The Judicial Title Insurance Agency LLC
YOUR TITLE EXPERTS

WESTCHESTER
800 Westchester Ave
Suite S340
Rye Brook, NY 10573
Tel: (914) 381-6700
Fax:(914) 381-3131

NEW YORK CITY
114 West 47th Street, 19th Fl.
New York, NY 10036
800-281-TITLE (8485)
Tel: (212) 432-3272
Fax: 800-FAX-9396

http://www.judicialtitle.com

TAKE JUDICIAL NOTICE

Tax Test on Cancelled Debt

March 21, 2011

With the tax deadline rapidly approaching and almost every other deal involving a short sale or modification a review of the tax implications for homeowners involved in those situations is appropriate.

Normally, when any creditor cancels a debt the result is ordinary taxable income. So when a bank forgives a student loan or the unpaid balance on a credit card, those amounts are treated as taxable income by the IRS. Notwithstanding, congress has carved out a few special rules for homeowners in distress.

A close look at the rules is critical. In order for a homeowner to qualify for special treatment, and avoid paying tax on the debt forgiven in a short sale the following test is essential to understand.

- The debt the lender cancelled must have been used by the homeowner “to buy, build or substantially improve your principal residence.”

- Focus on the words. Only your main residence qualifies. It can’t be a second home or an investment condo. Then look at the purpose of the loan. Only a qualifying purpose relieves the tax burden. The unpaid mortgage balance cancelled by your lender in a modification or short sale must have been used to acquire or build.

- Refinanced mortgage debt used to consolidate bills or pay college tuition doesn’t pass the test.

- Finally, keep in mind that debt cancellation relief is capped at $1,000,000 for individuals filing separately and $2,000,000 for married taxpayers.

- For further information see IRS Form 982 and Publication 4681.

- If you’ve had mortgage debt cancelled make sure you receive a 1099-C from the lender.