

Short Sale Tax Break Coming to an End

[Carole VanSickle](#) | January 12, 2012 | [More](#)

Short sales are becoming more and more common, but that could change if the tax break that currently does not force homeowners who do short sales to claim the forgiven debt on their tax returns is not extended. At the end of this year, the Mortgage Debt Relief Act, also called the Mortgage Forgiveness Debt Relief Act, will expire if changes are not made to the legislation. When this happens, the amount a short sale falls short of the amount owed on a property will, once again, be viewed as income to the former homeowner and will likely make short sales far less attractive to nearly every distressed property owner[1]. And it could slow down the short sale market long before the end of this year, because “short sales take a while to get approved,” says Tim Becker, director of the Bergstrom Center for Real Estate. He adds that there probably won’t be “that much of a rush” to do short sales in the latter months of 2012 if something doesn’t change.

Additional fallout could take the form of more strategic defaults once short sales are no longer an option, warn analysts. If homeowners stand to lose money in the form of additional taxes on the “forgiven” debts on their homes, they may simply opt to walk away from the property all together and hope that the lender ultimately recoups the bulk of the debt when the property is auctioned off or otherwise sold. Of course, in the case of strategic defaults – or other forms of foreclosure as well – lenders can pursue the delinquent borrowers for the difference between the amount that they owed on the property when they stopped paying and the amount the lender was able to make when the property was sold. These debts are often difficult to collect, but some lenders opt to wait years before pursuing them in order to allow former homeowners to get back on their feet. Others sell the debts to third-party collections companies. Even if this part of the debt is ultimately written off, it can create tax problems years down the road for homeowners because when the debt is written off it may be considered income to the homeowner.

For the most part, real estate professionals are hoping that the Mortgage Debt Relief Act will be extended before it expires on December 31 of this year. If not, “it will be a shock to many taxpayers after 2012,” warns Mark Steber, a tax officer for Jackson Hewitt Tax Service[2]. If the legislation is not extended, more homeowners may opt to declare bankruptcy in order to avoid paying income taxes on their “forgiven” debts.

Do you think that the Mortgage Debt Relief Act should be extended through 2013?

Thank you for reading the Bryan Ellis Investing Letter!

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