NATIONAL ASSOCIATION OF REALTORS®
Government Affairs Update

FIRST-TIME HOMEBUYER TAX CREDIT

Frequently Asked Questions

On July 30, 2008, President Bush signed a major housing bill (H.R. 3221) into law. As part of the housing bill, Congress has created a new, temporary tax credit to provide an incentive for first-time homebuyers. The $7500 credit will be available for the purchase of a principal residence on or after April 9, 2008 and before July 1, 2009.

> CAVEAT: THIS INFORMATION IS ACCURATE BASED ON INFORMATION AVAILABLE AS OF JULY 30, 2008. AS WITH ANY TAX LAW CHANGE, CHECK WITH A TAX ADVISOR IF THERE ARE QUESTIONS ABOUT USING THIS PROVISION.

The Basics

1. ***How does a tax credit work?***

Tax credits are special provisions that reduce income tax liability on a dollar for dollar basis. Credits are claimed on an individual's income tax return. In this case, Congress has created a tax credit for first-time homebuyers. The maximum credit amount is $7500. Thus, if after figuring out all the income items and exemptions and making all the required additions, subtractions, deductions and other items on a tax return a person had total tax liability of $8000, a $7500 credit would wipe out all but $500 of the tax due.

2. ***So in the case of this new homebuyer tax credit, what happens if the purchaser is eligible for a $7500 credit but their entire income tax liability for the year is less than $7500?***

This new tax credit is a so-called "refundable" credit. Thus, if the actual tax liability was $6000, the purchaser would receive a tax credit refund of $1500. The refundable amount is the difference between $7500 credit amount and the amount of tax liability. (The term "tax liability" refers to the actual amount of tax computed on the tax return once all the computations are complete. The individual may already have "paid" their tax liability through withholding, by means of estimated taxes or simply by a check that makes up the difference when there is a shortfall of withholding or estimated tax payments. Most taxpayers determine their tax liability by referring to tables that the IRS prepares each year.)

3. Who can use the new tax credit?

Only first-time homebuyers are eligible to use the credit. A first-time homebuyer is defined as an individual who has not had an ownership interest in a principal residence in the previous three years. The 3-year period is measured as of the date of the purchase of the eligible principal residence.

4. Is there an income restriction?

Yes. The income restriction is based on the tax filing status the purchaser claims when filing his/her income tax return. Individuals whose Form 1040 filing status is Single (or Head of Household) are eligible for the credit if their income is no more than $75,000. Individuals who file a Joint return may have income of no more than $150,000.

5. Do individuals with incomes higher than the $75,000 or $150,000 limits lose all the benefit of the credit?

Not always. The credit has a phase-out so that the closer a buyer comes to the maximum phase-out amount, the smaller the credit will be. For this new credit, the credit amount is gradually reduced as an individual's income reaches $95,000 (single return) or $170,000 (joint return). Individuals with income above $95,000 ($170,000 joint return) will receive no tax credit.

For example, if a married couple had income of $165,000, their credit would be reduced by 75% as shown:

Couple's income	$165,000
Income limit	$150,000
Excess income	$15,000

The excess income amount ($15,000 in this example) is used to form a fraction. The numerator of the fraction is the excess income amount. The denominator is $20,000 (specified by the statute).

In this example, the *disallowed* portion of the credit is 75% of $7500, or $5625.
($15,000/$20,000 = 75% x $7500 = $5625)

Stated another way, only 25% of the credit would be allowed.
In this example, the allowable credit would be $1875. (25% x 7500 = $1875)

6. Is the amount of the credit tied to the price of the home?

Yes. The credit is for 10 percent of the cost of the home, up to a maximum credit of $7,500. If a home cost $65,000, the allowable credit would be $6,500. If a home cost $120,000, the allowable credit would be $7,500. The amount of the credit is the same for all taxpayers, married or single.

7. What's the definition of "principal residence?"

Generally, a principal residence is the home where an individual spends most of his/her time (generally defined as more than 50%). The term includes single-family detached housing, condos or co-ops, townhouses or any similar type of new or existing dwelling.

8. Are there restrictions on the location of the property?

Yes. Eligible property must be located in the United States. Property outside the US is not eligible for the credit.

9. Are there restrictions related to the financing for the mortgage on the property?

Yes. If the financing is obtained by means of mortgage revenue bonds (i.e., through a tax-exempt bond-related financing program offered by a state housing agency), then the purchaser is not eligible for the tax credit.

10. Why do some news reports call the credit an interest-free loan?

Unlike most other tax credits, this tax incentive must be paid back. All eligible purchasers who claim the credit will be required to repay it over 15 years. The statute specifies that the repayment amount will be 6.67% of the credit amount each year. Thus, a buyer who qualifies for the full $7500 credit will repay $502.50 each year. There will be no interest charge on outstanding balances. *(See "Repaying the Credit" below.)*

Some Practical Questions

11. How do I apply for the credit?

There is no pre-purchase authorization, application or similar approval process. Eligible purchasers will simply claim the credit on the appropriate IRS Form 1040 tax return and/or on any special forms the IRS might devise. In many, if not most cases, the IRS will be on notice that a purchase has occurred because the settlement officer at the time of purchase is required to report the transaction.

12. So I can't use the credit amount as part of my downpayment?

Presently, there is no mechanism available for claiming the credit any earlier than the 2008 tax return that will be filed in 2009. Congress tried to devise a mechanism that would allow pre-funding of the credit, but found that pre-funding would require cumbersome processes that would, in effect, bring the IRS into the purchase and settlement phase of the transaction.

13. So there's no way to get any cash flow benefits before I file my 2008 tax return?

Any first-time homebuyers who believe they would be eligible for all or part of the credit may wish to modify their income tax withholding (through their employers) or to adjust their quarterly estimated tax payments. Individuals subject to income tax withholding would get an IRS Form W-4 from their employer, follow the instructions on the schedules provided and give the completed Form W-4 back to the employer. In many cases their withholding would decrease and their take-home pay would increase. Those who make estimated tax payments would make similar adjustments.

14. ***I made an offer on a home that was accepted on March 27, 2008. We went to settlement on April 12, 2008. Do I qualify for the credit (assuming I meet all the other requirements)?***

Yes. A home is considered as "purchased" when all events have occurred that transfer the title from the seller to the new purchaser. If a property goes to settlement on or after April 9, 2008, then an otherwise qualified buyer would be eligible for the credit. Similarly, closings must occur before July 1, 2009 for purchases to be eligible for the credit.

15. ***If I don't make an eligible purchase until 2009, do I claim the credit when I file my 2009 tax return in 2010?***

You'll have a choice. Qualified first-time homebuyers who make their purchase between January 1, 2009 and before July 1, 2009 are permitted to make an election to treat the purchase as if it had occurred on December 31, 2008. This election allows them (depending on the timing of the sale) to claim the credit on their 2008 tax return that is due on April 15, 2009. They may also elect to file their 2008 tax return after April 15 by filing for an automatic extension and claim the credit on the extended 2008 return. If they file their 2008 return before they have purchased the home, they may utilize this election and file an amended 2008 tax return. Of course they will always have the option of claiming the credit for the 2009 purchase on their 2009 return filed in 2010.

16. ***My sister and I are both single and want to purchase a home together. Will we each receive a $7500 credit?***

No. The purchase of a residence will generate a tax credit amount that will total up to no more than $7500, no matter how many unmarried purchasers are buying the house.

17. ***My fiancé and I bought a house on June 1, 2008. We'll get married in 2009. I owned a home in 2006. He's never owned a home. Will we get a credit? For 2008? For 2009?***

It's pretty clear that *you* will not qualify for the credit for the 2008 purchase because *you* owned a home after June 1, 2005 (three years before the date of purchase). But since you and your fiancé were single when you made the purchase, he may qualify for the credit since he didn't own a home after June 1, 2005. If he's otherwise eligible, then he may be able to take the credit because you'll both file your tax return as Single for 2008. If you got married in 2008, neither of you could claim the credit. When purchasers file a joint tax return (as you would if you got married in 2008), *both* must be first-time homebuyers. Your 2009 marriage isn't relevant for this purpose.

18. ***My sister and I wish to purchase a home together. She previously owned a principal residence but sold it 2 years ago. I've never owned a residence. Can I qualify for a partial credit?***

Possibly. The statute is somewhat ambiguous. Note though, that Treasury will no doubt provide guidance to clarify this ambiguity. As it presently stands, the statute specifically provides that for a married couple to be eligible for the credit, *both* must be first-time homebuyers. Similarly, the statute provides that if a married couple files their tax return as Married Filing Separate, then the credit is limited to $3750 each. By contrast, the statute directs the IRS to determine how the credit can be shared when two or more unrelated individuals purchase a home. In that case, the statute does not specify whether all the unrelated purchasers must be first-time homebuyers. You'll want to check with a tax advisor.

19. ***I made an eligible purchase of a principal residence in May 2008. My brother, also a first-time homebuyer, wishes to move in with me next year and purchase a partial interest in the home in before July 1, 2009. Will he qualify for the credit, as well?***

No. Any purchase of a principal residence (or interest in a principal residence) from a related party such as a sibling, parent, grandparent, aunt or uncle is ineligible for the tax credit. Since you and your brother are related in this way, he cannot qualify for the credit on any portion of the home that he purchases from you, even if he is a first-time homebuyer. If you, as the first-time homebuyer, had bought the property from, for example, your grandparents, you would also be disqualified from using the credit.

20. ***I'm working outside the US for part of 2008, so part of my income will be excluded from tax. I'm single and want to buy a home when I come back (also in 2008). Can I disregard my non-taxable overseas income when figuring whether I am eligible for the credit?***

No. To determine whether you are eligible for the tax credit, you are required to combine your non-taxable overseas income with any US income you earn in 2008. Thus, for example, if you are single and had $45,000 of non-taxable overseas income and $55,000 of US income, you would be ineligible for the tax credit because your 2008 income ($100,000) exceeded even the $95,000 phase-out amount. If you had $45,000 of non-taxable overseas income and $40,000 US income, you would qualify for a partial credit because your total income of $80,000 would be within the phase-out amount. If you had $45,000 non-taxable overseas income and $20,000 US income, you would qualify for the full credit (assuming you met all of the other requirements) because your income was less than $75,000. Similar rules would apply if you had non-taxable overseas income in 2009 and wished to purchase then.

21. ***I live in the District of Columbia and am eligible for the DC Homebuyer Tax Credit. Can I use both credits?***

No. You must choose one or the other. Note that the $5000 DC credit has no repayment feature, while the new $7500 credit must be repaid as an interest-free loan. *(See "Repaying the Credit" below)*

Repaying the Credit

22. ***What is the repayment feature of the credit?***

The repayment feature of the credit is similar to a recapture provision: in some circumstances the tax system takes back all or part of a tax benefit. In this case, there is no precedent for repayment of a tax credit created for individuals, so not much is known about how the repayment will occur, how it will be reflected at settlement (or on sales forms) or how the IRS will collect and enforce the payments. The repayment is the equivalent of converting the tax credit into an interest-free loan.

23. ***What are the terms for repayment?***

The credit amount is repaid in increments of 6.67% of the credit amount over 15 years. For individuals who take the full $7500 credit, the repayment will be about $502.50 a year. Individuals who claim a credit of less than $7500 will also have a 15-year repayment period and will pay 6.67% of their credit each year. For example, an individual who claims a credit of $6000 will repay $400.20 a year ($6000 x .0667). There is no interest charge applied to outstanding balances.

24. When do I make the payment?

The mechanics are not specified. Repayments for credits claimed on 2008 tax returns will go into effect for the 2010 tax year. As a practical matter, then, repayments of credits taken in 2008 will not actually start until 2010 returns are filed in 2011. Repayments for credits claimed on 2009 returns will go into effect for the 2011 tax year and reflected on 2011 returns filed in 2012.

25. Will the IRS put a lien on my property for the amount of the credit repayment?

The statute does not grant the IRS that authority. The rules for tax liens are quite specific about when the IRS can put a lien on property. It is not yet known how the IRS will identify and stake its claim to the repayment.

26. What if I sell my house before the 15-year repayment period is complete?

When the person who used the credit sells the home, any amount of tax credit that has not been repaid will be due in the year of sale. For example, if an individual still "owed" $4000 in repayments and realized $25,000 of proceeds from the sale, the $25,000 of seller proceeds would be reduced to $21,000 and $4000 will be remitted to the IRS. Again, the mechanics are unknown.

27. What if there's very little gain (or even a loss) on the sale and the proceeds won't cover the repayment amount?

If the gain on the sale is less than the amount that must be repaid, part of the liability is forgiven. For example, if the individual still "owed" $4000 but the gain on the sale was only $3500, then the seller would not be required to repay the IRS the $500 shortfall. If there was no gain or even a loss, then the remaining $4000 would not be repaid.

28. Are there any other exceptions to the repayment rules?

Yes. If the person who utilized the credit dies before the full credit amount has been repaid, then any balance that remains unpaid is disregarded. Special rules make adjustments for people who sell homes as part of a divorce before the credit has been fully repaid. Similarly, adjustments are made in the case of a home that is part of an involuntary conversion (property is destroyed in a natural disaster or subject to condemnation by eminent domain by an authorized agency).

29. If I received a refund of a portion of the tax credit because my total tax liability was less than the amount of my tax credit, do I have to repay the amount of the refund?

Yes. You would have received the maximum economic benefit of the any credit amount when you reduced your tax to zero and also received a refund of the balance. Thus, you would repay the full amount of the credit for which you were eligible. Again, there are no details that specify the mechanics for tracking those amounts.