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# Common Foreclosure & Cancellation of Debt Issues for Real Property



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# 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 Section 108, income exclusions
- Tax treatment – Principal residence, business, and investment
- Overview nonrecourse/anti-deficiency state laws



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# Terms

- Foreclosures
- Short sales
- Deed in lieu of foreclosure
- Abandonment



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# 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

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# 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

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# Form 1099-A



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CORRECTED (if checked)

LENDER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		OMB No. 1545-0877
		<b>2015</b> Form 1099-A
LENDER'S federal identification number	BORROWER'S identification number	<b>1</b> Date of lender's acquisition or knowledge of abandonment
		<b>2</b> Balance of principal outstanding \$
BORROWER'S name		<b>3</b>
Street address (including apt. no.)		<b>4</b> Fair market value of property \$
City or town, state or province, country, and ZIP or foreign postal code		<b>5</b> If checked, the borrower was personally liable for repayment of the debt . . . . . <input type="checkbox"/>
Account number (see instructions)		<b>6</b> Description of property

## Acquisition or Abandonment of Secured 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-C



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CORRECTED (if checked)

CREDITOR'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.	1 Date of identifiable event	OMB No. 1545-1424  <b>2015</b>  Form <b>1099-C</b>
	2 Amount of debt discharged \$	
	3 Interest if included in box 2 \$	

## Cancellation of Debt

CREDITOR'S federal identification number	DEBTOR'S identification number	4 Debt description	
DEBTOR'S name			
Street address (including apt. no.)		5 If checked, the debtor was personally liable for repayment of the debt . . . . . <input type="checkbox"/>	
City or town, state or province, country, and ZIP or foreign postal code			
Account number (see instructions)		6 Identifiable event code	7 Fair market value of property \$

**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.



# Potential Timing Differences

- Nonrecourse Loan
  - Report sale: Year of foreclosure or abandonment
- Recourse Loan
  - Report sale: Year of foreclosure sale

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# Exclusions from Income

## IRC § 108

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



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# Tax Attributes

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

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# 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

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# Business Property Tax Treatment

- Form 982 – Part I and Part II
  - Bankruptcy
  - Insolvency
  - Farm
  - Qualified real property business
- Foreclosure – Form 4797

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# Investment Property Tax Treatment

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

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# Foreclosure Example

## Recourse Debt

Debt balance	\$180,000
FMV of personal residence	<u>(170,000)</u>
Ordinary CODI	10,000

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# Example - continued

FMV of personal residence	\$170,000
Adjusted basis	<u>(\$200,000)</u>
Nondeductible loss on foreclosure	(\$30,000)

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# Nonrecourse / Anti-Deficiency States

- State law governs type of loan
- Different laws
- All loans are NOT nonrecourse

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# 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*



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# Contact information

- **Telephone Assistance for Individuals:  
Toll-Free, 800-829-1040**
- **Telephone Assistance for Businesses:  
Toll-Free, 800-829-4933**



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Hot Topics on IRS.gov	Search Word(s)
Affordable Care Act	ACA
Annual Filing Season Program	Filing season program
Continuing education for tax pros	tax pros
E-Services – online tax tools	eservice
Identity theft	ID theft
Practitioner events on IRS.gov	Practitioner events
Tangible Property Regulations	Tangible
Third party reporting information center	Third party
SB/SE Tax Calendar	Tax calendar