George Bush Got One Thing Right

You read it here first-our 43rd President was responsible for one of the most beneficial laws enacted in recent memory.

The year was 2007. According to the Mortgage Bankers Association, the first three months of the year showed a higher foreclosure rate than had been seen in the previous 50 years. People were either walking away from their homes or they were selling their homes for less than the mortgage owed. But the latter strategy- called a "short sale"- left the beleaguered seller facing a tax liability on the amount of the forgiven debt.

In the midst of this chaos, the Mortgage Tax Debt Relief Act of 2007 was introduced. In fact, in an uncommon act of responsiveness and legislative efficiency, this act was introduced, ratified and enacted in less than three months.

Due to the Mortgage Tax Debt Relief Act, homeowners who do a short sale on their primary residence and have a purchase-money loan (mortgages granted specifically for the purchase of the home), pay no taxes on the loss that their lender incurs.

The seller is notified of their possible tax liability if they receive an IRS form 1099-C. The 1099 series of forms are those created by the Internal Revenue Service to be used by payers to report income paid to payees. The 1099-C form is specifically used for those parties that have canceled a debt owed by the payee. In general, any debt canceled is considered income to the former debtor. Usually if certain Federal agencies, a financial institution, or an organization in the business of lending money, such as a finance or credit card company, cancels a debt of $600 or more, a 1099-C form must be provided to the former debtor. Unless certain circumstances apply, if you are an individual, you must include all canceled debts, even if less than $600, on the "Other income" line of your Form 1040. You must pay taxes on this canceled debt.

However, Mortgage Tax Debt Relief Act is the seller's saving grace, by forgiving the federal taxes owed.

This relief does not apply to houses that are not the filer's primary residence. Further, this Act is only in effect until December 31, 2012.

In addition, homeowners who took out home equity loans and did not use those funds to "substantially improve" their home, must pay taxes on the canceled mortgage amounts from the short sale.

Still, even if the home equity funds were not used to improve the home, a debtor may still avoid a tax liability on the canceled debt if he is "insolvent" as defined by the IRS at the time the debt is canceled. In order to be declared insolvent, the debtor must have more debts - including the mortgages in question - than assets.

State taxes are another matter altogether, but the greater burden of federal taxes are relieved, thanks to George Bush.

Thanks, Mr. President.