

Debt Cancelled After Foreclosure May Be Exempt From Taxable Income

Are you one of the many Americans who have had their homes foreclosed on recently? If you are and part or all of your debt has been forgiven, you must report the forgiven debt to the IRS on your tax return as though it were regular income. To provide relief to homeowners, Congress passed the Mortgage Forgiveness Debt Relief Act in 2007, which exempts certain types of forgiven debt from taxation.

How do you know if you qualify? If a lender forgave all or part of your debt, you should have received form 1099-C. If you have, the debt was forgiven in 2007 or 2008, the money borrowed was used to buy, build, or substantially improve your primary home, and your primary home secured that debt, you may exclude the forgiven debt from your income. You must file form 982 with your tax return and explain why you qualify.

If you borrowed money to refinance a mortgage on your primary home, the forgiven debt also is eligible for exclusion, but only up to the amount of the old principal right before refinancing. Debt that is forgiven in 2009 will qualify under this Act as well. However, debt forgiven on second homes, rental property, business property, credit cards, or car loans does not qualify for relief. In some cases, however, other kinds of tax relief based on insolvency may be available.

If you have already filed your 2007 tax returns and think you may have been eligible to exclude the forgiven debt, you can still file an amended return. Everyone who has had debt forgiven as part of foreclosure in 2007 or 2008 should visit the IRS website (www.irs.gov) for helpful information, or consult with a tax professional to see whether they can take advantage of this relief.

Dan Artav is a second-year law student at Michigan State University College of Law, and is a clinician at the MSU Tax Clinic (336-8088). He received his bachelor's degree from Kalamazoo College and plans to pursue a career in international commercial law.