

## Massachusetts Alliance Against Predatory Lending

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### FACTSHEET: AN ACT RELATIVE TO THE TAX RELIEF OF MORTGAGE DEBT

**House 3770 (formerly S1464) Main Sponsor:** Senator DiDomenico

**House 3770 (formerly H2607), Main Sponsor:** Representative Malia

#### **What Does This Bill Do?**

This legislation will bring state tax law in line with federal tax law, providing relief to the thousands of Massachusetts homeowners who receive a tax charge after losing their home to foreclosure and, as such, their biggest financial investment of their lives. Current state law presumes the foreclosure of their mortgage provides the homeowner with a windfall profit because their amount of debt was cut. Likewise, when the state's mortgage modification programs work so lender and homeowner come to a mutually agreeable principal reduction or short sale of the home, again there is no real windfall to be taxed. Federal representatives – in response to the burgeoning foreclosure crisis – created an exemption to taxation on unearned “profits” from a foreclosure sell – the Mortgage Forgiveness Debt Relief Act of 2007.

#### **Background**

Many limited income households continue to be affected by the mortgage foreclosure crisis. Household incomes are often devastated trying to pay an unaffordable mortgage. Some are foreclosed upon and end up with a deficiency because they owed more on their mortgage than they went for in the fire sale of a foreclosure auction. Some do a “short sale” where the lender allows the property to be sold for less than the outstanding debt. Some homeowners get modifications of their mortgages where the amount owed is reduced. In each of these cases, the forgiven debt is taxable under the Massachusetts tax code. Debt forgiveness is considered “income” and although the taxpayer never actually receives any money they are taxed on the amount their debt is reduced..

Under federal law the discharge of debt under these circumstances is not taxable under the Mortgage Debt Relief Act of 2007. Because Massachusetts stopped following the federal exemptions in 2005, this “income” based on the forgiven debt is currently taxable as income in Massachusetts. The current rate is 5.25 %, so – for example – if a family received a mortgage modification that resulted in a principal reduction of \$100,000, the family would owe \$5,250 in state taxes.

If you own a property valued at \$500,000 for the purpose of your mortgage & it is foreclosed on at \$350,000, there is a \$150,000 loss which the foreclosing lender sends the former homeowner/borrower on a tax form claiming that the homeowner gained \$150,000 by the devaluing of the loan even though they never got \$150,000 at the sale and lost their primary residence as well.

When the federal IRS is notified of that foreclosing lender's tax generated form there's a special form the homeowner fills out showing it was a foreclosure and the homeowner does not owe any tax liability on money that actually did not materialize.

MAAPL asks the state to follow the federal exemption that was renewed this January. People who lose their homes should not be additionally burdened with a huge tax bill for profits they never realized.

**Other bills filed include:** *An Act to Facilitate Alternatives to Foreclosure, An Act to Prevent Unnecessary Vacancies in Foreclosed Homes, an Act to Establish a Foreclosure Review Division of Superior Court.*

### **Who will be impacted?**

This bill provides relief to every Massachusetts citizen who receives any kind of debt forgiveness related to their primary residence.

Based on initial reports of the National Mortgage Settlement Monitor, in the short period between March 1st and September 30, 2012, Massachusetts residents on average received \$72,578 in debt forgiveness related to their mortgages (*Continued Progress: A Report from the Monitor of the National Mortgage Settlement*, Office of Mortgage Settlement Oversight, November 19, 2012). This would mean that an average borrower will have to pay an additional \$3,810 in additional state income taxes.

Even more troubling is the fact that the tax consequences of debt forgiveness are especially onerous for borrowers who are very low income. The largest amount of debt forgiveness typically goes to those who give up their home to a short sale. In Massachusetts this means an average tax bill of over \$3,810 for borrowers who have already given up their homes as well as any and all money they have paid toward that home for however long they owned it.

### **What impact will this bill have on state revenues/expenses?**

As described above, the current policy of taxing forgiven debt as income is disproportionately burdening low and moderate income taxpayers. Massachusetts could very well spend more on the cost of attempting to collect taxes from these low income people than they would receive in revenues.

### **Other States Provide Tax Relief**

The majority of states either recognize the federal tax exemption for debt reduction related to mortgages on borrowers' homes or have adopted similar laws. Massachusetts should recognize the devastating impact of the foreclosure crisis on its citizens and adopt common sense tax relief for mortgage debt.

### **Why Do Homeowners Still Need Financial Protection from Foreclosures?**

The cumulative impact of foreclosures continues to grow, with billions in consumer spending dollars lost and 67,000 foreclosures since 2005. The predicted return to increasing foreclosures have been realized: December 2014 showed a year over year increase of 323% - the highest in the US. Foreclosures have spread statewide, including in rural communities such as Winchendon and Athol and high income suburbs. The National Consumer Law Center affirmed national projections in early 2012 – projecting almost 100,000 more foreclosures in Massachusetts before this crisis ends.

**MAAPL MEMBERS/SUPPORTING ORGANIZATIONS:** *Action for Boston Community Development, Inc., Action for Regional Equity, Alliance of Providers of Legal Services to Individuals Facing Foreclosure, ARISE for Social Justice, Arlington Community Trabajando, Boston Tenants Coalition, Brazilian Women's Group, Brockton Interfaith Community, Carpenters Local 40, Carpenters Local 107, Charles Hamilton Houston Institute For Race & Justice, Chelsea Collaborative, Chinese Progressive Association, City Life/Vida Urbana, Coalition for Social Justice, Community Economic Development Ctr of S.E. MA, Community Labor United, Democratic Socialists of America, Dorchester People for Peace, Era Key Realty Services, ESAC, Fair Housing Center of Greater Boston, Greater Boston Legal Services, Greater Four Corners Action Coalition, Green-Rainbow Party of MA, Harvard Legal Aid Bureau, Homeowner Options for MA Elders, Jewish Alliance for Law and Social Action, Lawrence Community Works, Lawyers' Committee for Civil Rights Under Law, Lynn United for Change, Legal Assistance Corporation of Central Mass, Mass Advocates for Children, Mass AFL-CIO, Mass Coalition for the Homeless, Mass Community Action Network, Massachusetts Fair Housing Center, Mass Jobs With Justice, Mass Law Reform Institute, Mass Welfare Rights Union, Merrimack Valley Labor Council, NAACP N.E. Area Council, National Community Reinvestment Coalition, National Consumer Law Center, National Lawyers Guild, Neighbor-to-Neighbor, Neighborhood Legal Services, New England United for Justice, North Shore Labor Council, Oiste?, Organization for a New Equality, Painters District Council 35, Pleasant St. Neighborhood Network Center, Southbridge Community Connections, Springfield No One Leaves Coalition, Survivors Inc., UE Northeast Region, Union of Minority Neighborhoods, United Auto Workers Mass CAP, United Food & Commercial Workers 1445, United For a Fair Economy, United Steel Workers Local 5696, Volunteer Lawyers Project, Worcester Anti-Foreclosure Team.*

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