

*Qualified Principal Residence Indebtedness.* The Code excludes from gross income any income from the discharge, in whole or in part, of “qualified principal residence indebtedness” which occurs in 2007 through 2012. The debt referred to is acquisition indebtedness, as defined in the home mortgage interest deduction provisions of Code Sec. 163(h), but with a \$2 million limit (\$1 million for a married taxpayer filing a separate return) (Code Sec. 108(a) (1) (E) and (h) (2)).

An individual’s acquisition indebtedness is indebtedness with respect to his or her principal residence if it is incurred in the acquisition, construction, or substantial improvement of that residence, and the debt is secured by the residence. Qualified principal residence interest also includes refinancing of the indebtedness, but only to the extent of the amount of the refinanced indebtedness. Principal residence has the same meaning for purposes of the exclusion as it does for purposes of Code Sec. 121 (Code Sec. 108(h) (5)).

The Code contains several provisions aimed at preventing abuse of the exclusion of income from the discharge of qualified principal indebtedness. For example, the discharge of a loan will not be excluded from gross income if it is as a result of (1) services performed for the lender, or (2) other factors unrelated to either the financial condition of the taxpayer or a decline in value of the residence. In addition, if only a portion of discharged indebtedness is qualified principal residence indebtedness, the exclusion applies only to the amount of discharged debt that exceeds the portion of the debt that is not qualified principal residence indebtedness. The basis of the taxpayer’s principal residence is reduced, but not below zero, by the amount of qualified principal residence interest that is excluded from income (Code Sec. 108(h) (1)).<sup>209</sup>