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10 TIPS ON MORTGAGE DEBT FORGIVENESS

By Victor Sy, CPA

If your mortgage loan is forgiven, you end up with income from cancellation of debt. Here are 10 tips to exclude the forgiven debt from your income.

1. Cancellation of debt (COD) or debt forgiveness **results in taxable income**; however, you may be able to **exclude** the income (meaning you don't have to pay tax on it) under the Mortgage Forgiveness Debt Relief Act of 2007.
2. The limit of debt forgiveness relief on your **principal residence** is up to \$2 million (\$1 million for a married person filing a separate return).
3. To qualify, the debt must have been used to **buy, build or substantially improve your principal residence** and be secured by that residence.
4. Refinanced debt proceeds used for the purpose of **substantially improving your principal residence** also qualify for the exclusion.
5. You may exclude debt reduced through **loan modification**, as well as mortgage debt forgiven in a **foreclosure**.
6. Discuss **insolvency, bankruptcy**, and other tax relief provisions that may help you escape the terrible cancelation of debt income. Remember that COD results in ordinary income (higher tax rates) rather than the capital gains tax rates (lower tax rates).
7. But proceeds of refinanced debt used for **other purposes (travel, purchase a car, or pay off credit card debt)** do not qualify for the exclusion. Sorry.
8. Debts forgiven on **second homes, credit cards, or car loans do not qualify** for the tax relief provision. Sorry again.
9. If you qualify, you must also fill out **Form 982 Reduction of Tax Attributes Due to Discharge of Indebtedness**, and attach it to your federal income tax return for the tax year in which the qualified debt was forgiven.
10. If your debt is reduced or eliminated you normally receive a dreaded year-end statement, **Form 1099-C, Cancellation of Debt**, from your lender. By law, this form must show the amount of debt forgiven and the fair market value of any property foreclosed. Examine the Form 1099-C carefully. Notify the lender immediately if any of the information shown is incorrect. You should pay particular attention to the amount of debt forgiven in Box 2 as well as the value listed for your home in Box 7.