



## Tax Reprieve Brings Holiday Cheer for Thousands of Californians

By George Runner

Thousands of struggling Californians who short sold their homes to avoid foreclosure can rest easier this holiday season knowing they won't be hit with huge income tax bills.

The threat was real. A California law protecting homeowners from paying taxes on forgiven debt associated with a short sale expired at the end of 2012, and legislative efforts to extend it failed. Furthermore, a federal law providing the same protections expires at the end of this year.

Nearly everyone believed the result would be that debt forgiven in a short sale would be viewed as taxable income. A homeowner who short sold a home for \$300,000 but owed \$450,000 would be forced to pay taxes on \$150,000 of forgiven debt, known in the tax world as "cancellation of debt income." It wouldn't matter that the homeowner didn't receive those dollars—he or she would still owe the tax.

According to the Franchise Tax Board, the cumulative tax hit for Californians would have surpassed \$50 million at the state level alone. These tax bills would have hammered thousands who have already suffered the most during the recent economic downturn. Likely some would have been forced into bankruptcy.

Rather than simply mail in the keys when forced to move, these homeowners had taken the extra and often difficult step of negotiating a short sale with their lender. Little did they know they could be punished for doing so.

Those who became aware of the potential tax consequences have been worried sick. One homeowner told me she has literally lost sleep trying to figure out how she could possibly afford to pay.

After the legislative solution failed, I sent a letter to the Franchise Tax Board's Chief Counsel requesting a legal opinion on this matter. Perhaps there was another pathway to protect taxpayers.

Initially, FTB staff indicated they would need guidance from the IRS before providing an answer. That guidance arrived in an IRS letter to Senator Barbara Boxer. The IRS said that taxpayers would

not be on the hook for income tax from cancelled debts related to short sales. This will be significant for federal purposes following the expiration of the Mortgage Forgiveness Debt Relief Act at the end of this year.

Just this month FTB formally responded to my letter confirming that it will follow the lead of the Internal Revenue Service and not impose a tax penalty on Californians who have sold their home via a short sale. In her response, FTB Chief Counsel Jozel Brunett stated: "Since California conforms to the relevant portions of the federal tax law governing the forgiveness of nonrecourse and recourse indebtedness, California would follow the federal treatment for the [California Code of Civil Procedure] section 580e transactions."

This is welcome news for Californians who have had to short sell their homes this year. We learned last month they wouldn't face a federal tax penalty in the future, and now we know they won't face a current or future state tax hit either.

The FTB's announcement that it will conform with the IRS ensures continued protection for most taxpayers without the need for additional legislation. That is truly cause for celebration.

Among those celebrating is California Association of Realtors President Kevin Brown, who issued this statement: "We would like to thank Sen. Boxer and BOE member Runner for their leadership in obtaining this guidance from the IRS and FTB. Distressed California homeowners can now avoid foreclosure or bankruptcy and can opt for a short sale instead, without incurring federal and state tax liability, even after the Mortgage Forgiveness Debt Relief Act of 2007 expires at the end of this year."

As an elected taxpayer advocate, it's my duty to help taxpayers each and every day. My job is all the more enjoyable when I'm able to report good news.

One constituent responded by writing: "Thank you! You've saved our family from a burdensome tax that was looming over our heads as we approached the end of the year. I'm sure there are many families that will benefit from this and will be able to get back on their feet sooner because of this determination."

It's not every day Californians receive welcome news from tax agencies. When it happens it's worth noting and applauding, especially when it helps thousands of Californians who now have one less worry this holiday season.

*George Runner represents more than nine million Californians as a taxpayer advocate and elected member of the State Board of Equalization. For more information, visit [boe.ca.gov/Runner](http://boe.ca.gov/Runner).*