

General Information

These new tax credits are provided as an incentive to stimulate first time home purchases. The “First Time Homebuyer Tax Credit” was a new tax ruling included in the *Housing and Economic Recovery Act of 2008* and was recently modified in the *American Recovery and Reinvestment Act of 2009*. The new tax law of 2009 does not supersede the previous tax credit of 2008.

These are two separate programs that exist at the same time (at least until the 2008 tax credit terminates July 1, 2009). **Determination of which of the two tax credits that you qualify for, if any, depends upon the date of the new home purchase.** Both tax credits are claimed using the same tax form. And most of the mechanics of the two First Time Homebuyer tax credits are identical for both 2008 and 2009.

The main difference is that the 2008 version is similar to a 15-year interest-free loan whereas the 2009 version requires no repayment. Other fundamental differences are described in this report.

2008 \$7,500 Tax Credit

Are You A “First-Time Homebuyer”?

You are a First-Time Homebuyer if you, and any or all other purchasers of your home, did not own another main home at any time during the three years prior to the date of purchase.

For example, if you bought a home on January 15, 2009, you cannot take the 2009 tax credit for that home if you owned, or had an ownership interest in, another home at any time from January 15, 2006 through January 15, 2009.

If married filing jointly, both must meet the First-Time Homebuyer test to take the credit on a joint return. So if you have not owned a home in the past three years but your spouse has owned a principal residence, neither you nor your spouse qualifies for the first-time buyer tax credit.

However, unmarried joint purchasers may allocate the credit amount to any buyer who qualifies as a first time buyer, something that may occur if a parent jointly purchases a home with a son or daughter.

If you own or owned a vacation home and/or rental properties you are still eligible for the tax credit as long as you did not own a personal residence the last three years prior to the purchase of your main home. If the last time you owned a primary residence was 2005, you are eligible for the credit even though it is not actually your “first” home.

2009 \$8,000 Tax Credit

Are You A “First-Time Homebuyer”?

Same as on left.

2008
\$7,500 Tax Credit

What is the definition of “principal residence?”

Generally, a principal residence is the main home where you spend most (usually defined as more than 50%) of your time. It is also defined as “owner-occupied” housing. The term includes single-family detached housing, condos, townhomes, co-op apartments or house trailers. Even some houseboats or manufactured homes count as principal residences. The home must be located in the United States. For new construction, the “purchase date” is the date you occupy the home. So the move in date must be before July 1, 2009 to qualify for the \$7,500 tax credit.

How does a tax credit work?

Every dollar of a tax credit reduces your income taxes by a dollar. Credits are claimed on your income tax return. Thus, you would figure out your total tax due, then subtract the tax credit from your total. So, if before taking any credits on a tax return you had a total liability of \$9,000, a \$7,500 credit would wipe out all but \$1,500 of the tax due ($\$9,000 - \$7,500 = \$1,500$).

What is a “refundable” tax credit?

Let's say you're eligible for a \$7,500 credit but your entire income tax liability for the year is less than that amount, the remaining balance is refundable. So if your total tax liability was \$6,000, the IRS would send you a check for \$1,500. The refundable amount is the difference between the \$7,500 credit amount and the amount of tax liability ($\$7,500 - \$6,000 = \$1,500$).

What is the difference between a “tax credit” and a “tax deduction”?

A *tax credit* is a dollar-for-dollar reduction in what you owe. That means if you owe \$7,500 in income taxes and you get a \$7,500 tax credit, you would owe nothing to the IRS.

On the other hand, a *tax deduction* is subtracted from the amount of income that is taxed. So a tax deduction is a reduction against earned income. For the purposes of illustration, let's assume you are in the 15 percent tax bracket and owe \$7,500 in income taxes. If you receive a \$7,500 deduction, your liability would be reduced by \$1,125 (15 percent of \$7,500). In other words, your tax liability would be lowered from \$7,500 to \$6,375.

2009
\$8,000 Tax Credit

What is the definition of “principal residence?”

Same as on left, except the move in date is different.

The move in date must be before December 1, 2009 to qualify for the \$8,000 tax credit.

How does a tax credit work?

Same as on left, using \$8,000 credit amount.

What is a “refundable” tax credit?

Same as on left, using \$8,000 credit amount.

What is the difference between a “tax credit” and a “tax deduction”?

Same as on left, using \$8,000 credit amount.

2008
\$7,500 Tax Credit

How do I apply for the credit?

There is no pre-purchase authorization, application or similar approval process. If eligible, you simply claim the credit on your IRS Form 1040 tax return. The credit will be reflected on a new Form 5405 that will be attached to the 1040. Form 5405 can be found at www.irs.gov.

Generally speaking, who doesn't qualify?

You are not eligible for the tax credit if: you do not meet the income requirements; you buy your home from a close relative (spouse, parent, grandparent, child or grandchild); you acquired your home by gift or inheritance; or, you stop using your home as a main home or sell your home before the end of three years. A vacation home, or a rental property or a main home purchased outside of the U.S. are not qualified home purchases.

Can the credit amount be part of my down payment?

No. Congress tried hard to devise a mechanism that would make the funds available for closing costs, 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.

Is there any way to get the "cash flow" benefits of the tax credit before I file my tax return?

Yes. If you believe you are eligible for all or part of the credit, you can modify your income tax withholding (through your employers) or adjust your quarterly estimated tax payments. If you're subject to income tax withholding, you would get an IRS Form W-4 from your employer, follow the instructions on the schedules provided, and give the completed Form W-4 back to your employer. In your case, your withholding might decrease and your take-home pay could increase. If you make estimated tax payments, you would make similar adjustments.

2009
\$8,000 Tax Credit

How do I apply for the credit?

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Generally speaking, who doesn't qualify?

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2008
\$7,500 Tax Credit

Is there an income restriction?

Yes. The income restriction is based on your tax filing status. If you are filing Form 1040 as Single or Head of Household, you are eligible for the full credit if your income is no more than \$75,000. Married couples filing a Joint return may have income of no more than \$150,000.

How is my “income” determined?

If you're like most individuals, your income is defined and calculated in the same manner as your Adjusted Gross Income (AGI) on the 1040 income tax return. AGI includes items like wages, salaries, interest and dividends, pension and retirement earnings, rental income and a host of other elements. AGI is the final number on the bottom line of the front page of an IRS Form 1040.

If I exceed the income limits of \$75,000 (single) or \$150,000 (married filing jointly), do I lose all the benefit of the credit?

Not always. The credit phases-out between \$75,000 and \$95,000 for singles; \$150,000 and \$170,000 for married filing jointly. This means for singles making over \$75,000 and couples making over \$150,000, the credit is proportionately reduced as incomes approach \$95,000 and \$170,000 respectively.

The law provides a formula to gradually reduce the credit. If you make \$90,000, the excess amount is used to create a fraction $\frac{15,000}{20,000}$ ($\frac{\$90,000 - \$75,000}{\$95,000 - \$75,000}$) times the \$7,500 credit amount. In this case, 75% or \$5,625 of the credit would be disallowed, getting you a \$1,875 tax credit.

Are there restrictions related to the financing of the mortgage on the property?

For the \$7,500 tax credit in 2008, purchasers were ineligible for the credit if the financing was obtained by means of mortgage revenue bonds.

Mortgage revenue bonds are tax-exempt bonds issued by a state housing agency that must be used for below market loans to qualified buyers.

2009
\$8,000 Tax Credit

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If I exceed the income limits of \$75,000 (single) or \$150,000 (married filing jointly), do I lose all the benefit of the credit?

Same as on left, using \$8,000 credit amount.

Are there restrictions related to the financing of the mortgage on the property?

For the \$8,000 tax credit in 2009, Congress eliminated the financial restriction that applied to the \$7,500 tax credit.

Now, in 2009, mortgage-revenue bond financing will not disqualify an otherwise-eligible purchaser.

2008
\$7,500 Tax Credit

Are there any circumstances where I would have to repay the \$7,500 credit?

Yes. Remember, this \$7,500 credit basically acts as an interest free home loan from the federal government. You will be required to pay back the full credit over 15 years or when you sell your home.

The payment period is 15 years; but if the house is sold before the 15 years, then any amount that's not yet been repaid must be paid back. This is done on your tax return for the year of the sale and repayment is limited to the amount of gain of the sale. If you sell your home and there is insufficient profit, the remaining credit payback would be forgiven.

Please be aware that there may be repayment exceptions for the \$7,500 tax credit that are not detailed in this report.

2009
\$8,000 Tax Credit

Are there any circumstances where I would have to repay the \$8,000 credit?

One situation *does* require recapture payment back to the government. If you claim the credit but then sell the property within 3 years of the date of purchase, you are required to pay back the full amount of any credit. A few exceptions apply.

What does the term "recaptured" mean?

To take full advantage of the 2009 tax credit, you need to plan on staying in your new home for 3 consecutive years after purchase. If you sell your new home on which you claimed the tax credit **within 3 years**, the government will recapture the credits they've given you, including the entire amount of the tax credit and any refund that was sent to you.

This is done through your tax return the year the house is sold. If you are not expecting a tax refund to cover the amount you owe, you will have to mail a check to the IRS for the balance.

What happens to the tax credit in the event of a death, divorce or natural disaster within the 3 years of purchasing the home?

The repayment rules are eased for many circumstances. If the homeowner who used the credit dies within the first three years of ownership, there is no recapture. Special rules make adjustments for people who sell homes as a part of a divorce settlement, as well. 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) within the first 3 years. Please be aware that there may be repayment exceptions for the \$8,000 tax credit that are not detailed in this report.

REAL LIFE EXAMPLES

\$7,500 Tax Credit for 2008

I made an eligible purchase of a principal residence in 2008 and claimed the \$7,500 credit on my 2008 tax return. My brother, who has never owned a home, wishes to purchase a partial interest in the home this spring and move in. Will he qualify for the \$8,000 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.

I purchased my home in early 2009 before the stimulus bill was enacted. I claimed a \$7,500 tax credit on my 2008 return as prior law had permitted. Am I restricted to just a \$7,500 credit?

No, you would qualify for the \$8,000 credit. Eligible purchasers who have already claimed the \$7,500 credit on a 2008 return for a 2009 purchase may file an amended return (IRS Form 1040X) for the 2008 tax year. This amended return will enable you to obtain the additional \$500 credit amount and the rules for the 2009 credit would then apply.

\$8,000 Tax Credit for 2009

If I claim my 2009 \$8,000 credit on my 2008 tax return will I have to repay the credit just as the 2008 credits are repaid?

No. Congress anticipated this confusion and has made specific provision so that there would be no repayment of 2009 credits that are claimed on 2008 returns.

What if I purchase later this year but can't get to settlement before December 1, 2009?

The \$8,000 credit is available for purchases before December 1, 2009. A home is considered as "purchased" when all events have occurred that transfer the title from the seller to the new purchaser. Therefore, closings must occur before December 1, 2009 for purchases to be eligible for the credit.

I haven't filed my 2008 tax return yet. If I buy in 2009, do I have to wait until next year to get the benefit of the credit?

You'll have a helpful choice that might speed up the process. Eligible homebuyers who make their purchase between January 1, 2009 and December 1, 2009 can treat the purchase

as if it had occurred on December 31, 2008. You can claim the credit on their 2008 tax return that is due on April 15, 2009. In fact, you actually have three filing options:

- If you purchase between January 1, 2009 and April 15, 2009, you can claim the \$8,000 credit on the 2008 return due on April 15.
- You can extend your 2008 income-tax filing until as late as October 15, 2009. (The IRS grants automatic extension, but you must file for the extension. See www.irs.gov for instructions on how to obtain an extension.)
- If you have filed your 2008 return before you purchase the home, you may file an amended 2008 tax return on Form 1040X (available at www.irs.gov)

Of course, 2009 purchasers will always have the option of claiming the credit for the 2009 purchase on their 2009 return.

How does my withholding affect my tax credit and my refund?

The following are withholding examples. The impact of estimated tax payments would be the same.

Scenario #1:

Sally plans her withholding so that her withholding is as close as possible to what she anticipates as her income tax liability for the year. When she fills out her 1040, her liability is \$6,000. She has had \$6,000 withheld from her paycheck. She also qualifies for the \$8,000 homebuyer credit.

Result: Sally's withholding satisfies her tax liability and reduces it to zero. She will receive a refund of the full \$8,000.

Scenario #2:

Nick and Jennifer file a joint return. Nick is self-employed and makes estimated payments; Jennifer has taxes withheld from her salary. When they compute their taxes, their combined withholding and estimate tax payments are \$11,000, and their income tax liability is \$9,800. They also qualified as first-time homebuyers and are eligible for the \$8,000 refundable tax credit.

Result: Ordinarily, their combined estimated tax payments and withholding would make them eligible for a refund of \$1,200 ($\$11,000 - \$9,800 = \$1,200$). Because they are eligible for the refundable tax credit as well, they will receive a refund of \$9,200 ($\$1,200$ income tax refund + $\$8,000$ refundable tax credit = $\$9,200$).

Scenario #3:

Cesar and LuzMaria both have income taxes withheld from their salaries and file a joint return. When they file their income tax return, their combined withholding is \$5,000. However, their total tax liability is \$7,200, generating an additional income tax liability of \$2,200 (\$7,200-\$5,000). They also qualify for the \$8,000 first-time homebuyer tax credit.

Result: Cesar and LuzMaria have been under-withheld by \$2,200. Ordinarily, they would be required to pay the additional \$2,200 they owe (plus any applicable interest and penalties). Because they are eligible for the refundable homebuyer tax credit, the credit will cover the \$2,200 additional liability and they would instead receive a refund of \$5,800.

Resources:

2008 \$7,500 Tax Credit:

<http://www.irs.gov/>

2009 \$8,000 Tax Credit:

<http://www.realtor.org/>

<http://www.federalhousingtaxcredit.com/>

Disclaimer:

This information contained in this report is accurate to the best of our knowledge based on information provided as of March 10, 2009 by the National Association of Realtors, the National Association of Home Builders and the Internal Revenue Service.

This tax credit information is being provided for general guidance only. It does not constitute the provision of legal advice, tax advice, accounting services or investment advice. The information provided should not be used as a substitute for consultation with professional tax, accounting, legal, or other competent advisers. Before making any decision or taking any action on this information, you should consult a qualified professional advisor to whom you have provided all of the facts applicable to your particular situation or question.