108TH CONGRESS
2D SESSION
S. 2955

To amend the Internal Revenue Code of 1986 to exclude from gross income of individual taxpayers discharges of indebtedness attributable to certain forgiven residential mortgage obligations.

IN THE SENATE OF THE UNITED STATES

OCTOBER 8, 2004

Mr. Smith (for himself and Mr. Conrad) introduced the following bill; which was read twice and referred to the Committee on Finance

A BILL

To amend the Internal Revenue Code of 1986 to exclude from gross income of individual taxpayers discharges of indebtedness attributable to certain forgiven residential mortgage obligations.

1 Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

2 SECTION 1. SHORT TITLE.

3 This Act may be cited as the “Mortgage Cancellation Relief Act of 2004”.

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SEC. 2. EXCLUSION FROM GROSS INCOME FOR CERTAIN FORGIVEN MORTGAGE OBLIGATIONS.

(a) In General.—Paragraph (1) of section 108(a) of the Internal Revenue Code of 1986 (relating to exclusion from gross income) is amended by striking “or” at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting “, or”, and by inserting after subparagraph (D) the following new subparagraph:

“(E) in the case of an individual, the indebtedness discharged is qualified residential indebtedness.”.

(b) Qualified Residential Indebtedness Shortfall.—Section 108 of such Code (relating to discharge of indebtedness) is amended by adding at the end the following new subsection:

“(h) Special Rules for Qualified Residential Indebtedness.—

“(1) Limitations.—

“(A) In General.—The amount excluded under subparagraph (E) of subsection (a)(1) with respect to any qualified residential indebtedness shall not exceed the excess (if any) of—

“(i) the outstanding principal amount of such indebtedness (immediately before the discharge), over
“(ii) the sum of—

“(I) the amount realized from the sale of the real property securing such indebtedness reduced by the cost of such sale, and

“(II) the outstanding principal amount of any other indebtedness secured by such property.

“(B) OVERALL LIMITATION.—The amount excluded under subparagraph (E) of subsection (a)(1) with respect to any qualified residential indebtedness shall not exceed $50,000.

“(2) QUALIFIED RESIDENTIAL INDEBTEDNESS.—

“(A) IN GENERAL.—The term ‘qualified residential indebtedness’ means indebtedness which—

“(i) was incurred or assumed by the taxpayer in connection with real property used by the taxpayer as a principal residence (within the meaning of section 121) and is secured by such real property,

“(ii) is incurred or assumed to acquire, construct, reconstruct, or substantially improve such real property, and
“(iii) with respect to which such taxpayer makes an election to have this paragraph apply.

“(B) REFINANCED INDEBTEDNESS.—Such term shall include indebtedness resulting from the refinancing of indebtedness under subparagraph (A)(ii), but only to the extent the refinanced indebtedness does not exceed the amount of the indebtedness being refinanced.

“(C) EXCEPTIONS.—Such term shall not include qualified farm indebtedness or qualified real property business indebtedness.

“(3) REGULATIONS.—The Secretary may by regulation provide for the disallowance of an exclusion under this section by reason of subparagraph (E) of subsection (a)(1) in cases where the failure to repay the indebtedness is due to the bad faith of the taxpayer.”.

(c) CONFORMING AMENDMENTS.—

(1) Paragraph (2) of section 108(a) of such Code is amended—

(A) in subparagraph (A) by striking “and (D)” and inserting “(D), and (E)”, and

(B) by amending subparagraph (B) to read as follows:
“(B) INSOLVENCY EXCLUSION TAKES
PRECEDENCE OVER QUALIFIED FARM EXCLU-
SION, QUALIFIED REAL PROPERTY BUSINESS
EXCLUSION, AND QUALIFIED RESIDENTIAL
SHORTFALL EXCLUSION.—Subparagraphs (C),
(D), and (E) of paragraph (1) shall not apply
to a discharge to the extent the taxpayer is in-
solvent.”.

(2) Paragraph (1) of section 108(b) of such
Code is amended by striking “or (C)” and inserting
“(C), or (E)”.

(3) Subsection (b) of section 121 of such Code
is amended by adding at the end the following new
paragraph:

“(4) SPECIAL RULE RELATING TO DISCHARGE
OF INDEBTEDNESS.—The amount of gain which
(but for this paragraph) would be excluded from
gross income under subsection (a) with respect to a
principal residence shall be reduced by any amount
excluded from the gross income of the taxpayer
under section 108(a)(1)(E) with respect to such resi-
dence.”.
(d) **Effective Date.**—The amendments made by this section shall apply to discharges after the date of the enactment of this Act.