

# TAKE JUDICIAL NOTICE

## Short Sales

January 24, 2008

It is a comment on things as they are, and a portend of things to come that "Short Sales" are on everybody's minds, including the United States Congress.

Put simply, a "Short Sale" is an arrangement where a homeowner contacts his mortgage holder, and obtains consent to sell his house for an amount which is less than the unpaid principle balance remaining on the mortgage.

For Example: "A" buys a house in 2004 for \$600,000 and borrows \$550,000 from Citibank. "A" loses his job in 2007 and is facing foreclosure. "A" decides to sell his house to avoid foreclosure, but discovers the house is now worth only \$520,000. Enter the "Short Sale." The bank consents to the transaction, and in so doing forgives \$30,000 of the debt in order to facilitate the sale.

### Why would a bank do this?

Banks are in the banking business, not the real estate management business. They do not want to own these homes.

The newly signed "Mortgage Debt Relief Act of 2007" (2 H.R.3647) facilitates the "Short Sale" transaction by clarifying the issue of payment of federal income tax on the portion of the debt that has been forgiven by the lender, the so-called 'Phantom Tax'.

### What are the qualifying criteria in order to come within the Act and eliminate the forgiven debt from gross income?

1. The house must be the principal residence of the borrower.
2. The "Short Sale" must have occurred after January 1, 2007.
3. The mortgage must be what is termed "acquisition indebtedness", that is debt incurred for the acquisition, construction, or substantial improvement of the principal residence. This does not rule out a "Short Sale" if the acquisition mortgage has been refinanced. However, the refinance mortgage is only eligible to the extent of the amount of the original acquisition mortgage.
4. The maximum amount of the mortgage is \$2,000,000. The two sections of the Internal Revenue Code relevant to this discussion are IRC Section 108 and 163 (h) (3) (B).

As in life, there is no free lunch. The amount of debt which is forgiven, and excluded from gross income is applied to reduce the basis of the principal residence of the tax payer/homeowner.

This act is a good first step. Equally, if not more important is that Congress raises the Jumbo Mortgage limit substantially over its current amount of \$417,000.

The Act, as signed into law expires January 1, 2010.