

Avoiding Foreclosure

The U.S. real estate boom of the past ten years has seen homeownership rise from 65% to 69%. Unfortunately with the market cooling the value of real estate is plummeting leaving homeowners holding mortgages that greatly out value the real estate they presently hold. There is now something that can help.

The Mortgage Forgiveness Debt Relief Act of 2007 was enacted on December 20, 2007 to assist homeowners who are in such a predicament. Normally, a homeowner, in an attempt to avoid foreclosure would modify their current mortgages, that is, “short sell” the property, or deed their home in lieu of foreclosure back to the bank holding the lien on the property. Such remedies often leave the homeowner with a debt for property no longer in their possession. In most situations the lender would forgive the homeowner’s debt either in part or full. Unfortunately this left the homeowner facing an additional and in most cases, undischargable financial difficulty, the IRS. That debt which is so graciously forgiven by the lender is now recognized as taxable income by the IRS. The homeowner receives a tax bill for the forgiven amount for money forgiven and never truly received.

The Mortgage Forgiveness Debt Relief Act is designed to exclude such debt forgiveness on the principal residence if the balance of the loan was less than \$2 million for a debtor’s primary domicile. The act only applies to that debt which was forgiven in the 2007, 2008 or 2009 tax years. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a short sale or foreclosure, may qualify for this relief. The requirements are that the debt must have been used to buy, build or substantially improve the taxpayer’s principal residence and must have been secured by that residence. Debt used to refinance qualifying debt is also eligible for the exclusion, but only up to the amount of the old mortgage principal, just before the refinancing.

What does this mean to the homeowner in trouble? Everything. There is now another option available to them, which will not lead them from one financial frying pan to the other. Prior to the Act, homeowners would attempt to negotiate with the lender not to forgive the deficit in the loan but to file suit against them. This was the strategy in the reasoning that a judgment lien is dischargeable under a Chapter 7 or Chapter 13 bankruptcy were IRS liens are not. IRS tax liens remain through the bankruptcy filing and distribution and the homeowner would end up with the lien coming out on the other side of the bankruptcy. Leaving them in the same predicament of owing money on income never actually received.

The Act will not extend to other forgiven debt such as those on second homes, income or rental property, business property, credit cards or car loans. In those instances the filing of a Chapter 7 or Chapter 13 bankruptcy might be in the homeowner's best interest depending on the financial situation he is presently in. The homeowner should always consult with an attorney regarding what strategy would be in their best interest.