Mortgage Forgiveness Tax Treatment Gets One More Year January 9, 2013

While there is still very little focus on the importance of this law, the fiscal cliff deal did extend its provisions for one more year. The law – which was set to expire at the end of 2012 - is crucial to foreclosure mitigation efforts such as principal forgiveness and short sales. Normally, U.S. law decrees that when a lender forgives all or a portion of a borrower's debt, the forgiven amount is considered taxable income for the borrower. This is known as Cancellation of Debt (COD) Income and must be included in a taxpayer's gross income. This Act, however, created an exception to this rule under the U.S. Tax Code. The Mortgage Forgiveness Debt Relief Act allows homeowners who received principal reductions or other forms of debt forgiveness to not pay taxes on the amount forgiven. The amount extends up to $2 million of debt forgiven on the homeowner's principal residence. For homeowner's to qualify, their debt must have been used to "buy, build, or substantially improve" their principal residence and be secured by that residence. The law, which was passed in 2007 with a 5 year sunset provision, will now be in effect until January 1, 2014.