

United States Senate

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August 28, 2013

Acting Commissioner Daniel Werfel
U.S. Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20004

Dear Commissioner Werfel:

I am writing today to request that the Internal Revenue Service (IRS) provide written clarification as to whether or not a short sale under the laws of California results in taxable "cancellation-of-debt" income.

This clarification is necessary to avoid confusion and uncertainty among distressed homeowners in California who are considering a short sale of their properties as an alternative to foreclosure. Because the federal Mortgage Forgiveness Debt Relief Act of 2007 exempted any forgiven mortgage debt from being counted as income, homeowners in California and elsewhere who engage in a short sale currently do not have to worry about being hit with a large tax bill on this forgiven debt. However, this law is set to expire at the end of 2013, meaning California borrowers potentially no longer will face such protections unless the IRS treats non-recourse debt in a short sale the same way it already treats non-recourse debt in a foreclosure. Without such an interpretation, distressed borrowers may face the unfortunate incentive to go to foreclosure rather than seek a short sale in order to avoid a large tax bill.

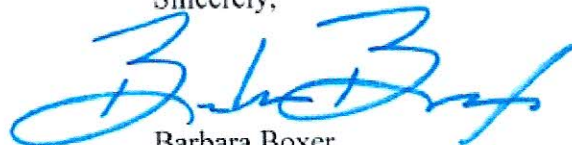
The IRS's Publication 4681 (Canceled Debts, Foreclosures, Repossessions, and Abandonments) states that, "if you are not personally liable for the debt, you do not have ordinary income from the cancellation of debt unless you retain the collateral." Unfortunately, the specific example of a residential short sale and California's unique prohibition on personal recourse for the forgiven debt is not expressly addressed.

Specifically, I would appreciate an answer to the following question: Would a household realize a cancellation of debt if a lender elected to approve a short sale, which by operation of the state's law would mandate a discharge of recourse debt (as California's Civil Code Section 580e does), and at which time the borrower is released from personal liability on the indebtedness secured by the mortgage?

Even in the recovering real estate market, California expects to see 80,000 – 90,000 short sales this year. Many of these homeowners have struggled through years of economic hardships during this recession and have drained life savings attempting to stay in their homes. I would appreciate an expedited response to my letter as a way of providing the certainty these homeowners need to gracefully exit their property and move on with their lives.

Thank you for your help and I look forward to your response.

Sincerely,

A handwritten signature in blue ink, appearing to read 'Barbara Boxer', with a stylized flourish at the end.

Barbara Boxer
United States Senator