

### SHORT SALES IN CALIFORNIA - Q & A

By Victor Sy, CPA

A short sale occurs when you sell your property for a price that is short of the balance owed to avoid a foreclosure - with the consent of your lender. Let's define recourse and non-recourse loans and discuss variations when the property is outside California or if you move into or out of California. Here are some questions and answers for you:

#### What Is A Recourse Loan?

- Lender can come after you for the deficiency (difference between loan balance & fair market value/sales price).
- You can end up with both capital gain/loss and cancellation of debt (COD or debt relief) income.
- Capital gain or loss is the difference between the sales price and the adjusted basis (cost) of your property.
- Debt relief income is the difference between your property's fair market value and outstanding loan balance.
- Fair market value becomes the deemed sales price.
- Debt relief is ordinary income (instead of capital gain that is taxed at lower rates).
- COD becomes income in the year the lender forgives the deficiency.
- Purchase money loans (meaning original loans when you bought the property) are non-recourse.
- Refinanced loans and equity loans become recourse loans.

#### What Is A Non-Recourse Loan?

- Lender's only remedy is to repossess the property used as collateral.
- Lender cannot come after you for deficiency.
- Foreclosure or short sale could result in either capital gain or loss.
- But it does not generate COD income. ☺
- The debt is treated as part of amount realized.
- Non-recourse loan states include [Alaska](#), [Arizona](#), [California](#), [Connecticut](#), [Idaho](#), [Minnesota](#), [North Carolina](#), [North Dakota](#), [Oregon](#), [Texas](#), [Utah](#), and [Washington State](#).

#### What If The Property Is Located In Another State?

- Treatment of recourse or non-recourse loans depends on the laws of the state where the property is located.
- Each state has its own set of rules concerning what a creditor/lender can do to collect a debt.
- California's rules are not binding in other states.

#### What If You Change State Of Residency During The Year?

- Let's start with a basic premise - a [California resident](#) is taxed on all income, regardless of its source.
- A [part-year resident](#) is taxed on all income while you were a resident of this state, regardless of source, plus for any part of the taxable year the taxpayer was a nonresident for income derived from sources within this state.
- A [nonresident](#) is taxed if you have California-source income.
- If the lender does not discharge the indebtedness [until after you have become a California resident](#), it would be [taxable to California](#), regardless of where the property is located. Ouch!

#### What Forms Do Lenders File With The IRS?

- Form [1099A](#) is issued when a [borrower abandons](#) secured property, or when a [lender acquires](#) property in full or partial satisfaction of a debt and the property was used as security for the debt.
  - Transaction is treated as a [deemed sale](#).
  - Use the outstanding debt as your sales price.
- Form [1099C](#) is issued once a [creditor abandons a right to collect](#) a balance due (deficiency)
  - In other words, you do not have COD income until the creditor abandons the right to collect.
  - It is the [discharge of indebtedness that results in the realization of income](#).
  - If creditor does [not](#) cancel the debt and decides to pursue collection, you would [not](#) have COD income.