.'

Pub. L. 99-514, Sec. 1171(b)(4), struck out last sentence which had been eliminated by the general amendment of subpar. (B) by Pub. L. 99-514, Sec. 231(d)(3)(D). See above.

Subsec. (b)(2)(E). Pub. L. 99-514, Sec. 1847(b)(7), substituted 'section 27' for 'section 33'.

Subsec. (b)(3). Pub. L. 99-514, Sec. 104(b)(2), substituted '33 1/3 cents' for '50 cents'.

Subsec. (c). Pub. L. 99-514, Sec. 822(b)(2), struck out subsec. (c) relating to tax treatment of discharge of qualified business indebtedness.

Subsec. (d). Pub. L. 99-514, Sec. 822(b)(3)(B), struck out reference to subsec. (c) in heading.

Subsec. (d)(4). Pub. L. 99-514, Sec. 822(b)(3)(A), struck out par. (4) relating to treatment of indebtedness as qualified business indebtedness.

Subsec. (d)(6), (7)(A). Pub. L. 99-514, Sec. 822(b)(3)(B), struck out reference to subsec. (c) in heading and text.

Subsec. (d)(7)(B). Pub. L. 99-514, Sec. 822(b)(3)(C), struck out 'The preceding sentence shall not apply to any discharge to the extent that subsection (a)(1)(C) applies to such discharge.'

Subsec. (d)(9)(A). Pub. L. 99-514, Sec. 822(b)(3)(D), struck out 'under paragraph (4) of this subsection or' after 'An election'.

Subsec. (e)(7)(A)(ii)(I). Pub. L. 99-514, Sec. 805(c)(2), substituted 'subsection (a) or (b) of section 166' for 'subsection (a), (b), or (c) of section 166'.

Subsec. (e)(7)(B) to (D). Pub. L. 99-514, Sec. 805(c)(3), redesignated subpars. (C) to (E) as (B) to (D), respectively, and struck out former subpar. (B) which related to taxpayers on reserve method.

Subsec. (e)(7)(E), (F). Pub. L. 99-514, Sec. 805(c)(3), (4), redesignated subpar. (F) as (E) and substituted 'the foregoing subparagraphs' for 'subparagraphs (A), (B), (C), (D), and (E)'. Former subpar. (E) redesignated (D).

Subsec. (e)(10)(C). Pub. L. 99-514, Sec. 621(e), repealed the amendment by Pub. L. 98-369, Sec. 59(b)(1), which had added subpar. (C) creating an exception for transfers in certain workouts of the satisfaction of indebtedness by corporation's stock. See 1984 Amendment note below.

Subsec. (g). Pub. L. 99-514, Sec. 405(a), added subsec. (g).

1984 - Subsec. (b)(2)(B). Pub. L. 98-369, Sec. 474(r)(5), substituted provisions relating to research credits and general business credits covering carryovers to or from the taxable year of a discharge of an amount for purposes of determining the amount allowable as a credit under section 30 (relating to credit for increasing research activities), or section 38 (relating to general business credit), and directing that there shall not be taken into account any portion of a carryover which is attributable to the employee stock ownership credit determined under section 41 for former provisions covering carryovers to or from the taxable year of the discharge of an amount for purposes of determining the amount of a credit allowable under section 38 (relating to investment in certain depreciable property), section 40 (relating to expenses of work incentive programs), section 44B (relating to credit for employment of certain new employees), section 44E (relating to alcohol used as a fuel), or section 44F (relating to credit for increasing research activities), and directing that, for purposes of clause (i), there could not be taken into account any portion of a carryover which was attributable to the employee plan credit (within the meaning of section 48(o)(3)).

Subsec. (d)(6). Pub. L. 98-369, Sec. 721(b)(2), struck out 'or S corporation shareholder level' in heading and second sentence which provided that 'In the case of an S corporation, subsections (a), (b), and (c) shall apply at the shareholder level.'. See par. (7)(A).

Subsec. (d)(7) to (10). Pub. L. 98-369, Sec. 721(b)(2), added par. (7) and redesignated former pars. (7) to (9) as (8) to (10), respectively.

Subsec. (e)(10). Pub. L. 98-369, Sec. 59(a), added par. (10).

Subsec. (e)(10)(C). Pub. L. 98-369, Sec. 59(b)(1), which added subpar. (C), effective as if included in the amendments made by section 806(e) and (f) of Pub. L. 94-455, was repealed by Pub. L. 99-514, Sec. 621(e), (f)(2), eff. Jan. 1, 1986, with certain exceptions, see Effective Date of 1986 Amendment note below.

Subsec. (f). Pub. L. 98-369, Sec. 1076(a), added subsec. (f).

1983 - Subsec. (b)(2)(B)(v). Pub. L. 97-448, Sec. 102(h)(1), added cl. (v).

Subsec. (e)(7)(A)(iii). Pub. L. 97-448, Sec. 304(d), added cl. (iii).

1982 - Subsec. (d)(6). Pub. L. 97-354 inserted 'or S corporation shareholder level' in heading and inserted 'In the case of an S corporation, subsections (a), (b), and (c) shall be applied at the shareholder level.'

1980 - Pub. L. 96-589 completely revised and expanded provisions by specifying the types of indebtedness and by setting out priorities among the exclusions, to reflect the revision of Title 11, Bankruptcy, in 1978.

1976 - Pub. L. 94-455, Sec. 1951(b)(2)(A), struck out '(a) Special rule of exclusion. - ' after 'Income from discharge of indebtedness' and struck out subsec. (b) which related to discharge, cancellation, or modification of indebtedness of certain railroad corporations.

Pub. L. 94-455, Sec. 1906(b)(13)(A), struck out 'or his delegate' after 'Secretary'.

1960 - Subsec. (b). Pub. L. 86-496 provided that if the discharge, cancellation, or modification of any indebtedness is effected pursuant to a court order in a receivership proceeding or in a proceeding under section 77 of the Bankruptcy Act, commenced before Jan. 1, 1960, then no amount is to be included in gross income with respect to it, and struck out provisions which made subsection inapplicable to discharges occurring in a taxable year beginning after Dec. 31, 1957.

1956 - Subsec. (b). Act June 29, 1956, substituted 'December 31, 1957' for 'December 31, 1955'.

EFFECTIVE DATE OF 2010 AMENDMENT

Amendment by section 10908(a) of Pub. L. 111-148 effective for amounts received by an individual in taxable years beginning after December 31, 2008.

EFFECTIVE DATE OF 2009 AMENDMENT

Amendment by Div. B, section 1231(a) of Pub. L. 111-5 effective for discharges in taxable years ending after December 31, 2008.

EFFECTIVE DATE OF 2008 AMENDMENT

Amendment by Div. A, section 303(a) of Pub. L. 110-343 effective for discharges of indebtedness on or after January 1, 2010.

EFFECTIVE DATE OF 2007 AMENDMENTS

Amendments by section 2 of Pub. L. 110-142 effective for discharges of indebtedness on or after January 1, 2007.

EFFECTIVE DATE OF 2004 AMENDMENT

Amendment by section 896(a) of Pub. L. 108-357 effective for cancellations of indebtedness occurring on or after the date of the enactment of this Act [Enacted: Oct. 22, 2004].

Amendment by section 320(a) of Pub. L. 108-357 effective for amounts received by an individual in taxable years beginning after December 31, 2003.

EFFECTIVE DATE OF 2002 AMENDMENT

Amendment by section 402(a) of Pub. L. 107-147 effective for discharges of indebtedness after October 11, 2001, in taxable years ending after such date.

Section 402(b)(2) of Pub. L. 107-147 provided the following exception:

"(2) Exception.-The amendment made by this section shall not apply to any discharge of indebtedness before March 1, 2002, pursuant to a plan of reorganization filed with a bankruptcy court on or before October 11, 2001."

EFFECTIVE DATE OF 1998 AMENDMENTS

Amendments by section 6004(f) of Pub. L. 105-206 effective as if included in the provisions of the Taxpayer Relief Act of 1997 to which they relate [Effective Date of Pub. L. 105-34, Sec. 225: Discharges of indebtedness after Aug. 5, 1997].

EFFECTIVE DATE OF 1997 AMENDMENTS

Amendments by section 225(a) of Pub. L. 105-34 effective for discharges of indebtedness after the date of the enactment of this Act [Aug. 5, 1997].

EFFECTIVE DATE OF 1996 AMENDMENT

Amendment by section 1703(o) of Pub. L. 104-188 effective "as if included in the provision of the Revenue Reconciliation Act of 1993, to which such amendment relates."

EFFECTIVE DATE OF 1993 AMENDMENT

Amendment by section 13150 of Pub. L. 103-66, effective for discharges after December 31, 1992, in taxable years ending after such date.

Section 13226(a)(3) of Pub. L. 103-66, provided that:

"(A) In General. -- Except as otherwise provided in this paragraph, the amendments made by this subsection shall apply to stock transferred after December 31, 1994, in satisfaction of any indebtedness.

"(B) Exception For Title 11 Cases. -- The amendments made by this subsection shall not apply to stock transferred in satisfaction of any indebtedness if such transfer is in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Internal Revenue Code of 1986) which was filed on or before December 31, 1993."

Amendment by section 13226(b) of Pub. L. 103-66, shall apply to discharges of indebtedness in taxable years beginning after December 31, 1993.

EFFECTIVE DATE OF 1990 AMENDMENT

Section 11325(c) of Pub. L. 101-508 provided that:

'(1) In general. - Except as provided in paragraph (2), the amendments made by this section (amending this section and section 1275 of this title) shall apply to debt instruments issued, and stock transferred, after October 9, 1990, in satisfaction of any indebtedness.

'(2) Exceptions. - The amendments made by this section shall not apply to any debt instrument issued, or stock transferred, in satisfaction of any indebtedness if such issuance or transfer (as the case may be) -

'(A) is in a title 11 or similar case (as defined in section 368(a)(3)(A) of the Internal Revenue Code of 1986) which was filed on or before October 9, 1990,

'(B) is pursuant to a written binding contract in effect on October 9, 1990, and at all times thereafter before such issuance or transfer,

'(C) is pursuant to a transaction which was described in documents filed with the Securities and Exchange Commission on or before October 9, 1990, or

'(D) is pursuant to a transaction -

'(i) the material terms of which were described in a written public announcement on or before October 9, 1990,

'(ii) which was the subject of a prior filing with the Securities and Exchange Commission, and

'(iii) which is the subject of a subsequent filing with the Securities and Exchange Commission before January 1, 1991.'

Amendment by section 11813(b)(6) of Pub. L. 101-508 applicable to property placed in service after Dec. 31, 1990, but not applicable to any transition property (as defined in section 49(e) of this title), any property with respect to which qualified progress expenditures were previously taken into account under section 46(d) of this title, and any property described in section 46(b)(2)(C) of this title, as such sections were in effect on Nov. 4, 1990, see section 11813(c) of Pub. L. 101-508, set out as a note under section 29 of this title.

EFFECTIVE DATE OF 1988 AMENDMENT

Amendment by Pub. L. 100-647 effective, except as otherwise provided, as if included in the provision of the Tax Reform Act of 1986, Pub. L. 99-514, to which such amendment relates, see section 1019(a) of Pub. L. 100-647, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1986 AMENDMENT

Amendment by section 104(b)(2) of Pub. L. 99-514 effective for taxable years beginning after Dec. 31, 1986, see section 151(a) of Pub. L. 99-514, set out as a note under section 1 of this title.

Amendment by section 231(d)(3)(D) of Pub. L. 99-514 effective for taxable years beginning after Dec. 31, 1985, see section 231(g) of Pub. L. 99-514, set out as a note under section 41 of this title.

Section 405(c) of Pub. L. 99-514 provided that: 'The amendments made by this section (amending this section and section 1017 of this title) shall apply to discharges of indebtedness occurring after April 9, 1986, in taxable years ending after such date.'

Repeal by section 621(e)(1) of Pub. L. 99-514 of amendment by section 59(b)(1) of Pub. L. 99-369, which was effective as if included in the amendments made by section 806(e) and (f) of Pub. L. 94-455, effective Jan. 1, 1986, with certain exceptions, see section 621(f)(2) of Pub. L. 99-514, set out as a note under section 382 of this title.

Amendment by section 805(c)(2), (4) of Pub. L. 99-514 effective for taxable years beginning after Dec. 31, 1986, with certain changes required in method of accounting, see section 805(d) of Pub. L. 99-514, set out as a note under section 166 of this title.

Section 822(c) of Pub. L. 99-514 provided that: 'The amendments made by this section (amending this section and section 1017 of this title) shall apply to discharges after December 31, 1986.'

Amendment by section 1171(b)(4) of Pub. L. 99-514 effective for compensation paid or accrued after Dec. 31, 1986, in taxable years ending after such date, except as otherwise provided, see section 1171(c) of Pub. L. 99-514, set out as a note under section 38 of this title.

Amendment by section 1847(b)(7) of Pub. L. 99-514 effective, except as otherwise provided, as if included in the provisions of the Tax Reform Act of 1984, Pub. L. 98-369, div. A, to which such amendment relates, see section 1881 of Pub. L. 99-514, set out as a note under section 48 of this title.

EFFECTIVE DATE OF 1984 AMENDMENT

Section 59(b)(2) of Pub. L. 98-369 provided that: 'The amendment made by paragraph (1) (amending this section) shall take effect as if it had been included in the amendments made by subsections (e) and (f) of section 806 of the Tax Reform Act of 1976 (Pub. L. 94-455).' See Effective Date of 1976 Amendment note set out under section 382 of this title.

Section 59(b) (c) of Pub. L. 98-369 provided that:

'(1) In general. - Except as otherwise provided in this subsection, the amendment made by subsection (a) (amending this section) shall apply to transfers after the date of the enactment of this Act (July 18, 1984) in taxable years ending after such date.

'(2) Transitional rule. - The amendment made by subsection (a) shall not apply to the transfer by a corporation of its stock in exchange for debt of the corporation after the date of the enactment of this Act if such transfer is -

'(A) pursuant to a written contract requiring such transfer which was binding on the corporation at all times on June 7, 1984, and at all times after such date but only if the transfer takes place before January 1, 1985, and only if the transferee held the debt at all times on June 7, 1984, or

'(B) pursuant to the exercise of an option to exchange debt for stock but only if such option was in effect at all times on June 7, 1984, and at all times after such date and only if at all times on June 7, 1984, the option and the debt were held by the same person.

`(3) Certain transfers to controlling shareholder. - The amendment made by subsection (a) shall not apply to any transfer before January 1, 1985, by a corporation of its stock in exchange for debt of such corporation if -

`(A) such transfer is to another corporation which at all times on June 7, 1984, owned 75 percent or more of the total value of the stock of the corporation making such transfer, and

`(B) immediately after such transfer, the transferee corporation owns 80 percent or more of the total value of the stock of the transferor corporation.

`(4) Certain transfers pursuant to debt restructure agreement. - The amendment made by subsection (a) shall not apply to the transfer by a corporation of its stock in exchange for debt of the corporation after the date of the enactment of this Act and before January 1, 1985, if -

`(A) such transfer is covered by a debt restructure agreement entered into by the corporation during November 1983, and

`(B) such agreement was specified in a registration statement filed with the Securities and Exchange Commission by the corporation on March 7, 1984.'

Amendment by section 474(r)(5) of Pub. L. 98-369 applicable to taxable years beginning after Dec. 31, 1983, and to carrybacks from such years, see section 475(a) of Pub. L. 98-369, set out as a note under section 21 of this title.

Amendment by section 721(b) of Pub. L. 98-369 applicable to contributions to capital after Dec. 31, 1980, in taxable years ending after such date, see section 721(y)(2) of Pub. L. 98-369, set out as a note under section 1361 of this title.

Section 1076(b) of Pub. L. 98-369 provided that: 'The amendments made by this section (amending this section) shall apply to discharges of indebtedness made on or after January 1, 1983.'

EFFECTIVE DATE OF 1983 AMENDMENT

Amendment by title I of Pub. L. 97-448 effective, except as otherwise provided, as if it had been included in the provision of the Economic Recovery Tax Act of 1981, Pub. L. 97-34, to which such amendment relates, see section 109 of Pub. L. 97-448, set out as a note under section 1 of this title.

EFFECTIVE DATE OF 1982 AMENDMENT

Amendment by Pub. L. 97-354 effective for taxable years beginning after Dec. 31, 1982, see section 6(a) of Pub. L. 97-354, set out as an Effective Date note under section 1361 of this title.

EFFECTIVE DATE OF 1980 AMENDMENT

Section 7 of Pub. L. 96-589, as amended by Pub. L. 99-514, Sec. 2, Oct. 22, 1986, 100 Stat. 2095, provided that:

`(a) For Section 2 (Relating to Tax Treatment of Discharge of Indebtedness). -

`(1) In general. - Except as provided in paragraph (2), the amendments made by section 2 (amending this section and sections 111, 118, 382, 703 and 1017 of this title) shall apply to any transaction which occurs after December 31, 1980, other than a transaction which occurs in a proceeding in a bankruptcy case or similar judicial proceeding (or in a proceeding under the Bankruptcy Act) (Title 11, Bankruptcy) commencing on or before December 31, 1980.

`(2) Transitional rule. - In the case of any discharge of indebtedness to which subparagraph (A) or (B) of section 108(a)(1) of the Internal Revenue Code of 1986 (formerly I.R.C. 1954) (relating to exclusion from gross income), as amended by section 2, applies and which occurs before January 1, 1982, or which occurs in a proceeding in a bankruptcy case or similar judicial proceedings commencing before January 1, 1982, then -

`(A) section 108(b)(2) of the such Code (relating to reduction of tax attributes), as so amended, shall be applied without regard to subparagraphs (A), (B), (C), and (E) thereof, and

`(B) the basis of any property shall not be reduced under section 1017 of such Code (relating to reduction in basis in connection with discharges of indebtedness), as so amended, below the fair market value of such property on the date the debt is discharged.

`(b) For Section 3 (Relating to Rules Relating to Title 11 Cases for Individuals). - The amendments made

by section 3 (enacting sections 1398 and 1399 of this title and amending sections 443, 6012 and 6103 of this title) shall apply to any bankruptcy case commencing more than 90 days after the date of the enactment of this Act (Dec. 24, 1980).

`(c) For Section 4 (Relating to Corporate Reorganization Provisions). -

`(1) In general. - The amendments made by section 4 (enacting section 370 of this title and amending sections 354, 355, 357, 368 and 381 of this title) shall apply to any bankruptcy case or similar judicial proceeding commencing after December 31, 1980.

`(2) Exchanges of property for accrued interest. - The amendments made by subsection (e) of section 4 (amending sections 354 and 355 of this title) (relating to treatment of property attributable to accrued interest) shall also apply to any exchange -

`(A) which occurs after December 31, 1980, and

`(B) which does not occur in a bankruptcy case or similar judicial proceeding (or in a proceeding under the Bankruptcy Act) commenced on or before December 31, 1980.

`(d) For Section 5 (Relating to Miscellaneous Corporate Amendments). -

`(1) For subsection (a) (relating to exemption from personal holding company tax). - The amendments made by subsection (a) of section 5 (amending section 542 of this title) shall apply to any bankruptcy case or similar judicial proceeding commenced after December 31, 1980.

`(2) For subsection (b) (relating to repeal of special treatment for certain railroad redemptions). - The amendments made by subsection (b) of section 5 (amending section 302 of this title) shall apply to stock which is issued after December 31, 1980 (other than stock issued pursuant to a plan of reorganization approved on or before that date).

`(3) For subsection (c) (relating to application of 12-month liquidation rule). - The amendment made by subsection (c) of section 5 (amending section 337 of this title) shall apply to any bankruptcy case or similar judicial proceeding commenced after December 31, 1980.

`(4) For subsection (d) (relating to permitting bankruptcy estate to be subchapter s shareholder). - The amendment made by subsection (d) of section 5 (amending section 1371 of this title) shall apply to any bankruptcy case commenced on or after October 1, 1979.

`(5) For subsection (e) (relating to certain transfers to controlled corporations). - The amendments made by subsection (e) of section 5 (amending section 351 of this title) shall apply as provided in subsection (a) of this section.

`(6) For subsection (f) (relating to effect of debt discharge on earnings and profits). - The amendment made by subsection (f) of section 5 (amending section 312 of this title) shall apply as provided in subsection (a) of this section.

`(e) For Section 6 (Relating to Changes in Tax Procedures). - The amendments made by section 6 (enacting sections 6658 and 7464 of this title, amending sections 128, 354, 422, 1023, 3302, 6012, 6036, 6155, 6161, 6212, 6213, 6216, 6326 (now 6327), 6404, 6503, 6512, 6532, 6871, 6872, 6873, 7430, and 7508 of this title, repealing section 1018 of this title, and redesignating former section 7464 of this title as 7465) shall take effect on October 1, 1979, but shall not apply to any proceeding under the Bankruptcy Act (Title 11) commenced before October 1, 1979.

`(f) Election To Substitute September 30, 1979, for December 31, 1980. -

`(1) In general. - The debtor (or debtors) in a bankruptcy case or similar judicial proceeding may (with the approval of the court) elect to apply subsections (a), (c), and (d) by substituting 'September 30, 1979' for 'December 31, 1980' each place it appears in such subsections.

`(2) Effect of election. - Any election made under paragraph (1) with respect to any proceeding shall apply to all parties to the proceeding.

`(3) Revocation only with consent. - Any election under this subsection may be revoked only with the consent of the Secretary of the Treasury or his delegate.

`(4) Time and manner of election. - Any election under this subsection shall be made at such time, and in such manner, as the Secretary of the Treasury or his delegate may by regulations prescribe.

“(g) Definitions. - For purposes of this section -

“(1) Bankruptcy case. - The term ‘bankruptcy case’ means any case under title 11 of the United States Code (as recodified by Public Law 95-598).

“(2) Similar judicial proceeding. - The term ‘similar judicial proceeding’ means a receivership, foreclosure, or similar proceeding in a Federal or State court (as modified by section 368(a)(3)(D) of the Internal Revenue Code of 1986).”

EFFECTIVE DATE OF 1976 AMENDMENT

Amendment by section 1951(b)(2)(A) of Pub. L. 94-455 applicable with respect to taxable years beginning after Dec. 31, 1976, see section 1951(d) of Pub. L. 94-455, set out as a note under section 72 of this title.

EFFECTIVE DATE OF 1960 AMENDMENT

Section 1(b) of Pub. L. 86-496 provided that: ‘The amendment made by subsection (a) (amending this section) shall apply to taxable years ending after December 31, 1959, but only with respect to discharges occurring after such date.’

EXCLUSIONS OF CERTAIN CANCELLATIONS OF INDEBTEDNESS BY REASON OF HURRICANE KATRINA

Section 401 of Pub. L. 109-73 provided that:

“(a) IN GENERAL.--For purposes of the Internal Revenue Code of 1986, gross income shall not include any amount which (but for this section) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of a natural person described in subsection (b) by an applicable entity (as defined in section 6050P(c)(1) of such Code).

“(b) PERSONS DESCRIBED.--A natural person is described in this subsection if the principal place of abode of such person on August 25, 2005, was located--

“(1) in the core disaster area, or

“(2) in the Hurricane Katrina disaster area (but outside the core disaster area) and such person suffered economic loss by reason of Hurricane Katrina.

“(c) EXCEPTIONS.--

“(1) BUSINESS INDEBTEDNESS.--Subsection (a) shall not apply to any indebtedness incurred in connection with a trade or business.

“(2) REAL PROPERTY OUTSIDE CORE DISASTER AREA.--Subsection (a) shall not apply to any discharge of indebtedness to the extent that real property constituting security for such indebtedness is located outside of the Hurricane Katrina disaster area.

“(d) DENIAL OF DOUBLE BENEFIT.--For purposes of the Internal Revenue Code of 1986, the amount excluded from gross income under subsection (a) shall be treated in the same manner as an amount excluded under section 108(a) of such Code.

“(e) EFFECTIVE DATE.--This section shall apply to discharges made on or after August 25, 2005, and before January 1, 2007.”

EXCLUSION OF CERTAIN CANCELLATIONS

Section 105 of Pub. L. 107-134 provided that:

“(a) IN GENERAL- For purposes of the Internal Revenue Code of 1986--

“(1) gross income shall not include any amount which (but for this section) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of any taxpayer if the discharge is by reason of the death of an individual incurred as the result of the terrorist attacks against the United States on September 11, 2001, or as the result of illness incurred as a result of an attack involving anthrax occurring on or after September 11, 2001, and before January 1, 2002, and

“(2) return requirements under section 6050P of such Code shall not apply to any discharge described in paragraph (1).

“(b) EFFECTIVE DATE- This section shall apply to discharges made on or after September 11, 2001, and before January 1, 2002.”

SAVINGS PROVISION

For provisions that nothing in amendment by section 11813 of Pub. L. 101-508 be construed to affect treatment of certain transactions occurring, property acquired, or items of income, loss, deduction, or credit taken into account prior to Nov. 5, 1990, for purposes of determining liability for tax for periods ending after Nov. 5, 1990, see section 11821(b) of Pub. L. 101-508, set out as a note under section 29 of this title.

Section 1951(b)(2)(B) of Pub. L. 94-455 provided that: 'If any discharge, cancellation, or modification of indebtedness of a railroad corporation occurs in a taxable year beginning after December 31, 1976, pursuant to an order of a court in a proceeding referred to in section 108(b)(A) or (B) which commenced before January 1, 1960, then, notwithstanding the amendments made by subparagraph (A) (amending this section) the provisions of subsection (b) of section 108 shall be considered as not repealed with respect to such discharge, cancellation, or modification of indebtedness.'

PLAN AMENDMENTS NOT REQUIRED UNTIL JANUARY 1, 1989

For provisions directing that if any amendments made by subtitle A or subtitle C of title XI (Sec. 1101-1147 and 1171-1177) or title XVIII (Sec. 1800-1899A) of Pub. L. 99-514 require an amendment to any plan, such plan amendment shall not be required to be made before the first plan year beginning on or after Jan. 1, 1989, see section 1140 of Pub. L. 99-514, as amended, set out as a note under section 401 of this title.

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UNITED STATES of America, Appellant

v.

Soneet R. KAPILA, Appellee.

No. 08-60723-CIV.

Aug. 18, 2008

(2008 WL 5612316 (S.D.Fla.))

--- B.R. ---

--- B.R. ---, 2008 WL 5612316 (S.D.Fla.), 103 A.F.T.R.2d 2009-477
(Cite as: 2008 WL 5612316 (S.D.Fla.))

H

United States District Court, S.D. Florida,
Miami Division.

UNITED STATES of America, Appellant,

v.

Soneet R. KAPILA, Appellee.

No. 08-60723-CIV.

Aug. 18, 2008.

Background: Chapter 7 trustee brought adversary proceeding against United States, seeking to avoid and recover, as fraudulent transfer, debtor's prepetition election of irrevocable waiver of net operating loss (NOL) carryback under Internal Revenue Code (IRC). Parties cross-moved for summary judgment. The Bankruptcy Court, John K. Olson, J., 386 B.R. 361, granted trustee's motion for summary judgment, and federal government appealed.

Holdings: The District Court, Cecilia M. Altonaga, J., held that:

- (1) net operating loss (NOL) carryback to which debtor-taxpayer was entitled under federal tax law, prior to waiving that carryback in favor of speculative NOL carryforward less than two years prior to commencement of his Chapter 7 case, was "interest of the debtor in property," as that term was used in bankruptcy fraudulent transfer statute;
- (2) debtor's waiver of NOL carryback was in nature of "transfer" of interest of the debtor in property; and
- (3) irrevocable nature of debtor-taxpayer's election, under federal tax law, to treat net operating loss (NOL) that he sustained from operation of business as an NOL carryforward to reduce income that he anticipated earning in future tax years, rather than as NOL carryback to obtain refund of taxes which he had paid in prior tax years, did not in any way affect trustee's ability, in exercise of avoidance rights granted to trustee under the Bankruptcy Code, to set aside debtor's election as constructively fraudulent transfer.

Affirmed.

[1] Bankruptcy 51

51 Bankruptcy

District court reviews bankruptcy court's conclusions of law de novo.

[2] Bankruptcy 51

51 Bankruptcy

Power of trustee to avoid fraudulent transfers under fraudulent-transfer-avoidance provision of the Code presents question of law, that bankruptcy appellate court must review de novo. 11 U.S.C.A. § 548.

[3] Bankruptcy 51

51 Bankruptcy

Net operating loss (NOL) carryback to which debtor-taxpayer was entitled under federal tax law, prior to waiving that carryback in favor of speculative NOL carryforward less than two years prior to commencement of his Chapter 7 case, was "interest of the debtor in property," as that term was used in bankruptcy fraudulent transfer statute. 11 U.S.C.A. § 548(a)(1).

[4] Bankruptcy 51

51 Bankruptcy

While, pursuant to provision of the Internal Revenue Code, trustee of debtor-taxpayer's bankruptcy estate may succeed to debtor-taxpayer's net operating losses (NOLs) only as they exist as of petition date, either as NOL carrybacks or carryforwards, this is separate question from whether trustee, in exercise of transfer-avoidance powers, may set aside debtor's prior election to treat net operating losses (NOLs) sustained as carryforward to reduce his future income. 26 U.S.C.A. § 1398(g).

[5] Bankruptcy 51

51 Bankruptcy

Debtor-taxpayer's waiver, less than two years prior to commencement of his Chapter 7 case, of the net operating loss (NOL) carryback to which he was entitled under federal tax law, in favor of speculative NOL carryforward that he could apply to reduce any income earned in future tax years, was in nature of "transfer" of interest of the debtor in property, such as trustee could avoid as constructively fraudulent to creditors provided that other requirements of constructive fraudulent transfer provision were met. 11 U.S.C.A. § 548(a)(1).

[6] Bankruptcy 51 ☞0

51 Bankruptcy

Term "transfer," as it is used in the Bankruptcy Code, is to be broadly construed. 11 U.S.C.A. § 101(54).

[7] Bankruptcy 51 ☞0

51 Bankruptcy

Irrevocable nature of debtor-taxpayer's election, under federal tax law, to treat net operating loss (NOL) that he sustained from operation of business as an NOL carryforward to reduce income that he anticipated earning in future tax years, rather than as NOL carryback to obtain refund of taxes which he had paid in prior tax years, did not in any way affect Chapter 7 trustee's ability, in exercise of avoidance rights granted to trustee under the Bankruptcy Code, to set aside debtor's election as constructively fraudulent transfer; there was distinction between "revocation" of debtor's election, and "avoidance" of that election as fraudulent transfer, and trustee, in exercise of avoidance rights, was not limited to undoing only those transactions that could have been undone by debtor outside bankruptcy. 11 U.S.C.A. § 548; 26 U.S.C.A. § 172(b)(3).

[8] Bankruptcy 51 ☞0

51 Bankruptcy

Bankruptcy trustee is not constrained by only being able to act as debtor could have acted.

[9] Bankruptcy 51 ☞0

51 Bankruptcy

Internal Revenue 220 ☞0

220 Internal Revenue

Purpose underlying the irrevocability of taxpayer's election to treat a net operating loss (NOL) either as carryback to obtain refund of taxes previously paid or as carryforward to reduce future income is to prevent taxpayer from manipulating the Internal Revenue Code once taxpayer discovers that mistake has been made, a purpose not implicated if trustee of taxpayer's bankruptcy estate were allowed to avoid his election to generate tax refunds for payment of creditor claims. 26 U.S.C.A. § 172(b)(3).

ORDER

CECILIA M. ALTONAGA, District Judge.

*1 Appellant, the United States of America, appeals an Order Granting Plaintiff's Motion for Summary Judgment and Denying Defendant's Cross Motion for Summary Judgment (the "Order") entered by the United States Bankruptcy Court for the Southern District of Florida (the "bankruptcy court"). See *In re Taylor*, 386 B.R. 361 (Bankr.S.D.Fla.2008). In its Order, the bankruptcy court granted summary judgment in favor of Appellee, Soneet R. Kapila ("Kapila"), Trustee for the Debtor, Daniel Taylor ("Taylor"), in the underlying bankruptcy proceeding, and denied summary judgment in favor of Appellant, the United States. The Court has carefully considered the briefs submitted by the parties, applicable law, and the pertinent portions of the record.

I. BACKGROUND^{FN1}

Taylor purchased a sign manufacturing franchise called Sign-A-Rama in 2000 through Lula Corporation ("Lula"), an S-Corporation of which he was the sole shareholder. See *Taylor*, 386 B.R. at 363. In

2004, Taylor acquired a second Sign-A-Rama franchise which he operated through Dundee Corporation ("Dundee"), also an S-Corporation of which he was sole owner. *Id.* Shortly after purchasing the second franchise, Taylor's consolidated business operations began to fail. *Id.* He shut down operations of Dundee in September 2005.*Id.*

As a result of these business losses, Taylor incurred a net operating loss ("NOL") of \$58,612 for the tax year 2005. *Id.* Pursuant to 26 U.S.C. § 172(c), a taxpayer generates a NOL during a tax year if his or her deductible business expenses exceed net income. Under the Internal Revenue Code ("IRC"), when this situation occurs the taxpayer may elect either to apply the loss to the two preceding tax years to offset past tax liability and possibly receive a tax refund (*see* 26 U.S.C. § 172(b)(1)), or to waive this option and "carry forward" the entire NOL to offset future tax liabilities (*see id.* at § 172(b)(3)). Once this election is made, it is deemed to be "irrevocable." *Id.*

On July 24, 2006, Taylor filed his tax return for the 2005 tax year. *See Taylor*, 386 B.R. at 363. The bankruptcy court accepted Kapila's assertion that had Taylor not waived the NOL carry-back, he would have been entitled to apply it to the 2003 tax year for a refund of \$11,201. Instead, Taylor elected to carry forward the entire NOL to use in future tax years on the advice of his accountant. Taylor's accountant advised him to make that election because Taylor had informed him that he expected to sell his businesses in the near future for between \$100,000 and \$150,000.

On July 16, 2006, Taylor entered into an agreement (the "Sales Agreement") for the sale of Lula's assets for \$285,000. *See id.* at 364. The Sales Agreement contained a number of contingencies including the absence of any outstanding judgment against Lula, and a due diligence period during which the buyer could back out of the sale and be refunded his deposit if he was "unsatisfied with the business." *Id.* A \$3,930 judgment had been entered against Lula in Florida state court on February 7, 2006, which

remains unsatisfied. *See id.* at 365. The Sales Agreement was supposed to close on July 26, 2006, the same day Taylor signed his 2005 tax return. *See id.* at 364. However, the buyer backed out of the sale and it was never consummated. *See id.* On January 22, 2007, Taylor filed a voluntary petition for bankruptcy under Chapter 7 of the Bankruptcy Code. Kapila was subsequently appointed Trustee of Taylor's estate.

*2 As a result of Taylor's NOL waiver election, Kapila was unable to amend Taylor's 2005 tax return to claim a refund for the estate, a refund which Taylor would have been entitled to absent the waiver election. Kapila, therefore, commenced an adversary proceeding against the United States on August 31, 2007 seeking to avoid Taylor's NOL carry-back waiver as a fraudulent transfer pursuant to 11 U.S.C. § 548(a) ("Section 548"). He subsequently filed a motion for summary judgment before the bankruptcy court on December 20, 2007. The United States, in turn, cross-moved for summary judgment in its favor on January 9, 2008.

In its Order granting summary judgment in favor of Kapila, the bankruptcy court observed that "although [Taylor] may subjectively have believed that there was a reasonable prospect of selling Lula's assets ... at the time he executed the waiver of the NOL carryback on July 24, 2006, the failure of each of [the contingencies set forth in the Sales Agreement] meant that there was ... no reasonable objective prospect that the sale ... would close." *Taylor*, 386 B.R. at 365. Thus, Taylor "was insolvent at the time of his election to waive the NOL carryback." *Id.* In light of these findings, the bankruptcy court granted summary judgment in favor of Kapila and avoided Taylor's NOL carry-back waiver as a fraudulent transfer.

The court premised this holding on a series of legal conclusions. First, "as a matter of law the pre-transfer NOL carryback tax attribute is an interest in property held by the Debtor." *Id.* at 369. Second, "Debtor's waiver operated as a matter of law as a transfer of property to the United States." *Id.* Third,

the Court acknowledged “[t]he sound tax policy for irrevocability under the Tax Code” but concluded that policy was “not offended or harmed by the avoidance of the NOL carryback waiver under bankruptcy law,” and thus Kapila was entitled to recover Taylor’s transfer of his NOL carry-back under Section 548. *Id.* at 372.

The United States filed its Notice of Appeal on May 15, 2008. The sole issue presented is purely one of law: whether an insolvent taxpayer’s irrevocable election of a waiver of NOL within a year of filing a bankruptcy petition is avoidable as a fraudulent transfer under 11 U.S.C. § 548. The United States asserts the bankruptcy court’s determination that a NOL carry-back waiver is avoidable by a trustee is incorrect as a matter of law. In support of this assertion, it raises three specific reasons the bankruptcy court’s conclusion is in error: (1) a taxpayer’s net operating loss is not a property right; (2) waiving a NOL carry-back does not constitute a transfer to the United States; and (3) a trustee cannot use Section 548 to avoid Taylor’s NOL carry-back waiver because the IRC mandates this tax election is irrevocable. The undersigned considers each of these arguments in turn.

II. ANALYSIS

A. Standard of Review

*3 [1][2] District courts have appellate jurisdiction over the judgments, orders, and decrees of bankruptcy courts. 28 U.S.C. § 158(a). A district court reviews a bankruptcy court’s conclusions of law *de novo*. *In re Citation Corp.*, 493 F.3d 1313, 1317 (11th Cir.2007). Moreover, the power of a trustee to avoid fraudulent transfers under Section 548 presents a question of law that must be reviewed *de novo*. See *In re Cannon*, 277 F.3d 838, 849 (6th Cir.2002).

B. Whether Taylor’s NOL Carry-Back Waiver is Avoidable as a Fraudulent Transfer under Sec-

tion 548

Section 548(a)(1)(B) of the Bankruptcy Code permits a trustee to “avoid” pre-petition transfers of property by a debtor where the trustee can “show that (i) there was a transfer of an interest of the Debtor in property, (ii) the transfer occurred within two years preceding the Petition Date, (iii) the Debtor received less than reasonably equivalent value in exchange for the transfer, and (iv) the Debtor was either insolvent on the date of the transfer or became insolvent as a result of the transfer.” *In re Clarkston*, 387 B.R. 882, 888 (Bankr.S.D.Fla.2008) (citing 11 U.S.C. § 548(a)(1)(B)) (additional citations omitted). For purposes of this appeal, the United States does not dispute that Taylor was insolvent at the time he made the NOL carry-back waiver, nor that the waiver occurred within two years of his bankruptcy petition. Instead, the United States contends that the waiver fails because it is neither a property interest, nor does it constitute a transfer to the United States.

1. Whether a NOL Carry-Back Waiver is a Property Right under Bankruptcy Law

[3]“Section 541(a)(1) [of the Bankruptcy Code] defines property of the bankruptcy estate as ‘all legal or equitable interests of the debtor in property as of the commencement of the case.’ “ *In re Bracewell*, 454 F.3d 1234, 1237 (11th Cir.2006) (quoting 11 U.S.C. § 541(a)(1)). In *Segal v. Rochelle*, 382 U.S. 375, 379, 86 S.Ct. 511, 15 L.Ed.2d 428 (1966), a pre-Bankruptcy Code decision, the Supreme Court held that, since the purpose of bankruptcy law was “to secure for creditors everything of value the bankrupt may possess in alienable or leviable form when he files his petition,” a debtor’s interest in a tax refund was property of the estate, even though the NOL was sustained for the year in which the debtor filed his bankruptcy petition. The United States contends that the bankruptcy court was in error to rely upon *Segal* in support of its conclusion that Taylor’s NOL carry-back waiver was an interest in property

subject to Kapila's avoidance powers.

As an initial matter, a number of federal appellate courts have recognized that *Segal's* broad conception of "property" remains good law after the enactment of the Bankruptcy Code. See, e.g., *In re Fruehauf Trailer Corp.*, 444 F.3d 203, 211 (3rd Cir.2006) (holding that right of employer under ERISA to recoup future surpluses in pension plan was a transferable property interest subject to a trustee's avoidance powers); *In re Feiler*, 218 F.3d 948, 955-56 (9th Cir.2000) (stating that Congress explicitly adopted *Segal's* holding into the Bankruptcy Code and concluding that NOL carry-back waiver was avoidable by bankruptcy trustee); *In re Bakersfield Westar, Inc.*, 226 B.R. 227, 233-34 (9th Cir.BAP1998) (holding that trustee was entitled to avoid debtor's "irrevocable" election to be treated as subchapter S corporation); *In re Barowsky*, 946 F.2d 1516, 1518-19 (10th Cir.1991) (relying upon *Segal* in holding that portion of tax refund attributable to pre-petition portion of a taxable year was property of the bankruptcy estate); *In re Prudential Lines, Inc.*, 928 F.2d 565, 572 (2nd Cir.1991) (concluding that NOL carryforward was property of bankruptcy estate). Moreover, as the Second Circuit observed, "[t]he legislative history of § 541 demonstrates that Congress agreed with the result reached by the *Segal* Court[.]"

*4 [T]he estate is comprised of all legal or equitable interest of the debtor in property, wherever located, as of the commencement of the case. The scope of this paragraph is broad. It includes all kinds of property, including tangible or intangible property, causes of action ... and all other forms of property currently specified in [the predecessor statute to § 541].... The result of *Segal v. Rachelle*, 382 U.S. 375 [86 S.Ct. 511, 15 L.Ed.2d 428] (1966), is followed, and the right to a refund is property of the estate.

Prudential, 928 F.2d at 571 (quoting H.R.Rep. No. 95-595, 367 (1978)).

The United States acknowledges that the only two

federal appellate courts to have considered the same issue raised here have concluded that a NOL carry-back waiver is an interest in property avoidable by a bankruptcy trustee. See *In re Feiler*, 218 F.3d at 955-56; *In re Russell*, 927 F.2d 413, 416-17 (8th Cir.1991). It contends, however, that these cases were wrongly decided for reasons it now explains on appeal.

In support of its position that NOL carry-back waivers are not property under the Bankruptcy Code, the United States relies on the operative language of 26 U.S.C. § 1398(g) ("Section 1398(g)") which details the tax attributes of a debtor to which a bankruptcy estate will succeed. In relevant part, Section 1398(g)(1) provides that the bankruptcy estate "shall succeed to and take into account the following items (determined as of the first day of the debtor's taxable year in which the case commences) of the debtor ... (1) Net operating loss carryovers.-The net operating loss carryovers determined under section 172."The United States contends the enactment of Section 1398(g) indicates Congress did not consider NOLs to be property that automatically passes to a bankruptcy estate under Section 541 of the Bankruptcy Code. Thus, it submits that Section 1398(g) only permits the bankruptcy estate to succeed to NOLs as they existed at the time of the bankruptcy since Congress made no provision to permit a bankruptcy trustee to modify or reverse a debtor's prior NOL elections.

In addressing the identical argument in *Feiler*, the Ninth Circuit noted:

What a trustee "succeeds to" under I.R.C. § 1398 is not the same as what he may avoid under B.C. § 548; what property is part of the bankruptcy estate and what property may be recovered with a trustee's avoidance powers are two separate questions. I.R.C. § 1398 merely allocates the NOLs as bankruptcy estate property. Whether the election to carry forward the NOLs is a fraudulent transfer is another question, and depends on B.C. § 548.

218 F.3d at 953.

[4] Although the *Feiler* and *Russell* decisions are not binding, their reasoning is nevertheless persuasive. The recognition of a NOL carry-back waiver as an interest in property which is avoidable by a bankruptcy trustee is consistent with Congress' clear intent that "property" and "an interest in property" be broadly defined under the Bankruptcy Code. The undersigned is not persuaded by the United States' argument that Section 1398(g) alters this analysis. Even if the Court were to accept the United States' position that a bankruptcy trustee only succeeds to NOLs as they existed at the time of the bankruptcy petition, that would not resolve the question of whether Taylor's NOL carry-back waiver is avoidable by Kapila as recognized by *Feiler*.

*5 The practical effect of Taylor's election to waive his NOL carry-back was to relinquish his interest in a present tax refund of \$11,201 in favor of a speculative future refund. In light of Taylor's insolvency at the time of his election, and the likelihood that the value of the present refund he waived would far outstrip the value of any potential future refund, the bankruptcy court correctly concluded that all of the elements of a fraudulent transfer were satisfied. *See Taylor*, 386 B.R. at 370-71. It is the transfer of Taylor's present right to a refund for less than equivalent value that Kapila is entitled to avoid under Section 548. A NOL is an accounting device used to determine a taxpayer's entitlement to a tax refund. The manner in which a NOL is deemed to become property of the bankruptcy estate is inapposite to the issue of whether a debtor has transferred his present interest in a tax refund for less than equivalent value so as to put that property beyond the reach of his creditors. Accordingly, the bankruptcy court was correct in concluding that a NOL waiver is a property interest subject to a bankruptcy trustee's avoidance powers.

2. Whether Taylor's Waiver of the NOL Carry-Back was a Transfer to the United States

[5] The United States also argues that even if a

NOL carry-back waiver is deemed to be a property interest, all of the elements of a fraudulent transfer were not satisfied because there was no actual transfer of that interest. In support of this position, it relies upon Section 548(d)(1), which provides:

For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

11 U.S.C. § 548(d)(1).

The United States contends that based on this description, a transfer requires the existence of a "transferee." It submits that Taylor's NOL carry-back waiver did not transfer anything of value to the United States, and thus the waiver does not constitute a transfer of property subject to a trustee's avoidance powers under Section 548.

[6] The Bankruptcy Code defines "transfer" as "each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with ... property; or ... an interest in property."¹¹ U.S.C. § 101(54)(D)(i-ii). Contrary to the United States' assertions, the term is to be broadly construed. *In re Shingledecker*, 242 B.R. 80, 82 (Bankr.S.D.Fla.1999) ("[T]he term 'transfer' under § 727(a)(2) and § 101(54) is to be broadly construed."); *accord In re Bajgar*, 104 F.3d 495, 498 (1st Cir.1997) ("[T]he legislative history of Section 101(54), which defines 'transfer,' explains that '[t]he definition of transfer is as broad as possible.'" (quoting S.Rep. No. 989, 95th Cong. 27 (1978)); *In re Dereve*, 381 B.R. 309, 326 (Bankr.N.D.Fla.2007).

*6 Although the United States contends that characterizing Taylor's election of the NOL waiver as a

“transfer” risks stretching this definition “beyond recognition” (*Appellant’s Brief* [D.E. 4] at 10), it is the United States’ reading of the term that risks departing farthest from Congress’ intent. The United States argues it did not receive anything of value as a result of Taylor’s NOL carry-back waiver since the waiver “does not forever rid the taxpayer of the benefits of an NOL.” (*Id.* at 11). This assertion, however, ignores the practical effect of the NOL waiver.

As previously discussed, by electing to carry-forward his NOL, Taylor waived his right to a present tax refund of \$11, 201 in favor of a future tax attribute. Had Taylor failed to make an affirmative election, the United States would have been required to pay him a tax refund. Thus, Taylor’s NOL waiver absolved the United States of its obligation to pay a refund it would otherwise have been required to make. *See In re Feiler*, 218 F.3d at 956 (Debtors “traded [their] right to a refund to the IRS in exchange for the right to carry the NOLs forward, and as a result, the IRS was no longer required to pay the \$287,493 refund. Rather than require that the IRS actually pay itself the amount of the tax refund to be considered a “transferee” of the benefit, it is enough that the IRS traded one obligation for another....”). As Taylor was insolvent at the time of the election, the effect of his NOL carry-back waiver was to constructively place that refund amount in the possession of the United States and out of the reach of Taylor’s creditors. The United States’ contention that it did not physically receive a transfer of cash amounts to little more than semantics. The undersigned therefore concludes Taylor’s waiver of a present tax refund falls within the undisputably broad definition of “transfer” under the Bankruptcy Code.

3. Whether Section 548 Permits a Trustee to Avoid an Irrevocable Tax Election by a Debtor

[7] Finally, the United States argues that regardless of whether Taylor’s NOL carry-back waiver is an interest in property which he transferred to the

United States, it is not subject to Kapila’s avoidance powers because Taylor’s election of the waiver is “irrevocable” under 26 U.S.C. § 172(b)(3)). The United States’ argument ignores the fact that Kapila is not seeking to “revoke” Taylor’s NOL carry-back waiver but rather to avoid it as a fraudulent transfer under Section 548. This is a critical distinction. A trustee’s avoidance powers under Section 548 are frequently used to undo transactions that are “irrevocable” as to the debtor. *Russell*, 927 F.2d at 416 (A bankruptcy trustee’s avoidance powers “are exclusively geared toward protecting the rights of creditors via protection of the bankruptcy estate,” and are so broad that they even enable trustees to avoid transfers considered ‘irrevocable’ under state law.”) (internal citations omitted).

*7 [8] The undersigned is in agreement with the bankruptcy court that the United States’ focus on the fact that the NOL carry-back waiver is irrevocable as to Taylor is misplaced since “the bankruptcy trustee is not constrained by only being able to act as the debtor could....” *Feiler*, 218 F.3d at 952. Indeed, “had Congress only intended that a trustee be able to avoid transactions that were otherwise revocable by the debtor, there would be no reason to grant the trustee extraordinary B.C. § 548 avoidance powers at all.” *Id.*

[9] As the bankruptcy court observed, preventing Kapila from avoiding Taylor’s NOL carry-back waiver would essentially permit Taylor to protect a future tax attribute from his creditors and thereby commit “money laundering through the kind auspices of the United States.” *Taylor*, 386 B.R. at 370. “The purpose underlying the irrevocability of a § 172(b)(3)(C) election is to prevent a taxpayer from manipulating the Tax Code once the taxpayer discovers that a mistake has been made.” *Russell*, 927 F.2d at 416. No such interest is implicated here by Kapila’s attempt to avoid Taylor’s NOL carry-back waiver. The undersigned is therefore in agreement with the bankruptcy court that the “irrevocable” nature of the waiver under the IRC does not impact Kapila’s ability to avoid the elec-

tion under Section 548.

Moreover, permitting a trustee to avoid a NOL waiver is the most logical manner to reconcile Section 172 of the IRC with the avoidance powers set forth in Section 548. The ultimate damage to the administration of the nation's tax policies that results from permitting a bankruptcy trustee to avoid a debtor's NOL waiver election is relatively minimal since "absent an election by the taxpayer, the normal practice is for the IRS to carry NOLs back to previous taxable years to be applied against previous tax bills, normally resulting in a tax refund." *Feiler*, 218 F.3d 955. In contrast, Section 548 "would be completely eviscerated by exempting a [NOL carry-back waiver] from [a trustee's] avoidance powers" particularly since the United States' interpretation of I.R.C. § 1398(g) would also preclude a trustee's avoidance of "transfers made with the 'actual intent to hinder, delay, or defraud' the debtor's creditors." *Id.*

The undersigned is also unpersuaded by the United States' reliance on *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Prot.*, 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986). In *Midlantic*, the Supreme Court observed that "[i]f Congress wishes to grant the trustee an extraordinary exemption from nonbankruptcy law, 'the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt.'" *Id.* at 501 (quoting *Swartz v. Hammer*, 194 U.S. 441, 444, 24 S.Ct. 695, 48 L.Ed. 1060 (1904)). The United States cites this language for the proposition that Congress' failure to explicitly exempt bankruptcy trustees from Section 172(b)(3) demonstrates they, too, are subject to the irrevocability of the NOL waiver.

*8 Contrary to the United States' assertions, the avoidance powers of Section 548 are an explicit expression of Congress' intent that a trustee be given an extraordinary exemption to undo transactions that may be otherwise irreversible under state or federal law. See *Feiler*, 218 F.3d at 954 ("Congress

has granted the bankruptcy trustee an 'extraordinary exemption' to non-bankruptcy law by conferring B.C. § 548 avoidance powers to allow the trustee to avoid any number of transactions that would otherwise be final and irrevocable by the debtor under non-bankruptcy law.") (emphasis in original). This power, however, is not unlimited. In creating the Section 548 avoidance powers, Congress has explicitly stated that a trustee may void otherwise valid transactions only where the specified elements of constructive or actual fraud are present. Moreover, as discussed, to exempt NOL carry-back waivers from these avoidance powers would run counter to the underlying rationale for Congress' creation of this power. Accordingly, the undersigned concludes the bankruptcy court's decision was not in error.

III. CONCLUSION

For all of the foregoing reasons, it is

ORDERED AND ADJUDGED that the United States Bankruptcy Court for the Southern District of Florida's Order Granting Plaintiff's Motion for Summary Judgment and Denying Defendant's Cross Motion for Summary Judgment is **AFFIRMED**. The Clerk of the Court is instructed to **CLOSE** this case.

DONE AND ORDERED.

FN1. The United States does not dispute the factual findings by the bankruptcy court for purposes of this appeal. The undersigned briefly recounts those findings as they relate to the legal issue presented.

S.D.Fla., 2008.

U.S. v. Kapila

--- B.R. ---, 2008 WL 5612316 (S.D.Fla.), 103 A.F.T.R.2d 2009-477

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