Tax benefit rule Is §111.

Under the tax benefit rule receipt of an amount that was part of a deduction or credit taking an earlier tax year is considered a recovery and generally must be included in gross income in the year of receipt. §1.111–1.

§111. Recovery of Tax Benefit Items. Gross income does not include income attributable to the recovery during the taxable year of any amount deducted any prior taxable year, to the extent such amount <u>did not reduce the amount of tax</u> imposed.

IRS Publication 525 contains a worksheet for computing the amount of taxable itemized deduction recovered among other things:

-- (Page 23, First Middle Column) <u>Tax Benefit Rule.</u> You must include a recovery in your income in the year you receive it <u>up to the amount by which the deduction or credit you took for the recovered amount reduced your tax</u> in the earlier year. For this purpose, any increase to an amount carried over to the current year that resulted from the deduction or credit is considered to have reduced your tax in the earlier year.

-- (Page 28, First Column) <u>Total Recovery Not Included in Income.</u> If any part of the deduction you took for the recovered amount didn't reduce your tax, you may be able to exclude at least part of the recovery from your income. You must include the recovery in your income only up to the amount of the deduction that reduced your tax in the year of the deduction.

-- (Page 27) Worksheet 2. <u>Recoveries of Itemized Deductions</u>. A recovery is included in income only to the extent of the deduction amount that reduced your tax in the prior year (year of the deduction). If you were subject to the AMT or your tax credits reduced your tax to zero, see Unused tax credits and Subject to AMT under Itemized Deduction Recoveries. If your recovery was for an itemized deduction that was limited, you should read deductions limited under Itemized Deduction Recoveries.