

Foreclosed home tax gets waived, but few know of new law

BY KIMBERLY POHL

kpohl@dailyherald.com

081

Lose your house to foreclosure and it used to be you could expect a big tax bill to add to your woes.

The IRS viewed your canceled mortgage debt as extra

income and wanted its share.

With the newly enacted Mortgage Forgiveness Debt Relief Act of 2007, that sometimes-shocking tax hit is easier to avoid.

But some critics, including the IRS' own government watchdog, complain not

enough has been done to publicize the tax break and how to qualify for it.

Here's how it used to work: Say a family owed \$250,000 on their home when the lender foreclosed. The lender sells the home for \$200,000 and writes off the rest. The

family is stuck paying taxes on the remaining \$50,000 of "phantom income."

The same applies in a short sale, in which homeowners sell for less than what they owe.

The part of the mortgage forgiven by the lender is sub-

ject to taxes. "Not only do you not have a house to live in anymore, but you'd have a huge tax to pay, too," said Rolando Palacios, director of tax services at the Chicago-based Center for

See TAX on PAGE 4

Tax: Illinois had more than 90,000 foreclosures in 2007

Continued from Page 1

081

Economic Progress.

Now, the IRS erases the owed taxes provided certain conditions are met: The new law only applies to homes lost in 2007, 2008 or 2009; the house must be a primary residence; and the borrower must have owed less than \$2 million on the mortgage.

In the past, to have foreclosure-related taxes forgiven, those who lost their homes had to show they were insolvent — meaning their debts exceeded their assets.

Proving insolvency proved a big hassle, says Palacios.

"You had to go through a fairly complicated process," he said. "It was a confusing calculation that not a lot of taxpayers knew how to navigate, and certainly not low-income people."

And a person affected by foreclosure couldn't always prove insolvency.

Lynette Briggs, a housing counselor with the DuPage Homeownership Center in Wheaton, says some of her clients pulling in big salaries wouldn't have qualified to have their tax debt forgiven.

"Plenty of people with a relatively good income can get into a bad situation," says Briggs. "You'd think a person making \$100,000 a year would be fine but there's the \$3,500 monthly mortgage, kids in college and other factors."

Foreclosure tax debt wasn't on the DuPage Homeownership Center's radar until the housing market crashed. That was because until recently, most homes could be sold for

more than the value of the mortgage.

"There weren't too many instances from 2001 to 2005 when someone owed more than their property was worth," Briggs said. "It rarely came up."

It's a hot topic now, though, as Illinois had nearly 91,000 foreclosure filings in 2007, according to Irvine, Calif.-based online firm RealtyTrac.

While the new tax relief is welcome, it hasn't been particularly well-explained, according to the government's watchdog for the IRS.

The Washington, D.C.-based National Taxpayer Advocate in its annual report to Congress describes the foreclosure tax debt forgiveness rules as complex and hard to grasp. Many don't even find out they owe taxes until the IRS sends out its tax forms.

As a result, ex-homeowners may shell out more than they should.

"It's a big criticism that the IRS doesn't do a good enough job informing people," says Palacios.

The National Taxpayer Advocate recommended the IRS publish a consolidated guide on canceled debts and provide more assistance in person and by phone. A phone number should also be printed on tax return forms for taxpayers who have questions, the advocate said.

In response, the IRS posted a lengthy question and answer section on its Web site. It acknowledged clarity is needed and says that action is being taken to address the concerns.

The Center for Economic Progress is offering tax counseling. Illinois residents who lost their homes and make less than \$26,000 as an individual or \$53,000 for a family of four are eligible. The group also set up a foreclosure hotline at (312) 630-0248.