

## United States Senate

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May 21, 2014

Commissioner John Koskinen  
U.S. Internal Revenue Service  
1111 Constitution Avenue, NW  
Washington, DC 20004

Dear Commissioner Koskinen:

I am writing to thank you for the Internal Revenue Service (IRS) September 19, 2013 and April 29, 2014 letters providing written clarification that most short sales under the laws of California will not result in taxable "cancellation-of-debt" income. These clarifications will afford thousands of distressed homeowners in California the certainty they need to consider a short sale of their properties as an alternative to foreclosure.

The April 29 letter, which bases its analysis on a different section of the California code than the prior letter, however, raises several additional questions regarding forgiven debt and its tax effect upon the homeowner. I would very much appreciate your clarification on the following issues that are still unclear in light of the new letter.

First, is "purchase-money" debt as described in the letter the same as "acquisition" debt, a term that is referenced in various relevant IRS publications but not used in the California code? It seems from the letter that they might be, but if they are not, it is important to distinguish them. In particular, when a home improvement loan has contributed to the homeowner's basis in the property (and would thus be acquisition debt), would it have the character of purchase money debt for the purposes of cancellation of debt when it is consolidated into a single loan that refinances the original mortgage, and which is without recourse after an approved short sale?

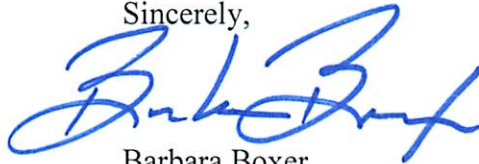
Second, because your most recent analysis relies on a section of the California code that addresses the nature of debt from its inception, rather than upon a short sale as with the previous letter, it raises questions about other forms of forgiven debt. Specifically, would a reduction in the principal balance of a homeowner's purchase money mortgage as part of a loan modification result in cancellation of debt income? Although in the case of a principal reduction there is no disposition of the home in connection with the change (indeed, that is the point of the loan modification), as your letter notes, this purchase-money debt is non-recourse from its inception.

Finally, what is the IRS's position on homeowners who completed a short sale in the first part of this year while relying upon the earlier letter? I am concerned that the current letter, with its more narrow analysis, may have negative consequences for some homeowners who made a good faith decision to go through with a short sale based on the earlier guidance. Although most of the estimated 12,000 or more California homeowners who completed a short sale in the first

four months of 2014 will be unaffected, it seems unfair to subject a short seller to unanticipated cancellation of debt tax liability if they would not have been subject to such liability, and had acted with this understanding, under the analysis of the earlier letter.

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

Sincerely,

A handwritten signature in blue ink, appearing to read 'Barbara Boxer', written in a cursive style.

Barbara Boxer  
United States Senator