

Real Estate Short Sale Taxes

By Gary Case

Things seem always to be changing when it comes to taxes. Either the regulations change or your personal life takes a turn that has an impact on your tax burden. Here are some things that may be of use to you with respect to taxes if you are selling real estate for less than is owed on the property (a short-sale):

If you are short selling a property, you should understand that, if you sell the property for more than you paid for it (even though you sell it for less than the outstanding debt), your tax gain or loss is based on the difference between the selling price and what you paid for the property (your basis). Even if you lose money on the sale of the property, you may still have a capital gain. The good news is that you'll probably be able to exclude the gain for federal income tax purposes.

You could also have a tax loss on a short sale, but unless the property is an investment or business property, you won't be able to deduct the loss. A capital loss on a personal residence is considered a non-deductible personal expense.

Other interesting news you may get on a short sale is a Form-1099 showing income for the amount your lender forgives in a short sale, called debt-discharge income (DDI). There are some tax-payer friendly exceptions to DDI:

- Up to \$2 million in DDI is tax free if the short sale is a personal residence. Be aware that if you used mortgage money for purposes other than acquiring, building or improving your personal residence, you may owe tax
- Bankruptcy allows the DDI to be tax free
- Insolvency (more debts than assets) allows the DDI to be tax-free as long as the DDI does not cause the borrower to become solvent
- Unpaid mortgage interest that was added to the loan principal and then forgiven is tax-free

The important thing to remember is that a real-estate short sale can potentially be a taxable event. Often the gain may be excluded under the federal home-sale-gain exclusion deal and you might be able to exclude some or all of the DDI, too. You should consult your tax advisor and financial planner to determine the impact a short sale may have on your personal tax situation.

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