These days, many people find themselves in a difficult situation involving mortgages on real estate. They may not be able to service the loan under the terms of the promissory note, or they find themselves obligated to make payments on a mortgage larger than the property's fair market value. An increasingly common way to address this matter is to seek out what is called a "short sale." This little two word phrase means nothing other than the process via which the mortgage holder, typically a bank, agrees to accept less than what it is owed on the promissory note in exchange for a discharge of the mortgage. It all sounds so nice and easy, until one realizes that there are tax implications in the transaction.

When a short sale takes place, the bank holding the mortgage is required to file with the Internal Revenue Service, Form 1099-C, Cancellation of Debt. Assume this case: a $200,000 mortgage of a home worth $150,000; and, the bank agrees to accept $150,000 in full and complete satisfaction of its mortgage, and it issues a discharge so marketable title can be passed to the third party purchaser. Where did the $50,000 go? Well, first of all, it's attributed to the seller (the grantor of the $200,000 mortgage) by the bank on Form 1099-C. The reason the IRS wants to know about the transaction is because the cancellation of secured debt is *taxable income* to the person released from the obligation to pay that sum to the bank. And in a real world example, the cancellation of debt amount is likely to be even higher than in our hypothetical, because the amount will almost certainly include the bank's costs in doing the deal, as well as accrued interest and penalty charges.

A carryover concept from the world of bankruptcy may affect one's tax outcome in a forgiveness of debt situation. If the person released from the obligation to pay is *insolvent* at the time of the default, than the amount forgiven IS NOT taxable income. Insolvency is determined with reference to state law, and typically means that one is unable to pay one's bills as they become due; or, that one's assets exceed one's liabilities.