

Congress Extends Mortgage Forgiveness Debt Relief

The mortgage debt relief provisions for homeowners in the federal tax code, first enacted in 2007, expired at midnight on December 31, 2012. However, the fiscal cliff bill enacted at the 13th hour by Congress extended the relief through the end of 2013. This was one of the biggest issues in the fiscal cliff debate because there are still huge numbers of financially distressed homeowners with underwater mortgages. Had Congress not acted, the tax code would have reverted to its pre-2007 treatment of mortgage principal reductions or cancellations by lenders, whether through loan modifications, short sales, deeds-in-lieu, or foreclosures.

Without the extension, all principal balances unpaid by the homeowner and forgiven by the lender would have been treated as ordinary income to the homeowner. For example, if a lender wrote off \$200,000 of mortgage debt to facilitate a loan modification or short sale, the borrower or seller would have been taxed on that \$200,000 at regular marginal rates, just as if he or she had earned it as wages.

The Mortgage Forgiveness Debt Relief Act of 2007 (the Act) (Pub L 110-142, 121 Stat 1803) and its extending amendment allowed exclusion of income realized as a result of debt reduction on the taxpayer's principal residence. See IRS, Ten Facts for Mortgage Debt Forgiveness

(Mar. 3, 2011). See also IRS Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments 2011. Under the Act, taxpayers may exclude debt forgiven on their qualified principal residence up to \$2 million (\$1 million for a married person filing a separate return). IRC §§108(h)(2), 163(h)(3)(B)(ii). The law as originally enacted applied to debt forgiven in calendar years 2007, 2008, and 2009. Pub L 110-142, §2(a), (d), 121 Stat 1803. A 2008 amendment to the Act, applicable to discharges of indebtedness occurring on or after January 1, 2010, extended the Act through 2012. Pub L 110-343, Div A, Title III, §303, 122 Stat 3765. The fiscal cliff bill extended it through the calendar year 2013.

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