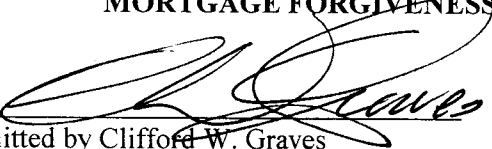


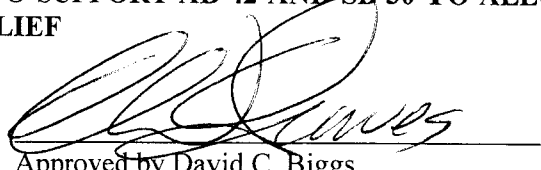


City of Carson Report to Mayor and City Council

February 5, 2013
New Business Consent

SUBJECT: CONSIDER RESOLUTION NO. 13-013 TO SUPPORT AB 42 AND SB 30 TO ALLOW MORTGAGE FORGIVENESS DEBT RELIEF


Submitted by Clifford W. Graves
Director of Community Development


Approved by David C. Biggs
City Manager

I. SUMMARY

This item is on tonight's agenda at the request of Councilman Gipson. As a result of the housing crisis of the last few years, many homeowners have found their home to be worth far less than the mortgage on the property with no reasonable hope of being able to refinance at a reasonable rate or sell the property at a high enough price to satisfy the loan. The federal government and the state have allowed the amount of the forgiven loan to be excluded from being taxable income. The state exclusion expired January 1. Resolution No. 13-013 (Exhibit No. 1) is presented for consideration to support extending the exclusion.

II. RECOMMENDATION

WAIVE further reading and ADOPT Resolution No. 13-103, "A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF CARSON, CALIFORNIA, SUPPORTING AB 42 AND SB 30 TO ALLOW MORTGAGE FORGIVENESS DEBT RELIEF."

III. ALTERNATIVES

TAKE another action the City Council deems appropriate.

IV. BACKGROUND

As home prices fell, many owners found their mortgages to be far beyond the value of the home. For those with short-term or adjustable mortgages, that sometimes meant they had no way to refinance to avoid a balloon payment or huge upward rate adjustment. In other cases, the value was so far below the loan amount that the property would be "upside down" for many years.

Tax laws were such that a sale for less than the value of the loan would create a tax burden that treated the difference between the loan and the sale price as taxable income. Congress voted to exclude this amount with some limitations. California followed suit. While Congress has extended that exclusion to the current year, California has yet to do so.

There are certainly homeowners in Carson who are benefitting from the exclusion. Staff regularly sees notices of short sales, and there are cases where lenders are forgiving a portion of the loan in refinancing. Two pieces of legislation, AB 42

(Exhibit No. 2) by Assembly Member Perea and SB 30 (Exhibit No. 3) by Senator Calderon, would extend the exclusion for all of 2013. The attached analysis (Exhibit No. 4) from the Franchise Tax Board reviews the matter in much more detail. Should these pieces of legislation be enacted, it would be great benefit to Carson residents who find themselves severely underwater on their home loan.

V. FISCAL IMPACT

None.

VI. EXHIBITS

1. Resolution No. 13-013 (pgs. 3-4)
2. Text of AB 42 (pgs. 5-6)
3. Text of SB 30 (pgs. 7-8)
4. Franchise Tax Board analysis of SB 30 (pgs. 9-16)

Prepared by: Barry Waite, Business Development Manager

TO: Rev09-04-2012

Reviewed by:

City Clerk	City Treasurer
Administrative Services	Public Works
Community Development	Community Services

Action taken by City Council

Date_____ Action_____

RESOLUTION NO. 13-013

A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF
CARSON, CALIFORNIA, SUPPORTING AB 42 AND SB 30
TO ALLOW MORTGAGE FORGIVENESS DEBT RELIEF

WHEREAS, the financial crisis in our nation has reduced the value of many homes to a level far below the mortgage debt on the home; and

WHEREAS, many home owners are unable to sell their property at a price high enough to cover the mortgage; and

WHEREAS, if a person borrows money from a commercial lender and the lender later cancels (forgives) the debt, the taxpayer may have to include the cancelled amount for income tax purposes; and

WHEREAS, such a tax burden can be crippling to a family already struggling to pay for housing and potentially in serious debt; and

WHEREAS, the federal government has taken action to allow a person to exclude the cancelled debt amount from federal tax purposes; and

WHEREAS, California law allowed until 2013 for a limited similar relief from state income tax purposes; and

WHEREAS, two pieces of legislation, AB 42 by Assembly Member Perea and SB 30 by Senator Calderon, have been proposed to continue that relief through 2013.

NOW, THEREFORE, BE IT RESOLVED, by the City of Carson, that it supports the extension of the tax exclusion; and

BE IT FURTHER RESOLVED, that the City of Carson also supports AB 42 AND SB 30 to enact the extension.

[MORE]

PASSED, APPROVED and ADOPTED this _____ day of February, 2013.

Mayor Jim Dear

ATTEST:

City Clerk Donesia L. Gause, CMC

APPROVED AS TO FORM:

City Attorney

ASSEMBLY BILL

No. 42

Introduced by Assembly Member Perea

December 7, 2012

An act relating to taxation.

LEGISLATIVE COUNSEL'S DIGEST

AB 42, as introduced, Perea. Taxation: cancellation of indebtedness: mortgage debt forgiveness.

The Personal Income Tax Law conforms to specified provisions of the federal Mortgage Forgiveness Debt Relief Act of 2007, as amended by the federal Emergency Economic Stabilization Act of 2008, relating to the exclusion of the discharge of qualified principal residence indebtedness, as defined, from an individual's income if that debt is discharged after January 1, 2007, and before January 1, 2013, as provided.

This bill would make findings and declarations regarding mortgage debt forgiveness and would state the intent of the Legislature to enact legislation that would conform to federal law with regard to any extension of the exclusion described above.

Vote: majority. Appropriation: no. Fiscal committee: no.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. The Legislature finds and declares all of the
2 following:
3 (a) A homeowner can lose his or her job or become seriously
4 ill and then be unable to pay the monthly mortgage. In the resulting

1 short sale or foreclosure, the homeowner not only loses his or her
2 home, but may also be taxed on relief of indebtedness income that
3 the homeowner did not receive.

4 (b) If the homeowner refinances his or her mortgage, as many
5 homeowners do, the nature of the debt is changed and the
6 homeowner may be personally liable for the payment of that debt.

7 (c) Absent an extension of the debt forgiveness protections
8 beyond this year, homeowners will again be subject to taxation on
9 income they never actually received.

10 SEC. 2. It is the intent of the Legislature to enact legislation
11 that would extend the operation of Section 17144.5 of the Revenue
12 and Taxation Code, relating to the exclusion of the discharge of
13 qualified principal residence indebtedness from an individual's
14 income, to conform to any federal legislation that extends the
15 operation of this exclusion in federal income tax law.



**Introduced by Senator Calderon
(Coauthors: Senators Block, Correa, Lieu, and Price)**

December 3, 2012

An act to amend Section 17144.5 of the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

SB 30, as introduced, Calderon. Taxation: cancellation of indebtedness: mortgage debt forgiveness.

The Personal Income Tax Law conforms to specified provisions of the federal Mortgage Forgiveness Debt Relief Act of 2007, relating to the exclusion of the discharge of qualified principal residence indebtedness, as defined, from a taxpayer's income if that debt is discharged after January 1, 2007, and before January 1, 2010, as provided. The federal Emergency Economic Stabilization Act of 2008 extended the operation of those provisions to debt that is discharged before January 1, 2013.

This bill would extend the operation of the exclusion of the discharge of qualified principal residence indebtedness to debt that is discharged before January 1, 2014.

This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.
State-mandated local program: no.

The people of the State of California do enact as follows:

- 1 SECTION 1. Section 17144.5 of the Revenue and Taxation
- 2 Code is amended to read:

1 17144.5. (a) Section 108(a)(1)(E) of the Internal Revenue
2 Code; is modified ~~to~~ *as follows*:
3 (1) To provide that the amount excluded from gross income
4 shall not exceed \$500,000 (\$250,000 in the case of a married
5 individual filing a separate return).
6 (2) *By substituting the phrase "January 1, 2014" for the phrase*
7 *"January 1, 2013" contained therein.*
8 (b) Section 108(h)(2) of the Internal Revenue Code, is modified
9 by substituting the phrase "(within the meaning of section
10 163(h)(3)(B), applied by substituting '\$800,000 (\$400,000' for
11 '\$1,000,000 (\$500,000' in clause (ii) thereof)" for the phrase
12 "(within the meaning of section 163(h)(3)(B), applied by
13 substituting '\$2,000,000 (\$1,000,000' for '\$1,000,000 (\$500,000'
14 in clause (ii) thereof)" contained therein.
15 (c) This section shall apply to discharges of indebtedness
16 occurring on or after January 1, 2007, and, notwithstanding any
17 other law to the contrary, no penalties or interest shall be due with
18 respect to the discharge of qualified principal residence
19 indebtedness during the 2007 or 2009 taxable year regardless of
20 whether or not the taxpayer reports the discharge on his or her
21 return for the 2007 or 2009 taxable year.
22 SEC. 2. This act provides for a tax levy within the meaning of
23 Article IV of the Constitution and shall go into immediate effect.

Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

Author: Calderon, et al.Analyst: Scott McFarlaneBill Number: SB 30Related Bills: See Legislative HistoryTelephone: 845-6075Introduced Date: December 3, 2012Attorney: Patrick Kusiak

Sponsor: _____

SUBJECT: Mortgage Forgiveness Debt Relief**SUMMARY**

This bill would extend the state exclusion of mortgage forgiveness debt relief for one year, through 2013.

RECOMMENDATION

No position.

Summary of Suggested Amendments

Amendment one is suggested to provide specific operative-date language.

PURPOSE OF THE BILL

The purpose of the bill is to prevent undue hardship to taxpayers who would otherwise be subject to taxation resulting from having all or part of their loan balance on their principal residence forgiven by their lender.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately, and would be operative for discharges of indebtedness occurring on or after January 1, 2013.

Background*Cancellation of Debt (COD)*

If a taxpayer borrows money from a commercial lender and the lender later cancels ("forgives") the debt, the taxpayer may have to include the cancelled amount in income for tax purposes. When the taxpayer borrowed the money, the loan proceeds were not required to be included in income because the taxpayer had an obligation to repay the lender. When that obligation is subsequently extinguished, the amount received as loan proceeds is often reportable as income because there is no longer an obligation to repay the lender. The lender is usually required to report the amount of COD to the taxpayer and the IRS on a Form 1099-C, Cancellation of Debt.

Board Position:

_____ S	_____ NA	<u> X </u> NP
_____ SA	_____ O	_____ NAR
_____ N	_____ OUA	

Executive Officer

Date

Example: A taxpayer borrows \$10,000 and defaults on the loan after paying back \$2,000. If the lender is unable to collect the remaining debt, there is a cancellation of debt of \$8,000, which generally is taxable income.

When COD Income is Taxable

While COD income is generally includable as taxable income, there are some exceptions:

- Bankruptcy: Debts discharged through bankruptcy are not considered taxable income.
- Insolvency: If a taxpayer is insolvent when the debt is cancelled, some or all of the cancelled debt may not be taxable. A taxpayer is insolvent when the taxpayer's total debts are more than the fair market value of the taxpayer's total assets.
- Mortgage forgiveness debt relief. Certain home mortgage debts forgiven by a lender are not considered taxable income. (See below for more detail.)
- Certain farm debts.
- Non-recourse loans: A non-recourse loan is a loan for which a lender's only remedy in case of default is to repossess the property being financed or used as collateral. That is, the lender cannot pursue the borrower personally in case of default. Forgiveness of a non-recourse loan resulting from a foreclosure does not result in COD income. However, it may result in other tax consequences, such as capital gain.

Note: Section 580b of the California Code of Civil Procedure provides that indebtedness incurred to purchase a home in California is non-recourse debt. Therefore, in general, first mortgages in California are non-recourse debt. If a California homeowner refinances that debt, or takes out a home equity loan, the refinanced indebtedness or the home equity loan is generally recourse debt.

ANALYSIS

FEDERAL/STATE LAW

FEDERAL LAW

Gross Income in General

Gross income is the starting point in determining an individual's taxable income. Gross income is broadly defined, and generally consists of all income from all sources, such as compensation for services, business income, interest, rents, dividends, and gains from the sale of property.¹ Only items that are specifically exempt may be excluded from gross income.

Gross Income from the Discharge of Indebtedness

Gross income includes income that is realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain student loans, certain farm indebtedness, certain real property business indebtedness, and qualified principal residence indebtedness (IRC sections 61(a)(12) and 108). In cases involving

¹ IRC section 61.

discharges of indebtedness that are excluded from gross income under the exceptions to the general rule, taxpayers generally reduce certain tax attributes, including basis in property, by the amount of the discharge of indebtedness.

The amount of discharge of indebtedness excluded from income by an insolvent debtor not in a Title 11 bankruptcy case cannot exceed the amount by which the debtor is insolvent. In the case of a discharge in bankruptcy or where the debtor is insolvent, any reduction in basis may not exceed the excess of the aggregate bases of properties held by the taxpayer immediately after the discharge over the aggregate of the liabilities immediately after the discharge (IRC section 1017).

Mortgage Forgiveness Debt Relief

The Mortgage Forgiveness Debt Relief Act of 2007 (Public Law 110-142)

The Mortgage Forgiveness Debt Relief Act of 2007, enacted December 20, 2007, excludes from the gross income of a taxpayer any discharge-of-indebtedness income by reason of a discharge of qualified principal residence indebtedness occurring on or after January 1, 2007, and before January 1, 2010. Qualified principal residence indebtedness means acquisition indebtedness (within the meaning of IRC section 163(h)(3)(B)), up to \$2,000,000. Acquisition indebtedness with respect to a principal residence generally means indebtedness incurred in the acquisition, construction, or substantial improvement of the principal residence of the individual and secured by the residence. It also includes refinancing of such debt to the extent the amount of the refinancing does not exceed the amount of the indebtedness being refinanced.²

If, immediately before the discharge, only a portion of a discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to so much of the amount discharged as exceeds the portion of the debt that is not qualified principal residence indebtedness. Thus, assume that a principal residence is secured by an indebtedness of \$1 million, of which \$800,000 is qualified principal residence indebtedness. If the residence is sold for \$700,000 and \$300,000 debt is discharged, then only \$100,000 of the amount discharged may be excluded from gross income under this provision.

The individual's adjusted basis in their principal residence is reduced by the amount excluded from income under the Act. Under the Act, the exclusion does not apply to a taxpayer in a Title 11 case; instead, the present-law exclusion applies. In the case of an insolvent taxpayer not in a Title 11 case, the exclusion under the Act applies unless the taxpayer elects to have the present-law exclusion apply.

The Emergency Economic Stabilization Act of 2008 (Public Law 110-343)

The Emergency Economic Stabilization Act of 2008, enacted October 3, 2008, extended the gross-income exclusion of discharge-of-indebtedness income by reason of a discharge of

² The term "principal residence" has the same meaning as the home-sale exclusion rules under IRC section 121. Refer to federal Treasury Regulation section 1.121-1 for the facts and circumstances used to determine "principal residence."



qualified principal residence indebtedness by three years (i.e., the exclusion applies to discharges occurring before January 1, 2013).

The American Taxpayer Relief Act of 2012 (Public Law 112-240)

The American Taxpayer Relief Act of 2012, enacted January 2, 2013, extended the gross-income exclusion of discharge-of-indebtedness income by reason of a discharge of qualified principal residence indebtedness by one year (i.e., the exclusion applies to discharges occurring before January 1, 2014).

STATE LAW

California generally conforms to the federal definition of gross income, and conforms to the federal rules for the exclusion of discharge-of-indebtedness income by reason of a discharge of qualified principal residence indebtedness (i.e., mortgage forgiveness debt relief), with the following modifications:

- The exclusion does not apply to discharges occurring in 2013.
 - The California exclusion applies to discharges occurring on or after January 1, 2007, and before January 1, 2013.
 - The federal exclusion applies to discharges occurring on or after January 1, 2007, and before January 1, 2014.
- The maximum amount of qualified principal residence indebtedness (i.e., the amount of principal residence indebtedness eligible for the exclusion) is reduced.
 - The California maximum amount of qualified principal residence indebtedness is \$800,000 (\$400,000 in the case of a married/registered domestic partner (RDP) individual filing a separate return).
 - The federal maximum amount of qualified principal residence indebtedness is \$2,000,000 (\$1,000,000 in the case of a married/individual filing a separate return).
- The total amount that may be excluded from gross income is limited.
 - For discharges occurring in 2007 or 2008, California limits the total amount that may be excluded from gross income to \$250,000 (\$125,000 in the case of a married/RDP individual filing a separate return).
 - For discharges occurring in 2009, 2010, 2011, or 2012, California limits the total amount that may be excluded from gross income to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return).
 - There is no comparable federal limitation in any year.
- Interest and penalties are not imposed with respect to 2007 or 2009 discharges.
 - California prohibits the imposition of any interest or penalties with respect to discharges of qualified principal residence that occurred during the 2007 or 2009 taxable years.
 - There is no comparable federal prohibition.

THIS BILL

This bill would extend California's modified conformity to mortgage forgiveness debt relief for one year, through 2013. Specifically,

- The California exclusion would apply to discharges occurring before January 1, 2014,
- The maximum amount of qualified principal residence indebtedness would be \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return), and
- The total amount excludable from gross income would be limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return).

TECHNICAL CONSIDERATIONS

This bill does not contain an operative date for the changes that would be made to Revenue & Taxation Code (R&TC) section 17144.5; without a specified operative date, this bill could be interpreted to retroactively increase the current-law exclusion limitation on 2007 and 2008 discharges from \$250,000 (\$125,000 in the case of a married/RDP individual filing a separate return) to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return). Amendment one is suggested to specify that the amendments made by this bill would apply to discharges occurring on or after January 1, 2013.

LEGISLATIVE HISTORY

AB 856 (Jeffries, 2011/2012) would have added a new section to the R&TC relating to mortgage forgiveness debt relief without making a substantive change to current law. That bill failed to pass.

AB 111 (Niello, 2009/2010) would have provided the same exclusion from gross income for mortgage forgiveness debt relief that is allowed under federal law for discharges occurring on or after January 1, 2007, and before January 1, 2013. That bill failed to pass.

AB 1580 (Calderon, 2009/2010) would have extended mortgage forgiveness debt relief through 2012, modified to provide that the total amount excludable would have been limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return), and qualified principal residence indebtedness would have been limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return). That bill was vetoed by the Governor on October 11, 2009. A copy of the Governor's veto message is provided in Exhibit A.

AB 1779 (Niello et al., 2009/2010) would have provided the same exclusion from gross income for mortgage forgiveness debt relief that is allowed under federal law for discharges occurring on or after January 1, 2007, and before January 1, 2013. That bill failed to pass.

ABX6 7 (Blakeslee and Niello, 2009/2010) would have provided the same exclusion from gross income for mortgage forgiveness debt relief that is allowed under federal law for discharges occurring on or after January 1, 2007, and before January 1, 2013. That bill failed to pass.

SB 97 (Calderon and Correa, 2009/2010) would have extended mortgage forgiveness debt relief through 2012, modified to provide that the total amount excludable would have been limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return), qualified principal residence indebtedness would have been limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return), and interest and penalties would not be imposed with respect to discharges that occurred in the 2009 taxable year. That bill failed to pass.

SB 401 (Wolk, 2009/2010, Ch. 14, Laws 2010) generally conforms California law to the federal extension of mortgage forgiveness debt relief provided in the Emergency Economic Stabilization Act of 2008, with the following modifications: (1) the exclusion applies to discharges occurring in 2009, 2010, 2011, and 2012; (2) the total amount of qualified principal residence indebtedness is limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return); (3) the total amount excludable is limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return); and (4) interest and penalties are not imposed with respect to discharges that occurred in the 2009 taxable year.

SBX6 14 (Calderon, et al., 2009/2010) would have extended mortgage forgiveness debt relief through 2012, modified to provide that the total amount excludable would be limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return), qualified principal residence indebtedness would be limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return), and interest and penalties would not be imposed with respect to discharges that occurred in the 2009 taxable year. That bill failed to pass.

SBX8 25 (Calderon and Correa, 2009/2010) would have extended mortgage forgiveness debt relief through 2012, modified to provide that the total amount excludable would be limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return), qualified principal residence indebtedness would be limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return), and interest and penalties would not be imposed with respect to discharges that occurred in the 2009 taxable year. That bill failed to pass.

SBX8 32 (Wolk, Leno, and Calderon, 2009/2010) would have extended mortgage forgiveness debt relief through 2012, modified to provide that the total amount excludable would have been limited to \$500,000 (\$250,000 in the case of a married/RDP individual filing a separate return), qualified principal residence indebtedness would have been limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return), and interest and penalties would not have been imposed with respect to discharges that occurred in the 2009 taxable year. That bill was vetoed by the Governor on March 25, 2010. A copy of the Governor's veto message is provided in Exhibit B.

AB 1918 (Niello, 2007/2008) was nearly identical to SB 1055 (Machado/Correa, 2007/2008), except that it did not contain the \$250,000/\$125,000 exclusion limitation. That bill failed to pass.

SB 1055 (Machado/Correa, 2007/2008, Ch. 282, Laws 2008) generally conforms California law to the federal Mortgage Forgiveness Debt Relief Act of 2007, with the following modifications: (1) the exclusion applies to discharges occurring in 2007 and 2008; (2) the total amount of qualified principal residence indebtedness is limited to \$800,000 (\$400,000 in the case of a married/RDP individual filing a separate return); (3) the total amount excludable is limited to \$250,000 (\$125,000 in the case of a married/RDP individual filing a separate return); and (4) interest and penalties are not imposed with respect to discharges that occurred in the 2007 taxable year.

OTHER STATES' INFORMATION

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws. *Illinois, Michigan, Minnesota and New York* conform to the federal mortgage-forgiveness-debt-relief exclusion rules, and *Massachusetts* does not. *Florida* does not impose personal income tax: thus, this provision is "not applicable" to *Florida*.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

Estimated Revenue Impact of SB 30 For Discharges Occurring On or After January 1, 2013, and Before January 1, 2014 Assumed Enactment After June 30, 2013 (\$ in Millions)			
Fiscal Year	2012-13	2013-14	2014-15
Amount	\$0	-\$50	-\$5

SUPPORT/OPPOSITION

Support: None provided.

Opposition: None provided.

ARGUMENTS

Pro: Proponents may argue that this bill would provide much-needed state-level tax relief to homeowners facing financial hardship because of the mortgage crisis.

Con: Opponents may argue that an extension of mortgage forgiveness debt relief could make debt forgiveness more attractive for homeowners relative to current state tax law and may encourage homeowners to be less responsible about fulfilling their debt obligations.

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