

Calculating Income After Foreclosure

The increased home foreclosure rate Michigan is an unfortunate effect of current economic conditions. During a foreclosure, it can be easy to forget that tax issues will remain after the sale. If faced with an imminent home foreclosure, there are a few things mortgage borrowers should be aware of. One of the most important considerations is determining whether the Internal Revenue Service will require the borrower to recognize income from the foreclosure through cancellation of debt income or recognition of capital gains income.

If debt is forgiven, the mortgage lender is required to send the mortgage borrower and the Internal Revenue Service a 1099-C, cancellation of debt form. The mortgage lender may also send a 1099-A, Acquisition or Abandonment of Secured Property form, if the circumstances demand. These two forms are vital to a borrower's understanding of whether or not the IRS will recognize income from the foreclosure.

Cancellation of debt income is created when the mortgage lender relieves the borrower of part or all of the difference between the sale price of the home and the amount the borrower had left to pay on the mortgage. The amount is cancelled most typically because the lender is unable to collect the outstanding balance owed from the borrower. The cancelled debt is then reported to the IRS as income, but is not necessarily taxable. Bankruptcy, insolvency, certain farm debts, and a non-recourse loan are exceptions to the general rule that cancelled debt is taxable income.

Taxable income from a home foreclosure sale can also arise in the form of capital gains income. If gain results from a home foreclosure sale, the borrower must attach form 1099-A and account for the income correctly on his income tax return.

The federal tax laws regarding home foreclosures have been clarified and are discussed at www.irs.gov.

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