



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

OFFICE OF THE CHIEF COUNSEL

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The Honorable Senator Boxer
United States Senate
Washington, DC 20510

Attention:

Dear Senator Boxer:

I am responding to your inquiry dated May 21, 2014, on general information we provided to you in our responses dated September 19, 2013, and April 29, 2014, on forgiveness of debt and its tax effect on California homeowners.

You asked 3 questions based on our previous responses to you. The answers to your questions follow.

1. Is the term "purchase-money" debt, as used in our prior letter the same as "acquisition" debt, as that term is used in Internal Revenue Service (IRS) publications but not in the California code?

Section 580b(a) of the California Code of Civil Procedure (CCP) addresses the term "purchase-money loan" providing that:

- A deficiency judgment will not apply in any event after a sale of real property under a mortgage that secures a purchase-money loan.
- A purchase-money loan is a loan that was used to pay all or part of the purchase price of an owner-occupied dwelling for not more than four families and that is secured by that property.
- A deficiency judgment will not apply to a credit transaction used to refinance a purchase-money loan.

As it relates to your inquiry, "acquisition" debt means any indebtedness incurred to acquire, construct, or substantially improve a principal residence and that is secured by that residence. It also includes any debt secured by a principal residence resulting from the refinancing of debt incurred to acquire, construct, or substantially improve a principal

residence, but only to the extent the amount of debt does not exceed the amount of the refinanced debt (sections 108(h) and 163(h) of the Internal Revenue Code (Code)).

Whether the term “purchase-money loan” as used in section 580b(a) of the CCP has the same meaning as acquisition indebtedness for federal income tax purposes is a question of state law, not federal income tax law. Therefore, we do not express an opinion on this matter.

2. Would a reduction in the principal balance of a homeowner’s purchase-money loan as part of a loan modification result in cancellation of indebtedness income?

Generally, a taxpayer realizes cancellation of indebtedness income if a loan modification reduces the principal balance of a nonrecourse debt when there is no disposition of the collateral (Revenue Ruling 91-31, 1991-1 Cumulative Bulletin 19).

Taxpayers must include cancellation of indebtedness in gross income, unless an exclusion applies. For discharges occurring after 2013, although the qualified principal residence indebtedness exclusion does not apply, the homeowner may qualify to exclude cancellation of indebtedness income if the indebtedness is discharged in a federal bankruptcy proceeding or while the homeowner is insolvent (sections 61(a)(12) and 108(a) of the Code).

3. What is the IRS’ position on homeowners who completed a short sale in the first four months of this year?

Your last question concerns our position on homeowners who completed a short sale in the first part of this year based on the general information we provided to you in our letter dated September 19, 2013. This letter and our 2 prior letters to you are “information letters.” An information letter does no more than call attention to a well-established interpretation or principle of tax law without applying it to a specific set of facts. An information letter is advisory only and has no binding effect on the IRS (section 601.201(a)(5) of the Statement of Procedural Rules and section 2.04 of Revenue Procedure 2014-1, 2014-1 Internal Revenue Bulletin 1).

However, your letters have identified issues regarding the interaction of state anti-deficiency statutes and federal tax law that we think warrant published guidance. Accordingly, we are considering publishing formal guidance addressing the tax consequences of a sale of real property secured by a loan that is subject to a state’s anti-deficiency statute. Taxpayers will be able to rely on this guidance when they file their federal income tax returns.

I hope this general information is helpful. If you have questions, please call me or
at .

Sincerely,

Michael J. Montemurro
Chief, Branch 4
Office of Associate Chief Counsel
(Income Tax and Accounting)