



**Regarding Provisions of HR 3221 (now known as Public Law 110-289)
(A Public Policy summary prepared by NeighborWorks America)
August 8, 2008**

Homebuyer Tax Credit

A major housing bill signed by President Bush on July 30, 2008 created a new, temporary tax credit for first-time homebuyers. With all of the foreclosure-related provisions of HR 3221 capturing the attention, many have overlooked this important “Homebuyer Tax Credit” provision that could be very helpful to NeighborWorks organizations and other affordable housing practitioners.

The \$7,500 tax credit created by this bill will be available for any qualified home purchase between April 9, 2008 and June 30, 2009. The credit is repayable, at the rate of \$500 per year, over 15 years -- making it, in effect, an interest free loan.

With foreclosure rates at historically high levels, and the credit crunch diminishing capital available for homebuyers and homeowners, some may question the wisdom of promoting homeownership; particularly among families of modest means. Yet, the fundamentals of homeownership remain the same: Homeownership is the most effective method to assist families in building assets, moving up the economic ladder and providing greater stability for their children. It is also a major driving force in the health of communities across the nation.

How does a Tax Credit work?

Tax credits reduce the federal income tax that a person would otherwise be obligated to pay. A tax credit is claimed on an individual’s income tax return. In the case of this tax credit for first-time homebuyers, the maximum tax credit is \$7,500. Therefore, if after calculating all income, exemptions and other items on a tax return an individual has a total ‘tax due’ of say \$8,000 the \$7,500 tax credit would eliminate all but \$500 of the tax due.

What if the Homebuyer’s total income tax liability is less than \$7,500?

This tax credit is a so-called “refundable tax credit”. So, if the individual’s tax obligation was \$6,000 the homebuyer would receive a tax credit refund of \$1,500 – the difference between the \$7,500 tax credit and the amount of their tax obligation. Keep in mind, that the individual may have already “paid” their tax liability through withholding or other means.

Who can Claim this new Tax Credit?

Only first-time homebuyers are eligible to claim this tax 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.

Is there an Income Restriction?



Yes. Individuals whose Form 1040 filing status is Single or Head of Household are eligible for the tax credit if their income is no more than \$75,000. Individuals who file a joint return may have a combined income of no more than \$150,000.

Do Individuals with Income higher than \$75,000 (or \$150,000 for joint returns) lose all the benefit of the credit?

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

Is the Amount of the Tax 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 costs \$65,000 the allowable credit would be \$6,500.

If a home costs \$120,000, the maximum allowable credit would be \$7,500. The amount of the credit is the same for all taxpayers, whether married or single.

What's the definition of "Principal Residence"?

A principal residence is the home where an individual spends most of his/her time (generally defined as more than 50%). The tax credit applies to single-family homes, condos or coops, townhouses or any similar type of new or existing dwelling.

Interestingly, not only does the tax credit not apply to second homes. The tax credit cannot be claimed by anyone who owns a second home – even if they wish to claim the credit for their principal residence.

Are there Restrictions on the Location of the Property?

Only that it has to be located in the United States.

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 finance agency) then the purchaser is not eligible for the tax credit.

Why do some news reports call the Tax Credit an Interest-Free Loan?

Unlike most other tax credits, this tax incentive must be paid back. All eligible homebuyers 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. Therefore, a homebuyer who qualifies for the full \$7,500 credit will repay \$502.50 each year. There will be no interest charge on outstanding balances.

How do I apply for the Credit?



There is no pre-purchase authorization, application or similar approval process. Eligible purchasers will simply claim the tax credit on the appropriate IRS 1040 tax return. In 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.

Can I use the Tax Credit amount as part of my Downpayment?

There is no mechanism available for claiming the credit earlier than the 2008 tax return that will be filed in 2009.

If I live in Washington, DC 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 DC credit has no repayment feature, while the new \$7,500 credit must be repaid as an interest-free loan. The new tax credit can be used with other local tax credit programs,

What if I sell my House before the 15-year repayment period is complete?

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’ \$4,000 in repayments and realized \$25,000 of proceeds from the sale, the \$25,000 of seller proceeds would be reduced to \$21,000 and \$4,000 will be remitted to the IRS.

What if there’s very little gain, or even a loss on the sale of the house?

If the gain on the sale of the house is less than the amount that must be repaid, part of the liability is forgiven. For example, if the individual still ‘owed’ \$4,000 but the gain on the sale was only \$3,500, 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 \$4,000 would not be repaid.

Are there any 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. Also, special rules make adjustments for people who sell homes as part of a divorce before the credit has been fully repaid. Adjustments are also made in the case of a home that is part of an “involuntary conversion (property is destroyed by a natural disaster or subject to condemnation by eminent domain by an authorized agency).

HOUSING AND ECONOMIC RECOVERY ACT OF 2008

First-time Homebuyer Tax Credit

FEATURE	H.R. 3221 Housing and Economic Recovery Act of 2008
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Amount of Credit	Ten percent of cost of home, not to exceed \$7500
Eligible Property	Any single-family residence (including condos, co-ops) that will be used as a principal residence.
Refundable	Yes. Reduces income tax liability for the year of purchase. Claimed on tax return for that tax year.
Income Limit	Yes. Full amount of credit available for individuals with adjusted gross income of no more than \$75,000 (\$150,000 on a joint return). Phases out above these caps (\$95,000 and \$170,000, respectively).
First-time Homebuyer Only	Yes. Purchaser (and purchaser's spouse) may not have owned a principal residence in 3 years previous to purchase.
Recapture	Yes. Portion (6.67 % of credit) to be repaid each year for 15 years. If home sold before 15 years, then remainder of credit recaptured on sale.
Impact on District of Columbia Homebuyer Credit	DC credit not available if purchaser uses this credit.
Effective Date	Purchases on or after April 9, 2008
Termination	July 1, 2009
Interaction with Alternative Minimum Tax	Can be used against AMT, so credit will not throw individual into AMT.