



The Mortgage Forgiveness Debt Relief Act and Debt Cancellation

If you owe a debt to someone else and they cancel or forgive that debt, the canceled amount may be taxable.

The Mortgage Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for the relief.

This provision applies to debt forgiven in calendar years 2007 through 2012. Up to \$2 million of forgiven debt is eligible for this exclusion (\$1 million if married filing separately). The exclusion does not apply if the discharge is due to services performed for the lender or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.

More information, including detailed examples can be found in [Publication 4681](#), Canceled Debts, Foreclosures, Repossessions, and Abandonments. Also see IRS news release [IR-2008-17](#).

The following are the most commonly asked questions and answers about The Mortgage Forgiveness Debt Relief Act and debt cancellation:

What is Cancellation of Debt?

If you borrow money from a commercial lender and the lender later cancels or forgives the debt, you may have to include the cancelled amount in income for tax purposes, depending on the circumstances. When you borrowed the money you were not required to include the loan proceeds in income because you had an obligation to repay the lender. When that obligation is subsequently forgiven, the amount you received as loan proceeds is normally 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-C, Cancellation of Debt.

Here's a very simplified example. You borrow \$10,000 and default on the loan after paying back \$2,000. If the lender is unable to collect the remaining debt from you, there is a cancellation of debt of \$8,000, which generally is taxable income to you.

Is Cancellation of Debt income always taxable?

Not always. There are some exceptions. The most common situations when cancellation of debt income is not taxable involve:

- **Qualified principal residence indebtedness:** This is the exception created by the Mortgage Debt Relief Act of 2007 and applies to most homeowners.
- **Bankruptcy:** Debts discharged through bankruptcy are not considered taxable income.
- **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.
- **Certain farm debts:** If you incurred the debt directly in operation of a farm, more than half your income from the prior three years was from farming, and the loan was owed to a person or agency regularly engaged in lending, your cancelled debt is generally not considered taxable income.
- **Non-recourse loans:** A non-recourse loan is a loan for which the lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue you personally in case of default. Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income. However, it may result in other tax consequences.

These exceptions are discussed in detail in [Publication 4681](#).

What is the Mortgage Forgiveness Debt Relief Act of 2007?

The Mortgage Forgiveness Debt Relief Act of 2007 was enacted on December 20, 2007 (see [News Release IR-2008-17](#)). Generally, the Act allows exclusion of income realized as a result of modification of the terms of the mortgage, or foreclosure on your principal residence.

What does exclusion of income mean?

Normally, debt that is forgiven or cancelled by a lender must be included as income on your tax return and is taxable. But the Mortgage Forgiveness Debt Relief Act allows you to exclude certain cancelled debt on your principal residence from income. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualifies for the relief.

Does the Mortgage Forgiveness Debt Relief Act apply to all forgiven or cancelled debts?

No. The Act applies only to forgiven or cancelled debt used to buy, build or substantially improve your principal residence, or to refinance debt incurred for those purposes. In addition, the debt must be secured by the home. This is known as qualified principal residence indebtedness. The maximum amount you can treat as qualified principal residence indebtedness is \$2 million or \$1 million if married filing separately.

Does the Mortgage Forgiveness Debt Relief Act apply to debt incurred to refinance a home?

Debt used to refinance your home qualifies for this exclusion, but only to the extent that the principal balance of the old mortgage, immediately before the refinancing, would have qualified. For more information, including an example, see [Publication 4681](#).

How long is this special relief in effect?

It applies to qualified principal residence indebtedness forgiven in calendar years 2007 through 2012.

Is there a limit on the amount of forgiven qualified principal residence indebtedness that can be excluded from income?

The maximum amount you can treat as qualified principal residence indebtedness is \$2 million (\$1 million if married filing separately for the tax year), at the time the loan was forgiven. If the balance was greater, see the instructions to Form 982 and the detailed example in [Publication 4681](#).

If the forgiven debt is excluded from income, do I have to report it on my tax return?

Yes. The amount of debt forgiven must be reported on [Form 982](#) and this form must be attached to your tax return.

Do I have to complete the entire Form 982?

No. Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Adjustment), is used for other purposes in addition to reporting the exclusion of forgiveness of qualified principal residence indebtedness. If you are using the form only to report the exclusion of forgiveness of qualified principal residence indebtedness as the result of foreclosure on your principal residence, you only need to complete lines 1e and 2. If you kept ownership of your home and modification of the terms of your mortgage resulted in the forgiveness of qualified principal residence indebtedness, complete lines 1e, 2, and 10b. Attach the Form 982 to your tax return.

Where can I get this form?

If you use a computer to fill out your return, check your tax-preparation software. You can also download the form at IRS.gov, or call 1-800-829-3676. If you call to order, please allow 7-10 days for delivery.

How do I know or find out how much debt was forgiven?

Your lender should send a Form 1099-C, Cancellation of Debt, by February 2, 2009. The amount of debt forgiven or cancelled will be shown in box 2. If this debt is all qualified principal residence indebtedness, the amount shown in box 2 will generally be the amount that you enter on lines 2 and 10b, if applicable, on Form 982.

Can I exclude debt forgiven on my second home, credit card or car loans?

Not under this provision. Only cancelled debt used to buy, build or improve your principal residence or refinance debt incurred for those purposes qualifies for this exclusion. See Publication 4681 for further details.

If part of the forgiven debt doesn't qualify for exclusion from income under this provision, is it possible that it may qualify for exclusion under a different provision?

Yes. The forgiven debt may qualify under the insolvency exclusion. Normally, you are not required to include forgiven debts in income to the extent that you are insolvent. You are insolvent when your total liabilities exceed your total assets. The forgiven debt may also qualify for exclusion if the debt was discharged in a Title 11 bankruptcy proceeding or if the debt is qualified farm indebtedness or qualified real property business indebtedness. If you believe you qualify for any of these exceptions, see the instructions for Form 982. Publication 4681 discusses each of these exceptions and includes examples.

I lost money on the foreclosure of my home. Can I claim a loss on my tax return?

No. Losses from the sale or foreclosure of personal property are not deductible.

If I sold my home at a loss and the remaining loan is forgiven, does this constitute a cancellation of debt?

Yes. To the extent that a loan from a lender is not fully satisfied and a lender cancels the unsatisfied debt, you have cancellation of indebtedness income. If the amount forgiven or canceled is \$600 or more, the lender must generally issue Form 1099-C, Cancellation of Debt, showing the amount of debt canceled. However, you may be able to exclude part or all of this income if the debt was qualified principal residence indebtedness, you were insolvent immediately before the discharge, or if the debt was canceled in a title 11 bankruptcy case. An exclusion is also available for the cancellation of certain nonbusiness debts of a qualified individual as a result of a disaster in a Midwestern disaster area. See Form 982 for details.

If the remaining balance owed on my mortgage loan that I was personally liable for was canceled after my foreclosure, may I still exclude the canceled debt from income under the qualified principal residence exclusion, even though I no longer own my residence?

Yes, as long as the canceled debt was qualified principal residence indebtedness. See Example 2 on page 13 of Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments.

Will I receive notification of cancellation of debt from my lender?

Yes. Lenders are required to send Form 1099-C, Cancellation of Debt, when they cancel any debt of \$600 or more. The amount cancelled will be in box 2 of the form.

What if I disagree with the amount in box 2?

Contact your lender to work out any discrepancies and have the lender issue a corrected Form 1099-C.

How do I report the forgiveness of debt that is excluded from gross income?

(1) Check the appropriate box under line 1 on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment) to indicate the type of discharge of indebtedness and enter the amount of the discharged debt excluded from gross income on line 2. Any remaining canceled debt must be included as income on your tax return.

(2) File Form 982 with your tax return.

My student loan was cancelled; will this result in taxable income?

In some cases, yes. Your student loan cancellation will not result in taxable income if you agreed to a loan provision requiring you to work in a certain profession for a specified period of time, and you fulfilled this obligation.

Are there other conditions I should know about to exclude the cancellation of student debt?

Yes, your student loan must have been made by:

- (a) the federal government, or a state or local government or subdivision;
- (b) a tax-exempt public benefit corporation which has control of a state, county or municipal hospital where the employees are considered public employees; or
- (c) a school which has a program to encourage students to work in underserved occupations or areas, and has an agreement with one of the above to fund the program, under the direction of a governmental unit or a charitable or educational organization.

Can I exclude cancellation of credit card debt?

In some cases, yes. Nonbusiness credit card debt cancellation can be excluded from income if the cancellation occurred in a title 11 bankruptcy case, or to the extent you were insolvent just before the cancellation. See the examples in Publication 4681.

How do I know if I was insolvent?

You are insolvent when your total debts exceed the total fair market value of all of your assets. Assets include everything you own, e.g., your car, house, condominium, furniture, life insurance policies, stocks, other investments, or your pension and other retirement accounts.

How should I report the information and items needed to prove insolvency?

Use Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment) to exclude canceled debt from income to the extent you were insolvent immediately before the cancellation. You were insolvent to the extent that your liabilities exceeded the fair market value of your assets immediately before the cancellation.

To claim this exclusion, you must attach Form 982 to your federal income tax return. Check box 1b on Form 982, and,

on line 2, include the smaller of the amount of the debt canceled or the amount by which you were insolvent immediately prior to the cancellation. You must also reduce your tax attributes in Part II of Form 982.

My car was repossessed and I received a 1099-C; can I exclude this amount on my tax return?

Only if the cancellation happened in a title 11 bankruptcy case, or to the extent you were insolvent just before the cancellation. See Publication 4681 for examples.

Are there any publications I can read for more information?

Yes.

(1) [Publication 4681](#), Canceled Debts, Foreclosures, Repossessions, and Abandonments (for Individuals) is new and addresses in a single document the tax consequences of cancellation of debt issues.

(2) See the IRS news release [IR-2008-17](#) with additional questions and answers on IRS.gov.

Page Last Reviewed or Updated: February 20, 2009



Home Foreclosure and Debt Cancellation

Update Dec. 11, 2008 — The Mortgage Forgiveness Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of debt on their principal residence. Debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, qualify for this relief.

This provision applies to debt forgiven in calendar years 2007 through 2012. Up to \$2 million of forgiven debt is eligible for this exclusion (\$1 million if married filing separately). The exclusion doesn't apply if the discharge is due to services performed for the lender or any other reason not directly related to a decline in the home's value or the taxpayer's financial condition.

The amount excluded reduces the taxpayer's cost basis in the home. More details. Further information, including detailed examples, can also be found in [Publication 4681](#), Canceled Debts, Foreclosures, Repossessions, and Abandonments.

The questions and answers, below, are based on the law prior to the passage of the Mortgage Forgiveness Debt Relief Act of 2007.

1. What is Cancellation of Debt?

If you borrow money from a commercial lender and the lender later cancels or forgives the debt, you may have to include the cancelled amount in income for tax purposes, depending on the circumstances. When you borrowed the money you were not required to include the loan proceeds in income because you had an obligation to repay the lender. When that obligation is subsequently forgiven, the amount you received as loan proceeds is 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-C, Cancellation of Debt.

Here's a very simplified example. You borrow \$10,000 and default on the loan after paying back \$2,000. If the lender is unable to collect the remaining debt from you, there is a cancellation of debt of \$8,000, which generally is taxable income to you.

2. Is Cancellation of Debt income always taxable?

Not always. There are some exceptions. The most common situations when cancellation of debt income is not taxable involve:

- **Bankruptcy:** Debts discharged through bankruptcy are not considered taxable income.
- **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.
- **Certain farm debts:** If you incurred the debt directly in operation of a farm, more than half your income from the prior three years was from farming, and the loan was owed to a person or agency regularly engaged in lending, your cancelled debt is generally not considered taxable income. The rules applicable to farmers are complex and the assistance of a tax professional is recommended if you believe you qualify for this exception.
- **Non-recourse loans:** A non-recourse loan is a loan for which the lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue you personally in case of default. Forgiveness of a non-recourse loan resulting from a foreclosure does not result in cancellation of debt income. However, it may result in other tax consequences, as discussed in Question 3 below.

3. I lost my home through foreclosure. Are there tax consequences?

There are two possible consequences you must consider:

- Taxable cancellation of debt income. (Note: As stated above, cancellation of debt income is not taxable in the case of non-recourse loans.)
- A reportable gain from the disposition of the home (because foreclosures are treated like sales for tax purposes). (Note: Often some or all of the gain from the sale of a personal residence qualifies for exclusion from income.)

Use the following steps to compute the income to be reported from a foreclosure:

Step 1 - Figuring Cancellation of Debt Income (Note: For non-recourse loans, skip this section. You have no income from cancellation of debt.)

1. Enter the total amount of the debt immediately prior to the foreclosure. _____
2. Enter the fair market value of the property from Form 1099-C, box 7. _____
3. Subtract line 2 from line 1. If less than zero, enter zero. _____

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question 2. Enter it on line 21, Other Income, of your Form 1040.

Step 2 – Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure. _____
5. Enter your adjusted basis in the property. (Usually your purchase price plus the cost of any major improvements.) _____
6. Subtract line 5 from line 4. If less than zero, enter zero. _____

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

4. I lost money on the foreclosure of my home. Can I claim a loss on my tax return?

No. Losses from the sale or foreclosure of personal property are not deductible.

5. Can you provide examples?

A borrower bought a home in August 2005 and lived in it until it was taken through foreclosure in September 2007. The original purchase price was \$170,000, the home is worth \$200,000 at foreclosure, and the mortgage debt canceled at foreclosure is \$220,000. At the time of the foreclosure, the borrower is insolvent, with liabilities (mortgage, credit cards, car loans and other debts) totaling \$250,000 and assets totaling \$230,000.

The borrower figures income from the foreclosure as follows:

Use the following steps to compute the income to be reported from a foreclosure:

Step 1 - Figuring Cancellation of Debt Income (Note: For non-recourse loans, skip this section. You have no income from cancellation of debt.)

1. Enter the total amount of the debt immediately prior to the foreclosure. \$220,000
2. Enter the fair market value of the property from Form 1099-C, box 7. \$200,000
3. Subtract line 2 from line 1. If less than zero, enter zero. \$20,000

The amount on line 3 will generally equal the amount shown in box 2 of Form 1099-C. This amount is taxable unless you meet one of the exceptions in question 2. Enter it on line 21, Other Income, of your Form 1040.

Step 2 – Figuring Gain from Foreclosure

4. Enter the fair market value of the property foreclosed. For non-recourse loans, enter the amount of the debt immediately prior to the foreclosure. \$200,000
5. Enter your adjusted basis in the property. (Usually your purchase price plus the cost of any major improvements.) \$170,000
6. Subtract line 5 from line 4. If less than zero, enter zero. \$30,000

The amount on line 6 is your gain from the foreclosure of your home. If you have owned and used the home as your principal residence for periods totaling at least two years during the five year period ending on the date of the foreclosure, you may exclude up to \$250,000 (up to \$500,000 for married couples filing a joint return) from income. If you do not qualify for this exclusion, or your gain exceeds \$250,000 (\$500,000 for married couples filing a joint return), report the taxable amount on Schedule D, Capital Gains and Losses.

In this situation, the borrower has a tax-free home-sale gain of \$30,000 (\$200,000 minus \$170,000), because they owned and lived in their home as a principal residence for at least two years. Ordinarily, the borrower would also have taxable debt-forgiveness income of \$20,000 (\$220,000 minus \$200,000). But since the borrower's liabilities exceed assets by \$20,000 (\$250,000 minus \$230,000) there is no tax on the canceled debt.

Other examples can be found in IRS Publication 544, Sales and Other Dispositions of Assets, under the section "Foreclosures and Repossessions".

6. I don't agree with the information on the Form 1099-C. What should I do?

Contact the lender. The lender should issue a corrected form if the information is determined to be incorrect. Retain all records related to the purchase of your home and all related debt.

7. I received a notice from the IRS on this. What should I do?

The IRS urges borrowers with questions to call the phone number shown on the notice. The IRS also urges borrowers who wind up owing additional tax and are unable to pay it in full to use the installment agreement form, normally included with the notice, to request a payment agreement with the agency.

8. Where else can I go to get tax help?

If you are having difficulty resolving a tax problem (such as one involving an IRS bill, letter or notice) through normal IRS channels, the [Taxpayer Advocate Service](#) may be able to help. For more information, you can also call the TAS toll-free case intake line at 1-877-777-4778, TTY/TDD 1-800-829-4059.

In some cases, you may qualify for free or low-cost assistance from a Low Income Taxpayer Clinic (LITC). LITCs are independent organizations that represent low income taxpayers in tax disputes with the IRS. Find [information](#) on an LITC in your area.

Related Items:

- [Publication 523, Selling Your Home](#)

- [Publication 544](#), Sales and Other Dispositions of Assets
- [Publication 908](#), Bankruptcy Tax Guide
- [Form 1040](#), U.S. Individual Income Tax Return
- [Form 1040, Schedule D](#), Capital Gains and Losses
- [Form 1099-C](#), Cancellation of Debt
- [Form 9465](#), Installment Agreement Request

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