

Tax Reminders for Homeowners

As more homeowners fall behind on mortgages and other loans, there is an increased likelihood that a debt may be forgiven or cancelled by a lender. Taxpayers should be aware that the cancellation of a debt by a lender can have federal income tax consequences.

This information provides guidance to taxpayers regarding foreclosures and bad debts. In addition, it includes reminders about deductions for mortgage interest and insurance.

If you borrow money from a commercial lender and the lender later cancels or forgives the debt, you may have to include the amount of the debt forgiven or cancelled as part of your taxable income when you file your federal income tax return.

The reason for this is that when you borrowed the money you did not include the loan proceeds in income because you had an obligation to repay the lender. When that obligation goes away because the loan is forgiven or the property securing the loan is abandoned or foreclosed, the amount you received as loan proceeds becomes reportable as income because you no longer have an obligation to repay the lender.

The lender is usually required to report the amount of the canceled debt to you and the IRS on a Form 1099-A, *Acquisition or Abandonment of Secured Property*, or Form 1099-C, *Cancellation of Debt*.

If you received a Form 1099-A, or Form 1099-C, check the forms carefully. Borrowers should pay particular attention to the amount of debt forgiven and the value listed for their home. If the information is incorrect, notify the lender immediately.

Lenders send copies of Forms 1099-A and 1099-C to the IRS. The IRS matches the information from the forms to the income reported on your tax return. If you fail to report these amounts as income on your return, the IRS may assess additional tax, penalties and interest.

Not all debt forgiveness is taxable, there are exceptions. One exception is for debts discharged through a bankruptcy proceeding. Another exception is insolvency: If you are insolvent when the debt is cancelled, some or all of the cancelled debt may not be taxable to you. You are insolvent when your total debts are more than the fair market value of your total assets. Insolvency can be fairly complex to determine and the assistance of a tax professional is recommended if you believe you qualify for this exception.

Mortgage Forgiveness Debt Relief Act of 2007 Provisions

The Mortgage Forgiveness Debt Relief Act of 2007 includes provisions for special tax relief. If a lender forgives a debt on your principal residence, this amount of forgiven debt is not included in your taxable income.

This relief applies to debt forgiven in 2007, 2008 or 2009. There is no dollar limit if the principal balance of the loan was less than \$2 million (\$1 million if married filing separately) at the time the loan was forgiven.

Homeowners whose mortgage debt was partly or entirely forgiven may be able to claim the special tax relief by filling out newly-revised Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness*, and attaching it to their federal income tax return.

Deducting Home Mortgage Interest and Mortgage Insurance Premiums

Deductible mortgage interest is interest you pay on a loan secured by your primary residence or second home. These loans include:

- mortgage to buy your home
- second mortgage
- line of credit
- home equity loan

You can usually deduct as an itemized deduction on Form 1040, Schedule A, line 13, the interest you pay on a mortgage for your primary residence or second home. Your lender will send a Form 1098, or similar statement, reporting the total mortgage interest you paid, the mortgage insurance premiums and, if you purchased your home during the year, and deductible points you paid.

You can treat mortgage insurance premiums you paid during 2007 as home mortgage interest. The mortgage insurance must be paid in connection with home acquisition debt, the mortgage insurance contract must have been issued after 2006, and you must have paid the premiums before 2008 for coverage in effect during 2007.

The new mortgage-insurance deduction is limited to those with income below a certain level. The deduction begins to disappear once your 2007 adjusted gross income on Form 1040, line 38 exceeds \$100,000 or \$50,000 for a married person filing separately. If your income exceeds \$109,000 or \$54,500, respectively, you cannot deduct your mortgage insurance premiums.

Conclusion

Although mortgage workouts and foreclosures can have tax consequences, special relief provisions can reduce or eliminate the tax bite for financially strapped borrowers.

Related Items:

- [Publication 544, Sales and Other Dispositions of Assets](#)
- [Publication 936, Home Mortgage Interest Deduction](#)
- [Instructions for Schedule A \(Form 1040\)](#)
- [Frequently asked questions on the Mortgage Forgiveness Debt Relief Act](#)
- [Frequently asked questions on the Mortgage Interest Deduction](#)
- [Frequently asked questions on Home Foreclosure and Debt Cancellation](#)
- [Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness](#)
- [Form 1099-A](#)
- [Form 1099-C](#)