ROBBING PETER TO PAY FOR PAUL'S RESIDENTIAL REAL ESTATE SPECULATION: THE INJUSTICE OF NOT TAXING FORGIVEN MORTGAGE DEBT

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INTRODUCTION

Forgiven or cancelled loan debt is an accession to wealth,[1] and

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therefore constitutes taxable income under the Internal Revenue Code.[2] However, for the period of January 1, 2007, through December 31, 2012,[3] Congress has enacted legislation in the Mortgage Forgiveness

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their skilled editorial review and assistance.

[1] *See* Martin J. McMahon, Jr. & Daniel Simmons, *A Field Guide to Cancellation of Debt Income*, 63 TAX LAW 415, 417 (2010) ("If the loan transaction is viewed as a whole, when a borrower receives money in a loan transaction and is later discharged from the liability without repaying the debt, the borrower has realized an accession to wealth. Recognizing the existence of income in this situation generally is not a problem for the income tax system. The receipt of the proceeds of a loan is not income because the receipt is offset by an obligation to repay the borrowed amount. If the obligation to repay the borrowed amount is eliminated or reduced without the concomitant repayment, the borrower realizes an accession to wealth that, as a matter of tax theory, should be included in gross income."); *See also* United States v. Kirby Lumber Co., 284 U.S. 1, 3, 5 (1931) (A corporation sold its own bonds in 1923 for $12,126,800, equal to their par value. Later that same year, the corporation repurchased the bonds below par, at a discount of approximately $137,521. The court ruled that ". . . the taxpayer made a clear gain. As a result of its dealings it made available $ 137,521.30 assets previously offset by the obligation of bonds now extinct. We see nothing to be gained by the discussion of judicial definitions. The defendant in error has realized within the year an accession to income . . .."); *See also* James L. Musselman, *Is Income from Discharge of Indebtedness Really Income at All? A Proposal for a More Reasoned Analysis*, 34 U. MEM. L. REV. 607, 633-634 (2004) ("When determining the value received from the discharge of indebtedness, it is necessary to evaluate the transaction that initially created the indebtedness since any value the taxpayer received from a discharge of indebtedness would have been received at that time. Notably, the value received by the taxpayer at the time of the transaction initially creating the indebtedness would not have been included in the taxpayer's gross income at that time because the receipt of such value coincided with the creation of the indebtedness by the taxpayer, thus resulting in no accession to the taxpayer's wealth. In most cases, determination of the value received by the taxpayer in a transaction creating an indebtedness is simple. If a taxpayer borrows $ 10,000 from a bank in cash, and the debt is subsequently discharged by the bank, the taxpayer would clearly have $ 10,000 of gross income from discharge of indebtedness. No one would argue with the conclusion that the taxpayer received $ 10,000 of value when he borrowed that amount from the bank because he received $ 10,000 in cash.") *See generally* Jay A. Nathanson, *Tax Issues in Workouts and Foreclosures*, 65 J. MO. B. 240, 240-241 (2009) (explaining that unless otherwise expressly excluded, income from cancellation or discharge of indebtedness is generally to be included in gross income as an accession to wealth).

[2] *See* 26 U.S.C. § 61(a)(12) (2010) ("[G]ross income means all income from whatever source derived, including (but not limited to) . . . (12) Income from discharge of indebtedness . . . ."); *See also* Lawrence Zelenak, *Cancellation-of-Indebtedness Income and Transactional Accounting,* 29 VA. TAX REV. 277, 313-315 (2009) (explaining that there is a philosophical distinction between a forgiven loan where the taxpayer receives an actual economic gain versus a "no benefit debt" such as a forgiven tort judgment where the tort debtor never benefitted from a tangible economic benefit by incurring the original tort debt).

[3] The Mortgage Forgiveness Debt Relief Act of 2007 initially allowed the tax free discharge of debt from January 1, 2007 through December 31, 2009. *See* H.R. Res. 3648, 110th Cong. §§ 2(a), 2(d) (2007) (enacted). The Emergency Economic Stabilization Act of 2008 extended the deadline from December 31, 2009 to December 31, 2012. *See* H.R. Res.

Debt Relief Act of 2007[4] (hereinafter "MoFoDRA") which exempts forgiven loan debt on a principal residence[5] from taxation. From 2007 through 2012, MoFoDRA allows individuals to completely escape taxation on unpaid loan debt used to speculate on residential real estate.[6]

1424, 110th Cong. § 303 (2008) (enacted). *See* 26 U.S.C. § 108(a)(1)(E) (2010).

4 H.R. Res. 3648, 110th Cong. (2007) (enacted); *See also* 26 U.S.C. § 108(a)(1)(E) ("Gross income does not include any amount which . . . would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if . . . the indebtedness discharged is qualified principal residence indebtedness which is discharged before January 1, 2013.").

5 Vacation homes and rental properties are excluded from coverage. *See* 26 U.S.C. § 108(h)(5) (2010) ("(5) Principal residence. For purposes of this subsection, the term "principal residence" has the same meaning as when used in section 121."). The legislation's reference to section 121 (26 U.S.C. § 121) is a bit misleading because section 121 nowhere defines "principal residence." Instead, one must look to the Internal Revenue Service regulations for guidance. *See* 26 C.F.R. § 1.121-1(b)(1) (2010) ("Whether property is used by the taxpayer as the taxpayer's residence depends upon all the facts and circumstances."); *See also* 26 C.F.R. § 1.121-1(b)(2) (2010) ("In the case of a taxpayer using more than one property as a residence, whether property is used by the taxpayer as the taxpayer's principal residence depends upon all the facts and circumstances. If a taxpayer alternates between 2 properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year ordinarily will be considered the taxpayer's principal residence. In addition to the taxpayer's use of the property, relevant factors in determining a taxpayer's principal residence, include, but are not limited to (i) The taxpayer's place of employment; (ii) The principal place of abode of the taxpayer's family members; (iii) The address listed on the taxpayer's federal and state tax returns, driver's license, automobile registration, and voter registration card; (iv) The taxpayer's mailing address for bills and correspondence; (v) The location of the taxpayer's banks; and (vi) The location of religious organizations and recreational clubs with which the taxpayer is affiliated.").

6 *See* 26 U.S.C. § 108(h)(2) (2010) (placing a cap of $2,000,000 of loan forgiveness for married couples filing a joint return, and $1,000,000 for all others); *See also* 26 U.S.C. § 163(h)(3)(B)(i) (2010) (defining acquisition indebtedness (referenced in 26 U.S.C. § 108(h)(2)) as any indebtedness "incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer" and "secured by such residence."); McMahon & Simmons, *supra* note 1, at 467-68 ("[The tax exclusion] does not apply to (1) indebtedness on a home that is not the taxpayer's principal residence, or (2) home equity indebtedness. Furthermore, the provision applies only if the debt cancellation was on account of either (1) a decline in the value of the home, or (2) the taxpayer's financial condition. The taxpayer's basis in the residence must be reduced by the excluded amount. This basis reduction will not result in any subsequent income recognition as long as the taxpayer does not dispose of the residence; and even if the taxpayer does sell the residence, the taxpayer could exclude all or part of the realized gain under section 121."); Charles J, Russo, Jeffrey W. Mitchell Jr. & Seth Hammer, *Tax Clinic*, TAX ADVISER, Aug. 1, 2009, at 517 ("DOI [discharge of indebtedness] income includes discharge of an individual's home mortgage indebtedness. However, DOI income of a qualified principal residence is excluded from gross income for debt discharges from January 1, 2007, to December 31, 2012 (Sec. 108(a)(1)(E)). The exclusion applies whether the taxpayer restructures the debt on the principal residence or the debt is reduced because of foreclosure and sale (IR-2008-17). The

This tax-free income, in the form of unpaid loan debt, can arise through a foreclosure,[7] through what is commonly known in real estate parlance as a "short sale,"[8] or through a significant loan modification.[9]

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exclusion is claimed on Form 982, Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment). The exclusion applies only to qualified principal residence indebtedness, which is the same as acquisition indebtedness as defined for purposes of the home mortgage interest deduction. Acquisition indebtedness generally includes debt for acquiring, constructing, or substantially improving a principal residence.").

[7] *See* McMahon & Simmons, *supra* note 1, at 439 ("When a recourse debt secured by a lien is reduced to judgment in a foreclosure suit, the amount realized on a subsequent sale of the property is the actual sales price. Any deficiency resulting from a sales price less than the judgment is a continuing obligation of the debtor, the discharge from which for less than full payment will give rise to cancellation of debt income."); *But cf.* SHARON KREIDER & KAREN BROSI, 2010 REAL ESTATE & INVESTMENT TAX UPDATE, 3-30 (Western CPE 2010) (explaining that if the mortgage is nonrecourse, meaning that the lender has agreed that taking ownership of the property is its sole remedy, then no cancellation of debt income arises from the lender's foreclosure, even if the amount received upon foreclosure sale is less than the mortgage debt owed); McMahon & Simmons, *supra* note 1, at 440 ("If the debt is nonrecourse, then the full amount of the debt is treated as the amount realized on the transfer of the property, regardless of the value of the property, and no cancellation of debt income is realized.").

[8] *See* Gregg A. Nathanson, *Real Property Law: What's New in Residential Transactions?*, 86 MICH. B. J. 16, 18 (2007) ("A 'short sale' occurs when a mortgage lender agrees to accept less than the total amount owed and releases the borrower from the remaining unpaid indebtedness."); *See also* KREIDER & BROSI, *supra* note 7, at 3-36 ("One phenomenon in a declining residential mortgage market is dubbed a 'short pay' or a 'short sale,' that is, the home is sold for less than ('short of') what is owed on the mortgage. Property advertisements sometimes refer to it as a 'pre-foreclosure' sale. While the home is marketed by the mortgage holder in foreclosure, it is marketed by the homeowner in a short sale, generally with the disclosure 'subject to lender approval.' . . . In a short sale transaction, the lender, not the property owner, makes the ultimate decision to sell. For the property owner, a short sale is sometimes better for their [sic] credit rating then [sic] going through foreclosure proceedings. For the lender, the short sale alternative cuts their [sic] losses faster than the protracted foreclosure process."); McMahon & Simmons, *supra* note 1, at 467-68 ("A short sale normally involves the sale of the property at or near market price with the lender forgiving debt in excess of the sales price.").

[9] *See* Russo, Mitchell & Hammer, *supra* note 6, at 517 ("Under the general rule, a modification is significant if, based on all the facts and circumstances, the legal rights or obligations that are altered and the degree to which they are altered are economically significant (Regs. Sec. 1.1001-3(e)(1)). Under Regs. Sec. 1.1001-3(e), there are four specific categories that are considered to be significant modifications to a debt instrument: Changes in yield; Changes in the timing of payments; Changes in obligor or security; and Changes in the nature of the debt instrument."); *See also* 26 U.S.C. § 108(e)(10) (2010); Michaels v. Comm'r, 87 T.C. 1412, 1414-1416 (1986) (holding that lender's discount for prepayment of home mortgage gives rise to cancellation of debt income); 26 C.F.R.§ 1.1001-3(b); John E. Capps, *In the Wake of Cottage Savings: The Tax Consequences of Debt Modifications*, 72 TEX. L. REV. 2015, 2018 (1994) (changes in yield, maturity, obligor, or collateral are relevant in considering a modification of debt); McMahon & Simmons, *supra* note 1, at 428 ("Any reduction in the principal amount of a debt results in realization of cancellation of

MoFoDRA is part of a continuing saga of ill-conceived preferential tax treatment for residential real estate that includes the 1997 legislation that fueled housing speculation by granting up to half a million dollars of tax free income, every two years, for profit arising from the sale of a primary residence.[10] When losses instead of profits became the issue, Congress enacted MoFoDRA to grant up to two million dollars of tax free income from unpaid mortgage debt. In this Article, I assert that MoFoDRA raises continuing concerns regarding ethics, equality, and equity in tax and public policy.

Perhaps guided by lobbyist dollars rather than policy-making logic, Congress has failed to assemble coherent tax legislation related to residential housing. MoFoDRA does not selectively limit its rewards to those with low to moderate incomes who remain in their home and continue paying a reduced mortgage obligation. Instead, MoFoDRA rewards those who walk away from mortgage debt on a huge scale. MoFoDRA allows up to two million dollars of tax-free income, and is regressive by rewarding persons who aggressively speculated and stood to reap the greatest benefit had they turned a profit. MoFoDRA violates vertical equity due to its regressive impact, and violates horizontal equity by virtue of its disparate treatment of similarly situated persons by providing tax-free income for a random six year time period (2007 through 2012, inclusive). MoFoDRA discriminates against all other persons who were taxed in the past, and who will be taxed in the future for forgiven mortgage debt.

MoFoDRA's tax-free treatment of discharged loan income represents yet another zenith of imprudence in tax policy by creating a reward and incentive for solvent individuals to be unaccountable for residential real estate speculation. Congress's singling out of a tax preference for residential real estate speculators who walk away from mortgage loan debt from 2007 through 2012 is unfair, unwise, and creates a downward influence on residential real estate prices,[11] thereby

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debt income, regardless of whether a new debt instrument has been substituted or the creditor simply agrees to accept a lesser amount in satisfaction of the debt.").

[10] *See* 26 U.S.C. § 121 (2010); *See also* Chang Cho, *Business Property Sales Under Secs. 1031 and 121*, TAX ADVISER, Apr. 1, 2000, at 223-24 ("Under Sec. 121(b)(2), for the sale of a principal residence on or after May 7, 1997, married couples filing jointly may exclude up to $500,000 of gain ($250,000 for singles) . . . .").

[11] *See* Peter Salsich, *National Affordable Housing Trust Fund Legislation: The Subprime Mortgage Crisis Also Hits Renters*, 16 GEO. J. ON POVERTY L. & POL'Y 11, 24 (2011) ("Massive foreclosures of mortgages on both single-family and multi-family residences in turn threaten many neighborhoods, particularly those with high concentrations

punishing those who pay their debts and remain in their homes.

In the name of consistency, equality, and equity, I offer three solutions to the tax exemption problem under MoFoDRA and any future progeny. The first solution is that all discharged debt should be taxed as income, and MoFoDRA's tax exemption should be immediately revoked. The second solution is that all discharged debt, mortgage or otherwise, should not be taxed, and reparations should be paid to those who were taxed in the past for this income. The third and perhaps most pragmatic solution is that MoFoDRA should be amended to protect lower and middle-income individuals who remain in their homes and continue to pay their revised loan obligations.

Popular media coverage of those facing foreclosure tugs at the heart strings.[12] It is understandable to feel sympathy for those individuals who have been innocently taken hostage by tough economic times, and to feel empathy for those who exercised poor judgment by counting on low interest rates and compounded growth in residential real estate thereby causing such individuals to be overextended on a mortgage.

Members of Congress have vehemently argued that MoFoDRA was necessary to help such individuals.[13] However, even prior to

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of low-income and/or minority households."); *See generally* Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 5-6 (2011) ("Foreclosures increase housing supply and push down housing prices, affecting neighboring homeowners' property values and eroding property tax bases. This effect, in turn, hurts neighbors who have to bear either higher taxes or reduced services.").

[12] *See* John L. Smith, *Desperate Homeowners Find Little Help In Foreclosure Battles*, LAS VEGAS REV., Sept. 21, 2012, at 1B; Mike Tharp, *Discussion Of Trying Times; Residents Share Common Experiences Of Losing Homes, Worries About The Future,* THE MERCED SUN-STAR (CA), Mar. 8, 2010, at A1; Gregg Zoroya, *Military Foreclosure Rate Up 32% Over 2008; 20,000 Servicemembers, Veterans Lost Their Homes,* USA TODAY, Feb. 4, 2011, at 1A; *See also* Julie Schmit, *In Housing Bust, A 'New Normal,'* USA TODAY, Feb. 8, 2011, at 1 (housing decline has resulted in massive numbers of "underwater mortgages" with homeowners strapped to make ends meet); Julie Lynem, *A Dream Foreclosed,* TRIBUNE (SAN LUIS OBISPO), Feb. 13, 2011, at 1 (loan modifications are difficult to obtain, resulting in ongoing increase in foreclosures); Marlize Van Romburgh, *Foreclosure Fiasco's Ground Zero*, PAC. COAST BUS. TIMES, Oct. 22-28, 2010, at 1 (explaining that statewide in California, one in every 178 housing units received a foreclosure filing in September 2010, and a temporary moratorium on foreclosures simply delays a continued sink in residential housing values).

[13] *See* 153 CONG. REC. H11, 256 (daily ed. Oct. 4, 2007) (statement of Rep. Cardoza) ("I have seen the joy in families' eyes when they have been able to purchase their first home and achieve the American Dream. I have seen the tears when they struggle to make their payments and their dream is taken away . . . . The way I see it, if you are unfortunate enough to lose your home to foreclosure because you are struggling, you have suffered

MoFoDRA, there already was, and is, a safety valve under the tax code in the form of an exemption from taxation on any forgiven debt. This insolvency exemption does not require the filing of bankruptcy, and it is applied if the borrower meets the qualifications for being deemed as insolvent.[14] MoFoDRA goes beyond the built-in safety valve of the Internal Revenue Code, and it gives solvent real estate speculators a tax exempt status, offering a reward and shield to persons who engage in strategic defaults and walk away from a home without actually being insolvent.

Part 1 of this Article examines the discharge of indebtedness as a form of income that should be taxed. Part 2 evaluates the so-called "mortgage meltdown" and the resultant legislation providing a windfall to those who benefit from non-payment of mortgage debt. Part 3 analyzes the public policy and ethical issues associated with the tax-free windfall under MoFoDRA. Part 4 proposes practical and equitable solutions to the disparate treatment and inequities from the tax exemption contained in MoFoDRA.

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enough. You shouldn't be punished further by being taxed on what you no longer own."); 153 CONG. REC. S15, 985 (daily ed. Dec. 19, 2007) (statement of Sen. Sununu) ("The last thing someone struggling to stay in their home needs is a huge tax obligation on income that they never saw.").

[14] *See* 26 U.S.C. § 108(a)(1)(B) (2010) ("Gross income does not include any amount which . . . would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if . . . (B) the discharge occurs when the taxpayer is insolvent . . . ."); *See also* McMahon & Simmons, *supra* note 1, at 454-55 ("Section 108(a)(1)(B) excludes cancellation of debt income realized while the debtor is insolvent, as defined by section 108(d)(3) . . . . Insolvency is defined in section 108(d)(3) as the excess of the taxpayer's liabilities over the fair market value of the taxpayer's assets."); 26 U.S.C. § 108(a)(1)(a) (2010) ("Gross income does not include any amount which . . . would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if . . . (A) the discharge occurs in a title 11 case . . . . "); McMahon & Simmons, *supra* note 1, at 460 ("An interesting--and for the taxpayer, unpleasant--result occurs when the section 108(a)(1)(A) bankruptcy exception applies and a mortgage lien survives the bankruptcy. When personal liability on the debt is discharged but the lien survives, the debt is transformed into a nonrecourse debt. When the property is sold or foreclosed upon, the amount of any remaining nonrecourse debt encumbering the property is included in the amount realized by the taxpayer along with any cash received."); Monica D. Armstrong, *From the Great Depression to the Current Housing Crisis: What Code Section 108 Tells Us About Congress' Response to Economic Crisis*, 26 AKRON TAX J. 69, 72-84 (2011); *But see* Jay L. Zagorsky & Lois R. Lupica, *A Study Of Consumers' Post-Discharge Finances: Struggle, Stasis, Or Fresh-Start?*, 16 AM. BANKR. INST. L. REV. 283, 294 (2008) (data reflects Chapter 11 is rarely used in personal bankruptcy cases); *Bankruptcy in the United States*, http://en.wikipedia.org/wiki/Bankruptcy_in_the_United_States (last visited February 12, 2011) ("Chapter 11 filings by individuals are allowed, but are rare.").

I. FORGIVEN DEBT IS AN ACCESSION TO WEALTH, AND THEREFORE CREATES TAXABLE INCOME

My former tax law professor said that revenue from any source is income unless the tax code says otherwise. His postulate holds true to what the Internal Revenue Code actually states, "Except as otherwise provided, gross income means all income from whatever source derived . . . ."[15]

Loan proceeds are not customarily taxed due to the repayment obligation of the borrower to repay the loan proceeds.[16] However, when a loan is forgiven, it is customarily treated as income of the borrower under the Internal Revenue Code.[17] This logical rule exists because a loan which is unpaid effectively places income in the pocket of the borrower, even if the borrower speculates with, and loses, the money. Concurrently, the lender for an unpaid load is provided with a deduction against income for the loss associated with the unpaid loan, thereby balancing out the taxation of the transaction.[18]

> If the loan transaction is viewed as a whole, when a borrower receives money in a loan transaction and is later discharged from the liability without repaying the debt, the borrower has realized an accession to wealth. Recognizing the existence of income in this situation generally is not a problem for the income tax system. The receipt of the proceeds of a loan is not income because the receipt is

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[15] *See* 26 U.S.C. § 61(a)(12) (2010) ("Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items . . . (12) Income from discharge of indebtedness . . . .").

[16] *See supra* note 1.

[17] *See supra* note 2; *See also* Kirby Lumber Co., 284 U.S. at 1 (holding that taxpayer corporation had issued bonds and subsequently repurchased the bonds for less than face value. U.S. Supreme Court ruled that this generated income: "[T]he taxpayer made a clear gain. As a result of its dealings it made available $137,521.30 [of] assets previously offset by the obligation of bonds now extinct . . . The [taxpayer] has realized within the year an accession to income, if we take words in their plain popular meaning, as they should be taken here."); *Id.* at 3.; *See generally* Fred T. Witt, Jr. & William H. Lyons, *An Examination of the Tax Consequences of Discharge of Indebtedness*, 10 VA. TAX REV. 1 (1990) (providing an historic analysis of the topic); McMahon & Simmons, *supra* note 1 (providing an extensive analysis of cancellation of debt as income, including the recent home mortgage exception).

[18] *See* 26 U.S.C. § 166 (2010); *See also* TOPIC 453 BAD DEBT DEDUCTION, http://www.irs.gov/taxtopics/tc453.html; McMahon & Simmons, *supra* note 1, at 416 ("Every loan charge-off and mortgage foreclosure has tax consequences. While the creditor most often claims a bad-debt deduction or business-related loss, the debtor generally must recognize gross income and pay income taxes on an amount roughly equal to the creditor's loss, unless a special exception applies to exclude the debt relief from income.").

> offset by an obligation to repay the borrowed amount. If the obligation to repay the borrowed amount is eliminated or reduced without the concomitant repayment, the borrower realizes an accession to wealth that, as a matter of tax theory, should be included in gross income.[19]

An unpaid and forgiven loan is attributed as income of the borrower, regardless of whether the borrower used the money to buy stock which declined in value, bought black tar heroin which turned out to be counterfeit, or, without MoFoDRA, speculated in residential real estate.[20]

Forgiven mortgage debt is akin to untaxed wage income.[21] The recipient of a mortgage loan receives the benefit as well as constructive custody and control of loan proceeds which are used to speculate on residential real estate. Instead of repaying the debt, which is the cornerstone of income exclusion,[22] the borrower never repays the debt. The borrower receives the benefit of the proceeds by gaining ownership of the home, subject to the collateral interest secured by a deed of trust,

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19 McMahon & Simmons, *supra* note 1, at 415.

20 *See generally* McMahon & Simmons, *supra* note 1, at 426 ("In theory, realization of cancellation of debt income does not depend on the nature of the debt.") and Zelenak, *supra* note 2, at 285 ("Borrowed funds are excluded from income in the first instance because the taxpayer's obligation to repay the funds offsets any increase in the taxpayer's assets; if the taxpayer is thereafter released from his obligation to repay, the taxpayer enjoys a net increase in assets equal to the forgiven portion of the debt, and the basis for the original exclusion thus evaporates.") *But see* Zarin v. Commissioner, 916 F.2d 110 (3d Cir. 1990), rev'g 92 T.C. 1084 (1989) (Tax Court ruled that forgiven gambling debt was taxable income, but Court of Appeals reversed, reasoning that the forgiven debt was not taxable because the amount owed was not "indebtedness" within the ambit of Internal Revenue Code 108(d)(1) and also that Zarin disputed the validity of the debt, even though the value of the underlying gambling chips and extension of credit was undisputed). *See also,* Zelenak, *supra* note 2, at 319-325 (discussion of Zarin case and comment that the Zarin majority opinion is technically indefensible and widely criticized).

21 *See* Rachel Carlton, *Mortgage Forgiveness Debt Relief Act of 2007*, 45 HARV. J. ON LEGIS. 601, 610 (2008) ("For instance, if, upon property acquisition, a $500,000 mortgage is secured by a home worth $500,000, the homeowner's net worth is unchanged. If the lender later extinguishes a portion of the homeowner's mortgage debt, the liability decreases and a corresponding increase in net worth results. Continuing with the example, if the lender decreases the mortgage debt owed to $400,000, the homeowner's net worth increases to $100,000. From a tax law perspective, the homeowner has realized a gain; and according to generally accepted tax theory this gain should be taxable as income."). *See generally supra* notes 1-2 (discussing that unlike other types of forgiven debt which is treated as taxable income, under MoFoDRA the borrower derives an immediate direct economic benefit of the loan proceeds extended to him/her coupled with no tax on the unpaid debt).

22 *See generally supra* notes 1-2 (discussing that receipt of loan proceeds is not income because it is offset with the obligation to repay the borrowed amount).

mortgage, or similar instrument.[23]

Members of Congress who oppose taxation of income from forgiven mortgage loans like to use the mantra "phantom income."[24] There is nothing phantom about the income. The recipient of the loan received the benefit of those funds, used those funds for a purpose which he or she selected (i.e. to buy residential real estate), and did not repay those funds.

> Senators and Representatives are concerned that without the new exemption [of income under MoFoDRA], taxpayers will pay taxes on phantom income. But it is not phantom income. If a taxpayer has a mortgage of $1000 per month and the house is foreclosed on because he or she cannot afford the $1000 per month payment, the taxpayer may move into an apartment and pay $500 per month. That is $500 less per month than what the taxpayer owed on the mortgage, which is $500 more the taxpayer can keep or spend on other things. Moreover, it has long been the policy of the tax code that where a taxpayer's assets are freed from the obligation to secure a debt, the taxpayer has incurred taxable income.[25]

MoFoDRA provides an incentive to those real estate speculators who are solvent, but who elect to strategically walk away from a home. "In short, the financial costs of foreclosure, while not insignificant, are minimal compared to the financial benefit of strategic default, particularly for seriously underwater homeowners. For many, default is the 'in-the-money' option by any objective measure."[26]

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[23] *See generally* TED H. GORDON, CALIFORNIA REAL ESTATE LAW 267 (6th ed. 2006) (explaining that title in a mortgage remains with the person who is borrowing money to purchase the home, and is a contract by which the property is pledged without delivery for repayment of the underlying loan); Fannie Mae, Form 3005, UNIFORM SECURITY INSTRUMENT: California Deed of Trust §§ 18 and 23, *available at* http://www.freddiemac.com/uniform/unifsecurity.html#highlights (deed of trust as collateral security with transfer rights in the borrower); Christopher L. Peterson, *Foreclosure, Subprime Mortgage Lending, and the Mortgage Electronic Registration System,* 78 U. CIN. L. REV. 1359, 1367 (2010) ("At closing the homeowner signs a promissory note on behalf of the originating lender and a mortgage or deed of trust with the originator as the mortgagee or the trust beneficiary.")

[24] *See* Carlton, *supra* note 21, at 609; *See also* Rue Toland, *No Tax for "Phantom Income:" How Congress Failed To Encourage Responsible Housing Consumption With Its Recent Tax Legislation*, 85 CHI.-KENT L. REV. 345, 352-53 (2010).

[25] Curt Hochbein, *Mortgage Forgiveness Debt Relief Act of 2007*, 38 CAP. U. L. REV. 889, 917-18 (2010).

[26] Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and The Social Management Of The Housing Crisis*, 45 WAKE FOREST L. REV. 971, 986 (2010).

II. THE SO CALLED "MORTGAGE MELTDOWN" AND EXCLUSION OF FORGIVEN DEBT AS INCOME FROM 2007 THROUGH 2012

As of the end of the second quarter of 2011, there was approximately thirteen and a half trillion dollars of mortgage debt outstanding in the U.S.[27] Within this pool of mortgage debtors,

> . . . it has been credibly estimated that there are at least 11.3 million U.S. homeowners, and probably as many as 15.2 million or more, who are 'underwater' in that the outstanding balances on their mortgages exceed the market value of their homes . . . . These two estimates constitute 23% and 32.2%, respectively, of all mortgaged residential properties, and some informed observers expect this percentage to sharply increase to as high as 48% by 2011 if property values continue to decline in some areas of the country.[28]

Congress is responsible for the residential real estate bubble due to its 1997 legislation granting tax free treatment for profits in residential real estate.[29] Not only is Congress to blame for the bubble, but is also now to blame for solvent individuals walking away from ill conceived acquisitions of residential real estate, thereby driving down prices for those who hold on to their homes and pay their debts.[30]

MoFoDRA is proof that residential real estate is Congress' favorite child, and why shouldn't it be? A mantra calling for every citizen to

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[27] FED. RESERVE STATISTICS AND HISTORICAL DATA, MORTGAGE DEBT OUTSTANDING (2011), *available at* http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm.

[28] Gregory Scott Crespi, *The Trillion Dollar Problem of Underwater Homeowners: Avoiding A New Surge of Foreclosures by Encouraging Principal-Reducing Loan Modifications*, 51 SANTA CLARA L. REV. 153, 155 (2011).

[29] *See generally* Toland, *supra* note 24 (examining various recent tax laws, including MoFoDRA, and positing that Congress has failed to address the problems which caused, and continue to fuel, the residential housing bubble); Bradford P. Anderson, *Welcome to My Flipperhood: A Call to Repair the Residential Real Estate Tax Swindle*, 7 GEO. J. L. & PUB. POL'Y 415, 417 (2009) (detailing how the 1997 Taxpayer Relief Act changed the tax code to allow the sale of a primary residence for up to half a million dollars of *tax-free* federal income, with only a two year ownership and occupancy requirement. This tax preference fanned the flames of speculation and irrational exuberance in the residential housing sector and also set the stage for a far reaching overall financial meltdown. Financial markets have succumbed to the artifice of tax-free incentives targeted at residential real estate, with devastating results); 26 U.S.C. § 121 (2010); Chang Cho, *Business Property Sales Under Secs. 1031 and 121*, TAX ADVISER, Apr. 1, 2000, at 223 ("Under Sec. 121(b)(2), for the sale of a principal residence on or after May 7, 1997, married couples filing jointly may exclude up to $500,000 of gain ($250,000 for singles) . . . .").

[30] *See supra* note 11.

own his or her own home is politically popular,[31] but perhaps the plea should only apply to every fiscally responsible citizen.Legislation is influenced by money, and there was big money from the residential real estate sector and financial loan sector pumped in to Congress in order to support passage of MoFoDRA.[32]

No other type of forgiven debt, whether credit card, auto loan, or otherwise,[33] benefits from the singular preferential treatment that Congress has conferred upon residential real estate. Those who roll the dice on residential real estate get to walk away from their debts on a tax free basis under MoFoDRA. The message from Congress is to act irresponsibly, and hope that many others do the same, because then you will receive preferential treatment.

Congress adopted the position that MoFoDRA is justified due to the fortuity of circumstances and market conditions out of the taxpayer's control.[34] If Congress is so in tune with market conditions outside of one's control, then why was there no tax relief for stock market investors during the "dot com" decline?[35] Congress failed to

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[31] *See generally* President George W. Bush, Remark at the Signing of H.R. 3648, The Mortgage Forgiveness Debt Relief Act of 2007 (Dec. 20, 2007) (on file with White House Office of Press Sec'y) ("We want people to have a place they can call their own. After all, it's an essential part of the American Dream. And we want that dream to extend throughout our nation. - President George W. Bush").

[32] *See generally* MAPLIGHT, http://maplight.org/us-congress/bill/110-hr-3648/323588/total-contributions (last visited Feb. 16, 2011) (Maplight.org report on contributions to members of the U.S. Senate for passage of MoFoDRA showing a total of $15,411,298 paid in contributions to U.S. Senators for passage of this bill, of which $15,068,073 originated from real estate agents, finance, insurance & real estate interests, and mortgage bankers and brokers); MAPLIGHT, http://maplight.org/us-congress/bill/110-hr-3648/376414/total-contributions (last visited Feb. 16, 2011) (Maplight.org report on contributions to members of the U.S. House of Representatives for passage of MoFoDRA showing a total of $11,691,876 paid in contributions to members of the U.S. House of Representatives for this bill, of which $11,050,276 originated from real estate agents, finance, insurance & real estate interests, and mortgage bankers and brokers) Additional sums were also contributed for the extension of MoFoDRA, through the Emergency Economic Stabilization Act of 2008. *See* MAPLIGHT, http://maplight.org/us-congress/bill/110-hr-1424/352600/contributions-by-vote; MAPLIGHT, http://maplight.org/us-congress/bill/110-hr-1424/352600/total-contributions (discussing extensive lobbying payments by security brokers, investment companies, commercial banks, and finance companies).

[33] *But cf.* Mark J. Marroni, Zarin v. Commissioner*: Does a Gambler Have Income From the Cancellation of a Casino Debt?*, 27 NEW ENG. L. REV. 993, 994-1000 (1993) (explaining that in this particular case, the gambler's debt owed to the casino was not enforceable as a matter of New Jersey law, and therefore there was no discharge of indebtedness).

[34] *See generally* Carlton, *supra* note 21, at 611-13.

[35] *See generally* Wayne A. Smith, *Tax Treatment of Employee Stock Options in High-*

come to the rescue of those suffering massive losses during this market decline, and press coverage indicated a less than sympathetic attitude to the victims of the decline.[36] "Dot com" victims were the sacrificial lambs, and residential housing remains the sacred cow. This perverse tax treatment is untenable and indefensible.

Congress' fueling of residential real estate speculation with up to half a million dollars of tax free gain every two years[37] coupled with real estate agents and mortgage lenders who market residential housing as an "investment," instead of a home in which to live, have thrust the Las Vegas mentality of gambling into residential real estate.[38] MoFoDRA is to intelligent tax legislation what the Titanic was to sink-proof shipbuilding.

Tech Industry: When the Market Crashes, Make Sure You're Not on the Corner of Easy Street and Alternative Minimum Tax Boulevard, 13 ALB. L. J. SCI. & TECH 865, 880-885 (2003) (discussing that alternative minimum tax liability resulted in many individuals paying large tax bills but having no actual gain after the high technology market collapse; although Congress was aware of this problem, no revisions to alternative minimum tax occurred to remedy the harm).

[36] *See generally* Michelle Quinn & Kamika Dunlap, *Silicon Valley Slide; The Heart of the Tech Boom Has Seen a Lot of Businesses and its Extravagant Lifestyle Go Bust, But Some Optimism Remains*, ST. PAUL PIONEER PRESS, Aug. 20, 2002, at 1E ("When the mighty fall, as Silicon Valley has done, it's natural for others to take pleasure from it. 'There's a sense that people think, "You guys got what you deserved,"' said Michael Perkins, author of 'The Internet Bubble.'"); *The Dot Com Debacle*, NEW YORK OBSERVER, Mar. 12, 2001, at 4 ("The downfall of the dot-coms may be a good thing for the long-term health of the city, as we witness a return to the values of work and patience, and as young professionals realize there is virtue in holding a job instead of hopping from one so-called "opportunity" to another. After all, earning a salary, rather than depending on options and playing the markets, is where the smart money always places it bets in the end."); *When Dot Coms Ruled,* Nov. 13, 2000, BANGOR DAILY NEWS ("Many of these businesses deserved to die.").

[37] *See supra* note 29.

[38] *See generally* Mark Andrew Snider, *The Suburban Advantage: Are the Tax Benefits of Homeownership Defensible*, 32 N. KY. L. REV. 157, 157-158 (2005) ("If owning a home is the American dream, then owning a home might also be described as a tax dream ...."); *Keep the Tax Man Away from Real-Estate Gains*, WALL STREET JOURNAL, Nov. 20, 2002, *available at* http://web.archive.org/web/20021122115127/http://www.realestatejournal.com/buysell/mortgages/20021120-smartmoney.html. ("If you've owned your home and have lived in it for two of the previous five years, then you can make a profit of up to $250,000 if you're single or $500,000 if you're married, with no tax bill. You may however owe state taxes. Never the less, this deal is so good that you should do everything you possibly can to get it.").

III. THE INJUSTICE OF NOT TAXING FORGIVEN DEBT.

"Justice isn't blind; it just looks the other way."[39]

A. Equity and Consistency: Things that are alike should be treated similarly.

"Adam Smith's first canon of taxation was that taxes should be equal or equitable. . . . Aristotle, John Locke, and Adam Smith provided the philosophical foundation for a requirement of equality in taxation."[40] MoFoDRA in every respect is contrary to these great minds, and Congress now supports inequality and inequity as a standard baseline.

Under John Rawls' Theory of Justice, MoFoDRA violates his two principles of justice in that the current law does not guarantee an equal claim to basic rights, and there is no equality of opportunity.[41] "The original purpose of equality in taxation was to prevent both privilege and oppression. In ancient regimes, some were able to receive exemptions from taxation while others without influence paid the bulk of the taxes."[42] The current exclusion of taxation on forgiven residential mortgage debt favors the wealthy and those who engaged in high stakes speculation because our progressive tax scheme affords those individuals the greatest tax exemption benefit.[43] A wealthy individual

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39 THE BOOMTOWN RATS, *The Elephants Graveyard, on* MONDO BONGO (CBS Records 1981).

40 William B. Barker, *The Three Faces of Equality: Constitutional Requirements in Taxation*, 57 CASE W. RES. 1, 8 (2006).

41 Marjorie E. Kornhauser, *Equality, Liberty, And A Fair Income Tax,* 23 FORDHAM URB. L. J. 607, 623-24 (1996);
see also, Peter Halewood, *Law's Bodies: Disembodiment and the Structure of Liberal Property Rights,* 81 Iowa L. Rev. 1331, 1346 (1996) ("John Rawls - probably the most influential liberal theorist of our time - draws on Kant to argue that justice should be understood as fairness.").

42 Barker, *supra* note 40, at 13.

43 *See* Internal Revenue Service, Tax Guide 2010 for Individuals 17, at 137-201 (2010), *available at* http://www.irs.gov/pub/irs-pdf/p17.pdf; Andres Martinez, *It's Your Housing Bubble And I'm Paying For It*, PITTSBURGH POST-GAZETTE, June 26, 2005, at C-2 ("All deductions are regressive by nature because they are worth more to taxpayers with higher incomes. The Treasury will give you a $1,500 break for every $10,000 in mortgage interest you pay if you are in the 15 percent tax bracket, but you'll get a $2,800 break on the same deal if you are wealthier and paying a 28 percent marginal tax on your income. Isn't this backward? The deduction is a massive handout to the real estate industry, and a federal subsidy to the lifestyles of the nation's richest households."); *see also* Anthony C. Infanti, *Tax Equity*, 55 BUFF. L. REV. 1191, 1195 (2008) (Tax equity is concerned with the fair

receives a greater tax benefit from untaxed forgiven mortgage debt, not just in real dollars, but proportionately than a lower income individual.

> Currently in America there is widespread concern that the middle class is shrinking. It is becoming more difficult for many in the middle class to maintain their position, and the upper classes are expanding, thus creating a wider gap between the 'haves and the have-nots' . . . [with] the potential of negatively affecting the economy and creating political instability.[44]

As an example of MoFoDRA's regressive impact, assume that William is single with an annual adjusted gross income of $200,000. William is in a 33% federal marginal income tax bracket,[45] paying thirty-three cents in federal tax for every dollar of income at this level. When William walks away from his expensive home and receives another $300,000 in untaxed forgiven debt, his highest marginal benefit increases up to 35% of the forgiven debt.[46] Meanwhile, Susan, a middle income single person, has an adjusted gross income of $40,000. She is in a 25% federal marginal income tax bracket.[47] When Susan's middle class home is foreclosed upon, Susan realizes an additional $30,000 in forgiven debt, still within the 25% marginal tax bracket. Susan's tax benefit under MoFoDRA is 25% of the forgiven debt, while wealthy William receives a regressive benefit ranging between 33-35% of the forgiven debt. This regressive treatment unfairly favors high income individuals who gambled on a major scale, providing substantially less benefit to lower income individuals. If the goal of Congress was to help

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treatment of individuals who have the same or different incomes); Richard H. Thaler, *It's Time To Rethink The Charity Deduction*, THE NEW YORK TIMES, Dec. 19, 2010, Sunday Business Section, at 5 (explaining that due to our progressive marginal tax bracket system, mortgage deductions and charitable deductions are magnified in favor of the highest income individuals).

[44] Susan Pace Hamill, *A Moral Perspective On The Role of Education in Sustaining the Middle Class*, 24 NOTRE DAME J. L. ETHICS & PUB POL'Y 309, 309-10 (2010)*; see also* Susan Pace Hamill, *Ideologies of Entire Systems: A Moral Perspective on "Big Business" Fair Share of America's Tax Burden,* 1 U. ST. THOMAS L. J. 857, 869 (2004) ("All reasonable tax policy experts conclude that tax structures should not be regressive . . . .").

[45] Internal Revenue Service, Tax Guide 2010 for Individuals 17, at 267 (2010), *available at* http://www.irs.gov/pub/irs-pdf/p17.pdf.

[46] *Id.* In this example, William has an adjusted gross income of $200,000, plus an additional $300,000 of forgiven loan debt which is untaxed under MoFoDRA (totaling $500,000 of adjusted gross income). William's marginal rate is 33% on the adjusted gross income up to $373,650, accounting for his $200,000 of income plus $173,650 of forgiven loan debt, with the remainder of the forgiven loan debt ($126,350) benefitting William in the 35% marginal tax bracket.

[47] *Id.*

the downtrodden, then why not place some reasonable middle class income caps on the tax exclusion rather than the upper class caps? Additionally, states with legislation which conforms to MoFoDRA confer further tax benefits upon those who are solvent and walk away from mortgage debt.[48]

In addition to the vertical equity[49] problem described above, MoFoDRA violates horizontal equity by treating persons at the same income level and in the same circumstances differently, purely on the fortuity of whether the debt was, or will be, forgiven between 2007 and 2012. "Horizontal equity reflects the notion that similarly situated taxpayers should carry the same burden."[50] Under MoFoDRA, two people with the same identical income level and circumstances are treated differently. Person A is taxed for forgiven mortgage debt if it occurs prior to 2007, or after 2012. Meanwhile, person B receives the exact same discharged debt and resultant income in 2007 through 2012, and person B is not taxed.

> The formal concept of HE [horizontal equity] has its roots in the literature of public finance economics. Indeed, some trace the notion of HE as a fundamental tax principle to John Stuart Mill, who opined that a tax system ought to demand an equal tax burden from taxpayers with equal capacity to contribute. Twentieth century economists fleshed out that idea further, and Richard Musgrave gave

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48 *See* DeLoitte MultiState Tax, External Update, *California Updates Federal Tax Conformity to January 1, 2009* (Apr. 15, 2010), *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_multistate_CA_4-16-2010.pdf. *See generally* CAL. REV. & TAX. CODE § 17144.5; California Tax Conformity Bill, 2010 Cal. Stat. S.B. 401, § 93 (2010) *available at* http://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_multistate_CA_4-16-2010.pdfhttp://www.deloitte.com/assets/Dcom-UnitedStates/Local%20Assets/Documents/Tax/us_tax_multistate_CA_4-16-2010.pdf (conforming partially to federal law, but with a lower exclusion of income than under MoFoDRA).

49 *See* Susan Pace Hamill, *An Argument for Tax Reform Based on Judeo-Christian Ethics*, 54 ALA. L. REV. 1, 7 (2002) [hereinafter Hamill *Alabama*] ("Vertical equity, which primarily focuses on the taxpayer's ability to pay the tax, seeks to define how to fairly apportion the tax burden among taxpayers with different levels of income and wealth. Progressive taxes significantly factor in ability to pay by requiring taxpayers with a greater ability to pay to bear a higher burden, while regressive taxes disregard ability to pay by imposing a heavier burden on taxpayers with less ability to pay.").

50 Leo P. Martinez, *The Trouble with Taxes: Fairness, Tax Policy, and the Constitution*, 31 HASTINGS CONST. L.Q. 413, 422 (2004).

the idea its current name.[51]

MoFoDRA also confuses those with rational minds who thrive upon consistency because the legislation imposes inconsistent treatment.[52] For example, you go to a restaurant and order a glass of iced tea from your server. Your server brings you iced tea. When you ask for a refill of iced tea, you next receive lemonade, and then vodka, and then finally spicy salsa in your glass. You would be understandably puzzled, having no idea of what might occur next. Indeed, you would find meal planning difficult, never knowing what to expect next. MoFoDRA's bizarre tax free zone, coupled with a reinstatement of taxation on forgiven home loans in 2013, puzzles the mind of a rational human and begs for an explanation of where the consistency lies.

MoFoDRA's selective and preferential treatment of residential real estate speculators runs counter to the moral evaluation of tax policy proposed by tax scholar Susan Pace Hamill, who posits that a moral evaluation of tax policy is essential to determine sound tax policy.[53] She

> believes that a moral evaluation of tax policy is essential to determine sound tax policy. Hamill argues that a moral evaluation of tax policy is the only valid metric that can be used to choose among competing tax regimes because the economic models that have been used to evaluate tax policy are fatally flawed through their use of limited variables . . . . Hamill argues that Judeo-Christian ethical

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51 Brian Galle, *Tax Fairness*, 65 WASH. & LEE L. REV. 1323, 1329 (2008).

52 *See* Joshua D. Sarnoff, *Equality as Uncertainty*, 84 IOWA L. REV. 377, 388 (1999) ("[P]rescriptive equality thus exerts its force by urging decisionmakers [sic] to seek greater certainty before deciding what treatment people deserve and before treating them unequally in the name of dispensing justice.").

53 Susan Pace Hamill, *An Evaluation Of Federal Tax Policy Based On Judeo-Christian Ethics,* 25 VA. TAX REV. 671, 673-675 (2006) [hereinafter Hamill *Virginia*]. *See also*, Hamill *Alabama*, *supra* note 49, at 3-4 ("This Article applies the moral principles of Judeo-Christian ethics as a basis for urging the citizens of Alabama to insist that Alabama's elected political leaders reform Alabama's state tax structure, a critically important step towards ensuring that Alabama's children, especially children from low-income families, enjoy an opportunity to build a positive future. Although using these principles as a reason to support tax reform may seem unusual, principles of Judeo-Christian ethics offer moral arguments that complement and often strengthen secularly based ethical arguments illustrating the need for social reform. Throughout American history, the moral principles of Judeo-Christian ethics have been used as one of many effective tools to evaluate and reform a wide variety of social structures, and have continued to be invoked in political debates. Moreover, when distinguishing ethical from unethical tax structures, Judeo-Christian ethics use broad principles similar to traditional tax policy theory, both indicating that tax burdens should be apportioned according to some measure of the taxpayer's ability to pay and should raise adequate revenues to meet at least the minimum needs of the community subject to the tax.")

> principles "require tax policy structures that both raise adequate revenues providing all citizens a reasonable opportunity to reach their potential, and allocate the burden for paying the taxes under a moderately progressive model."
>
> . . . . Hamill concludes that a valid Judeo-Christian tax policy must strike a balance between respecting individual property rights and providing everyone with a chance to realize their potential.[54]

Rather than individual accountability and societal participation, MoFoDRA represents the pinnacle of individual favoritism. MoFoDRA excludes equal treatment of all others who have carried the burden of taxes on discharged mortgage debt outside of the "no-tax" window from 2007-2012. "Objectivist ethics views human beings as independent agents and deems each person acting in his or her own long-term rational self-interest as the only avenue to reach moral correctness . . . [I]ndividual autonomy and the right of each person to be able to personally benefit from their efforts in the free market are valued above all other considerations . . . ."[55]

The real threat of the objectivist ethics model represented by MoFoDRA is the self-centered preferential treatment coupled with the lack of accountability and elimination of social responsibility for the behavior of the individual. That is, those who overextended themselves are viewed as victims of circumstance and receive tax free income, while those who did not overextend themselves receive no such benefit and carry the entire burden of residential real estate speculation.

> Objectivist ethics represents a form of atheism because the human person is substituted for a supreme deity. Within the framework of objectivist ethics, individuals owe no moral obligations to endure greater sacrifices for anyone else's benefit because only each individual's own self-interest has any moral relevance. Human beings acting in their long-term self-interest are considered the sole source of all wealth, and through the strength of their own rationality are viewed as capable of acting morally . . . .[56]

Those who overextended themselves and speculated on residential real estate are being rewarded by Congress for their imprudence, which

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[54] W. Edward Afield, *Dining with Tax Collectors: Reducing the Tax Gap Through Church-Government Partnerships*, 7 RUTGERS BUS. L. J. 53, 107-108 (2010).

[55] Hamill *Virginia*, *supra* note 53, at 739-40. *See also,* Halewood, *supra* note 39, at 1387 ("The progression from Kantian abstract universalism to communicative ethics is a progression from an objectivist ethics and epistemology to an intersubjective model.").

[56] Hamill *Virginia*, *supra* note 53, at 743-44 (internal citations omitted).

is simply unfair. "To Aristotle, equality was the measure of justice; the unjust is unequal, the just is equal."[57] In Aristotelian theory, "things that are alike should be treated alike . . . "[58] That being the case, either all forgiven debt should not be taxed, whether residential mortgage debt or otherwise, or all forgiven debt should be taxed as income because it represents an accession to wealth. "Equality is all about determining who equals are."[59] Forgiven residential mortgage debt is a superior among equals.

B. A Superior Among Equals: Disparate Treatment is not an Unfamiliar Face in Tax Law.

"The idea of equality may be particularly problematic as a restraint on governments' power to tax."[60] From a constitutional perspective of equality, proportional taxation or a fair distribution of taxes would require, at a minimum, that the identical same source of income, for example, forgiven mortgage debt, should be taxed.[61]

Taking consistency and equality to its natural and necessary result, one could argue that the disparate treatment of forgiven mortgage debt constitutes a violation of the Equal Protection Clause. Although at first blush this may be attractive, "[t]he history of the Supreme Court's jurisprudence shows a move from an individual, rights-based concept of equality to a regime that appears to have no real concept of equality in

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57 Barker, *supra* note 40, at 5.

58 *Id*.

59 *Id.* at 36; *see also id*. at 48 ("The three faces of equality have been described as classical, social, and popular. Classical equality is an individual, rights-based principle that limits government action that aims oppressive measures at certain taxpayers while giving unwarranted privileges to others . . . . Social equality is a communal, group-based principle that relies on a constitutional vision of a more equal society premised on a fairer distribution of resources . . . Popular equality is popularly constituted equality. Its content is a matter of current political choice.").

60 *Id.* at 2.

61 KREIDER & BROSI, *supra* note 7, at 3-31 (mentioning that there exists another problem of inequality in the tax treatment of discharged or excused non-recourse mortgage debt. A non-recourse loan is a situation where the lender looks only to the collateral (home) for recovery, and not any other assets of the borrower. . . "[T]here will never be COD [cancellation of debt] income in the foreclosure of a property with nonrecourse debt."); *see also*, McMahon & Simmons, *supra* note 1, at 426-27 (noting that a borrower who retains ownership of the property will realize cancellation of debt income, but that if "property subject to a nonrecourse debt is deeded to the lender in lieu of foreclosure, the entire amount of the nonrecourse debt is included in the amount realized on the sale of the property, even if the debt exceeds the fair market value of the property at the time of transfer."); Frederick H. Robinson, *Nonrecourse Indebtedness*, 11 VA. TAX REV. 1, 37-39 (1991).

tax at all . . . leading to almost complete deference to the legislature in tax matters."[62]

This deference to the legislative branch in creating tax preferences is the foundation of disparate treatment and the resultant lack of equity contained in MoFoDRA.

> [M]any incentives clearly have nothing to do with the objective of fairness in taxation since their purpose is to treat taxpayers differently not on the basis of their particular circumstances, including their benefits received or their ability to pay, but instead on the basis of public purposes that intentionally distort equality.[63]

An Equal Protection argument from one who was taxed on forgiven debt prior to MoFoDRA is highly unlikely to meet with success.

> Unless the classification infringes a fundamental constitutional right (other than the right to equality), Congress is given the widest latitude in taxation to make distinctions between taxpayers. A legislative enactment represents a legislative determination that the classified persons or objects of taxation are, in fact, dissimilar. Such a determination cannot be overturned unless the classification does not bear a rational relationship to a legitimate governmental purpose. There is no requirement that the legislature supply this purpose, and the legislation will be sustained as long as the courts find *any* justification. Indeed, the taxpayer must 'negative every conceivable basis which might support' the legislative classification. Though there is a requirement that there be a relation between justification and classification, the courts only require a plausible connection, not a provable one. In the case of individualized relief provisions for special taxpayers, it may be sufficient that Congress concluded that these few individuals faced hardship. Whether they did or did not is not judicially relevant. Speculation as to whether the classification was overinclusive is irrelevant; simply unwise legislation is not unconstitutional legislation . . . Though modern taxation often creates extreme differences in the taxation of quite economically similar taxpayers, these disparities have not been viewed as involving the wholesale shifting of the tax burden from one class to another.[64]

Imagine that you lost your home to foreclosure in December of 2006. Assume that you had a $250,000 mortgage, and upon foreclosure,

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[62] Barker, *supra* note 40, at 4-5.
[63] *Id*. at 33.
[64] *Id.* at 34-35 (emphasis in original) (internal citations omitted).

the home sold for $200,000. You would have $50,000 of discharged debt that would be fully taxed. Assuming that you are in a 25 percent federal marginal tax bracket, this is $12,500 of federal tax that you owe for the cancelled residential mortgage debt, plus any state income tax. Yet if you had fortuitously defaulted and been foreclosed upon one month later, you would have zero tax liability. MoFoDRA is roulette wheel tax policy from Congress.

What if Congress had addressed the right of women to vote in the same fashion as MoFoDRA? What if the Nineteenth Amendment,[65] granting women the right to vote, would have only existed for six years, with an automatic repeal clause to take effect thereafter? If something is wrong, like prohibiting women from voting, it needs to be resolved permanently. If taxing forgiven loan debt is wrong, then it should be permanently addressed by MoFoDRA. Alternatively, if taxing forgiven loan debt is the right thing to do, then we should always do it. MoFoDRA's peculiar six-year preferential treatment of those who are solvent, but walk away from imprudent speculation in residential real estate, is a bizarre state of affairs. Even the prohibition of alcohol[66] did not contain an automatic expiration. When Congress subsequently decided that it was bad policy, the prohibition was repealed.[67] With MoFoDRA, Congress has adopted the following rationale: Good idea to tax forgiven mortgage debt prior to 2007; bad idea to tax from 2007 through 2012; good idea to tax in 2013 and thereafter.[68]

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[65] U.S. CONST. amend. XIX.

[66] U.S. CONST. amend. XVIII.

[67] U.S. CONST. amend. XXI.

[68] *See supra* note 4 (MoFoDRA, as enacted and codified, took effect with the 2007 tax year, and by virtue of the text of the statute, terminates if the debt is discharged before January 1, 2013, i.e. by the conclusion of the tax year 2012).

C. Shoddy Tax Policy: Rewarding Bad Conduct and Fiscal Irresponsibility.

"The world owes me a living . . . I'm gonna take your money; count your loss when I'm gone. I'm alright Jack; I'm lookin' after number one."[69]

With human activity influenced by the tax code, Congress has reinforced speculation in residential real estate through MoFoDRA. "[T]he power to tax may well be the most important of all governmental powers; not only does tax revenue make all other powers practically possible, but tax in itself has enormous capacity to mold human activity."[70]

In a period of an increasing government deficit,[71] MoFoDRA's tax exemption imposes the cost of real estate speculation on innocent bystanders. As I describe in this Article, MoFoDRA has transferred the externalities and opportunity cost of speculating in residential real estate[72] from those who overextended themselves and/or engaged in imprudent speculation onto the shoulders of those individuals who pay their debts, pay tax on their income, and act in a fiscally responsible manner.

A tax system, unlike a theory of the universe, must not only be

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[69] THE BOOMTOWN RATS, *Lookin' After One, on* THE BOOMTOWN RATS (CBS Records 1977).

[70] Barker, *supra* note 40, at 1.

[71] *See generally* Howard Schneider, *U.S. Must Reduce Deficit, IMF Warns*, WASH. POST, Jan. 28, 2011, at A16 ("The IMF warning comes as federal officials grapple with a congressional projection this week that the annual deficit will reach a historic $1.5 trillion this year. This was the latest report to raise concerns about how massive government debts in developed countries could undermine the global economic recovery."); *U.S. Deficit to Hit Record $1.5 Trillion,* CHICAGO SUN-TIMES, Jan. 27, 2011, at 22 ("A continuing weak economy and last month's bipartisan tax cut legislation will drive the government's deficit to a record $1.5 trillion this year, a new government estimate predicts. The eye-popping numbers mean the government will continue to borrow 40 cents for every dollar it spends."); Seth McLaughlin, *Deficit Diggers Now Vow to Fill Hole; Both Parties Bear Debt Blame,* WASH. TIMES, Feb. 9, 2011, at 1 ("During Mr. Bush's eight years in office, the national debt jumped from $5.628 billion to $9.98 trillion. Mr. Obama's $814 billion stimulus package and unchecked entitlement spending over the past two years pushed the total debt past $14 trillion.").

[72] *See* Michael A. Livingston, *Reinventing Tax Scholarship: Lawyers, Economists, and the Role of the Legal Academy,* 83 CORNELL L. REV. 365, 374 (1998) ("The principal themes of tax scholarship – fairness, efficiency, and the search for a comprehensive tax base – are essentially economic in nature, so that even "traditional" tax scholarship has something of a law-and-economics flavor.").

> simple, it must also be 'fair.' At a minimum, it must be perceived as fair by the taxpaying public in order to withstand the public's scrutiny . . . Fairness is indispensable to enacting tax legislation because it increases taxpayer morale and enhances voluntary compliance.[73]

The only moral compass guiding the exemption of discharged mortgage debt from taxation is the self-interest of the ranks of those who engage in or benefit from residential real estate speculation, including real estate brokers and agents, mortgage lenders, and speculators. "Income tax law is utilized to encourage or reward activities considered to be beneficial from society's perspective . . . ."[74] Those who lost homes and were taxed on forgiven debt prior to 2007 simply did not fail in large enough numbers or lobby strong enough to receive this tax preference. What does this say about Congress and the current tax preference in MoFoDRA? "[G]reed drives the . . . powerful to do everything they can to avoid paying their fair share of taxes."[75] Residential real estate tax legislation is clearly influenced by the powerful real estate lobby.[76]

At its core, MoFoDRA creates an incentive for people to strategically walk away from homes that they speculated upon by providing tax-free treatment for the forgiven loan debt.[77] One impact of this incentive is to further drive down home prices by increasing the supply of homes on the market.[78] Although members of Congress may argue that MoFoDRA was intended to aid the residential housing market, I posit that it has the opposite effect, leading to increased defaults on mortgages.[79] MoFoDRA also drives down home values, creating a long-term punishment and disincentive for those who pay

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73 Martinez, *supra* note 50, at 414-16.

74 Barker, *supra* note 40, at 31.

75 Hamill *Virginia*, *supra* note 53, at 763.

76 *See supra* note 32.

77 White, *supra* note 26, at 985 ("The most significant financial risk from a foreclosure is the risk of . . . tax liability for the unsatisfied portion of one's loan upon foreclosure. But even these potential costs are significantly less than one might expect . . . . tax regulations have recently changed to waive taxes on the unpaid portion of a mortgage upon foreclosure, which was previously classified as income to the borrower if the lender reported it as such.")

78 *See supra* note 11. *See generally* Tim Iglesias, *Our Pluralist Housing Ethics and the Struggle for Affordability,* 42 WAKE FOREST L. REV. 511, 520-530 (2007) (discussing the various housing ethics which have shaped U.S. housing law and policy, including housing as an economic good, housing as a home, and housing as providing social order).

79 *See supra* note 77.

their mortgage obligations, by leaving such persons with lower home values.[80]

"It is no great insight to observe that a tax system can serve several different functions. Most obviously, taxes raise revenue for government services."[81] In an era of escalating government debt caused by bailouts and so-called 'stimulus' spending, it seems odd that the federal government would elect to reduce its ability to collect taxes by granting a tax-free exemption for income derived from discharged residential mortgage debt.[82] "The IRS estimates that as many as 169,000 returns included a form 982 excluding as much as $24.6 billion in cancelled debt on 2008 tax returns."[83]

MoFoDRA violates the delicate yin and yang balance of tax policy for a loan and its repayment. When a lender loans money to a borrower, the borrower receives the benefit of the proceeds but is not subject to taxation on the loan proceeds due to the repayment obligation.[84] When the borrower repays the loan, the loan proceeds return to the lender, along with taxable income in the form of the interest paid on the loan.[85] The non-taxation of the borrower, due to repayment, and taxation of the lender for interest provides a natural balance.[86] When a loan is not

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[80] *See supra* note 11.

[81] Galle, *supra* note 51, at 1346 ("The structure of a tax system can also serve a regulatory function, as with the classic Pigouvian tactic of imposing a tax on activities that give rise to externalities."); *Id.*

[82] *See supra* note 4.

[83] KREIDER & BROSI, *supra* note 7, at 3-39.

[84] Allen Holzer, *Restructuring the Tax Treatment for Home Equity Draws: Implementing Consumption Tax Fundamentals to Preserve Home Equity,* 24 BYU J. PUB. L. 225, 232-233 (2010) ("Currently, a mortgagor (a borrower who takes out a home loan) is not taxed on proceeds received from a loan. This policy is rooted in the Internal Revenue Code's ("the Code's") presumption that a borrower will pay her loan back in full. Therefore, the borrower will not receive a net economic gain. . . . In theory, if a borrower pays her loan back in full, this tax treatment is logical because she truly does not have a net economic gain. However, if the borrower defaults on the loan, she benefits from tax-free gains extracted from her property.") *See also* Comm'r v. Indianapolis Power & Light Co., 493 U.S. 203, 207-08 (1990) (explaining that a loan is not income due to the repayment obligation); Comm'r v. Tufts, 461 U.S. 300, 307 (1983); James v. United States, 366 U.S. 213, 219 (1961).

[85] 26 U.S.C. § 61(a)(4) (2010).

[86] McMahon & Simmons, *supra* note 1, at 416. ("Every loan charge-off and mortgage foreclosure has tax consequences. While the creditor most often claims a bad-debt deduction or business-related loss, the debtor generally must recognize gross income and pay income taxes on an amount roughly equal to the creditor's loss, unless a special exception applies to exclude the debt relief from income.").

repaid, the lender engaged in the business of making loans reduces his or her taxes by taking a deduction for a bad debt, which is offset by the borrower being taxed on the unpaid loan proceeds.[87] This natural tax policy balance is tainted by MoFoDRA, which exempts the borrower from taxation on the discharged debt while granting the lender (e.g., banks which received bailout money) a tax deduction for the unpaid loan.[88] Instead of creating a level playing field of asset parity, Congress's exclusion of income from discharged mortgage debt is merely putting more fuel on the fire for residential real estate speculation.

D. Even Without MoFoDRA, There Was Already Relief for Those Who Were Insolvent.

MoFoDRA was never needed to protect those who are truly underwater. Section 108(a)(1)(B) of the Internal Revenue Code excludes discharge of indebtedness from income if the taxpayer is "insolvent."[89] Insolvency is defined in Section 108(d)(3) as "the excess of liabilities over the fair market value of assets."[90] Judicial interpretation of this provision "requires that all of the taxpayer's assets, including assets exempt from the claims of creditors under state law, be included in determining whether the taxpayer's liabilities exceed his assets."[91]

For those who argue that MoFoDRA was necessary to prevent harming those who are upside down in their mortgage, the insolvency exception already offered protection. MoFoDRA extends tax-free treatment to individuals who are solvent and have the capacity to pay income tax on discharged mortgage debt. The insolvency exception obviates the need for MoFoDRA. Similarly, if MoFoDRA's income tax exclusion rests upon the elusive concern of anticipatory filings for bankruptcy, then perhaps **<u>all</u>** forgiven loan debt, mortgage or otherwise, should be excluded from taxation for the fear that the recipients of this

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87 26 U.S.C. § 166 (2010).

88 *Id.*

89 26 U.S.C. § 108(a)(1)(B) (2010). *See also* Leila E. Dal Pos, *Hard Times for Individuals: Creditor Issues & Estate Administration*, 50 N.H.B.J. 16, 19 (2009) ("[T]he term 'insolvent' means the excess of liabilities over the fair market value of assets, determined immediately before the discharge. The amount that may be excluded from income is no more than the amount by which the taxpayer is insolvent.").

90 26 U.S.C. § 108(d)(3) (2010).

91 McMahon & Simmons, *supra* note 1, at 455.

income might declare bankruptcy. Barking at shadows does not justify poor tax policy.

If banks and mortgage brokers are the evil *causa sine quo non* of mortgage debt being incurred in the first place, and individuals who speculated in residential real estate did so under the duress of nasty banks and mortgage brokers, then the victim should pursue civil remedies against the transgressors for all damages.[92] Civil remedies are also appropriate in the event of fraudulent foreclosure mills.[93] MoFoDRA cannot be justified by using a broad brush to paint a picture of borrowers being unfairly influenced by real estate agents, banks, and mortgage brokers.

It could be argued that a person who walks away from his or her home is already punished by loss of any down payment and principal amount paid, or by virtue of a bad credit score. The loss of the down payment and any principal payments made are part of home ownership, and in any event, would reduce the total amount of discharged debt and taxable income, even without MoFoDRA. As to the issue of credit scores, "While the actual financial cost of having a poor credit score for a few years may be hard to quantify, it is not likely to be significant for most individuals - especially not when compared to the savings achieved by walking away from a seriously underwater mortgage. Whereas a good credit score might save an average person tens of thousands of dollars over the course of a lifetime, a few years of poor credit shouldn't cost more than few thousand dollars. "[94]

Professor Brent White of the University of Arizona has published an intriguing article about the strategic decision on whether to walk away from an underwater mortgage.[95] His article is well reasoned and even handed in its legal, moral, and ethical analysis of the topic. My

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[92] White, *supra* note 26, at 993, note 100.

[93] *See generally* Todd Ruger, *Shortcuts On The Paper Trail,* SARASOTA HERALD TRIBUNE, Nov. 28, 2010, at A1 (improper dates and signatures on mortgage documents have resulted in inappropriate foreclosures); Tom Harvey, *B of A Focus of Utah Foreclosure Lawsuit,* THE SALT LAKE TRIBUNE, Feb. 17, 2011 (no page number listed) (challenges raised to foreclosure process); Julie Creswell & Barry Meier, *Bet on Foreclosure Boom Turns Sour For Investors*, N.Y. TIMES, Feb. 2, 2011, § B, at 1 (investors in a business specializing in foreclosures are concerned over possible inappropriate activity in the foreclosure process); John Schwartz, *Judges Berate Bank Lawyers in Foreclosures*, N.Y. TIMES, Jan. 11, 2011, § A, at 1 (failure to follow appropriate technicalities in foreclosure process raise judicial concerns).

[94] White, *supra* note 26, at 984-85.

[95] *Id.*

thesis in this article does not conflict with Professor White's analysis, as I merely offer up that part of the strategic analysis on whether to walk away from a mortgage must include the calculation of taxes due on the discharged debt for a solvent individual, because discharged mortgage loan debt is a form of income, but for the existence of MoFoDRA.

VI. UNFORGIVEN; THE SOLUTION TO INCOME FROM DISCHARGED MORTGAGE DEBT

My first two proffered solutions to the forgiveness of mortgage debt conundrum primarily address consistency in application. If taxing discharged loan debt is a good thing, then it must always be a good thing and always done. If taxing discharged loan debt is a bad thing, then it must never be done and reparations must be paid to those who were wronged.

A. The New Law is Good; Pay Reparations for the Past

If MoFoDRA's tax exemption for unpaid mortgage debt is such a great idea, then it should be extended perpetually and not terminate at the end of 2012.[96] In such an event, reparations must be paid to all persons who have paid income tax in the past on discharged mortgage indebtedness. Such reparations obviously must include the principal amount paid in taxes plus interest and any penalties paid thereupon. Indeed, other commentators have examined the topic of potential retroactive application of MoFoDRA:

"While retroactively applying the Act's provisions to years prior to 2007 would necessitate some burden on the IRS in refunding paid taxes, it is not clear why the usually applicable rules for amendment should not provide an administratively feasible retroactive start date. Apart from procedural considerations, there is little plausible substantive rationale for the start date, as the mortgage crisis was well underway during 2006."[97]

Additionally, if MoFoDRA is good tax policy, then the theme of consistency requires that all forgiven debt should not be taxed, whether

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[96] *See supra* note 4 (MoFoDRA, as enacted and codified, took effect with the 2007 tax year, and by virtue of the text of the statute, terminates if the debt is discharged before January 1, 2013, i.e. by the conclusion of the tax year 2012); *see also* Hamill *Virginia*, *supra* note 53, at note 138 (explaining that those who embrace supply side economic theory believe that cutting taxes will spur economic growth).

[97] *See* Carlton, *supra* note 21, at 612.

for credit cards, auto loans, gambling, or otherwise. No other type of forgiven debt should have to serve as the unappealing (i.e. taxed) step-brother or step-sister of the favorite child, residential real estate.

B. The New Law is Bad; Tax Discharged Mortgage Debt

Another consistent and equal solution is to determine that forgiven mortgage loan debt actually is income and it must be taxed. This would require Congress to immediately revoke the current tax exemption under MoFoDRA and commence taxing the discharged debt.

Opponents of this solution might argue that this could accelerate foreclosures, as individuals may seek to strategically walk away from loans before discharged debt becomes taxed once again. That is a possibility, but only one part of the equation on whether to walk away from a home.[98] Taxing the forgiven debt will only affect solvent individuals who walk away from homes. Those who are insolvent and receive income in the form of cancelled mortgage debt will continue to be protected by the insolvency provision in the Internal Revenue Code.[99]

What about those solvent individuals who have already profited by not being taxed upon forgiven loan debt? One way to address this problem would be to retroactively tax those who walked away.[100] The difficulty in doing so is that retroactive taxation runs counter to the tenets of fairness described earlier. Despite this, it is tempting to collect income tax from solvent individuals who were complicit in the housing bubble and benefited from untaxed income in the form of forgiven debt.

C. A Pragmatic Approach: Reward Those Who Pay and Stay

A third solution to the problem of MoFoDRA recognizes that perhaps some form of tax relief is digestible. The Internal Revenue

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98 *See* White, *supra* note 26.

99 *See supra* text accompanying notes 14, 89-91.

100 *See generally* Saul Levmore, *The Case For Retroactive Taxation*, 22 J. LEGAL STUD. 265 (1993) (analyzing economic, political, and public policy aspects of retroactive taxation, and establishing that retroactive taxation is a potential workable solution, despite the general disposition against it); ERIKA K. LUNDER ET AL. CONG. RESEARCH SERV., R40466, RETROACTIVE TAXATION OF EXECUTIVE BONUSES: CONSTITUTIONALITY OF H.R. 1586 AND S. 651 (2009) (discussing the constitutionality of retroactive taxation of bonuses). *But see* Harold M. Somers, *Retroactive Taxation: A Triumph of Law Over Economics*, (Univ. of Cal. L.A. Dep't of Econ., Working Paper No. 726, 1995) (arguing that changing the rules of taxation after economic decisions have been made is an abhorrent idea).

Code calls for taxation on any significant modification to a loan, such as the interest rate or timing of payments,[101] and not only discharged principal. MoFoDRA could be modified to only exempt taxation for individuals who receive a reduced interest rate, a "no interest rate" time period or tolling of interest accumulation, or extended payment terms. This approach would not allow discharge of any principal amount to be exempt from taxation. This significant loan modification exemption should only apply if the individual continues to pay the full principal amount of the loan. This resolution is a far cry superior to MoFoDRA's current allowance of tax-free income in the form of discharged principal debt.

Some might take this pragmatic solution a step further and support forgiveness of taxation on a small principal amount, something substantially less than the regressive $2 million exemption under MoFoDRA,[102] as long as the borrower continues to fully pay the remainder of the loan. Arguably, this approach could create an incentive for an individual to remain in his or her home and continue performing his or her payment obligations, albeit at a reduced principal amount. If the income forgiveness is significantly reduced below the current $2 million potential exemption, and tied to an individual's adjusted gross income in order to better protect low and middle income individuals, such a solution could address the vertical equity issues described earlier, but would still continue to fail to address the horizontal equity issue of those who were burdened with taxation prior to MoFoDRA. From a perspective of true equality, implementation of any part of this pragmatic solution would require application to all types of debt, and not just residential real estate.

V. CONCLUSION

The sacred cow of residential real estate tax preferences needs to be slaughtered, or at least forced to eat in the same pasture as all other capital investments. Congress created tax-free residential real estate profits through tax code revisions in 1997 which fueled speculation in housing. When the music stopped, Congress granted preferential tax treatment to persons who defaulted on their mortgage debt, instead of rewarding those who honor their mortgage obligations.

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[101] *See supra* note 9 and accompanying text.
[102] *See supra* note 6.

Given the fact that the Internal Revenue Code already shields against taxation on forgiven mortgage debt for those who are insolvent, MoFoDRA was entirely unnecessary. Instead of protecting the downtrodden, MoFoDRA grants a regressive preference to solvent and wealthy individuals who strategically evade taxation on forgiven residential mortgage debt. The cost of this legislation results in reduced governmental coffers and tighter mortgage lending practices, squeezing innocent newcomers from being able to purchase a home and actually pay the loan.

Tax policy should not result in disparate treatment. Tax legislation needs to have a coherent theme, commencing with standards of consistency and equality. MoFoDRA ultimately punishes individuals who perform their mortgage payment obligations, and rewards solvent persons who speculated and strategically default on residential real estate loans.