



DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D. C. 20224

OFFICE OF THE CHIEF COUNSEL

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The Honorable Ron Barber  
Member, U.S. House of Representatives  
3945 East Fort Lowell, Suite 211  
Tucson, AZ 85712

Attention:

Dear Congressman Barber:

I am responding to your inquiry dated March 4, 2014, on behalf of your constituent, . He requested information on the impact of the expiration at the end of 2013 of the Mortgage Forgiveness Debt Relief Act of 2007 (2007 Act) on Arizona homeowners. Specifically, he wants to know whether these homeowners would have taxable cancellation of indebtedness income from the short sale of their homes after 2013. He also asked whether Arizona's anti-deficiency statutes protect homeowners from having taxable income in this circumstance.

The 2007 Act enacted sections 108(a)(1)(E) and 108(h) of the Internal Revenue Code (Code), which applied to mortgage debt discharged from 2007 through 2013. These sections provided that a homeowner would not have taxable income due to forgiveness of a loan that the homeowner used to purchase a principal residence ("purchase-money home loan").

If under a state's anti-deficiency statute a lender cannot under any circumstance pursue the homeowner for the deficiency between the outstanding amount of the purchase-money home loan and the lesser amount received on the sale of the home (whether a foreclosure sale or short sale), then we would consider that loan a nonrecourse loan.

The cancellation of a nonrecourse loan upon disposition of property does not result in the cancellation of indebtedness income. Thus, the 2007 Act never applied to nonrecourse purchase-money home loans. Instead, we treat the entire amount of a nonrecourse loan as an amount realized on the sale of property. See section 1.1001-2 of the Income Tax Regulations. If an owner has a gain on the sale of property, the

owner generally must include the gain in gross income (section 61(a)(3) of the Code). However, if the property was the owner’s principal residence, the owner may qualify to exclude all or part of the gain from income (section 121 of the Code).

Our review of Arizona’s anti-deficiency statutes and underlying case law did not reveal any authorities explicitly addressing whether these statutes preclude a lender from pursuing a homeowner for the deficiency between the cancelled debt and the amount the lender received on a short sale of a home.

If Arizona’s anti-deficiency statutes apply to a short sale of a home, and those statutes prevent a lender from obtaining a deficiency judgment against the homeowner in any circumstance, the federal income tax consequences would follow the treatment of nonrecourse loans described above.

We express no opinion on whether Arizona’s anti-deficiency statutes apply to short sales of homes. \_\_\_\_\_ should consult with an Arizona real estate lawyer regarding the application of Arizona’s anti-deficiency statutes to short-sale transactions.

This letter includes certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See section 2.04 of Revenue Procedure 2014-1, 2014-1 Internal Revenue Bulletin 1.

I hope this information is helpful. If you have additional questions, please contact me at \_\_\_\_\_ or \_\_\_\_\_ at \_\_\_\_\_.

Sincerely,

Andrew James Keyso  
Associate Chief Counsel  
(Income Tax and Accounting)