Common Foreclosure and Cancellation of Debt Issues for Real Property
Objective

At the end of this learning experience, you will be able to explain to your clients the proper tax treatments for foreclosures and canceled debt related to their principal residence, business property, and investment property.
Overview

- Review common terms
- Define cancellation of debt income
- Explain nonrecourse and recourse debt
- IRC§108, income exclusions
- Tax treatment – Principal residence, business, and investment
- Overview nonrecourse/anti-deficiency state laws
Terms

• Foreclosures
• Short sales
• Deed in lieu of foreclosure
• Abandonment
Cancellation of Debt Income (CODI)

- Gross income includes income from cancellation of debt – IRC§61(a)(12)
- Where to report CODI
- Exceptions
Cancellation of Debt Income (CODI) - Continued

- Exclusions – IRC §108
  - Bankruptcy
  - Insolvency
  - Qualified Farm Indebtedness
  - Qualified Real Property Business Indebtedness
  - Qualified Principal Residence Indebtedness
Nonrecourse Debt

- Debtor NOT personally responsible to repay
- Loan secured only by the property
- Gain or loss:
  - Greater of debt balance or fair market value
    Less the adjusted basis
- Generally, no cancellation of debt income
Recourse Debt

• Debtor personally responsible to repay the loan
• CODI: debt balance less FMV
• Gain/Loss: lesser of FMV or debt balance less the adjusted basis
Form 1099-A

<table>
<thead>
<tr>
<th>LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.</th>
<th>OMB No. 1545-0877</th>
</tr>
</thead>
<tbody>
<tr>
<td>E</td>
<td>□ CORRECTED (if checked)</td>
</tr>
<tr>
<td></td>
<td>2015</td>
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<tr>
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<td>Form 1099-A</td>
</tr>
<tr>
<td>LENDER'S federal identification number</td>
<td>BORROWER'S identification number</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>BORROWER'S name</td>
<td></td>
</tr>
<tr>
<td>Street address (including apt. no.)</td>
<td></td>
</tr>
<tr>
<td>City or town, state or province, country, and ZIP or foreign postal code</td>
<td></td>
</tr>
<tr>
<td>Account number (see instructions)</td>
<td></td>
</tr>
</tbody>
</table>

1. Date of lender's acquisition or knowledge of abandonment
2. Balance of principal outstanding
   - $
3. |
4. Fair market value of property
   - $
5. If checked, the borrower was personally liable for repayment of the debt
6. Description of property
   -

Copy B
For Borrower
This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.

Form 1099-A (keep for your records) | www.irs.gov/form1099a | Department of the Treasury - Internal Revenue Service
**Form 1099-C**

<table>
<thead>
<tr>
<th><strong>CREDITOR’S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DEBTOR’S name</strong></td>
</tr>
<tr>
<td><strong>DEBTOR’S federal identification number</strong></td>
</tr>
<tr>
<td><strong>DEBTOR’S identification number</strong></td>
</tr>
<tr>
<td><strong>Account number (see instructions)</strong></td>
</tr>
<tr>
<td><strong>Street address (including apt. no.)</strong></td>
</tr>
<tr>
<td><strong>City or town, state or province, country, and ZIP or foreign postal code</strong></td>
</tr>
<tr>
<td><strong>1 Date of identifiable event</strong></td>
</tr>
<tr>
<td><strong>2 Amount of debt discharged</strong></td>
</tr>
<tr>
<td><strong>3 Interest if included in box 2</strong></td>
</tr>
<tr>
<td><strong>4 Debt description</strong></td>
</tr>
<tr>
<td><strong>5 If checked, the debtor was personally liable for repayment of the debt</strong></td>
</tr>
<tr>
<td><strong>6 Identifiable event code</strong></td>
</tr>
<tr>
<td><strong>7 Fair market value of property</strong></td>
</tr>
</tbody>
</table>

**CORRECTED (if checked)**

**Cancellation of Debt**

**Copy B For Debtor**

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if taxable income results from this transaction and the IRS determines that it has not been reported.

**OMB No. 1545-1424**

2015

Form 1099-C

www.irs.gov/form1099c

Department of the Treasury - Internal Revenue Service
Potential Timing Differences

• **Nonrecourse Loan**
  – Report sale: Year of foreclosure or abandonment

• **Recourse Loan**
  – Report sale: Year of foreclosure sale
Exclusions from Income
IRC§108

- Bankruptcy
- Insolvency
- Qualified farm indebtedness
- Qualified real property business indebtedness
- Qualified principal residence indebtedness
Tax Attributes

- CODI excluded from gross income
- Bankruptcy, Insolvency, & Farm exclusions
- Qualified real property business exclusion
- Qualified principal residence exclusion
Principal Residence Tax Treatment

• Qualified principal residence indebtedness exclusion
• Form 982 – Part I and Part II
• Loan modification – reduce basis
• Report foreclosure on Form 8949 – Schedule D
Business Property
Tax Treatment

• Form 982 – Part I and Part II
  – Bankruptcy
  – Insolvency
  – Farm
  – Qualified real property business

• Foreclosure – Form 4797
Investment Property Tax Treatment

- Form 982 - Part I and Part II
  - Bankruptcy
  - Insolvency
- Foreclosure – Form 8949 - Schedule D
Foreclosure Example

Recourse Debt

Debt balance $180,000
FMV of personal residence (170,000)
Ordinary CODI 10,000
Example - continued

FMV of personal residence       $170,000
Adjusted basis                  ($200,000)
Nondeductible loss on            ($30,000)
foreclosure
Nonrecourse / Anti-Deficiency States

- State law governs type of loan
- Different laws
- All loans are NOT nonrecourse
IRS.gov Resources

• Real Estate Tax Center
• Real Estate Foreclosure and COD ATG
• Publication 4681, Canceled Debts, Foreclosures, Repossessions, and Abandonments
• Publication 544, Sales and Other Dispositions of Assets