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[Home](#) > [Government Affairs](#) > [Issues](#) > [Subprime Lending](#)

Mortgage Cancellation Relief

Current Law, H.R. 3648, and "Pay-For"

Mortgage Cancellation Relief

Current Law: Any amount of mortgage debt forgiveness will be treated as income and the borrower will be taxed at ordinary income rates on the forgiven amount, even though there is no cash.

H.R. 3648/Rangel Bill: Generally, borrowers will not be required to pay tax on mortgage debt forgiven on or after January 1, 2007.

- No income limitation: All borrowers receive the relief, no matter what their income
- Dollar limitation: No more than \$2 million of mortgage debt is eligible for the exclusion.
- Relief applies only to principal residence.
- No relief is available for cash-outs, whether the cash-out takes the form of a refinanced first mortgage, a second mortgage, home equity line of credit or any other similar arrangement.
- The forgiven mortgage debt must have been secured by the residence
- Eligible debt is what is called "acquisition indebtedness." This is debt used to acquire, construct or rehabilitate a residence.
- Refinanced debt qualifies, so long as the debt does not exceed the original amount of the debt. (Same rule as MID)
- Home equity debt qualifies if the funds were used to improve the home. (Borrower must have adequate records, as under current law.)
- See cash-outs, above.

Pay-For

Current Law: An individual who owns more than one property (either a rental property or vacation home), may sell his/her principal residence and receive all the benefits of the \$250,000/\$500,000 exclusion at the sale of his/her principal residence. That person may then move into the vacation/rental property, use it as a principal residence and then receive the benefit of the full exclusion again after two years. If that person has another property, they can repeat the process, again receiving the benefit of the full exclusion after two years.

Rangel Bill: This rule is modified so that an individual who owns more than one property may still convert that property to a principal residence. The individual, however, will not be able to realize the full amount of the exclusion after 2 years of residency. A formula based on the period of ownership will determine the amount of excludable gain. The new formula will not be retroactive in its application.

IN THIS SECTION

[Issue Summary](#)
[Issue Timeline](#)
[In-Depth Analysis](#)



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