



Tax Item. Deduction or Credit for Amounts You Repaid

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Deduction or Credit for Repayments

If you included an amount in your income one year because you thought you had an unrestricted right to it, but you had to repay it in a later year, you can deduct it or, in some cases, take a tax credit for it.

Caution: This item does not cover:

- Repayments of social security or equivalent railroad retirement benefits. Get **Publication 915, Social Security and Equivalent Railroad Retirement Benefits.**
- Repayments of other railroad retirement benefits. Get **Publication 575, Pension and Annuity Income.**
- Bad debts. For business bad debts get **Publication 535, Business Expenses.** For nonbusiness bad debts get **Publication 550, Investment Income and Expenses (Including Capital Gains and Losses).**
- Deductions from sales to customers, such as returns and allowances, and similar items. Use **Schedule C (Form 1040), Profit or Loss From Business.**

When to Take Deduction or Credit

If, like most people, you use the cash method on your individual income tax return, take the deduction or credit for the tax year in which you actually make the repayment. (Under the cash method you report income when you receive it and expenses when you pay them.) If you use an accrual method of accounting, deduct the repayment or take the credit for the tax year in which the obligation to make the repayment accrues.

Deduction if You Repaid \$3,000 or Less

For a repayment of \$3,000 or less, take a deduction. In general, you report the deduction on the same form or schedule you used to report the income. This chart covers the following situations:

| IF you reported the amount as: | THEN deduct the repayment as: |
|--|---|
| wages, unemployment compensation, or other ordinary income (such as alimony or "other income") | an itemized deduction on Schedule A (Form 1040), Itemized Deductions , line 27. |
| income from your business | a deduction on Schedule C (Form 1040), Profit or Loss From Business , Part II, line 27, or Schedule C-EZ (Form 1040), Net Profit From Business. |

| IF you reported the amount as: | THEN deduct the repayment as: |
|--|--|
| supplemental unemployment benefits (benefits from a company-financed benefit plan to which you did not contribute) that you: <ul style="list-style-type: none"> ● included in wages on your prior year's return and ● repaid to qualify for a trade readjustment allowance under the Trade Act of 1974 (a type of unemployment compensation) | an adjustment to income on Form 1040, line 31. On the dotted line beside your entry write "Sub-pay TRA" and the amount you repaid. |
| capital gain | a capital loss on Schedule D (Form 1040) , <i>Capital Gains and Losses</i> . |
| rental real estate (not a business) or royalties | a deduction on Schedule E (Form 1040) , <i>Supplemental Income and Loss</i> , line 18. |
| farm income | a deduction on Schedule F (Form 1040) , <i>Profit or Loss From Farming</i> , line 34. |

Deduction or Credit if You Repaid More Than \$3,000

If you repaid more than \$3,000, you have a choice. You can take a deduction as you would if the repayment were \$3,000 or less, or you can take a credit. You should take the one that gives you the lower tax. The following example and the worksheet on the next page may help you decide which to take.

Example. On your 1996 return you used single filing status and reported income on the cash method. In 1997 you repaid \$5,000 that you had included in your 1996 income when you thought you had an unrestricted right to it. Your filing status in 1997 is the same as in 1996. Your income and tax for both years are as follows:

| | | |
|----------------|--------------------------------|-----------------------------|
| | <u>1996, With Income</u> | <u>1996, Without Income</u> |
| Taxable Income | \$15,000 | \$10,000 |
| Tax | \$ 2,254 | \$ 1,504 |
| | <u>1997, Without Deduction</u> | <u>1997, With Deduction</u> |
| Taxable Income | \$49,950 | \$44,950 |
| Tax | \$10,789 | \$ 9,389 |

You complete the worksheet as follows:

| <u>On line:</u> | <u>You enter:</u> | |
|-----------------|-------------------|-----------------------------------|
| 1 | \$9,389 | |
| 2a | \$10,789 | |
| 2b | \$2,254 | |
| 2c | \$1,504 | |
| 2d | \$ 750 | ($\$2,254 - \$1,504 = \$750$) |
| 2e | \$10,039 | ($\$10,789 - \$750 = \$10,039$) |

For line 2f you compare the amounts on lines 1 and 2e. You see that the lower tax is on line 1. You decide to take a deduction for the amount you repaid, rather than a credit.

**Worksheet:
Deduction or
Credit if You
Repaid More
Than \$3,000**

This worksheet may help you decide whether it is to your benefit to take a credit or a deduction for your repayment.

| Worksheet to Choose Deduction or Credit for Repayment (Do not file worksheet) | | |
|--|---|--|
| 1 | Figure your tax for 1997. Deduct the repayment as you would do if it were \$3,000 or less. Enter the tax here. This will be your tax if you take a deduction for the amount you repaid. | > 1 |
| 2 | a Refigure your tax for 1997 without deducting the amount you repaid. Enter the tax here. | 2a |
| | b Enter the tax shown on your return for the earlier year. | 2b |
| | c Refigure your tax from the earlier year. This time do NOT include in income the amount you repaid in 1997. | 2c |
| | d Tax difference in earlier year for amount you repaid in 1997. Subtract line 2c from line 2b. | 2d |
| | e Your tax for 1997 if you take a credit. Subtract line 2d from line 2a. | > 2e |
| f Compare lines 1 and 2e: | | |
| IF the lower amount is on ... | | THEN... |
| > Line 1 | | Deduct the repayment as you did for line 1, above. Enter the deduction on your return as explained under <i>Deduction if You Repaid \$3,000 or Less</i> , earlier. |
| > Line 2e | | Claim a credit on line 59 of Form 1040, and write "IRC 1341" next to line 59. The credit is the amount from line 2d, above. |

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