

Deficiency Judgments and Tax Consequences for Short Sales and Foreclosures

Arizona's Anti-Deficiency Statutes

If you sell your home in a short-sale or if it is foreclosed on, a lender may pursue a deficiency judgment against you for the difference loan balance and the greater of either the winning bid at the foreclosure sale or the fair market value property on the date of the sale. In Arizona, a lender may seek a deficiency judgment under A.R.S. §33-729(A) which pertains to purchase money mortgages or A.R.S. §33-814(G) which deals with deeds of trust.* These anti-deficiency statutes apply only to real estate that does not exceed two and a half acres, and that is either a single one-family or single two-family dwelling. These statutes do not differentiate between primary residences and investor properties. Contrary to popular sentiment, investors are protected as well. These statutes do not however protect commercial borrowers, raw land borrowers or borrowers on properties with more than two units. **

Tax Consequences

Generally, it is also important to consider the tax consequences when disposing of a distressed property. One must determine whether the loan on the property is recourse or non-recourse. If the debt is "recourse," the debtor is personally liable for the debt. If the debt is "non-recourse," the debt is only secured by the property, and the debtor is not personally liable for the balance. However, Congress passed H.R. 3648, the "Mortgage Forgiveness Debt Relief Act of 2007" or MFDRA. This legislation is effective for discharges of indebtedness on or after January 1, 2007 and before January 1, 2010. The Federal Bailout Legislation H.R. 1424, passed on October 3, 2008, extended this legislation through December 31, 2012. Unlike Arizona's Anti-Deficiency Statutes, the MFDRA does not apply to investor properties, it only applies to sales and foreclosures on primary residences.

*The basic difference between a mortgage and deed of trust is the number of parties involved. With a deed of trust there is a borrower, lender and trustee. With a mortgage there is only the borrower and the lender. In a deed of trust the borrower conveys title to a trustee who will hold the title of the property in trust for the benefit of the lender. The borrower will receive title when the note is paid.

**Although case law suggests that a purchase money lender may be not be allowed to obtain a judgment against the borrower for balance of the note if the property and loan also qualify for anti-deficiency protection in a foreclosure, borrowers should obtain a personal release from the lender to be certain that they are protected.

Please Note: This blog is not legal advice. Do not treat it as such or rely on it without consulting your own attorney or advising your clients to do so. This material is presented for educational purposes only, to apprise homeowners of the current general state of foreclosure litigation and possible defenses available to a defaulting borrower. Each borrower's facts and circumstances are unique and the foregoing defenses and law may not apply to each situation.