

LEXSTAT LEXIS EXPLANATION IRC SEC. 108(H)

LexisNexis Explanation

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IRC § 108(h)

Income from Discharge of Indebtedness

Special Rules Relating to Qualified Principal Residence Indebtedness

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Lexis Explanation IRC Sec. 108(h)

Prior to the enactment of the *Mortgage Forgiveness Debt Relief Act of 2007*,¹ discharge of indebtedness income on a principal residence was includable in gross income. Now, newly enacted Section 108(h) provides an exclusion from gross income for discharge of indebtedness income for qualified principal residence indebtedness. The amount of discharge of indebtedness excluded from income may not reduce the taxpayer's basis in the residence below zero² and it must be discharged due either to a decline in the value of the residence or to the financial condition of the taxpayer.³ This exclusion from gross income is effective only for discharge of indebtedness occurring on or after January 1, 2007.

"Qualified principle residence indebtedness" means acquisition indebtedness within the meaning of Section 163(h)(3)(B).⁴ When referring to a principal residence, acquisition indebtedness generally means indebtedness which is incurred in the acquisition, construction, or substantial improvement of the principal residence of an individual and is secured by the residence. It also includes any indebtedness secured by such residence resulting from the refinancing of indebtedness up to but not exceeding the amount of the refinanced indebtedness.⁵ The term "principal residence" is generally defined by Section 121 as property that has been owned or used by the taxpayer for two or more years during the past five years.

If only a portion of the debt discharged is qualified principal residence indebtedness, then only the portion of the amount discharged that exceeds the amount of the discharged debt that was not qualified principal residence indebtedness shall be excluded from gross income.⁶

Example:

Julia has a residence which is secured by \$1,500,000 worth of debt, \$1,000,000 of which is qualified principal residence indebtedness. She sells the residence for \$900,000 and has \$600,000 worth of debt discharged. Only \$100,000 of the discharge of indebtedness is excluded from gross income under Section 108(h).

FOOTNOTES

- (1) Pub Law 110-142, 121 Stat 1803 (December 20, 2007).
- (2) IRC § 108(h)(1).
- (3) IRC § 108(h)(3).
- (4) IRC § 108(h)(2).
- (5) IRC § 163(h)(3)(B).
- (6) IRC § 108(h)(4).