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DEBT RELIEF FROM “SELLING” YOUR HOME

By Victor Sy, CPA, MBA

As the economy bears down from the weight of the sub-prime mortgage mess, folks like you and me get more pressure to financially survive as we see layoffs and foreclosures. The distress of losing one's home does not end with that terrible experience; there are taxes to contend with as a result of debt relief foreclosures. Most taxpayers think that foreclosures produce losses all the time. They may. However, if the loan exceeds the basis of your house, you could end up with ordinary income from forgiveness of debt. This is not surprising at all because some of you have refinanced and cashed out your profits tax-free. There comes a time when taxes on that profit have to be paid. That time could be now. To make things worse, values have plummeted resulting in loans that could substantially exceed the value of your house.

After you lose your home and are faced with potential tax problems, would it not be just fine if you could “sell” your house to a company that would then have the house foreclosed on its name and absorb the debt relief itself? You would not receive that dreaded Form 1099 for debt relief.

Apparently, this is what Boston Harbor Corporation and other companies have been doing. You, the property owner, turns your property over to the corporation that then negotiates a short sale with the lender. You are promised not to receive any 1099 since you are led to believe that this is not a taxable event. You would then deed your property over to the company to change the owner of record. Boston Harbor and other companies claim that the transaction represents a sale. Since the corporation (not you) transact with the bank, that corporation (not you) receives a 1099 for forgiveness of debt.

Folks, this plan does not work. The IRS in a press release stated that the transfer is not a bonafide sale. It does not affect the forgiveness of debt reporting requirement. When the property is sold or foreclosed, you (the homeowner) not the corporation, realizes debt relief income. Furthermore, the IRS stated that you would be subject to penalties if you use this scheme.

While it is nice to be creative, “selling” your property to Boston Harbor and similar corporations just does not cut it. I suggest that you consult your tax adviser before proceeding. You certainly do not want to create another problem. You have enough problems in just dealing with current foreclosure and tax concerns. Sorry.