

MORTGAGE FORGIVENESS DEBT RELIEF ACT OF 2007

Under federal law, a creditor is required to file a form 1099-C whenever it forgives or cancels a loan balance greater than \$600. This may create a tax liability for the debtor because the canceled debt is considered "income" for tax purposes.

However, the Mortgage Forgiveness debt Relief Act of 2007 provides tax relief for some mortgage loans forgiven in 2007 through 2012. The Mortgage Forgiveness Debt Relief Act of 2007 allows taxpayers to exclude income from the discharge of debt on their principal residence.

What is the Mortgage Forgiveness Debt Relief Act of 2007?

The Mortgage Forgiveness Debt Relief Act of 2007 was enacted on December 20, 2007 (see News Release IR-2008-17). Generally, the Act allows exclusion of income realized as a result of modification of the terms of the mortgage, or foreclosure on your principal residence.

What does that mean?

Usually, debt that is forgiven or cancelled by a lender must be included as income on your tax return and is taxable. The Mortgage Forgiveness Debt Relief Act of 2007 allows you to exclude certain cancelled debt on your principal residence from income.

Does the Mortgage Forgiveness Debt Relief Act of 2007 apply to all forgiven or cancelled debts?

No, the Act applies only to forgiven or cancelled debt used to buy, build or substantially improve your principal residence, or to refinance debt incurred for those purposes.

The most common situations when cancellation of debt income is not taxable involve:

- **Qualified principal residence indebtedness:** This is the exception created by the Mortgage Debt Relief Act of 2007 and applies to most homeowners.
- **Bankruptcy:** Debts discharged through bankruptcy are not considered taxable income.
- **Insolvency:** If you are insolvent when the debt is cancelled, some or all of the cancelled debt may not be taxable to you. You are insolvent when your total debts are more than the fair market value of your total assets.
- **Certain farm debts:** If you incurred the debt directly in operation of a farm, more than half your income from the prior three years was from farming, and the loan was owed to a person or agency regularly engaged in lending, your cancelled debt is generally not considered taxable income.
- **Non-recourse loans:** A non-recourse loan is a loan for which the lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue you personally in case of default. Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income. However, it may result in other tax consequences.

These exceptions are discussed in detail in IRS Publication 4881.

What about refinanced homes?

Debt used to refinance your home qualifies for this exclusion, but only up to the extent that the principal balance of the old mortgage, immediately before the refinancing, would have qualified.