NAR Issue Summaries

Federal Tax / Mortgage Debt Cancellation Relief

NAR Committee:

Federal Taxation Committee

What is the fundamental issue?

A lender will, on occasion, forgive some portion of a borrower's debt, or reduce the principal balance. The general tax rule that applies to any debt forgiveness is that the amount forgiven is treated as taxable income to the borrower. Some exceptions to this rule are available, but, until 2007, when a lender forgave some portion of a mortgage debt for which the borrower was personally liable (such as in so-called "short sales," foreclosures and "workouts"), the borrower was required to pay tax on the debt forgiven.
A law enacted in 2007 provided temporary relief to troubled borrowers when some portion of mortgage debt is forgiven and the mortgage covers the borrower's principal residence. That relief has expired and been extended several times. The latest extension, enacted in December 2020, provides relief for debt forgiven from January 1, 2021 through December 31, 2025.

I am a real estate professional. What does this mean for my business?

Relief from the cancellation of indebtedness rules has facilitated the sale of homes in areas where home prices have declined or where foreclosures have occurred. In addition, providing tax relief corrects the unfair circumstance in which the only individuals who paid tax on the sale of a residence are fortunate sellers who have gains of more than $250,000/$500,000, and unfortunate sellers who have seen the value of their property decline to a level below what it is worth.
Short sale relief continues to be an urgent need for sellers in some areas of the country where home prices still have not rebounded.

NAR Policy:

NAR supports an exclusion from taxation of the phantom income generated when all or a portion of a mortgage on a primary residence is forgiven.
There should be no taxable event when a lender forgives some portion of a debt in a short sale, foreclosure, bank workout or similar situation.
An individual or family that has incurred a loss on the sale of their principal residence has suffered what is, for most, the biggest economic loss of their lifetime. It is unreasonable and unfair to require that they also pay tax on the phantom income associated with debt cancellation, especially because there will be no cash proceeds from the sale.

Opposition Arguments:

Opponents of NAR policy believe that a principal residence is a personal expense. Because the tax law does not allow for the deduction of personal expenses, tax relief from cancellation of debt on a personal residence is inappropriate, unless the homeowner is insolvent or bankrupt. Moreover, some opponents of

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tax relief in these situations believe it is wrong to "reward" borrowers who took on mortgages in excess of what they could afford by giving them tax relief from the consequences.

Legislative/Regulatory Status/Outlook

Over the past several years, expiring tax provisions often languished in Congress until after they expired. However, most were reinstated on a retroactive basis.
After the enactment of the Tax Cuts and Jobs Act of 2017, the group of temporary tax provisions known as the “extenders” (which includes the mortgage debt cancellation relief provision) seemed to be in a state of limbo. During 2018 and 2019, it appeared increasingly unlikely that Congress would pass legislation to reinstate the exclusion for those years. But in December 2019, the two sides of the political aisle came together on a larger tax bill dealing with the expired provisions and retroactively reinstated the exclusion for 2018 through the end of 2020. Then, as another pleasant surprise, in December 2020, Congress extended the provision for five more years, through the end of 2025.

Current Legislation/Regulation (bill number or regulation)

None at this time.

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