



You may owe federal income taxes in 2013 if you have a short sale, foreclosure

WASHINGTON – Jan. 9, 2012 – You may owe federal income taxes in 2013 if you have a short sale, foreclosure after this year. Now is the time to make the hard decision: Are you going to walk away from your underwater home?

Uncle Sam is still giving homeowners until Dec. 31, 2012, to go through a short sale or foreclosure without tax consequences – as long as the lender officially releases the debt.

But on Jan. 1, 2013, the rules change: The amount a lender forgives, either in a short sale or foreclosure, on a primary residence will be taxable on federal income taxes.

So if a house sold \$50,000 short of what is owed on the mortgage, then the selling homeowners will owe federal income taxes on that \$50,000. Homeowners would owe \$12,500 if they're in the 25 percent bracket; \$7,500 if in the 15 percent tax section.

Homeowners would be on the hook even if the house sold but the bank had not formally forgiven the loan in a letter: The banks must officially sign off in writing before Dec. 31.

"It's a huge issue – it will be a shock to many taxpayers after 2012," said Mark Steber, the Florida-based chief tax officer for Jackson Hewitt Tax Service.

The law first came into affect five years ago as the housing market went bust nationwide.

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

Up to \$2 million of forgiven debt can be forgiven this year, \$1 million if married and filing separately, according to the IRS.

Homeowners declaring bankruptcy could escape paying income taxes on any cancellation of debt income if the debt is forgiven in the bankruptcy even if the debtor is solvent, said Nick Jovanovich, a board-certified tax attorney in Fort Lauderdale, Fla.

"Bankruptcy trumps everything," he said.

Or homeowners might not have to pay income taxes on any cancellation of debt income to the extent that they are insolvent immediately before the cancellation – that is, their debts exceed the value of their assets, Jovanovich added.

Steber and Jovanovich said homeowners should decide now what they are going to do – to give themselves time.

Short sales can take a long time, said Timothy Singer of Coldwell Banker in Fort Lauderdale.

He said he knows of one that had been pending for three years.

But lenders "have been gearing up" and speeding up the process, Singer added.

But even if banks quickly approve a short sale, the would-be buyer may get cold feet and the deal fall through, Singer said.

Then the sellers have to begin again, he said.

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