Available Options to Homeowners Faced with Foreclosure

By: Randall A. Denha *

The IRS is under pressure to help homeowner's rather than simply be the enforcer of laws over which it has no control. In that regard, the IRS set up an information center on its irs.gov website to help homeowners. This information center has worksheets and examples to figure debt cancellation income and gain on foreclosure forms.

Cancellation of Debt
If a lender forgives any portion of the principal of a mortgage loan, there is a cancellation of debt which generally results in taxable income. Applicable exceptions are:

- A bankrupt taxpayer does not have income on debts discharged through bankruptcy.
- An insolvent taxpayer does not recognize income on some or all of the cancelled debt. A taxpayer whose debts exceed liabilities is insolvent. The taxpayer's basis in the property may be reduced.
- On a foreclosure, a taxpayer with a nonrecourse loan (the borrower is not personally liable) does not have cancellation of debt income, although there may be gain from the foreclosure.

The IRS urges homeowners to consider their options before giving up their homes through foreclosure.

Gain from Foreclosure
The foreclosure of property is treated like a sale. If the property's fair market value (or nonrecourse debt) exceeds its basis, the difference is taxable gain. The gain is excludable up to $250,000 ($500,000 for joint filers) under Code Sec. 121, if the property was owned and used as the principal residence for two of the previous five years. Any remaining gain is taxable as capital gain. Any losses are not recognized.

Installment Agreement / Offers in Compromise
If the debtor has taxable income and cannot pay the tax due in full, the IRS suggests that the debtor consider an installment agreement. Alternatively, for taxpayers with few assets, the IRS "in some cases" may be willing to enter into an offer in compromise that will relieve the taxpayer of some of the tax debt.

Legislative Relief
President Bush proposed changes to the Tax Code that would ensure cancelled mortgage debt on a primary residence as not claimed income and Congress is currently considering the proposal.

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University of Detroit School of Law where he obtained his law degree. Feeling that he still needed more education he then attended the University of Miami School of Law and completed a masters in law (LL.M.) in estate planning. The University of Miami is regarded as the premier school in the country for its program in estate planning. Randy has hosted a radio program and has written many articles in the estate planning arena on the importance of planning. Additionally, he is a former faculty member at Oakland University's Personal Financial Planning Program where he taught estate planning for those wishing to obtain a Certified Financial Planning (CFP) degree. Mr. Denha also serves as General Counsel for both local and national organizations and is a member of the Bank of Michigan's Board of Directors.

In addition to the estate and succession planning areas of law that Randy practices on a daily basis, he also specializes in an area commonly referred to as Asset Protection Planning (APP). As an APP attorney Randy is frequently encountering those clients that are fearful of creditor claims that lack merit and for no other reason are brought into litigation because the client has "deep pockets". Typical clients in this area are physicians, business owners, builders and real estate developers. APP is concerned with establishing entities and rearranging assets that in the event of a lawsuit, a creditor would have a difficult time attaching to the true asset because of the way such assets arranged. Corporations, partnerships, LLCs, domestic trust and Offshore trusts are commonly used in this area.