MICHIGAN STATE UNIVERSITY | Extension

OPTIONS IN FORECLOSURE

Washtenaw County MSUE
Mortgage Foreclosure Intervention Program (734) 222-9595

MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007

On December 20, 2007, President Bush signed into law the "Mortgage Forgiveness Debt Relief Act of 2007". This Act, among other things, relieves the taxpayer from including cancelled debt arising out of home foreclosure as income.

To qualify, the home must be the taxpayer's "Principle Residence", or the non-business location where the tax payer and his or her family reside. This act applies to principle residence debt that is cancelled between JANUARY 1, 2007 AND DECEMBER 31, 2012. In the case of cancelled debt that is only partially for a mortgage on a principle residence, only that portion of the cancelled debt that applied to the mortgage of the principal residence can be excluded from the adjusted gross income. In other words, only acquisition debt or debt incurred to improve the home is protected under this legislation. If the borrower took a cash-out refinance to pay off credit cards or to purchase a car or take a vacation etc., that portion of the debt is not protected and the borrower will have to pay taxes against it.

The borrower will receive a form 1099-C from the lender. We suggest taxpayers contact a competent tax attorney to discuss how the Mortgage Forgiveness Debt Relief Act of 2007 impacts their tax liability. The law is complex and has a number of conditions and exemptions and only a qualified tax attorney can provide you with counsel regarding your options. This act does not take away the right of lenders to seek the deficiency for the debt resulting from a foreclosure or a short sale. Seek the advice of an attorney to discuss the implications of a debt incurred through foreclosure.

OTHER EXCEPTIONS TO THE CANCELLATION OF DEBT TAX REPORTED ON FORM1099-C

Cancellation of debt income reported on a 1099-C is not always taxable. The following are five additional exceptions to the general rule that cancellation of debt income is taxable:

1. **Bankruptcy:** Debt cancelled or forgiven through bankruptcy is not considered taxable income.
2. **Insolvency:** If you are insolvent when the debt is cancelled or forgiven, some or all of the cancelled debt may not be taxable to you. Generally, a taxpayer is insolvent when his total debts exceed the fair market value of his total assets. It is often difficult to determine whether or not a taxpayer is insolvent. If you think this applies to your situation, consult a professional before filing your income tax return.
3. **Farm debts:** If you incurred the debt directly in operation of a farm, you secure income from farming, and you secured the loan from an institution or agency regularly engaged in lending, you may be eligible for an exception.
4. **Non-recourse loans:** Forgiveness or cancellation of a non-recourse loan does not result in cancellation of debt income but may have other tax consequences.
5. **Student loans:** If a taxpayer's student loans are cancelled under an agreement with the government lender, then the taxpayer need not include such cancelled debt in his or her taxable income.

It is highly recommended that taxpayers consult a qualified tax professional to discuss these matters in further detail to determine the best course of action.

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