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Tax Information on Bankruptcy

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Important Changes

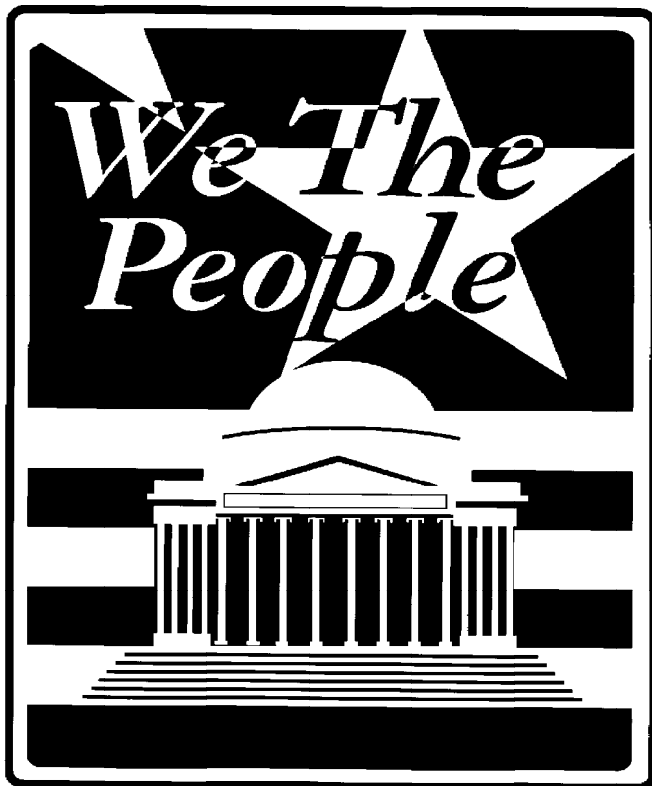
Debt cancellation. In an effort to focus this publication on bankruptcy issues, material included in previous editions concerning certain debt cancellations has been relocated. The exclusion from income resulting from the following debt cancellations is now located as indicated:

- Student loans—Publication 525, *Taxable and Nontaxable Income*.
- Farm debt—Publication 225, *Farmer's Tax Guide*.
- Purchase-money debt—Publication 334, *Tax Guide for Small Business*.
- Deductible debt—Publication 334.

New provisions concerning the exclusion from income resulting from the cancellation of qualified real property business indebtedness can be found in Publication 334.

Introduction

This publication covers the federal income tax aspects of bankruptcy. Bankruptcy proceedings begin with the filing of a petition with the bankruptcy court. The filing of the petition creates a bankruptcy estate, which generally consists of all the assets of the person filing the bankruptcy petition. A separate taxable entity is created if the bankruptcy petition is filed by an individual under chapter 7 or chapter 11 of the Bankruptcy Code. These chapters are explained in the beginning of the publication. The tax obligations of taxable estates are discussed later under *The Bankruptcy Estate*.



The tax obligations of the person filing a bankruptcy petition (the debtor) vary depending on the bankruptcy chapter under which the petition was filed. For individuals, these are also explained in the first part of this publication. For other entities, see *Partnerships and Corporations*, later.

Generally, when a debt owed to another is canceled the amount canceled or forgiven is considered income that is taxed to the person owing the debt. If a debt is canceled under a bankruptcy proceeding, the amount canceled is not income. However, the canceled debt reduces the amount of other tax benefits the debtor would otherwise be entitled to. See *Debt Cancellation*, later.

This publication is not intended to cover bankruptcy law in general, or to provide detailed discussions of the tax rules for the more complex corporate bankruptcy reorganizations or other highly technical transactions. In these cases, you should seek competent professional advice.

Useful Items

You may want to see:

Publication

- 536** Net Operating Losses
- 538** Accounting Periods and Methods
- 544** Sales and Other Dispositions of Assets
- 551** Basis of Assets

Form (and Instructions)

- SS-4** Application for Employer Identification Number
- 982** Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)
- 1041** U.S. Fiduciary Income Tax Return
- 1041-ES** Estimated Income Tax for Fiduciaries

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Individuals in Chapter 12 or Chapter 13 Proceedings

A separate estate, for tax purposes, is not created for an individual who files a petition under Chapter 12 or 13 of the Bankruptcy Code. You, the individual, should continue to file the same federal income tax return that was filed prior to the bankruptcy petition.

On your return, report all income received during the entire year and deduct all allowable expenses. Do not include any debt canceled

(because of bankruptcy) in income on your return. However, you must reduce (to the extent that you have) certain losses, credits or basis in property by the amount of canceled debt. See *Debt Cancellation*, later.

For information about determining the amount of tax due and paying tax, see *Tax Procedures*, later.

Note: Interest on trust accounts in Chapter 13 proceedings. If you are an individual debtor in a chapter 13 wage earner's plan, do not include as income on your return interest earned on amounts held in trust accounts while awaiting distribution to your creditors. This interest is not available either to you or to your creditors. It is available only to the trustee, and is taxable to the trustee as his or her individual income.

Individuals in Chapter 7 or Chapter 11 Proceedings

If you are an individual debtor who files for bankruptcy under chapter 7 or 11 of the Bankruptcy Code, a separate "estate" is created consisting of property that belonged to you before the filing date. This bankruptcy estate is a new taxable entity, completely separate from you as an individual taxpayer.

The estate, under a chapter 7 proceeding, is represented by a trustee. The trustee is appointed by the bankruptcy court to administer the estate and liquidate the nonexempt assets of the debtor. In a chapter 11 proceeding, the debtor remains in control of the assets as a "debtor-in-possession." However, sometimes the bankruptcy court will appoint a trustee in a chapter 11 case. In this case, the debtor-in-possession must turn over to the trustee control of the debtor's assets and operations.

The estate may produce its own income as well as incur its own expenses. See *The Bankruptcy Estate*, later. The creation of a separate bankruptcy estate also gives you a "fresh start"—with certain exceptions, wages you earn and property you acquire after the bankruptcy case has begun belong to you and do not become a part of the bankruptcy estate.

If your bankruptcy case began but was later dismissed by the bankruptcy court, the estate is not treated as a separate entity, and you are treated as if the bankruptcy petition had never been filed in the first place. File amended returns on Form 1040X to replace any returns you previously filed. Include on any amended returns items of income, deductions, or credits that were or would have been reported by the bankruptcy estate on its returns and were not reported on returns you previously filed.

Individual Debtor's Responsibilities

You, as the individual debtor, generally must file income tax returns during the period of the bankruptcy proceedings. Do not include on your return, the income, deductions, or credits

belonging to the separate bankruptcy estate. Also do not include as income on your return, the debts canceled because of bankruptcy. However, the bankruptcy estate must reduce certain losses, credits, and the basis in property (to the extent of these items) by the amount of canceled debt. See *Debt Cancellation*, later.

You have the option of ending your tax year on the day before you filed your bankruptcy petition. This allows the tax due on that short period return to be a claim against the bankruptcy estate. See *Election to End Tax Year*, later.

See *Tax Procedures*, later, for information about determining and paying the amount of tax due.

Tax attributes. Certain deduction and credit carryovers and decisions that you made in earlier years are taken over by the bankruptcy estate when you file for bankruptcy. These include carryovers of deductions, losses, and credits, your method of accounting, and the basis and holding period of assets. These are referred to as tax attributes.

When the estate is terminated, you assume any remaining tax attributes that were taken over by the estate as well as any attributes arising during the administration of the estate. See *Attribute carryovers*, later under *The Bankruptcy Estate*, for a list of attributes.

Disclosure of return information. The bankruptcy estate's income tax returns are open, upon written request, to inspection by or disclosure to you the individual debtor. The disclosure is necessary so that you can properly figure the amount and nature of the tax attributes, if any, that you must assume when the bankruptcy estate is terminated.

In addition, your income tax returns for the year the bankruptcy case begins and for earlier years are open to inspection by or disclosure to the bankruptcy estate's trustee. See *Disclosure of return information*, later, under *The Bankruptcy Estate*.

Transfer of assets to the estate. Bankruptcy law determines which of your assets become part of the bankruptcy estate. Generally, all of your legal and equitable interests become property of the estate. However, you can subsequently "exempt" certain property from the estate.

A transfer (other than by sale or exchange) of an asset from you to the bankruptcy estate is not treated as a "disposition" for income tax purposes. This means that the transfer does not result in gain or loss, recapture of deductions or credits, or acceleration of income or deductions. For example, the transfer of an installment obligation to the estate would not accelerate gain under the rules for reporting installment sales.

When the bankruptcy estate is terminated, you are treated the same as the estate was regarding any assets transferred back to you.

Carrybacks from your activities. As the individual debtor, you cannot carry back any net operating loss or credit carryback from a tax

year ending after the bankruptcy case has begun to any tax year ending before the case began. The estate, however, can carry the loss back to offset your pre-bankruptcy income.

Election to End Tax Year

If you are an individual debtor and have assets (other than those you exempt from the bankruptcy estate), you may choose to end your tax year on the day before the filing of your bankruptcy case. Then your tax year is divided into 2 "short" tax years of fewer than 12 months each. The first year ends on the day before the filing date, and the second year begins with the filing date and ends on the date your tax year normally ends. Once you make this choice, you may not change it. Any income tax liability for the first short tax year becomes an allowable claim (as a claim arising before bankruptcy) against the bankruptcy estate. If this tax liability is not paid in the bankruptcy proceeding, the liability is not canceled because of bankruptcy and it can be collected from you as an individual.

If you do not choose to end the tax year, then no part of your tax liability for the year in which bankruptcy proceedings begin can be collected from the estate.

Making the election. If you choose to end your tax year, you do so by filing a return on Form 1040 for the first short tax year on or before the 15th day of the fourth full month after the end of that first tax year.

Example. John Doe files a bankruptcy petition on July 10. To have a timely filed election, he must file Form 1040 (or an extension) for the period January 1 through July 9 by November 15.

To avoid delays in processing the return, write "Section 1398 Election" at the top of the return. You may also make the election by attaching a statement to an application for extension of time to file a tax return (Form 4868 or other). The statement must say that you choose under section 1398(d)(2) to close your tax year on the day before the filing of the bankruptcy case. You must file the application for extension by the due date of the return for the first short tax year. If your spouse decides to also close his or her tax year, see *Election by debtor's spouse*, next.

Election by debtor's spouse. If you are married, your spouse may also join in the choice to end the tax year, but only if you and your spouse file a joint return for the first short tax year. You must make these choices by the due date for filing the return for the first short tax year. Once you make the choice, it cannot be revoked for the first year; however, the choice does not mean that you and your spouse must file a joint return for the second short tax year.

Later bankruptcy of spouse. If your spouse files for bankruptcy later in the same year, he or she may also choose to end his or her tax year, regardless of whether he or she joined in the choice to end your tax year. Because each of you has a separate bankruptcy, one or both of you may have 3 short tax years in the same calendar year. If your spouse had

joined in your choice, or if you had not made the choice to end your tax year, you can join in your spouse's choice. But if you had made an election and your spouse did not join in the election, you cannot join in your spouse's later election. This is because you and your spouse, having different tax years, could not file a joint return for a year ending on the day before your spouse's filing of bankruptcy.

Example 1. Paul and Mary Harris are calendar-year taxpayers. A voluntary chapter 7 bankruptcy case involving only Paul begins on March 4.

If Paul does not make an election, his tax year does not end on March 3. If he does make an election, Paul's first tax year is January 1—March 3, and his second short tax year begins on March 4. Mary could join in Paul's election as long as they file a joint return for the tax year January 1—March 3. They must make the election by July 15, the due date for filing the joint return.

Example 2. Fred and Ethel Barnes are calendar-year taxpayers. A voluntary chapter 7 bankruptcy case involving only Fred begins on May 6, and a bankruptcy case involving only Ethel begins on November 1 of the same year.

Ethel could choose to end her tax year on October 31. If Fred had not elected to end his tax year on May 5, or if he had elected to do so but Ethel had not joined in his election, Ethel would have 2 tax years in the same calendar year if she decided to close her tax year. Her first tax year is January 1—October 31, and her second year is November 1—December 31.

If Fred had not decided to end his tax year as of May 5, he could join in Ethel's choice to close her tax year on October 31, but only if they file a joint return for the tax year January 1—October 31. If Fred had elected to end his tax year on May 5, but Ethel had not joined in Fred's choice, Fred could not join in Ethel's choice to end her tax year on October 31, because they could not file a joint return for that short year. They could not file a joint return because their tax years preceding October 31 were not the same.

Example 3. Jack and Karen Thomas are calendar-year taxpayers. A voluntary chapter 7 bankruptcy case involving only Karen begins on April 10, and a voluntary chapter 7 bankruptcy case involving only Jack begins on October 3 of the same year. Karen chooses to close her tax year on April 9 and Jack joins in Karen's choice.

Under these facts, Jack would have 3 tax years for the same calendar year if he makes the election relating to his own bankruptcy case. The first tax year would be January 1—April 9; the second April 10—October 2; and the third October 3—December 31.

Karen may (but does not have to) join in Jack's election if they file a joint return for the second short tax year (April 10—October 2). If Karen does join in, she would have the same 3 short tax years as Jack. Also, if Karen joins in Jack's election, they may file a joint return for the third tax year (October 3—December 31), but they are not required to do so.

Annualizing taxable income. If you choose to close your tax year, you must annualize your taxable income for each short tax year the same way it is done for a change in an annual accounting period. See *Short Tax Year* in Publication 538, *Accounting Periods and Methods*, for information on how to annualize your income and how to figure your tax for the short tax year.

Filing requirement. If you elect to end your tax year on the day before filing the bankruptcy case, you must file the return for the first short tax year as explained earlier under *Making the election*.

If you make this election, you must also file a separate Form 1040 for the second short tax year by the regular due date. You should note on the return that it is the "Second Short Year Return After Section 1398 Election."

If the bankruptcy case is later dismissed you, the debtor, must file an amended return to replace any full or short year returns that you filed. Attach a statement to any amended return you file explaining why you are filing an amended return. In this situation, no bankruptcy estate is created for tax purposes. Income that was or would be reported by the bankruptcy estate must be reported on your return.

The Bankruptcy Estate

The filing of a bankruptcy petition for an individual debtor under chapter 7 or chapter 11 of the bankruptcy code creates a separate taxable bankruptcy estate. The trustee (for chapter 7 cases) or the debtor-in-possession (for chapter 11 cases) is generally responsible for preparing and filing the estate's tax returns and paying its taxes. The debtor remains responsible for filing returns and paying taxes on any income that does not belong to the estate.

If a bankruptcy case begins, but later is dismissed by the bankruptcy court, the estate is not treated as a separate taxable entity. If tax returns have been filed for the estate, amended returns must be filed to move income and deductions from the estate's returns to the debtor's returns. If no returns have been filed, report all income and deductions on the debtor's returns.

The following discussions provide tax information for the bankruptcy estate.

Treatment of income, deductions, and credits. The gross income of the bankruptcy estate includes any of the debtor's gross income to which the estate is entitled under the bankruptcy law. The estate's gross income also includes any income the estate is entitled to and receives or accrues after the beginning of the bankruptcy case. Gross income of the bankruptcy estate does not include amounts received or accrued by the debtor before the bankruptcy petition date.

The bankruptcy estate may deduct or take as a credit any expenses it pays or incurs, the same way that the debtor would have deducted or credited them had he or she continued in the same trade, business, or activity

and actually paid or accrued the expenses. Allowable expenses include administrative expenses, such as attorney fees and court costs. These are discussed later under *Administrative expenses*.

The bankruptcy estate figures its taxable income the same way as an individual figures his or her taxable income. The estate can take one personal exemption and either individual (itemized) deductions or the basic standard deduction for a married individual filing a separate return. The estate cannot take the higher standard deduction allowed for married persons filing separately who are 65 or older or blind. The estate uses the rates for a married individual filing separately to figure the tax on its taxable income.

Transfer of assets between

debtor and estate. Bankruptcy law determines which of the debtor's assets become part of the bankruptcy estate. These assets are treated the same in the estate's hands as they were in the debtor's hands.

A transfer (other than by sale or exchange) of an asset from the debtor to the bankruptcy estate is not treated as a "disposition" for income tax purposes. This means that the transfer does not result in gain or loss, recapture of deductions or credits, or acceleration of income or deductions. For example, the transfer of an installment obligation to the estate would not accelerate gain under the rules for reporting installment sales. The estate is treated the same way the debtor would be regarding the transferred asset.

When the bankruptcy estate is terminated, that is, dissolved, any resulting transfer (other than by sale or exchange) of the estate's assets back to the debtor is not treated as a disposition. This transfer does not result in gain or loss, recapture of deductions or credits, or acceleration of income or deductions to the estate.

Attribute carryovers. The bankruptcy estate must treat its tax attributes the same way that the debtor would have treated them. These items must be determined as of the first day of the debtor's tax year in which the bankruptcy case begins. The bankruptcy estate gets the following tax attributes from the debtor:

- 1) Net operating loss carryovers,
- 2) Carryovers of excess charitable contributions,
- 3) Recovery of tax benefit items,
- 4) Credit carryovers,
- 5) Capital loss carryovers,
- 6) Basis, holding period, and character of assets,
- 7) Method of accounting,
- 8) Passive activity loss and credit carryovers,
- 9) Unused at-risk deductions, and
- 10) Other tax attributes as provided in regulations.

Certain tax attributes of the estate must be reduced by any excluded income from cancellation of debt occurring in a bankruptcy proceeding. See *Debt Cancellation*, later.

Termination of the estate. If the bankruptcy estate has any tax attributes at the time it is terminated, they are assumed by the debtor.

Passive and at-risk activities. For bankruptcy cases beginning on or after November 9, 1992, treat passive activity carryover losses and credits and unused at-risk deductions as tax attributes that the debtor passes to the bankruptcy estate and the estate passes back to the debtor when the estate terminates. Additionally, transfers to the debtor (other than by sale or exchange) of interests in passive or at-risk activities are treated as exchanges that are not taxable. These transfers include the return of exempt property to the debtor and the abandonment of estate property to the debtor.

Cases beginning before November 9, 1992. If a bankruptcy case begins before November 9, 1992, and ends on or after that date, the debtor and the trustee for an individual chapter 7 case (the debtor-in-possession for an individual chapter 11 case) can elect to have these provisions apply. In a chapter 7 case, the election is made jointly by the debtor and the trustee of the bankruptcy estate. In a chapter 11 case, the election is incorporated in the bankruptcy plan. See IRS regulations 1.1398-1 and 1.1398-2 for more information on how to make this election.

Administrative expenses. The bankruptcy estate is allowed a deduction for administrative expenses and any fees or charges assessed it. These expenses are generally deductible as itemized deductions subject to the 2% floor on miscellaneous itemized deductions. However, administrative expenses attributable to the conduct of a trade or business by the bankruptcy estate or the production of the estate's rents or royalties are deductible in arriving at adjusted gross income.

The expenses are subject to disallowance under other provisions of the Internal Revenue Code, such as disallowing certain capital expenditures, taxes, or expenses relating to tax-exempt interest. These expenses can only be deducted by the estate, and never by the debtor.

If the administrative expenses of the bankruptcy estate are more than its gross income for the tax year, the excess amount may be carried back 3 years and forward 7 years. The amounts can only be carried back or forward to a tax year of the estate and never to the debtor's tax year. The excess amount to be carried back or forward is treated like a net operating loss and must first be carried back to the earliest year possible. For a discussion of the net operating loss, see Publication 536, *Net Operating Losses*.

Change of accounting period. The bankruptcy estate may change its accounting period (tax year) once without getting approval from the Internal Revenue Service. This rule

allows the trustee of the estate to close the estate's tax year early, before the expected termination of the estate. The trustee can then file a return for the first short tax year to get a quick determination of the estate's tax liability.

Carrybacks from the estate. If the bankruptcy estate itself has a net operating loss, separate from any losses passing to the estate from the debtor under the attribute carryover rules, the bankruptcy estate can carry the loss back not only to its own earlier tax years but also to the debtor's tax years before the year the bankruptcy case began. The estate may also carry back excess credits, such as the general business credit, to the pre-bankruptcy years.

Return Requirements and Payment of Tax

The trustee (or debtor-in-possession) must file an income tax return on Form 1041, *U.S. Fiduciary Income Tax Return* if the estate has gross income that meets or exceeds the amount required for filing. This amount is the total of the personal exemption amount and the basic standard deduction for a married individual filing separately. See the Form 1041 instructions for the current year's amount.

If a return is required, the trustee (or debtor-in-possession) completes only the identification area at the top of the Form 1041, enters any tax due, and signs and dates it. Form 1041 is a transmittal for Form 1040, *U.S. Individual Income Tax Return*. Complete Form 1040 and figure the tax using the tax rate schedule for a married person filing separately. In the top margin of Form 1040, write "Attachment to Form 1041. **DO NOT DETACH.**" Attach Form 1040 to the Form 1041.

Note: The filing of a tax return for the bankruptcy estate does not relieve the individual debtor of his or her tax filing requirement.

Estimated tax. The trustee or debtor-in-possession must pay estimated tax (if any is due) for the bankruptcy estate. See the Instructions to Form 1041-ES, *Estimated Income Tax for Fiduciaries*, for information regarding the dollar limits and exceptions to filing Form 1041-ES and paying estimated tax.

Employer Identification Number. The trustee (or debtor-in-possession) must obtain an employer identification number (EIN) for a bankruptcy estate if the estate must file any form, statement, or document with the IRS. The trustee uses this EIN on any tax return filed for the bankruptcy estate including estimated tax returns. The trustee can obtain an EIN for a bankruptcy estate by filing Form SS-4, *Application for Employer Identification Number*. Form SS-4 is available at IRS or Social Security Offices. Trustees representing ten or more bankruptcy estates (other than estates that will be filing employment or excise tax returns) may file a consolidated application to obtain blocks of ten or more EINs by following the procedures set out in Revenue Procedure 89-37, 1989-1 C.B. 919.

Note: The social security number of the individual debtor **cannot** be used as the EIN for the bankruptcy estate.

Employment taxes. The trustee (or debtor-in-possession) must withhold income and social security taxes and file employment tax returns for any wages paid by the trustee (or debtor), including wage claims paid as administrative expenses. Until these employment taxes are deposited as required by the Internal Revenue Code, they should be set apart in a separate bank account to ensure that funds are available to satisfy the liability. If the employment taxes are not paid as required, the trustee may be held personally liable for payment of the taxes. See Publication 15, *Circular E, Employer's Tax Guide*, for details on employer tax responsibilities.

The trustee has the duty to prepare and file Forms W-2, *Wage and Tax Statement*, in connection with wage claims paid by the trustee, regardless of whether the claims accrued before or during bankruptcy. If the debtor fails to prepare and file Forms W-2 for wages paid before bankruptcy, the trustee should instruct the employees to file an IRS Form 4852, *SUBSTITUTE FOR FORM W-2, WAGE AND TAX STATEMENT OR FORM 1099R, DISTRIBUTIONS FROM PENSIONS, ANNUITIES, RETIREMENT OR PROFIT-SHARING PLANS, IRA'S, INSURANCE CONTRACTS, ETC.*, with their individual income tax returns.

Disclosure of return information. The debtor's income tax returns for the year the bankruptcy case begins and for earlier years are, upon written request, open to inspection by or disclosure to the trustee. If the bankruptcy case was not voluntary, disclosure cannot be made before the bankruptcy court has entered an order for relief, unless the court rules that the disclosure is needed for determining whether relief should be ordered.

For information concerning the disclosure of the bankruptcy estate's tax return see *Disclosure of return information*, earlier, under *Individual Debtor's Responsibilities*.

Example.

On December 15, 1992, Thomas Smith filed a bankruptcy petition under chapter 7. John Black was appointed trustee to administer the estate and to distribute the assets.

The estate received the following assets from Mr. Smith:

- 1) A \$100,000 certificate of deposit,
- 2) Commercial rental real estate with a fair market value of \$300,000, and

- 3) His personal residence with a fair market value of \$200,000.

Also, the estate received a \$253,000 capital loss carryover.

Mr. Smith's bankruptcy case was closed on December 31, 1993. During 1993, Mr. Smith was relieved of \$70,000 of debt by the court. The estate chose a calendar year as its tax year. John, the trustee, reviews the estate's transactions and reports the taxable events on the estate's final return.

Schedule B (Form 1040). The certificate of deposit earned \$5,500 of interest during 1993. John reports this interest on Schedule B. He completes this schedule and enters the result on Form 1040.

Form 4562. John enters the depreciation allowed on Form 4562. He completes the form and enters the result on Schedule E.

Schedule E (Form 1040). The commercial real estate was rented through the date of sale. John reports the income and expenses on Schedule E. He enters the net income on Form 1040.

Form 4797. The commercial real estate was sold on July 1, 1993, for \$300,000. The property was purchased in 1983 at a cost of \$250,000. It was depreciated using straight line depreciation and the total depreciation allowed or allowable as of the date of sale was \$100,000. Additionally, \$25,000 of selling expenses was incurred. He reports the gain or loss from the sale on Form 4797. He completes the form and enters the gain on Schedule D (Form 1040).

Form 2119. Mr. Smith's former residence was sold on September 30, 1993. The sale price was \$200,000, the selling expenses were \$20,000 and his adjusted basis was \$130,000. John enters this information on Form 2119. John completes Form 2119 and enters the gain on Schedule D (Form 1040).

Schedule D (Form 1040). John completes Schedule D, taking into account the \$250,000 capital loss carryover from 1992 (\$253,000 transferred to the estate minus \$3,000 used on the estate's 1992 return). He enters the results on Form 1040.

Form 1040, page 1. John completes page 1 of the 1040 and enters the adjusted gross income on the first line of Form 1040, page 2.

Schedule A (Form 1040). During 1993, the estate paid mortgage interest and real property tax on Mr. Smith's former residence. It also paid income tax to the state. John enters the mortgage interest, real estate tax and income tax on Schedule A. Also, he reports the estate's administrative expenses as a miscellaneous deduction subject to the 2% floor. He completes the Schedule A and enters the result on page 2 of Form 1040.

Form 1040, page 2. John determines the estate's taxable income and figures its tax using the tax rate schedule for married filing separately. He then enters the estate's estimated tax payments and figures the amount the estate still owes.

Form 982. John completes the Schedule D worksheet for capital loss carryover. Because \$70,000 of debt was canceled, John must reduce the tax attributes of the estate by the amount of the canceled debt. See *Debt Cancellation*, later. In 1994, Thomas Smith (the individual) will assume the estate's tax attributes. Mr. Smith will assume a capital loss carryover of \$2,000 (\$72,000 carryover minus the \$70,000 attribute reduction).

Form 1041. John enters the total tax, estimated tax payments, and tax due from Form 1040 on Form 1041. He completes the identification area at the top of Form 1041, then signs and dates the return.

Form 1041, page 1 for Thomas Smith Bankruptcy Estate
Form 1040, page 1 for Thomas Smith Bankruptcy Estate
Form 1040, page 2 for Thomas Smith Bankruptcy Estate
Schedule A (Form 1040) for Thomas Smith Bankruptcy Estate
Schedule B (Form 1040) for Thomas Smith Bankruptcy Estate
Schedule D (Form 1040) for Thomas Smith Bankruptcy Estate
Schedule E (Form 1040), page 1 for Thomas Smith Bankruptcy Estate
Form 2119 for Thomas Smith Bankruptcy Estate
Form 4797, page 1 for Thomas Smith Bankruptcy Estate
Form 4797, page 2 for Thomas Smith Bankruptcy Estate
Form 4562 for Thomas Smith Bankruptcy Estate
Form 982 for Thomas Smith Bankruptcy Estate

1041 U.S. Fiduciary Income Tax Return 1993

Department of the Treasury—Internal Revenue Service

For the calendar year 1993 or fiscal year beginning 1993, and ending 19 OMB No. 1545-0092

A Type of Entity <input type="checkbox"/> Decedent's estate <input type="checkbox"/> Simple trust <input type="checkbox"/> Complex trust <input type="checkbox"/> Grantor type trust <input checked="" type="checkbox"/> Bankruptcy estate—Chpt. 7 <input type="checkbox"/> Bankruptcy estate—Chpt. 11 <input type="checkbox"/> Pooled income fund	Name of estate or trust (grantor type trust, see instructions) Thomas Smith Bankruptcy Estate	C Employer identification number 00:0000000
	Name and title of fiduciary John Black, Trustee	D Date entity created 12-15-92
	Number, street, and room or suite no. (if a P.O. box, see page 5 of instructions.) 111 State Street	E Nonexempt charitable and split-interest trusts, check applicable boxes (see instructions): <input type="checkbox"/> Described in section 4947(a)(1) <input type="checkbox"/> Not a private foundation <input type="checkbox"/> Described in section 4947(a)(2)
B Number of Schedules K-1 attached (see instructions)	City, state, and ZIP code Anywhere, USA 00000	

F Check applicable boxes: <input type="checkbox"/> Initial return <input checked="" type="checkbox"/> Final return <input type="checkbox"/> Amended return Change in fiduciary's: <input type="checkbox"/> Name <input type="checkbox"/> Address	G Pooled mortgage account (see instructions) <input type="checkbox"/> Bought <input type="checkbox"/> Sold Date:
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Income	1	Interest income	1	
	2	Dividends	2	
	3	Business income or (loss) (attach Schedule C or C-EZ (Form 1040))	3	
	4	Capital gain or (loss) (attach Schedule D (Form 1041))	4	
	5	Rents, royalties, partnerships, other estates and trusts, etc. (attach Schedule E (Form 1040))	5	
	6	Farm income or (loss) (attach Schedule F (Form 1040))	6	
	7	Ordinary gain or (loss) (attach Form 4797)	7	
	8	Other income (state nature of income)	8	
	9	Total income (combine lines 1 through 8)	9	

Deductions	10	Interest (Check if Form 4952 is attached <input type="checkbox"/>)	10	
	11	Taxes	11	
	12	Fiduciary fees	12	
	13	Charitable deduction (from Schedule A, line 7)	13	
	14	Attorney, accountant, and return preparer fees	14	
	15a	Other deductions NOT subject to the 2% floor (attach schedule)	15a	
	15b	b Allowable miscellaneous itemized deductions subject to the 2% floor	15b	
	16	Total (add lines 10 through 15b)	16	
	17	Adjusted total income or (loss) (subtract line 16 from line 9). Enter here and on Schedule B, line 1	17	
	18	Income distribution deduction (from Schedule B, line 17) (see instructions) (attach Schedules K-1 (Form 1041))	18	
	19	Estate tax deduction (including certain generation-skipping taxes) (attach computation)	19	
20	Exemption	20		
21	Total deductions (add lines 18 through 20)	21		

Please attach check or money order here Tax and Payments	22	Taxable income of fiduciary (subtract line 21 from line 17)	22	
	23	Total tax (from Schedule G, line 7)	23	2,400
	24	Payments: a 1993 estimated tax payments and amount applied from 1992 return	24a	2,100
		b Estimated tax payments allocated to beneficiaries (from Form 1041-T)	24b	
		c Subtract line 24b from line 24a	24c	2,100
		d Tax paid with extension of time to file: <input type="checkbox"/> Form 2758 <input type="checkbox"/> Form 8736 <input type="checkbox"/> Form 8800	24d	
		e Federal income tax withheld	24e	
		Credits: f Form 2439; g Form 4138; h Other; Total	24i	
	25	Total payments (add lines 24c through 24e, and 24i)	25	2,100
	26	Penalty for underpayment of estimated tax (see instructions)	26	
27	Tax Due. If line 25 is smaller than the total of lines 23 and 26, enter amount owed	27	300	
28	Overpayment. If line 25 is larger than the total of lines 23 and 26, enter amount overpaid	28		
29	Amount of line 28 to be: a Credited to 1994 estimated tax; b Refunded	29		

Please Sign Here Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than fiduciary) is based on all information of which preparer has any knowledge.

John Black, Trustee | 3/10/94 | 00:0000001
 Signature of fiduciary or officer representing fiduciary Date EIN of fiduciary (see instructions)

Paid Preparer's Use Only	Preparer's signature	Date	Check if self-employed <input type="checkbox"/>	Preparer's social security no.
	Firm's name (or yours if self-employed) and address		E.I. No.	ZIP code

Form **1040**

Department of the Treasury—Internal Revenue Service
U.S. Individual Income Tax Return 1993

OMB No. 1545-0047

For the year Jan. 1–Dec. 31, 1993, or other tax year beginning . . . 1993, ending . . . 19

Label

(See instructions on page 12.)

Use the IRS label. Otherwise, please print or type.

Presidential Election Campaign (See page 12.)

L A B E L H E R E	Your first name and initial Thomas Smith Bankruptcy Estate		Last name Estate		
	If a joint return, spouse's first name and initial John Black Trustee		Last name Trustee		
	Home address (number and street). If you have a P.O. box, see page 12. 111 State Street			Apt. no. 	
	City, town or post office, state, and ZIP code. If you have a foreign address, see page 12. Anywhere USA 00000				

Your social security number

00-000000

Spouse's social security number

For Privacy Act and Paperwork Reduction Act Notice, see page 4.

Yes	No	Notes: Checking "Yes" will not change your tax or reduce your refund.
<input type="checkbox"/>	<input type="checkbox"/>	

Filing Status

(See page 12.)

Check only one box.

1	<input type="checkbox"/>	Single
2	<input type="checkbox"/>	Married filing joint return (even if only one had income)
3	<input checked="" type="checkbox"/>	Married filing separate return. Enter spouse's social security no. above and full name here. ▶
4	<input type="checkbox"/>	Head of household (with qualifying person). (See page 13.) If the qualifying person is a child but not your dependent, enter this child's name here. ▶
5	<input type="checkbox"/>	Qualifying widow(er) with dependent child (year spouse died ▶ 19). (See page 13.)

Exemptions

(See page 13.)

If more than six dependents, see page 14.

8a Yourself. If your parent (or someone else) can claim you as a dependent on his or her tax return, do not check box 8a. But be sure to check the box on line 33b on page 2

8b Spouse

c Dependents:	(2) Check if under age 1	(3) If age 1 or older, dependent's social security number	(4) Dependent's relationship to you	(5) No. of months lived in your home in 1993
(1) Name (first, initial, and last name)				

d If your child didn't live with you but is claimed as your dependent under a pre-1985 agreement, check here ▶

e Total number of exemptions claimed

No. of boxes checked on 8a and 8b

No. of year children on 8c who:

- lived with you
- didn't live with you due to divorce or separation (see page 15)

Dependents on 8c not entered above

Add numbers entered on lines above ▶

Income

Attach Copy B of your Forms W-2, W-2G, and 1099-R here.

If you did not get a W-2, see page 10.

If you are attaching a check or money order, put it on top of any Forms W-2, W-2G, or 1099-R.

7	Wages, salaries, tips, etc. Attach Form(s) W-2	7	
8a	Taxable interest income (see page 16). Attach Schedule B if over \$400	8a	5,500
b	Tax-exempt interest (see page 17). DON'T include on line 8a. 8a 8b		
9	Dividend income. Attach Schedule B if over \$400	9	
10	Taxable refunds, credits, or offsets of state and local income taxes (see page 17)	10	
11	Alimony received	11	
12	Business income or (loss). Attach Schedule C or C-EZ	12	
13	Capital gain or (loss). Attach Schedule D	13	(3,000)
14	Capital gain distributions not reported on line 13 (see page 17)	14	
15	Other gains or (losses). Attach Form 4797	15	
16a	Total IRA distributions . 16a	b Taxable amount (see page 18)	
17a	Total pensions and annuities . 17a	b Taxable amount (see page 18)	
18	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	18	40,000
19	Farm income or (loss). Attach Schedule F	19	
20	Unemployment compensation (see page 19)	20	
21a	Social security benefits . 21a	b Taxable amount (see page 19)	
22	Other income. List type and amount—see page 20	22	
23	Add the amounts in the far right column for lines 7 through 22. This is your total income ▶	23	42,500

Adjustments to Income

(See page 20.)

24a	Your IRA deduction (see page 20)	24a	
b	Spouse's IRA deduction (see page 20)	24b	
25	One-half of self-employment tax (see page 21)	25	
26	Self-employed health insurance deduction (see page 22)	26	
27	Keogh retirement plan and self-employed SEP deduction	27	
28	Penalty on early withdrawal of savings	28	
29	Alimony paid. Recipient's SSN ▶	29	
30	Add lines 24a through 29. These are your total adjustments	30	

Adjusted Gross Income

31	Subtract line 30 from line 23. This is your adjusted gross income. If this amount is less than \$23,050 and a child lived with you, see page EIC-1 to find out if you can claim the "Earned Income Credit" on line 55	31	42,500
----	---	----	---------------

Tax Computation

(See page 23.)

32	Amount from line 31 (adjusted gross income)	32	42,500
33a	Check if: <input type="checkbox"/> You were 65 or older, <input type="checkbox"/> Blind; <input type="checkbox"/> Spouse was 65 or older, <input type="checkbox"/> Blind. Add the number of boxes checked above and enter the total here . . . ▶ 33a		
b	If your parent (or someone else) can claim you as a dependent, check here . . . ▶ 33b		
c	If you are married filing separately and your spouse itemizes deductions or you are a dual-status alien, see page 24 and check here . . . ▶ 33c		
34	Enter the larger of: Itemized deductions from Schedule A, line 28, OR Standard deduction shown below for your filing status. But if you checked any box on line 33a or b, go to page 24 to find your standard deduction. If you checked box 33c, your standard deduction is zero. • Single—\$3,700 • Head of household—\$5,450 • Married filing jointly or Qualifying widow(er)—\$6,200 • Married filing separately—\$3,100	34	24,150
35	Subtract line 34 from line 32	35	18,350
36	If line 32 is \$81,350 or less, multiply \$2,350 by the total number of exemptions claimed on line 6e. If line 32 is over \$81,350, see the worksheet on page 25 for the amount to enter	36	2,350
37	Taxable income. Subtract line 36 from line 35. If line 36 is more than line 35, enter -0-	37	16,000
38	Tax. Check if from a <input type="checkbox"/> Tax Table, b <input checked="" type="checkbox"/> Tax Rate Schedules, c <input type="checkbox"/> Schedule D Tax Worksheet, or d <input type="checkbox"/> Form 8815 (see page 25). Amount from Form(s) 8814 ▶ e	38	2,400
39	Additional taxes (see page 25). Check if from a <input type="checkbox"/> Form 4970 b <input type="checkbox"/> Form 4972	39	
40	Add lines 38 and 39	40	2,400

If you want the IRS to figure your tax, see page 24.

Credits

(See page 25.)

41	Credit for child and dependent care expenses. Attach Form 2441	41	
42	Credit for the elderly or the disabled. Attach Schedule R	42	
43	Foreign tax credit. Attach Form 1116	43	
44	Other credits (see page 25). Check if from a <input type="checkbox"/> Form 3800 b <input type="checkbox"/> Form 8386 c <input type="checkbox"/> Form 8801 d <input type="checkbox"/> Form (specify) _____	44	
45	Add lines 41 through 44	45	
46	Subtract line 45 from line 40. If line 45 is more than line 40, enter -0-	46	2,400

Other Taxes

47	Self-employment tax. Attach Schedule SE. Also, see line 25.	47	
48	Alternative minimum tax. Attach Form 6251	48	
49	Recapture taxes (see page 25). Check if from a <input type="checkbox"/> Form 4255 b <input type="checkbox"/> Form 8611 c <input type="checkbox"/> Form 8828	49	
50	Social security and Medicare tax on tip income not reported to employer. Attach Form 4137	50	
51	Tax on qualified retirement plans, including IRAs. If required, attach Form 5329	51	
52	Advance earned income credit payments from Form W-2	52	
53	Add lines 46 through 52. This is your total tax	53	2,400

Payments

Attach Forms W-2, W-2G, and 1099-R on the front.

54	Federal income tax withheld. If any is from Form(s) 1099, check ▶ <input type="checkbox"/>	54	
55	1993 estimated tax payments and amount applied from 1992 return	55	2,100
56	Earned income credit. Attach Schedule EIC	56	
57	Amount paid with Form 4868 (extension request)	57	
58a	Excess social security, Medicare, and RRTA tax withheld (see page 25)	58a	
b	Deferral of additional 1993 taxes. Attach Form 8841	58b	
59	Other payments (see page 25). Check if from a <input type="checkbox"/> Form 2439 b <input type="checkbox"/> Form 4138	59	
60	Add lines 54 through 59. These are your total payments	60	2,100

Refund or Amount You Owe

61	If line 60 is more than line 53, subtract line 53 from line 60. This is the amount you OVERPAID . . . ▶	61	
62	Amount of line 61 you want REFUNDED TO YOU	62	
63	Amount of line 61 you want APPLIED TO YOUR 1994 ESTIMATED TAX ▶	63	
64	If line 53 is more than line 60, subtract line 60 from line 53. This is the AMOUNT YOU OWE. For details on how to pay, including what to write on your payment, see page 29	64	300
65	Estimated tax penalty (see page 29). Also include on line 54	65	

Sign Here

Keep a copy of this return for your records.

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Your signature _____ Spouse's signature. If a joint return, BOTH must sign. _____	Date _____ Date _____	Your occupation _____ Spouse's occupation _____
Preparer's signature _____ Firm's name (or yours if self-employed) and address _____	Date _____	Check if self-employed <input type="checkbox"/> Preparer's social security no. _____ E.I. No. _____ ZIP code _____

SCHEDULES A&B
(Form 1040)

Schedule A—Itemized Deductions

OMB No. 1545-0074

Department of the Treasury
Internal Revenue Service

(Schedule B is on back)

1993

Attachment
Sequence No. **07**

▶ Attach to Form 1040. ▶ See instructions for Schedules A and B (Form 1040).

Name(s) shown on Form 1040

Thomas Smith Bankruptcy Estate

Your social security number

00-000000

Medical and Dental Expenses	Caution: Do not include expenses reimbursed or paid by others.				
	1	Medical and dental expenses (see page A-1)	1		
	2	Enter amount from Form 1040, line 32. 2	2		
	3	Multiply line 2 above by 7.5% (.075)	3		
	4	Subtract line 3 from line 1. If zero or less, enter -0- ▶	4		
Taxes You Paid (See page A-1.)	5	State and local income taxes	5	1,000	
	6	Real estate taxes (see page A-2)	6	4,000	
	7	Other taxes. List—include personal property taxes ▶	7		
	8	Add lines 5 through 7. ▶	8		5,000
Interest You Paid (See page A-2.)	9a	Home mortgage interest and points reported to you on Form 1098	9a	10,000	
	b	Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see page A-3 and show that person's name, identifying no., and address ▶			
	10	Points not reported to you on Form 1098. See page A-3 for special rules	10		
Note: Personal interest is not deductible.	11	Investment interest. If required, attach Form 4952. (See page A-3.)	11		
	12	Add lines 9a through 11 ▶	12		10,000
Gifts to Charity (See page A-3.)	Caution: If you made a charitable contribution and received a benefit in return, see page A-3.				
	13	Contributions by cash or check	13		
	14	Other than by cash or check. If over \$500, you MUST attach Form 8283	14		
	15	Carryover from prior year	15		
	16	Add lines 13 through 15 ▶	16		
Casualty and Theft Losses	17	Casualty or theft loss(es). Attach Form 4684. (See page A-4.) ▶	17		
Moving Expenses	18	Moving expenses. Attach Form 3903 or 3903-F. (See page A-4.) ▶	18		
Job Expenses and Most Other Miscellaneous Deductions (See page A-5 for expenses to deduct here.)	19	Unreimbursed employee expenses—job travel, union dues, job education, etc. If required, you MUST attach Form 2106. (See page A-4.) ▶	19		
	20	Other expenses—investment, tax preparation, safe deposit box, etc. List type and amount ▶	20	10,000	
	21	Add lines 19 and 20	21	10,000	
	22	Enter amount from Form 1040, line 32. 22 42,500	22		
	23	Multiply line 22 above by 2% (.02)	23	850	
	24	Subtract line 23 from line 21. If zero or less, enter -0- ▶	24		9,150
Other Miscellaneous Deductions	25	Other—from list on page A-5. List type and amount ▶	25		
Total Itemized Deductions	26	is the amount on Form 1040, line 32, more than \$108,450 (more than \$54,225 if married filing separately)?	26		24,150
		<ul style="list-style-type: none"> • NO. Your deduction is not limited. Add lines 4, 8, 12, 16, 17, 18, 24, and 25 and enter the total here. Also enter on Form 1040, line 34, the larger of this amount or your standard deduction. • YES. Your deduction may be limited. See page A-5 for the amount to enter. 			

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11330X

Schedule A (Form 1040) 1993

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side.

Your social security number

Thomas Smith Bankruptcy Estate

00-000000

Schedule B—Interest and Dividend Income

Attachment Sequence No. 08

**Part I
Interest
Income**

Note: If you had over \$400 in taxable interest income, you must also complete Part III.

(See pages 16 and B-1.)

Note: If you received a Form 1099-INT, Form 1099-OID, or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total interest shown on that form.

Interest Income		Amount
1	List name of payer. If any interest is from a seller-financed mortgage and the buyer used the property as a personal residence, see page B-1 and list this interest first. Also show that buyer's social security number and address ▶ Certificate of Deposit XYZ Bank	5,500
2	Add the amounts on line 1	5,500
3	Excludable interest on series EE U.S. savings bonds issued after 1989 from Form 8815, line 14. You MUST attach Form 8815 to Form 1040	
4	Subtract line 3 from line 2. Enter the result here and on Form 1040, line 8a ▶	5,500

**Part II
Dividend
Income**

Note: If you had over \$400 in gross dividends and/or other distributions on stock, you must also complete Part III.

(See pages 17 and B-1.)

Note: If you received a Form 1099-DIV or substitute statement from a brokerage firm, list the firm's name as the payer and enter the total dividends shown on that form.

Dividend Income		Amount
5	List name of payer. Include gross dividends and/or other distributions on stock here. Any capital gain distributions and nontaxable distributions will be deducted on lines 7 and 8 ▶	
6	Add the amounts on line 5	
7	Capital gain distributions. Enter here and on Schedule D*	
8	Nontaxable distributions. (See the inst. for Form 1040, line 9.)	
9	Add lines 7 and 8	
10	Subtract line 9 from line 6. Enter the result here and on Form 1040, line 9 ▶ *If you received capital gain distributions but do not need Schedule D to report any other gains or losses, see the instructions for Form 1040, lines 13 and 14.	

**Part III
Foreign
Accounts
and
Trusts**

If you had over \$400 of interest or dividends OR had a foreign account or were a grantor of, or a transferor to, a foreign trust, you must complete this part.

(See page B-2.)

	Yes	No
11a At any time during 1993, did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account? See page B-2 for exceptions and filing requirements for Form TD F 90-22.1		<input checked="" type="checkbox"/>
b If "Yes," enter the name of the foreign country ▶		
12 Were you the grantor of, or transferor to, a foreign trust that existed during 1993, whether or not you have any beneficial interest in it? If "Yes," you may have to file Form 3520, 3520-A, or 928.		<input checked="" type="checkbox"/>

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Schedule B (Form 1040) 1993

**SCHEDULE D
(Form 1040)**

Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See instructions for Schedule D (Form 1040).

▶ Use lines 20 and 22 for more space to list transactions for lines 1 and 9.

OMB No. 1545-0074

1993

Attachment
Sequence No. 12

Name(s) shown on Form 1040

Thomas Smith Bankruptcy Estate

Your social security number

00-000000

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
1						
2 Enter your short-term totals, if any, from line 21		2				
3 Total short-term sales price amounts. Add column (d) of lines 1 and 2		3				
4 Short-term gain from Forms 2119 and 6252, and short-term gain or (loss) from Forms 4684, 6781, and 8824					4	
5 Net short-term gain or (loss) from partnerships, S corporations, and fiduciaries from Schedule(s) K-1					5	
6 Short-term capital loss carryover from 1992 Schedule D, line 38					6	
7 Add lines 1, 2, and 4 through 6, in columns (f) and (g)					7 ()	
8 Net short-term capital gain or (loss). Combine columns (f) and (g) of line 7					8	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

9						
10 Enter your long-term totals, if any, from line 23		10				
11 Total long-term sales price amounts. Add column (d) of lines 9 and 10		11				
12 Gain from Form 4797; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824					12	175,000
13 Net long-term gain or (loss) from partnerships, S corporations, and fiduciaries from Schedule(s) K-1					13	
14 Capital gain distributions					14	
15 Long-term capital loss carryover from 1992 Schedule D, line 45					15	250,000
16 Add lines 9, 10, and 12 through 15, in columns (f) and (g)					16	(250,000) 175,000
17 Net long-term capital gain or (loss). Combine columns (f) and (g) of line 16					17	(75,000)

Part III Summary of Parts I and II

18 Combine lines 8 and 17. If a loss, go to line 19. If a gain, enter the gain on Form 1040, line 13. Note: If both lines 17 and 18 are gains, see the Schedule D Tax Worksheet on page D-4		18	(75,000)
19 If line 18 is a (loss), enter here and as a (loss) on Form 1040, line 13, the smaller of these losses: a The (loss) on line 18; or b (\$3,000) or, if married filing separately, (\$1,500) Note: See the Capital Loss Carryover Worksheet on page D-4 if the loss on line 18 exceeds the loss on line 19 or if Form 1040, line 35, is a loss.		19	(3,000)

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11338H

Schedule D (Form 1040) 1993

**SCHEDULE E
(Form 1040)**

Supplemental Income and Loss

(From rental real estate, royalties, partnerships,
S corporations, estates, trusts, REMICs, etc.)

OMB No. 1545-0074

1993

Attachment
Sequence No. 13

Department of the Treasury
Internal Revenue Service

▶ Attach to Form 1040 or Form 1041. ▶ See instructions for Schedule E (Form 1040).

Name(s) shown on return

Thomas Smith Bankruptcy Estate

Your social security number

00-0000000

Part I **Income or Loss From Rental Real Estate and Royalties** Note: Report income and expenses from your business of renting personal property on Schedule C or C-EZ (see page E-1). Report farm rental income or loss from Form 4835 on page 2, line 39.

1	Show the kind and location of each rental real estate property:	2	For each rental real estate property listed on line 1, did you or your family use it for personal purposes for more than the greater of 14 days or 10% of the total days rented at fair rental value during the tax year? (See page E-1.)	
			Yes	No
A	<u>Commercial Rental Real Estate</u> <u>Anywhere, USA 00000</u>			X
B				
C				

Income:	Properties			Totals (Add columns A, B, and C.)
	A	B	C	
3 Rents received	3 <u>75,000</u>			3
4 Royalties received	4			4
Expenses:				
5 Advertising	5			
6 Auto and travel (see page E-2)	6			
7 Cleaning and maintenance	7			
8 Commissions	8			
9 Insurance	9			
10 Legal and other professional fees	10			
11 Management fees	11			
12 Mortgage interest paid to banks, etc. (see page E-2)	12 <u>10,000</u>			12
13 Other interest	13			
14 Repairs	14			
15 Supplies	15			
16 Taxes	16 <u>20,000</u>			
17 Utilities	17			
18 Other (list) ▶	18			
19 Add lines 5 through 18	19 <u>30,000</u>			19
20 Depreciation expense or depletion (see page E-2)	20 <u>5,000</u>			20
21 Total expenses. Add lines 19 and 20	21 <u>35,000</u>			
22 Income or (loss) from rental real estate or royalty properties. Subtract line 21 from line 3 (rents) or line 4 (royalties). If the result is a (loss), see page E-2 to find out if you must file Form 6196.	22 <u>40,000</u>			
23 Deductible rental real estate loss. Caution: Your rental real estate loss on line 22 may be limited. See page E-3 to find out if you must file Form 8582.	23 () () ()			
24 Income. Add positive amounts shown on line 22. Do not include any losses.	24			<u>40,000</u>
25 Losses. Add royalty losses from line 22 and rental real estate losses from line 23. Enter the total losses here	25 () () ()			
26 Total rental real estate and royalty income or (loss). Combine lines 24 and 25. Enter the result here. If Parts II, III, IV, and line 39 on page 2 do not apply to you, also enter this amount on Form 1040, line 18. Otherwise, include this amount in the total on line 40 on page 2	26			<u>40,000</u>

For Paperwork Reduction Act Notice, see Form 1040 instructions.

Cat. No. 11344L

Schedule E (Form 1040) 1993

Sale of Your Home

1993

Attachment
Sequence No. 20

Department of the Treasury
Internal Revenue Service

▶ Attach to Form 1040 for year of sale.

▶ See separate instructions. ▶ Please print or type.

Your first name and initial. If a joint return, also give spouse's name and initial. Last name
Thomas Smith Bankruptcy Estate

Your social security number
00-0000000

Present address (no., street, and apt. no., rural route, or P.O. box no. if mail is not delivered to street address)
 Spouse's social security number

City, town or post office, state, and ZIP code

Part I General Information

- 1 Date your former main home was sold (month, day, year) ▶ **1 09 / 30 / 93**
- 2 Have you bought or built a new main home? Yes No
- 3 Is or was any part of either main home rented out or used for business? If "Yes," see instructions Yes No

Part II Gain on Sale—Do not include amounts you deduct as moving expenses.

4	Selling price of home. Do not include personal property items you sold with your home	4	200,000
5	Expense of sale (see instructions)	5	20,000
6	Amount realized. Subtract line 5 from line 4	6	180,000
7	Adjusted basis of home sold (see instructions)	7	130,000
8	Gain on sale. Subtract line 7 from line 6	8	50,000

Is line 8 more than zero? Yes No

Yes —▶ If line 2 is "Yes," you must go to Part III or Part IV, whichever applies. If line 2 is "No," go to line 9.

No —▶ Stop and attach this form to your return.

- 9 If you haven't replaced your home, do you plan to do so within the replacement period (see instructions)? Yes No
- If line 9 is "Yes," stop here, attach this form to your return, and see **Additional Filing Requirements** in the instructions.
 - If line 9 is "No," you must go to Part III or Part IV, whichever applies.

Part III One-Time Exclusion of Gain for People Age 55 or Older—By completing this part, you are electing to take the one-time exclusion (see instructions). If you are not electing to take the exclusion, go to Part IV now.

- 10 Who was age 55 or older on the date of sale? You Your spouse Both of you
- 11 Did the person who was age 55 or older own and use the property as his or her main home for a total of at least 3 years (except for short absences) of the 5-year period before the sale? If "No," go to Part IV now Yes No
- 12 At the time of sale, who owned the home? You Your spouse Both of you
- 13 Social security number of spouse at the time of sale if you had a different spouse from the one above. If you were not married at the time of sale, enter "None" ▶ 13 : : :
- 14 Exclusion. Enter the smaller of line 8 or \$125,000 (\$62,500 if married filing separate return). Then, go to line 15 14

Part IV Adjusted Sales Price, Taxable Gain, and Adjusted Basis of New Home

15	If line 14 is blank, enter the amount from line 8. Otherwise, subtract line 14 from line 8 • If line 15 is zero, stop and attach this form to your return. • If line 15 is more than zero and line 2 is "Yes," go to line 16 now. • If you are reporting this sale on the installment method, stop and see the instructions. • All others, stop and enter the amount from line 15 on Schedule D, col. (g), line 4 or line 12.	15	50,000
16	Fixing-up expenses (see instructions for time limits)	16	
17	If line 14 is blank, enter amount from line 16. Otherwise, add lines 14 and 16.	17	
18	Adjusted sales price. Subtract line 17 from line 6.	18	
19a	Date you moved into new home ▶ / /	19b	b Cost of new home (see instructions)
20	Subtract line 19b from line 18. If zero or less, enter -0-	20	
21	Taxable gain. Enter the smaller of line 15 or line 20 • If line 21 is zero, go to line 22 and attach this form to your return. • If you are reporting this sale on the installment method, see the line 15 instructions and go to line 22. • All others, enter the amount from line 21 on Schedule D, col. (g), line 4 or line 12, and go to line 22.	21	
22	Postponed gain. Subtract line 21 from line 15	22	
23	Adjusted basis of new home. Subtract line 22 from line 18b	23	

Sign Here Only if You Are Filing This Form by Itself and Not With Your Tax Return

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

Your signature _____ Date _____ Spouse's signature _____ Date _____

▶ If a joint return, both must sign.

Sales of Business Property
(Also Involuntary Conversions and Recapture Amounts
Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return. ▶ See separate instructions.

Name(s) shown on return Thomas Smith Bankruptcy Estate Identifying number 00-0000000

1 Enter here the gross proceeds from the sale or exchange of real estate reported to you for 1993 on Form(s) 1099-S (or a substitute statement) that you will be including on line 2, 11, or 22 1 300,000

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Property Held More Than 1 Year

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) LOSS ((f) minus the sum of (d) and (e))	(h) GAIN ((d) plus (e) minus (f))
2							

3 Gain, if any, from Form 4684, line 3B 3

4 Section 1231 gain from installment sales from Form 6252, line 26 or 37 4

5 Section 1231 gain or (loss) from like-kind exchanges from Form 8824 5

6 Gain, if any, from line 34, from other than casualty or theft 6 125,000

7 Add lines 2 through 6 in columns (g) and (h) 7 ()

8 Combine columns (g) and (h) of line 7. Enter gain or (loss) here, and on the appropriate line as follows: 8 125,000
Partnerships—Enter the gain or (loss) on Form 1065, Schedule K, line 6. Skip lines 9, 10, 12, and 13 below.
S corporations—Report the gain or (loss) following the instructions for Form 1120S, Schedule K, lines 5 and 6. Skip lines 9, 10, 12, and 13 below, unless line 8 is a gain and the S corporation is subject to the capital gains tax.
All others—If line 8 is zero or a loss, enter the amount on line 12 below and skip lines 9 and 10. If line 8 is a gain and you did not have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain as a long-term capital gain on Schedule D and skip lines 9, 10, and 13 below.

9 Nonrecaptured net section 1231 losses from prior years (see instructions) 9

10 Subtract line 9 from line 8. If zero or less, enter -0-. Also enter on the appropriate line as follows (see instructions): 10 125,000
S corporations—Enter this amount (if more than zero) on Schedule D (Form 1120S), line 13, and skip lines 12 and 13 below.
All others—If line 10 is zero, enter the amount from line 8 on line 13 below. If line 10 is more than zero, enter the amount from line 9 on line 13 below, and enter the amount from line 10 as a long-term capital gain on Schedule D.

Part II Ordinary Gains and Losses

11 Ordinary gains and losses not included on lines 12 through 18 (include property held 1 year or less):

(a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) LOSS ((f) minus the sum of (d) and (e))	(h) GAIN ((d) plus (e) minus (f))

12 Loss, if any, from line 8 12

13 Gain, if any, from line 8, or amount from line 9 if applicable 13

14 Gain, if any, from line 33 14

15 Net gain or (loss) from Form 4684, lines 31 and 38a 15

16 Ordinary gain from installment sales from Form 6252, line 25 or 38 16

17 Ordinary gain or (loss) from like-kind exchanges from Form 8824 17

18 Recapture of section 179 expense deduction for partners and S corporation shareholders from property dispositions by partnerships and S corporations (see instructions) 18

19 Add lines 11 through 18 in columns (g) and (h) 19 ()

20 Combine columns (g) and (h) of line 19. Enter gain or (loss) here, and on the appropriate line as follows: 20
a For all except individual returns: Enter the gain or (loss) from line 20 on the return being filed.
b For individual returns:
 (1) If the loss on line 12 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here and on line 20 of Schedule A (Form 1040). Identify as from "Form 4797, line 20b(1)." See instructions 20b(1)
 (2) Redetermine the gain or (loss) on line 20, excluding the loss, if any, on line 20b(1). Enter here and on Form 1040, line 15 20b(2)

Part III Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255

21 (a) Description of section 1245, 1250, 1252, 1254, or 1255 property:		(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)		
A	Commercial Real Estate - Bldg	07-01-83	07-01-93		
B					
C					
D					
Relate lines 21A through 21D to these columns		Property A	Property B	Property C	Property D
22	Gross sales price (Note: See line 1 before completing.)	22 300,000			
23	Cost or other basis plus expense of sale	23 275,000			
24	Depreciation (or depletion) allowed or allowable	24 100,000			
25	Adjusted basis. Subtract line 24 from line 23	25 175,000			
26	Total gain. Subtract line 25 from line 22	26 125,000			
27 If section 1245 property:					
a	Depreciation allowed or allowable from line 24	27a			
b	Enter the smaller of line 26 or 27a	27b			
28 If section 1250 property: If straight line depreciation was used, enter -0- on line 28g, except for a corporation subject to section 291.					
a	Additional depreciation after 1975 (see instructions)	28a			
b	Applicable percentage multiplied by the smaller of line 26 or line 28a (see instructions)	28b			
c	Subtract line 28a from line 26. If residential rental property or line 26 is not more than line 28a, skip lines 28d and 28e	28c			
d	Additional depreciation after 1969 and before 1976	28d			
e	Enter the smaller of line 28c or 28d	28e			
f	Section 291 amount (corporations only)	28f			
g	Add lines 28b, 28e, and 28f	28g -0-			
29 If section 1252 property: Skip this section if you did not dispose of farmland or if this form is being completed for a partnership.					
a	Soil, water, and land clearing expenses	29a			
b	Line 29a multiplied by applicable percentage (see instructions)	29b			
c	Enter the smaller of line 28 or 29b	29c			
30 If section 1254 property:					
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, and mining exploration costs (see instructions)	30a			
b	Enter the smaller of line 26 or 30a	30b			
31 If section 1255 property:					
a	Applicable percentage of payments excluded from income under section 126 (see instructions)	31a			
b	Enter the smaller of line 26 or 31a	31b			

Summary of Part III Gains. Complete property columns A through D, through line 31b before going to line 32.

32	Total gains for all properties. Add columns A through D, line 26	32 125,000
33	Add columns A through D, lines 27b, 28g, 29c, 30b, and 31b. Enter here and on line 14	33 -0-
34	Subtract line 33 from line 32. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	34 125,000

Part IV Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less
See instructions for Part IV.

	(a) Section 179	(b) Section 280F(b)(2)
35	Section 179 expense deduction or depreciation allowable in prior years	35
36	Recomputed depreciation (see instructions)	36
37	Recapture amount. Subtract line 36 from line 35. See instructions for where to report	37

**Depreciation and Amortization
(Including Information on Listed Property)**

Department of the Treasury
Internal Revenue Service

▶ See separate instructions. ▶ Attach this form to your return.

Name(s) shown on return

Thomas Smith Bankruptcy Estate

Identifying number

00-0000000

Business or activity to which this form relates

Commercial Rental Real Estate

Part I Election To Expense Certain Tangible Property (Section 179) (Note: If you have any "Listed Property," complete Part V before you complete Part I.)

1	Maximum dollar limitation (If an enterprise zone business, see instructions)	1	\$17,500
2	Total cost of section 179 property placed in service during the tax year (see instructions)	2	
3	Threshold cost of section 179 property before reduction in limitation	3	\$200,000
4	Reduction in limitation. Subtract line 3 from line 2, but do not enter less than -0-	4	
5	Dollar limitation for tax year. Subtract line 4 from line 1, but do not enter less than -0-. (If married filing separately, see instructions.)	5	
6	(a) Description of property	(b) Cost	(c) Elected cost
7	Listed property. Enter amount from line 26.	7	
8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	
9	Tentative deduction. Enter the smaller of line 5 or line 8	9	
10	Carryover of disallowed deduction from 1992 (see instructions).	10	
11	Taxable income limitation. Enter the smaller of taxable income or line 5 (see instructions)	11	
12	Section 179 expense deduction. Add lines 9 and 10, but do not enter more than line 11	12	
13	Carryover of disallowed deduction to 1994. Add lines 9 and 10, less line 12 ▶	13	

Note: Do not use Part II or Part III below for listed property (automobiles, certain other vehicles, cellular telephones, certain computers, or property used for entertainment, recreation, or amusement). Instead, use Part V for listed property.

Part II MACRS Depreciation For Assets Placed in Service ONLY During Your 1993 Tax Year (Do Not Include Listed Property)

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
14 General Depreciation System (GDS) (see instructions):						
a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g Residential rental property			27.5 yrs.	MM	S/L	
h Nonresidential real property			27.5 yrs.	MM	S/L	
15 Alternative Depreciation System (ADS) (see instructions):						
a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 40-year			40 yrs.	MM	S/L	

Part III Other Depreciation (Do Not Include Listed Property)

16	GDS and ADS deductions for assets placed in service in tax years beginning before 1993 (see instructions)	16	
17	Property subject to section 168(f)(1) election (see instructions)	17	
18	ACRS and other depreciation (see instructions)	18	<u>5,000</u>

Part IV Summary

19	Listed property. Enter amount from line 25.	19	
20	Total. Add deductions on line 12, lines 14 and 15 in column (g), and lines 16 through 19. Enter here and on the appropriate lines of your return. (Partnerships and S corporations—see instructions)	20	
21	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs (see instructions)	21	

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

OMB No. 1545-0048
 Expires: 1-31-95

Caution: DO NOT use this version for discharge of indebtedness in tax years beginning after 1993.
▶ Attach this form to your income tax return.

Attachment
 Sequence No. **94**

Name shown on return Thomas Smith Bankruptcy Estate Identifying number 00-000000

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 after 1992 of qualified real property business indebtedness
- 2 Total amount of discharged indebtedness excluded from gross income. 2 | 70,000
- 3 Do you elect to treat all real property described in section 1221(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 the transactions resulting in the reduction in basis under section 1017.)

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 | |
| 6 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 net capital loss for the tax year of the discharge including any capital loss carryovers to the tax year of the discharge | 8 | <u>70,000</u> |
| 9 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> | 9 | |
| 10 For a discharge of qualified farm indebtedness, applied to reduce the basis of: | | |
| 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. | 10a | |
| b Land used or held for use in a trade or business of farming | 10b | |
| c Other property used or held for use in a trade or business, or for the production of income | 10c | |
| 11 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge | 11 | |

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

The corporation named above has excluded under section 1081(b) of the Internal Revenue Code \$
 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) of the Internal Revenue Code 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.

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.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping 4 hr., 47 min.
- Learning about the law or the form 1 hr., 53 min.
- Preparing and sending the form to the IRS 2 hr., 5 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from

you. You can write to both the IRS and the Office of Management and Budget at the addresses listed in the instructions for the tax return with which this form is filed.

General Instructions

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

Purpose of Form.—Generally, the amount you receive from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you may exclude the amount of discharged indebtedness from your gross income. Unless you check the box on line 1d or make the election on line 5, the amount excluded from gross income is applied to reduce certain tax attributes dollar for dollar (see exceptions for lines 7 and 11) in the following order:

- Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year);
- Any general business credit carryover to or from the tax year of the discharge;
- Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year);
- Basis of property; and
- Any foreign tax credit carryover to or from the tax year of the discharge.

Caution: For discharges of indebtedness in tax years beginning after 1993, the Revenue Reconciliation Act of 1993 requires minimum tax credits and passive activity loss and credit carryovers to be reduced in addition to the attributes listed above. Do not use this version of Form 982 for discharges in tax years beginning after 1993; a new version will be available in January 1995 for these discharges.

Capital Loss Carryover Worksheet (keep for your records)

Use this worksheet to figure your capital loss carryovers from 1993 to 1994 if Schedule D, line 19, is a loss and **(a)** that loss is a smaller loss than the loss on Schedule D, line 18, **or (b)** Form 1040, line 35, is a loss.

1. Enter the amount from Form 1040, line 35. If a loss, enclose the amount in parentheses	1.	<u>18,350</u>
2. Enter the loss from Schedule D, line 19, as a positive amount	2.	<u>3,000</u>
3. Combine lines 1 and 2. If zero or less, enter -0-	3.	<u>21,350</u>
4. Enter the smaller of line 2 or line 3	4.	<u>3,000</u>
Note: If line 8 of Schedule D is a loss, go to line 5; otherwise, skip lines 5 through 9.		
5. Enter the loss from Schedule D, line 8, as a positive amount	5.	_____
6. Enter the gain, if any, from Schedule D, line 17	6.	_____
7. Enter the amount from line 4	7.	_____
8. Add lines 6 and 7	8.	_____
9. Short-term capital loss carryover to 1994. Subtract line 8 from line 5. If zero or less, enter -0-	9.	_____
Note: If line 17 of Schedule D is a loss, go to line 10; otherwise, skip lines 10 through 14.		
10. Enter the loss from Schedule D, line 17, as a positive amount	10.	<u>75,000</u>
11. Enter the gain, if any, from Schedule D, line 8	11.	_____
12. Subtract line 5 from line 4. If zero or less, enter -0-	12.	<u>3,000</u>
13. Add lines 11 and 12	13.	<u>3,000</u>
14. Long-term capital loss carryover to 1994. Subtract line 13 from line 10. If zero or less, enter -0-	14.	<u>72,000</u>

Partnerships and Corporations

A separate taxable estate is not created when a partnership or corporation files a bankruptcy petition. The court appointed trustee is, however, responsible for filing the regular income tax returns on Form 1065 or Form 1120.

Partnerships

The filing requirements for a partnership in bankruptcy proceedings do not change. However, the filing of required returns becomes the responsibility of an appointed trustee, receiver, or a debtor-in-possession rather than a general partner.

A partnership's debt that is canceled because of bankruptcy is not included in the partnership's income. It may or may not be included in the individual partners' income. See *Partnerships*, later under *Debt Cancellation*.

Corporations

The following discussion covers only the highlights of the bankruptcy tax rules applying to corporations. Because the details of corporate bankruptcy reorganizations are beyond the scope of this publication, you may want to seek the help of a professional tax advisor.

See *Corporations* under *Debt Cancellation*, for information about a corporation's debt canceled because of bankruptcy.

Tax-Free Reorganizations

The tax-free reorganization provisions of the Internal Revenue Code apply to a transfer by a corporation of all or part of its assets to another corporation in a title 11 or similar case, but only if, under the reorganization plan, stock or securities of the corporation to which the assets are transferred are distributed in a transaction qualifying under IRC section 354, 355, or 356.

A "title 11 or similar case," for this purpose, is a bankruptcy case under title 11 of the United States Code, or a receivership, foreclosure, or similar proceeding in a federal or state court, but only if the corporation is under the jurisdiction of the court in the case and the transfer of assets is under a plan of reorganization approved by the court. In a receivership, foreclosure, or similar proceeding before a federal or state agency involving certain financial institutions, the agency is treated as a court.

Generally, section 354 provides that no gain or loss is recognized if a corporation's stock is exchanged solely for stock or securities in the same or another corporation under a qualifying reorganization plan. In this case, shareholders in the bankrupt corporation would recognize no gain or loss if they exchange their stock solely for stock or securities of the corporation acquiring the bankrupt's assets.

Section 355 generally provides that no gain or loss is recognized by a shareholder if a corporation distributes solely stock or securities of another corporation that the distributing corporation controls immediately before the distribution. Section 356 provides that in an exchange

that would qualify under section 354 or 355 except that other property or money besides the permitted stock or securities is received by the shareholder, gain is recognized by the shareholder only to the extent of the money and the fair market value of the other property received. No loss is recognized in this situation.

Filing Requirements

The filing requirements of a corporation involved in bankruptcy proceedings do not change. However, the filing of required returns becomes the responsibility of an appointed trustee, receiver, or a debtor-in-possession, rather than a corporate officer.

Exemption from tax return filing. If you are a trustee, receiver, or an assignee of a corporation that is in bankruptcy, receivership, dissolution, or in the hands of an assignee by court order, you may apply to your IRS District Director for relief from filing federal income tax returns for the corporation. To qualify, the corporation must have ceased business operations and must have neither assets nor income.

Your request to the District Director must include the name, address, and employer identification number of the corporation and a statement of the facts (with any supporting documents) showing why you need relief from the filing requirements. You must also include a statement that you are making the request and furnishing the information under penalties of perjury. The District Director will act on your request within 90 days.

Personal Holding Company Tax

A corporation that is subject to the jurisdiction of the court in a title 11 or similar case is exempt from the personal holding company tax, unless the main reason for beginning or continuing this case is to avoid paying this tax. A "title 11 or similar case" is defined earlier under *Tax-Free Reorganizations*.

Tax Procedures

The following section discusses the procedures for determining the amount of tax due from the debtor or the bankruptcy estate, paying the tax claim, and obtaining a discharge of the tax liability.

Determination of Tax

The first step in the determination of the tax due is filing a return. As an individual bankrupt debtor, you file a Form 1040 for the tax year involved, and the trustee of your bankruptcy estate files a Form 1041, as explained earlier under *Individuals in Chapter 7 or Chapter 11 Proceedings*. A bankrupt corporation, or a receiver, bankruptcy trustee, or assignee having possession of, or holding title to, substantially all the property or business of the corporation, files a Form 1120 for the tax year.

After the return is filed, the Internal Revenue Service may redetermine the tax liability shown on the return. When the administrative

remedies within the Service have been exhausted, the tax issue may be litigated either in the bankruptcy court or in the U.S. Tax Court, as explained in the following discussion.

Request for prompt determination of tax liability by the trustee. The trustee of the bankruptcy estate may request a determination of any unpaid liability of the estate for tax incurred during the administration of the case by the filing of a tax return and a request for such a determination with the Internal Revenue Service. Unless the return is fraudulent or contains a material misrepresentation, the trustee, the debtor, and any successor to the debtor are discharged from liability for the tax upon payment of the tax:

- 1) As determined by the Internal Revenue Service,
- 2) As determined by the bankruptcy court, after the completion of the IRS examination, or
- 3) As shown on the return, if the IRS does not:
 - a) Notify the trustee within 60 days after the request for the determination that the return has been selected for examination, or
 - b) Complete the examination and notify the trustee of any tax due within 180 days after the request (or any additional time permitted by the bankruptcy court).

Making the request for determination.

To request a prompt determination of any unpaid tax liability of the estate, the trustee must file a written application for the determination with the IRS District Director for the district in which the bankruptcy case is pending. The application must be submitted in duplicate and executed under the penalties of perjury. The trustee must submit with the application an exact copy of the return (or returns) filed by the trustee with the IRS for a completed tax period, and a statement of the name and location of the office where the return was filed. On the envelope write "Personal Attention of the Special Procedures Function. **DO NOT OPEN IN MAILROOM.**"

The IRS examination function will notify the trustee within 60 days from receipt of the application whether the return filed by the trustee has been selected for examination or has been accepted as filed. If the return is selected for examination, it will be examined as soon as possible. The examination function will notify the trustee of any tax due within 180 days from receipt of the application or within any additional time permitted by the bankruptcy court.

Bankruptcy court jurisdiction. Generally, the bankruptcy court has authority to determine the amount or legality of any tax imposed on the debtor or the estate, including any fine, penalty, or addition to tax, whether or not the tax was previously assessed or paid.

The bankruptcy court does not have authority to determine the amount or legality of a tax, fine, penalty, or addition to tax that was contested before and finally decided by a court

or administrative tribunal of competent jurisdiction (that became *res judicata*) before the date of filing the bankruptcy petition.

Also, the bankruptcy court does not have authority to decide the right of the bankruptcy estate to a tax refund until the trustee of the estate properly requests the refund from the Internal Revenue Service and either the Service determines the refund or 120 days pass after the date of the request.

If you (the debtor) have already claimed a refund or credit for an overpayment of tax on a properly filed return or claim for refund, the trustee may rely on that claim. Otherwise, if the credit or refund was not claimed by you, the trustee may make the request by filing the appropriate original or amended return or form with the District Director for the district in which the bankruptcy case is pending. On the return or claim for refund write "Personal Attention of the Special Procedures Function. **DO NOT OPEN IN MAILROOM.**"

The appropriate form for the trustee to use in making the claim for refund is as follows:

- 1) For income taxes for which an individual debtor had filed a Form 1040, Form 1040A, or Form 1040EZ, the trustee should use a Form 1040X, *Amended U.S. Individual Income Tax Return*.
- 2) For income taxes for which a corporate debtor had filed a Form 1120, the trustee should use a Form 1120X, *Amended U.S. Corporation Income Tax Return*.
- 3) For income taxes for which a debtor had filed a form other than Form 1040, Form 1040A, Form 1040EZ, or Form 1120, the trustee should use the same type of form that the debtor had originally filed, and write "Amended Return" at the top of the form.
- 4) For taxes other than income taxes for which the debtor had filed a return, the trustee should use a Form 843, *Claim for Refund and Request for Abatement*, attaching an exact copy of any return that is the subject of the claim along with a statement of the name and location of the office where the return was filed.
- 5) For overpayment of taxes of the bankruptcy estate incurred during the administration of the case, the trustee may choose to use a properly executed tax return (for income taxes, a Form 1041) as a claim for refund or credit.

The IRS examination function, if requested by the trustee or debtor in possession as discussed later, will examine the appropriate amended return, claim, or original return filed by the trustee on an expedite basis, and will complete the examination and notify the trustee of its decision within 120 days from the date of filing of the claim.

Tax Court jurisdiction. The filing of a bankruptcy petition automatically results in a stay (suspension) of any U.S. Tax Court proceeding to determine your tax liability as the debtor. This stay continues until one of the acts removing it occurs. The stay may be lifted by the

bankruptcy court upon your request, the request of the IRS, or the request of any other party in interest. Because the bankruptcy court has power to lift the stay and allow you to begin or continue a Tax Court case involving your tax liability, the bankruptcy court has, in effect, during the pendency of the stay, the sole authority to determine whether the tax issue is decided in the bankruptcy court itself or in the Tax Court.

Suspension of time for filing. In any bankruptcy case, the 90-day period for filing a Tax Court petition, after the issuance of the statutory notice of deficiency, is suspended for the time you are prevented from filing the petition because of the bankruptcy case, and for 60 days thereafter. However, even if the statutory notice was issued before the bankruptcy petition was filed, the suspension exists if any part of the 90-day period remained at the date the bankruptcy petition was filed.

Trustee may intervene. The trustee of your bankruptcy estate in any title 11 bankruptcy case may intervene, on behalf of the estate, in any proceeding in the U.S. Tax Court to which you are a party.

Assessment of tax. After the determination of a tax by either the bankruptcy court or the U.S. Tax Court, the Internal Revenue Service may assess the tax against the estate, or against you or your successor, subject to applicable law.

Immediate assessments. In bankruptcy situations, the Internal Revenue Service has limited authority to immediately assess tax deficiencies, without following the normal procedure under which it issues a deficiency notice. In a bankruptcy case, an immediate assessment of tax may be made for a tax liability incurred by the debtor's estate, or on the debtor, if the liability for the tax has been finally decided (has become *res judicata*) in the bankruptcy case. No purpose would be served by requiring issuance of a deficiency notice prior to assessment of taxes imposed on the bankruptcy estate, or on the debtor when the liability has been finally determined in the bankruptcy court, because in neither case can the issue be litigated in the Tax Court.

Statute of limitations for assessment. In a title 11 bankruptcy case, the period of limitations for assessment of tax (generally, 3 years after the later of the date the return was due or was filed) is suspended for the period during which the Internal Revenue Service is prohibited, because of the bankruptcy case, from making the assessment, plus 60 days thereafter.

Disclosure of return information. In bankruptcy cases other than those of individuals filing under chapter 7 or 11, and in receivership proceedings where substantially all the debtor's property is in the hands of the receiver, current and earlier returns of the debtor are, upon written request, open to inspection by or disclosure to the trustee or receiver, but only if the Internal Revenue Service finds that the trustee or receiver has a material interest

which will be affected by information on the return.

Payment of Tax Claim

After the filing of a bankruptcy petition and during the period the debtor's assets or those of the bankruptcy estate are under the jurisdiction of the bankruptcy court, these assets are not subject to levy. The Internal Revenue Service may file a proof of claim in the bankruptcy court the same way as other creditors. This claim may be presented to the bankruptcy court even though the taxes have not yet been assessed or are subject to a Tax Court proceeding.

Seventh priority taxes. In bankruptcy, the debtor's debts are assigned priorities for payment. Most of the prepetition tax debts are classified as seventh priority claims. Generally, **prepetition taxes** are certain income and other taxes that the debtor is considered to owe before he or she files a bankruptcy petition.

The following federal taxes, if unsecured, are prepetition seventh priority taxes of the government:

- 1) Income taxes for tax years ending on or before the date of filing the bankruptcy petition, for which a return is due (including extensions) within 3 years of the filing of the bankruptcy petition.
- 2) Income taxes assessed within 240 days before the date of filing the petition. This 240-day period is increased by any time, plus 30 days, during which an offer in compromise with respect to these taxes was pending, that was made within 240 days after the assessment.
- 3) Income taxes that were not assessed before the petition date, but were assessable as of the petition date, unless these taxes were still assessable solely because no return, a late return (within 2 years of the filing of the bankruptcy petition), or a fraudulent return was filed.
- 4) Withholding taxes for which you are liable in any capacity.
- 5) Employer's share of employment taxes on wages, salaries, or commissions (including vacation, severance, and sick leave pay) paid as priority claims under 11 USC 507(a)(3) or for which a return is due within 3 years of the filing of the bankruptcy petition, including a return for which an extension of the filing date was obtained.
- 6) Excise taxes on transactions occurring before the date of filing the bankruptcy petition, for which a return, if required, is due (including extensions) within 3 years of the filing of the bankruptcy petition. If a return is not required, these excise taxes include only those on transactions occurring during the 3 years immediately before the date of filing the petition.

Priority of payment. For a chapter 7 case, the preceding seventh priority prepetition

taxes may be paid out of the assets of the bankruptcy estate to the extent there are assets remaining after paying the claims of secured creditors and other creditors having higher priority claims.

Different rules apply to payment of seventh priority prepetition taxes under chapters 11, 12, and 13:

- 1) In chapter 11, the debtor can pay these taxes over a period of 6 years from the date of assessment, including interest,
- 2) In chapter 12, the debtor can pay such tax claims in deferred cash payments over time, and
- 3) In chapter 13, the debtor can pay such taxes over 3 years (or over 5 years with court approval).

Certain taxes are assigned a higher priority for payment. Taxes incurred during administration by the bankruptcy estate are paid first, as administrative expenses. Taxes arising in the ordinary course of your business or financial affairs in an **involuntary** bankruptcy case, after the filing of the bankruptcy petition but before the earlier of the appointment of a trustee or the order for relief are included in the second priority of payment. The employee's portion of the employment taxes on the first \$2,000 described in (5) above is included in the third priority.

Relief from penalties. A penalty for failure to pay tax, including failure to pay estimated tax, will not be imposed for any period during which a title 11 bankruptcy case is pending, under the following conditions. If the tax was incurred by the bankruptcy estate, the penalty will not be imposed if the failure to pay resulted from an order of the court finding probable insufficiency of funds of the estate to pay administrative expenses. If the tax was incurred by you as the debtor, the penalty will not be imposed if:

- 1) The tax was incurred before the earlier of the order for relief or (in an involuntary case) the appointment of a trustee, and
- 2) The bankruptcy petition was filed before the due date for the tax return (including extensions) or the date for imposing the penalty occurs on or after the day the bankruptcy petition was filed.

This relief from the failure-to-pay penalty does not apply to any penalty for failure to pay or deposit tax withheld or collected from others and required to be paid over to the U.S. government. Nor does it apply to any penalty for failure to timely file a return.

FUTA credit. An employer is generally allowed a credit against the federal unemployment tax (FUTA) for contributions made to a state unemployment fund, if the contributions are paid by the last day for filing an unemployment tax return for the tax year. If the contributions to the state fund are paid after that date, generally only 90% of the otherwise allowable

credit may be taken against the federal unemployment tax.

However, for any unemployment tax on wages paid by the trustee of a title 11 bankruptcy estate, if the failure to pay the state unemployment contributions on time was without fault by the trustee, the full amount of the credit is allowed.

Statute of limitations for collection. In a title 11 bankruptcy case, the period of limitations for collection of tax (generally, 10 years after assessment) is suspended for the period during which the Internal Revenue Service is prohibited from assessing or collecting, plus 6 months thereafter.

Discharge of Unpaid Tax

Debts are divided into two categories; dischargeable and nondischargeable. Dischargeable debts are those that the debtor is no longer personally liable to pay after the bankruptcy proceedings are concluded. Nondischargeable debts are those that are not canceled because of the bankruptcy proceedings. The debtor remains personally liable for their payment.

As a general rule, there is **no discharge** for you as an individual debtor at the termination of a bankruptcy case for the second and seventh priority taxes described earlier, or for taxes for which no return, a late return (filed within 2 years of the filing of the bankruptcy petition), or a fraudulent return was filed. **However**, claims against you for other taxes pre-dating the bankruptcy petition by more than 3 years may be discharged. However, if the IRS has a lien on the debtor's property, this property may be seized to collect discharged tax debts.

Exception for individuals with regular income. If you complete all payments under a chapter 13 debt adjustment plan for an individual with regular income, the court may grant you a discharge of debts, **including** a discharge of the second and seventh priority prepetition taxes described earlier. However, if you fail to complete all payments under the plan, these taxes are not discharged although the court may grant a discharge of other debts in limited circumstances.

Debt Cancellation

If a debt is canceled or forgiven, other than as a gift or bequest, the debtor generally must include the canceled amount in gross income for tax purposes. A debt includes any indebtedness for which the debtor is liable or which attaches to property the debtor holds.

Exceptions and Exclusions

There are several exceptions and exclusions from the inclusion of canceled debt in income. The exceptions include:

- 1) The cancellation of a student loan for a student required to work for certain employers. See *Cancellation of student loan*

in Publication 525, *Taxable and Nontaxable Income*.

- 2) The cancellation of debt that would have been deductible if paid. See *Canceled debt* in Chapter 7 of Publication 334, *Tax Guide for Small Business*.
- 3) The reduction of a debt by the seller of property if the debt arose from the purchase of the property. See *Canceled debt* in Chapter 7 of Publication 334.

The exclusions are discussed next.

Exclusions

Do **not** include a canceled debt in gross income if any of the following situations apply:

- The cancellation takes place in a bankruptcy case under the U.S. Bankruptcy Code. See *Bankruptcy case exclusion*, later.
- The cancellation takes place when you are insolvent (see *Insolvency exclusion*, later), and the amount excluded is not more than the amount by which you are insolvent.
- The canceled debt is qualified farm debt (debt incurred in operating a farm). See Chapter 4 of Publication 225, *Farmer's Tax Guide*.
- The canceled debt is qualified real property business indebtedness (certain debt connected with business real property). See Chapter 7 of Publication 334.

Order of exclusions. If the cancellation of debt occurs in a Title 11 bankruptcy case, the bankruptcy exclusion takes precedence over the insolvency, qualified farm debt, or qualified real property business indebtedness exclusions.

To the extent that the taxpayer is insolvent, the insolvency exclusion takes precedence over qualified farm debt or qualified real property business indebtedness exclusions.

Bankruptcy case exclusion. A bankruptcy case is a case under title 11 of the United States Code, but only if the debtor is under the jurisdiction of the court and the cancellation of the debt is granted by the court or occurs as a result of a plan approved by the court.

None of the debt canceled in a bankruptcy case is included in your gross income in the year canceled. Instead, certain losses, credits, and basis of property must be reduced by the amount of excluded income (but not below zero). These losses, credits, and basis in property are called tax attributes and are discussed under *Reduction of Tax Attributes*, later.

Insolvency exclusion. You are insolvent when, and to the extent, your liabilities exceed the fair market value of your assets. Determine your liabilities and the fair market value of your assets immediately before the cancellation of your debt to determine whether or not you are insolvent and the amount by which you are insolvent.

Exclude from your gross income debt canceled when you are insolvent, but only up to

the amount by which you are insolvent. However, you **must** use the amount excluded to reduce certain tax attributes, as explained later under *Reduction of Tax Attributes*.

Example. \$4,000 of the Simpson Corporation's liabilities are cancelled outside bankruptcy. Immediately before the cancellation, the Simpson Corporation's liabilities totaled \$21,000 and the fair market value of its assets was \$17,500. Because its liabilities were more than its assets, it was insolvent. The amount of the insolvency was \$3,500 (\$21,000 – \$17,500).

The corporation may exclude only \$3,500 of the \$4,000 debt cancellation from income because that is the amount by which it was insolvent. It must also reduce certain tax attributes by the \$3,500 of excluded income. The remaining \$500 of canceled debt must be included in income.

Reduction of Tax Attributes

If a debtor excludes canceled debt from income because it is canceled in a bankruptcy case or during insolvency, he or she **must** use the excluded amount to reduce certain "tax attributes." Tax attributes include the basis of certain assets and the losses and credits listed next. By reducing these tax attributes, tax on the canceled debt is in part postponed instead of being entirely forgiven. This prevents an excessive tax benefit from the debt cancellation.

If a separate bankruptcy estate was created, the trustee or debtor-in-possession must reduce the estate's attributes (but not below 0) by the canceled debt. See *Individuals under chapter 7 or chapter 11*, later.

Order of reduction. Generally, use the amount of canceled debt to reduce the tax attributes in the order listed below. However, you may choose to use all or a part of the amount of canceled debt to first reduce the basis of depreciable property before reducing the other tax attributes. This choice is discussed later.

Net operating loss. First, reduce any net operating loss for the tax year in which the debt cancellation takes place, and any net operating loss carryover to that tax year.

General business credit carryovers. Second, reduce any carryovers, to or from the tax year of the debt cancellation, of amounts used to determine the general business credit.

Minimum tax credit. Third, reduce any minimum tax credit that is available as of the beginning of the tax year following the tax year of the debt cancellation. This only applies to debt canceled in tax years beginning after 1993.

Capital losses. Fourth, reduce any net capital loss for the tax year of the debt cancellation, and any capital loss carryover to that year.

Basis. Fifth, reduce the basis of your property as described under *Basis Reduction*, later. This reduction applies to the basis of both depreciable and nondepreciable property.

Passive activity loss and credit carryovers. Sixth, reduce any passive activity loss

or credit carryover from the tax year of the debt cancellation. This only applies to debt canceled in tax years beginning after 1993.

Foreign tax credit. Last, reduce any carryover, to or from the tax year of the debt cancellation, of an amount used to determine the foreign tax credit or the Puerto Rico and possession tax credit.

Amount of reduction. Except for the credit carryovers, reduce the tax attributes listed earlier one dollar for each dollar of canceled debt that is excluded from income. Reduce the credit carryovers by 33½ cents for each dollar of canceled debt that is excluded from income.

Making the reduction. Make the required reductions in tax attributes after figuring the tax for the tax year of the debt cancellation. In reducing net operating losses and capital losses, first reduce the loss for the tax year of the debt cancellation, and then any loss carryovers to that year in the order of the tax years from which the carryovers arose, starting with the earliest year. Make the reductions of credit carryovers in the order in which the carryovers are taken into account for the tax year of the debt cancellation.

Individuals under chapter 7 or chapter 11. In an individual bankruptcy under chapter 7 (liquidation) or chapter 11 (reorganization) of title 11 of the United States Code, the required reduction of tax attributes must be made to the attributes of the bankruptcy estate, a separate taxable entity resulting from the filing of the case. Also, the **trustee of the bankruptcy estate must make the choice** of whether to reduce the basis of depreciable property first before reducing other tax attributes. See the discussion of *The Bankruptcy Estate*, earlier.

Basis Reduction

If any amount of the debt cancellation is used to reduce the basis of assets as discussed under *Reduction of Tax Attributes*, the following rules apply to the extent indicated.

When to make the basis reduction. Make the reduction in basis at the beginning of the tax year following the tax year of the debt cancellation. The reduction applies to property held at that time.

Bankruptcy and insolvency reduction limit. The reduction in basis because of canceled debt in bankruptcy or in insolvency cannot be more than the total basis of property held immediately after the debt cancellation, minus the total liabilities immediately after the cancellation. This limit does not apply if an election is made to reduce basis before reducing other attributes. This election is discussed later.

Exempt property under title 11. If debt is canceled in a bankruptcy case under title 11 of the United States Code, make no reduction in basis for property that the debtor treats as exempt property under section 522 of title 11.

Election to reduce basis first. You (the estate in the case of an individual bankruptcy

under chapter 7 or 11) may choose to reduce the basis of depreciable property before reducing any other tax attributes. However, this reduction of the basis of depreciable property cannot be more than the total basis of depreciable property held at the beginning of the tax year following the tax year of the debt cancellation.

Depreciable property means any property subject to depreciation, but only if a reduction of basis will reduce the amount of depreciation or amortization otherwise allowable for the period immediately following the basis reduction. You may choose to treat as depreciable property any real property that is stock in trade or is held primarily for sale to customers in the ordinary course of trade or business. You must generally make this choice on the tax return for the tax year of the debt cancellation, and, once made, you can only revoke it with IRS approval. However, if you establish reasonable cause, you may make the choice with an amended return or claim for refund or credit.

Making elections. Make the election to reduce the basis of depreciable property before reducing other tax attributes as well as the election to treat real property inventory as depreciable property, on Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*.

Recapture of basis reductions. If any basis in property is reduced under these provisions and is later sold or otherwise disposed of at a gain, the part of the gain that is attributable to this basis reduction is taxable as ordinary income. Figure the ordinary income part by treating the amount of this basis reduction as a depreciation deduction and by treating any such basis-reduced property that is not already either section 1245 or section 1250 property as section 1245 property. In the case of section 1250 property, make the determination of what would have been straight line depreciation as though there had been no basis reduction for debt cancellation. Sections 1245 and 1250 and the recapture of gain as ordinary income are explained in *Chapter 4, Dispositions of Depreciable Property*, in Publication 544, *Sales and Other Dispositions of Assets*.

Partnerships

If a partnership's debt is canceled because of bankruptcy or insolvency, the rules for the exclusion of the canceled amount from gross income and for tax attribute reduction are applied at the individual partner level. Thus, each partner's share of debt cancellation income must be reported on the partner's return unless the partner meets the bankruptcy or insolvency exclusions explained earlier. Then all choices, such as the choices to reduce the basis of depreciable property before reducing other tax attributes, to treat real property inventory as depreciable property, and to end the tax year on the day before filing the bankruptcy case, must be made by the individual partners, not the partnership.

Depreciable property. For purposes of reducing the basis of depreciable property in attribute reduction, a partner treats his or her partnership interest as depreciable property to the extent of the partner's proportionate interest in the partnership's depreciable property. This applies only if the partnership makes a corresponding reduction in the partnership's basis in its depreciable property with respect to the partner.

Partner's basis in partnership. The allocation of an amount of debt cancellation income to a partner results in that partner's basis in the partnership being increased by that amount. At the same time, the reduction in the partner's share of partnership liabilities caused by the debt cancellation results in a deemed distribution, in turn resulting in a reduction of the partner's basis in the partnership. These basis adjustments are separate from any basis reduction under the attribute-reduction rules described earlier.

Corporations

Corporations in a bankruptcy proceeding or insolvency generally follow the same rules for debt cancellation and reduction of tax attributes as an individual or individual bankruptcy estate would follow. However, a different rule may exist when a corporation's stock is transferred in exchange for its own debt. This stock for debt exception is repealed for transfers made after 1994 unless the corporation filed for bankruptcy (or a similar court proceeding) before 1994. The principal difference between the stock for debt exception and the general treatment is that the corporation does not reduce its tax attributes under the stock for debt exception.

Stock for Debt Rules

If a corporation transfers its stock in satisfaction of indebtedness and the fair market value of its stock is less than the indebtedness it owes, the corporation has income (to the extent of the difference) from the cancellation of indebtedness. After 1994, a corporation can exclude all or a portion of the income created by the stock for debt transfer if it is in a bankruptcy proceeding or, if not in a bankruptcy proceeding, it can exclude the income to the extent it is insolvent. However, the corporation must reduce its tax attributes (to the extent it has any) by the amount of excluded income.

Stock for debt exception. Generally, before 1995, a corporation does not realize income because of such stock for debt exchanges if it is in bankruptcy or to the extent it is insolvent. Consequently, there is no gross income to exclude and no reduction of its tax attributes is necessary. This provision applies only to stock transferred before 1995 in satisfaction of its debt, unless the bankruptcy (or a similar court procedure) was filed before 1994.

De minimis exception. The stock for debt exception does not apply if:

- 1) The corporation issues nominal or token shares, or

- 2) The value of stock received by the creditor in exchange for cancellation of the debt is less than half the value of the stock that the creditor would receive if all the corporation's unsecured creditors taking part in the workout received a pro rata amount of stock issued.

A corporation that is in bankruptcy or to the extent that it is insolvent can exclude the debt cancellation income but it must reduce its tax attributes (to the extent it has any). A "workout" includes a title 11 bankruptcy case or other transaction or series of transactions involving a significant restructuring of the debt of a corporation in financial difficulty.

See IRS Regulation 1.108-1 and Revenue Procedure 94-26 for rules that can help you determine if an exchange of stock for debt qualifies for the stock for debt exception.

Example 1. Mr. Smith, a creditor, held \$1,000 of unsecured debt against a debtor corporation. In 1993, debtor corporation filed a chapter 11 bankruptcy proceeding. In 1994, in accordance with a confirmed plan of reorganization, the corporation fully satisfied \$10,000 of its unsecured debt by the transfer of \$6,000 (60% of the debt canceled) of its stock to creditors. Mr. Smith must receive at least \$300 ($\$1,000 \times 60\% = \$600 \times 50\%$) of stock in satisfaction of his claim in order for the debtor corporation to rely on the rule that it has no debt discharge amount with respect to the cancellation of Mr. Smith's claim in exchange for stock. If Mr. Smith receives only \$100 of stock for his \$1,000 debt, then the debtor corporation will have a debt discharge amount of \$900 with respect to Mr. Smith. Because the corporation is in bankruptcy, it does not include the \$900 in income. However, it must reduce its tax attributes, if any, by the \$900 amount.

Example 2. The facts are the same as in Example 1, except that the corporation is not bankrupt or insolvent. In this case, regardless of the value of the stock Mr. Smith receives in satisfaction of the debt, the corporation realizes debt cancellation income for Mr. Smith's claim equal to the difference between the \$1,000 debt and the fair market value of the stock transferred to him.

Example 3. Assume the same facts as are in example 1, except that the corporation filed for bankruptcy in 1995. As the result of any subsequent workout, the corporation must reduce its tax attributes by an amount equal to the difference between the \$1,000 debt and the fair market value of the stock transferred to him.

Earnings and Profits

The earnings and profits of a corporation do not include income from the discharge of indebtedness to the extent of the amount applied to reduce the basis of the corporation's property as explained earlier. Otherwise, discharge of indebtedness income, including amounts excluded from gross income, increases the earnings and profits of the corporation (or reduces a deficit in earnings and profits).

If there is a deficit in the corporation's earnings and profits and the interest of any shareholder of the corporation is terminated or extinguished in a title 11 or similar case (defined earlier), the deficit must be reduced by an amount equal to the paid-in capital allocable to the shareholder's terminated or extinguished interest.

S Corporations

For S corporations, the rules for excluding income from debt cancellation because of bankruptcy or insolvency apply at the corporate level.

Net operating losses. A loss or deduction that is disallowed for the tax year of the debt cancellation because it exceeds the shareholders' basis in the corporation's stock and debt is treated as a net operating loss for that tax year in making the required reduction of tax attributes for the amount of the canceled debt.

Example of Tax Attribute Reduction

The sample filled-in Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*, shown in this publication is based on the following situation.

Tom Smith is in financial difficulty, but he has been able to avoid declaring bankruptcy. In 1993, he reached an agreement with his creditors, whereby they agreed to forgive \$10,000 of the total that he owed them, in return for his setting up a schedule for repayment of the rest of his debts.

Immediately before the debt cancellation, Tom's liabilities totaled \$120,000 and the fair market value of his assets was \$100,000 (his total basis in all these assets was \$90,000). At the time of the debt cancellation, he was considered insolvent by \$20,000. He can exclude from income the entire \$10,000 debt cancellation because it was not more than the amount by which he was insolvent.

Among Tom's assets, the only depreciable asset is a rental condominium with an adjusted basis of \$50,000. Of this, \$10,000 is allocable to the land, leaving a depreciable basis of \$40,000. During the tax year of the debt cancellation, he had a net capital loss of \$5,000 resulting from sales of stock at a loss. He also has a net operating loss carryover to this year of \$3,000 from a previous tax year.

Tom's adjusted gross income for the year, without considering the debt cancellation, the capital loss, or the net operating loss carryover, is \$20,000. He does not itemize deductions, and he has no general business credit or foreign tax credit arising in the year of the debt cancellation or carried to this year.

Ordinarily, in applying the \$10,000 debt cancellation amount to reduce tax attributes, Tom would first eliminate his \$3,000 net operating loss carryover, and then his \$5,000 net capital loss. He would then have \$2,000 remaining to apply to basis reduction, but would not have to reduce basis because his total basis in assets (\$90,000) was less than his total

liabilities, immediately after the debt cancellation ($\$120,000 - \$10,000 = \$110,000$).

However, Tom figures that it is better for him to preserve his current deductions of \$3,000 for the net operating loss carryover and \$3,000 for the net capital loss, plus the \$2,000 capital loss carryover ($\$5,000 - \$3,000$) to the following year. (Only \$3,000 of a net capital loss can be applied to offset other income in any one tax year.) He can do this by choosing

to reduce the basis of his depreciable property before making other tax attribute reductions.

Tom elects to reduce basis first. Therefore, he can reduce the depreciable basis of his rental condominium (his only depreciable asset) by \$10,000. The tax effect of doing this will be to reduce his depreciation deductions for years following the year of the debt cancellation. However, if he later sells the condominium at a gain, the part of the gain attributable to

the basis reduction will be taxable as ordinary income.

Tom must file Form 982, as shown here, with his individual return (Form 1040) for the tax year of the debt discharge. In addition, he must attach a statement describing the debt cancellation transaction and identifying the property to which the basis reduction applies. This statement is not illustrated. Form 982 for Tom Smith

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

OMB No. 1545-0046
 Expires: 1-31-95
 Attachment Sequence No. **94**

Caution: **DO NOT** use this version for discharge of indebtedness in tax years beginning after 1993.
 ▶ Attach this form to your income tax return.

Tom Smith

Identifying number
000-00-0000

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 after 1992 of qualified real property business indebtedness
- 2 Total amount of discharged indebtedness excluded from gross income. 210,000
- 3 Do you elect to treat all real property described in section 1221(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 the transactions resulting in the reduction in basis under section 1017.)

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 10,000
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 net capital loss for the tax year of the discharge including any capital loss carryovers to the tax year of the discharge	8
9 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>	9
10 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. 10a b Land used or held for use in a trade or business of farming 10b c Other property used or held for use in a trade or business, or for the production of income 10c 	10a 10b 10c
11 Applied to reduce any foreign tax credit carryover to or from the tax year of the discharge	11

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

The corporation named above has excluded under section 1081(b) of the Internal Revenue Code \$ _____ 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) of the Internal Revenue Code 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.

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.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated average time is:

- Recordkeeping 4 hr., 47 min.
- Learning about the law or the form 1 hr., 53 min.
- Preparing and sending the form to the IRS 2 hr., 5 min.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form more simple, we would be happy to hear from

you. You can write to both the IRS and the Office of Management and Budget at the addresses listed in the instructions for the tax return with which this form is filed.

General Instructions

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

Purpose of Form.—Generally, the amount you receive from the discharge of indebtedness is included in your gross income. However, under certain circumstances described in section 108, you may exclude the amount of discharged indebtedness from your gross income. Unless you check the box on line 1d or make the election on line 5, the amount excluded from gross income is applied to reduce certain tax attributes dollar for dollar (see exceptions for lines 7 and 11) in the following order:

- Any net operating loss (NOL) for the tax year of the discharge (and any NOL carryover to that year);
- Any general business credit carryover to or from the tax year of the discharge;
- Any net capital loss for the tax year of the discharge (and any capital loss carryover to that tax year);
- Basis of property; and
- Any foreign tax credit carryover to or from the tax year of the discharge.

Caution: For discharges of indebtedness in tax years beginning after 1993, the Revenue Reconciliation Act of 1993 requires minimum tax credits and passive activity loss and credit carryovers to be reduced in addition to the attributes listed above. Do not use this version of Form 982 for discharges in tax years beginning after 1993; a new version will be available in January 1995 for these discharges.