The First-Time Homebuyer Tax Credit

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Summary

Unless Congress acts to extend the first-time homebuyer tax credit, November 30, 2009, is the last day on which a taxpayer may purchase a principal residence and qualify for the credit. Several bills have been introduced in the 111th Congress that would extend the credit through the end of 2009 or beyond. These include H.R. 1453, H.R. 1805, H.R. 1993, H.R. 2562, H.R. 2606, H.R. 2801, H.R. 2905, and H.R. 3389. A number of these and others, including H.R. 2619, H.R. 2655, and S. 740 would allow the credit to non-first-time homebuyers as well, and some would modify or eliminate the income limitation.

The credit was created in 2008 by the Housing Assistance Tax Act of 2008, part of the Housing and Economic Recovery Act of 2008 (P.L. 110-289). As originally enacted, § 36 of the Internal Revenue Code (IRC) created a refundable tax credit for first-time homebuyers who purchased a principal residence after April 8, 2008, and before July 1, 2009. The American Recovery and Reinvestment Act of 2009 (P.L. 111-5) modified the credit for taxpayers purchasing homes after December 31, 2008, and extended it to include purchases through November 30, 2009. First-time homebuyers generally include individuals who have not had a present interest in a principal residence within three years before buying the new property. The credit is based on 10% of the purchase price of the principal residence, but may not exceed $7,500 for residences purchased in 2008. Those purchased in 2009 may result in as much as an $8,000 credit. The credit may be reduced or eliminated for married taxpayers with income over $150,000 or other taxpayers with income over $75,000. To be eligible for the credit, taxpayers must purchase property after April 8, 2008, and before December 1, 2009, and use it as their principal residence.

The credit is refundable, but must be repaid if based on a 2008 purchase. For these credits, it is similar to an interest-free loan with a 15-year payback period that begins two years after the purchase. However, if the taxpayer sells the property or ceases to use it as a principal residence, the entire outstanding credit generally becomes due for that tax year. In certain circumstances, acceleration of the repayment will not be triggered; in others repayment is waived completely. However, there is no provision to modify the repayment provisions for military personnel who must abandon the property as their principal residence due to official orders. Similarly, no exception exists for other taxpayers who must move due to a job transfer. Several bills have been introduced in the 111th Congress that would provide a waiver of repayment for military personnel and some others. These include H.R. 1119, H.R. 2398, H.R. 3389, H.R. 3573, and H.R. 3590.

Repayment generally is not required for credits that are based on a 2009 purchase. However, if the taxpayer ceased using the property as a principal residence within 36 months of the purchase date, the taxpayer would be subject to the same repayment requirements as taxpayers who purchased their property in 2008 but ceased using it as their principal residence prior to repayment of the entire credit. Two bills, H.R. 525 and H.R. 2905, have been introduced in the 111th Congress that would eliminate all repayment requirements. H.R. 1805 would modify the repayment requirement for 2008 purchases, eliminating it unless the property ceased to be used as a principal residence within 36 months of purchase.

In mid-2009, the FHA authorized state housing finance agencies and others to arrange advances of the credit to taxpayers, effectively allowing taxpayers to borrow against the credit if funds were used for down payments, prepaid expenses, or closing costs. H.R. 1344 would prohibit the credit for those whose net down payment from non-borrowed funds was less than 5%.

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Background and Introduction

Unless Congress acts to extend the first-time homebuyer tax credit, November 30, 2009, is the last day on which a taxpayer may purchase a principal residence and qualify for the credit. At least two bills, H.R. 1453 and H.R. 1805, have been introduced in the 111th Congress that would extend the credit through the end of 2009. Other bills would extend the credit through the end of 2010. These include H.R. 1993, H.R. 2606, and H.R. 2801. At least one bill, H.R. 2905, would extend the credit through the end of 2011. Other bills would extend the time for qualifying purchases to November 30, 2010, for members of the military who were serving on qualified official extended duty outside the United States in 2009. These include H.R. 2562 and H.R. 3389. Additionally, bills have been introduced that would increase the credit,[1] supplement or replace it with a non-refundable credit,[2] or extend it to all taxpayers who purchase property that would be used as their principal residence.[3]

In response to the housing crisis in 2007 and 2008, the 110th Congress created the first-time homebuyer tax credit as part of the Housing and Economic Recovery Act of 2008, which became law on July 30, 2008.[4] As enacted, the credit was available only for purchases made after April 8, 2008, and before July 1, 2009. The credit also had two characteristics that made it unlike most other tax credits—it was refundable,[5] and it was repayable; however, the repayment requirement was subject to certain exceptions. The American Recovery and Reinvestment Act of 2009[6] (ARRA) modified the first-time homebuyer tax credit for those taxpayers purchasing principal residences in 2009, increasing the amount of the credit, extending the eligible purchase dates, and eliminating the repayment provision for many taxpayers.

According to the Internal Revenue Service, the first-time homebuyer tax credit has benefited more than 1.4 million taxpayers so far. This report addresses the credit both as it applies to 2008 purchases and as it applies to 2009 purchases. The report will also identify some of the recently introduced bills that propose changes to certain provisions of the existing credit.

Who and What Qualifies for the Credit?

The credit is called the "First-time Homebuyer Credit." Taxpayers must purchase property within a prescribed time period, use the property as their principal residence, and meet the definition of

[1] *See* H.R. 1344, H.R. 1453, S. 740. S. 1230, which proposes a separate, non-refundable credit, also proposes a larger credit amount..

[2] *See* H.R. 1245, H.R. 1295, H.R. 1903, H.R. 2619, S. 1230

[3] *See* H.R. 1119, H.R. 1344, H.R. 1453, H.R. 1805, H.R. 2606, H.R. 2619, H.R. 2655, H.R. 2655, H.R. 2801, H.R. 2905, S. 740. S. 1230, which proposes a separate, non-refundable credit, also proposes that all purchasers of principal residences be eligible.

[4] P.L. 110-289, § 3011.

[5] Taxpayers may receive refunds of refundable credits. Additionally, these credits may be used against taxes other than income tax that are reported on Form 1040: self-employment tax, the additional tax on early distributions from IRAs and other retirement plans, household employment taxes, etc. In contrast, nonrefundable credits can only be used to reduce income tax (and, in some cases, alternative minimum tax) to zero. For most of these, any amount that exceeds income tax is simply lost. For a few, the unused portion can be carried forward to a subsequent year.

[6] P.L. 111-5, § 1006.

"first-time homebuyer" as provided in the law. Several bills introduced in the 111th Congress would not limit the credit to first-time homebuyers, but would open it to others who were purchasing property to be used as their principal residence. H.R. 1119, H.R. 1344, H.R. 1453, H.R. 1805, H.R. 2606, H.R. 2619, H.R. 2655, H.R. 2801, H.R. 2905, and S. 740 are among the bills that would eliminate the "first-time" requirement.

Who Is a First-time Homebuyer?

One might think that only someone who had never before purchased a principal residence could be considered a first-time homebuyer. However, the law is not that literal. A first-time homebuyer is an individual who, during the three-year period ending on the date of the purchase, has had no present interest in property used as that individual's principal residence. If the individual is married, neither spouse may have had such an interest in the three-year period. Ownership of real property that has not been used as a principal residence within the three-year period does not disqualify an individual for the tax credit. Examples of such property include vacation homes and rental or investment properties.

This definition of "first-time homebuyer" is less lenient than the one used for the credit for first-time homebuyers in the District of Columbia (D.C. Credit), which requires no present interest for only one year prior to the purchase.[7] It is also less lenient than the one used to exclude early distributions from qualified retirement plans from the 10% additional tax.[8] In that case, a first-time homebuyer is defined as one who has not had a present interest in a principal residence within the two-year period ending on the date the new property is acquired.

What Is a Principal Residence?

The code section that creates the credit does not explicitly define the term "principal residence." The term is said to have "the same meaning as when used in section 121"[9] of the Internal Revenue Code (IRC). Section 121 provides no explicit definition but uses the term and refers to situations in which property that might otherwise not be thought of as a principal residence will nonetheless be considered one.[10] However, a Treasury regulation provides guidance regarding property that may be considered a principal residence.[11]

According to regulation § 1.121-1, to be a principal residence, property must first be used as a residence. Facts and circumstances determine whether property is used as a residence. The regulation notes that "a houseboat, a house trailer, or the house or apartment that the taxpayer is entitled to occupy as a tenant-stockholder in a cooperative housing corporation"[12] may be a residence, but personal property that is not a fixture under local law is not included.

[7] 26 U.S.C. § 1400C(c)(1).

[8] 26 U.S.C. § 72(t)(2)(F), (8)(D)(i)(I).

[9] 26 U.S.C. § 36(c)(2).

[10] *See* 26 U.S.C. § 121(d) (providing special rules for a variety of situations including use or ownership by only one spouse, ex-spouses, or decedents, as well as involuntary conversions, and non-use during periods of military service or when the taxpayer is incapable of self-care).

[11] 26 C.F.R. § 1.121-1.

[12] 26 C.F.R. § 1.121-1(b)(1).

A taxpayer may have more than one residence, but can have only one principal residence. When there is more than one residence, determining which of the residences is the principal one depends on facts and circumstances. Some of the factors that can be relevant are where the taxpayer works; where the taxpayer's family lives; where the taxpayer banks; where the taxpayer attends religious services; where the taxpayer belongs to recreational clubs; the taxpayer's usual mailing address for bills; and the addresses used on income tax returns, driver's licenses, car registrations, and voter registrations. When a taxpayer relocates due to employment, the residence in the new location may or may not be the taxpayer's principal residence. If the taxpayer's family remains in the old location temporarily until a house is sold, a lease expires, or a school year is completed, the residence in the new location could be considered the taxpayer's principal residence. However, if the taxpayer leaves the family indefinitely in the old location and lives in a small dwelling in the new location, it becomes more likely that the old residence will remain the taxpayer's principal residence. Thus, if the taxpayer's spouse and four children remain in a large rental property in another location, that rental property might continue to be the taxpayer's principal residence even if the taxpayer purchased a small condominium in the new location. The taxpayer would not be eligible for the first-time homebuyer's credit on the newly purchased property if the rental property was still the taxpayer's principal residence.

Even if a property is used as the taxpayer's principal residence when it is purchased, it will not qualify for the credit if the taxpayer ceases to use it as the principal residence before the end of the tax year in which the residence was purchased.[13]

What Is a Purchase?

The law defines a purchase as generally being "any acquisition,"[14] but excludes certain acquisitions. As written, the law may be a bit ambiguous. It states the following:

> 36(c)(3) PURCHASE.—
>
> **(A)** IN GENERAL.—The term "purchase" means any acquisition, but only if—
>
> > **(i)** the property is not acquired from a person related to the person acquiring such property, and
> >
> > **(ii)** the basis of the property in the hands of the person acquiring such property is not determined—
> >
> > > **(I)** in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or
> > >
> > > **(II)** under section 1014(a) (relating to property acquired from a decedent).

This can be read to mean that purchases from related parties do not qualify as purchases eligible for the tax credit if either of the basis provisions in § 36(c)(3)(A)(ii) applies, but could qualify if purchased from a related party at full fair market value. However, the provision could also be read to mean that any purchase from a related party is unqualified and that any purchase, even if

[13] 26 U.S.C. § 36(d)(4).

[14] 26 U.S.C. § 36(c)(3)(A).

not from a related party, is unqualified if either of the basis provisions applies.[15] This is the position adopted by the Internal Revenue Service in its various materials.

The "first-time homebuyer credit for District of Columbia" has a similar provision:

> 1400C(e)(2) PURCHASE—
>
> **(A)** IN GENERAL—The term "purchase" means any acquisition, but only if—
>
> > **(i)** the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), and
> >
> > **(ii)** the basis of the property in the hands of the person acquiring it is not determined—
> >
> > > **(I)** in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or
> > >
> > > **(II)** under section 1014(a) (relating to property acquired from a decedent).

A recognized tax commentary has interpreted this provision of the D.C. Credit to mean that purchases from related parties never qualify for that credit.[16] However, soon after enactment of the § 36 credit, it interpreted that credit's similar provision to mean that purchases from related parties were only disqualified if either of the basis provisions applies.[17] The instructions for Form 8859, which is used to claim the D.C. Credit on the federal tax return, advise taxpayers, "[Y]ou *cannot* claim the credit if ... [y]ou acquired your home from certain related persons or by gift or inheritance." Similarly, the instructions for Form 5405, which is used to claim the § 36 tax credit, state "You cannot claim the credit if ... [y]ou acquired your home from a related person." The instructions then give examples of "a related person," which may include corporations or partnerships in which the taxpayer or a taxpayer's relative holds a significant interest.[18]

When Must the Property Be Purchased?

The credit is available only for principal residences purchased after April 8, 2008, and before December 1, 2009.[19] If the residence is being constructed by the taxpayer, it will be considered purchased on the date when the taxpayer first occupies it.[20] Therefore, to qualify for the credit, any residence constructed by the taxpayer must not only be sufficiently finished to allow

[15] For a discussion of basis, including times when the owner's basis may be determined by the basis of the previous holder, see CRS Report RL34662, *Tax Basis: What Is It? Why Is It Important?*, by Carol A. Pettit.

[16] Stand. Tax Rep. (CCH) ¶ 32,429.035. Available at http://tax.cchgroup.com. It also notes that any property whose basis is determined by the seller's basis or through a step-up in basis when inherited does not qualify for the credit.

[17] Housing Assistance Tax Act of 2008: Law, Explanation, and Analysis (CCH) ¶ 205. Available at http://tax.cchgroup.com.

[18] For the statutory definition of "related person" as it applies to the § 36 credit, see 26 U.S.C. § 36(c)(5).

[19] 26 U.S.C. § 36(h). P.L. 110-289 required purchases to be completed before July 1, 2009. P.L. 111-5 extended the purchase period to include July 1, 2009, through November 30, 2009.

[20] 26 U.S.C. § 36(c)(3)(B).

occupancy but must also be occupied by the taxpayer as the principal residence before December 1, 2009.

As indicated in the "Background and Introduction" section of this report, several bills have been introduced in the 111th Congress that would extend the applicable purchase dates to at least the end of 2009 for all first-time homebuyers and through November 30, 2010, for certain military personnel.

How Much Is the Credit?

The credit is calculated as 10% of the residence's purchase price,[21] which is defined as its adjusted basis in the taxpayer's hands on the date of acquisition.[22] However, the amount of the credit is limited in two ways—by dollar amount[23] and by modified adjusted gross income.[24]

Dollar Limitation

The credit is currently limited to $7,500 for qualifying 2008 purchases and $8,000 for qualifying 2009 purchases. Three bills introduced in the 111th Congress, H.R. 1344, H.R. 1453, and S. 740, would increase the limit to $15,000. Another bill, S. 1230, proposes a non-refundable $15,000 credit.

Purchases in 2008

The credit cannot be more than $7,500 for residences purchased in 2008. For married couples filing separate returns, it is limited to $3,750 each.[25] When unmarried individuals purchase property together, with each using it as a principal residence, the total amount claimed between them cannot exceed $7,500. The law states that the credit "shall be allocated among such individuals in such manner as the Secretary may prescribe."[26] The instructions for Form 5405 state that "[i]f two or more unmarried individuals buy a main home, they can allocate the credit among the individual owners using any reasonable method" so long as the total amount allocated does not exceed the allowable credit. The instructions note that "[a] reasonable method is any method that does not allocate all or a part of the credit to a co-owner who is not eligible to claim that part of the credit."

[21] 26 U.S.C. § 36(a).

[22] 26 U.S.C. § 36(c)(4).

[23] 26 U.S.C. § 36(b)(1).

[24] 26 U.S.C. § 36(b)(2).

[25] There is no indication of how the total credit can be allocated within this limit. For a credit of $7,500, the credit must be allocated equally between the spouses to remain within the limit. However, if the allowable credit is less than $7,500, it would be possible to allocate a larger amount to one spouse than to the other without exceeding the limit.

[26] 26 U.S.C. § 36(b)(1)(C).

Purchases in 2009

The dollar limitation was raised to $8,000 for purchases in 2009. This means that married couples filing separate returns may allocate no more than $4,000 to each spouse. Unmarried individuals may allocate the entire amount using "any reasonable method."

Limitation Based on Modified Adjusted Gross Income

The credit may be reduced or eliminated for taxpayers whose "modified adjusted gross income" (MAGI)[27] exceeds the statutory thresholds. The threshold is $150,000 for taxpayers who are married and file a joint federal tax return. For all other taxpayers, the threshold is $75,000. The amount by which the credit is reduced is determined by a ratio, where $20,000 is the denominator and the numerator is the difference between the taxpayer's MAGI and the threshold amount. This ratio is multiplied by the otherwise allowable credit. If the MAGI exceeds the threshold amount by $20,000 or more, the credit is reduced to zero.

Since the passage of ARRA, at least two bills, H.R. 2801 and S. 740, have been introduced that would eliminate the income limitation. Another bill, H.R. 1119, would increase the income limit.

Example of Credit Reduction for a Married Couple Who Files Jointly

Assume a married couple with no previous ownership interest in a principal residence purchases a house costing $425,000. Since 10% of the purchase price is more than $7,500, their credit is limited to $7,500. If their MAGI is $154,000, their credit would be $6,000. These are the calculations:

MAGI - threshold = $154,000 - $150,000 = $4,000
$4,000/$20,000 = 20% [reduction ratio]
$7,500 x 20% = $1,500 [reduction]
$7,500 - $1,500 = $6,000 [allowable credit]

Example of Credit Elimination for a Single Taxpayer

Assume a single taxpayer with no previous ownership interest in a principal residence buys a condominium costing $220,000. The credit is limited to $7,500 since 10% of the purchase price would be greater than $7,500. If the taxpayer's MAGI is $95,000, the credit would be eliminated. These are the calculations:

MAGI - threshold = $95,000 - $75,000 = $20,000
$20,000/$20,000 = 100% [ratio]
$7,500 x 100% = $7,500 [reduction]
$7,500 - $7,500 = $0 [allowable credit]

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[27] "Modified adjusted gross income" (MAGI) is a term used in a number of tax situations and generally has a specific definition for each situation. Section 36 defines it as being adjusted gross income plus income earned abroad and excluded from income, 26 U.S.C. § 911; income excluded by residents of Guam, American Samoa, and the Northern Mariana Islands, 26 U.S.C. § 931; and income excluded by residents of Puerto Rico, 26 U.S.C. § 933. "Adjusted gross income" is total income minus adjustments (the bottom line of page 1 of Form 1040).

When Is the Credit Claimed?

The credit is claimed on the tax return for the tax year in which the property is purchased.[28] However, taxpayers who purchase a principal residence in the first 11 months of 2009 may choose to treat the property as if it had been purchased in 2008.[29] A taxpayer purchasing an eligible property before filing the 2008 tax return would be able to claim the credit on the original return for 2008. If a taxpayer had already filed the 2008 tax return, an amended return could be filed to claim the credit. Taxpayers choosing to claim the credit for their 2009 purchase on their 2008 tax return would still be able to claim up to $8,000 as their credit even though the limit for 2008 purchases is $7,500.

The advantage to claiming the credit on the 2008 tax return is that the credit could produce a refund sooner than if it were claimed on the 2009 return. In the case of a taxpayer who would otherwise have a balance due on the 2008 return, claiming the credit for 2008 would reduce or eliminate that balance due. The credit for a 2009 purchase generally does not have to be repaid, and claiming the credit on the 2008 return would not change this.

Taxpayers choosing not to claim the credit for their 2009 purchase on their 2008 tax return could still effectively receive their credit before filing their 2009 return. To do this, they would adjust the amount they pay toward their federal taxes for the remainder of the year. For taxpayers with wage income, this can be done by filing a new Form W-4 with the employer, increasing withholding allowances to adjust withholdings so that the total withheld for the year is reduced by an amount equal to their anticipated credit. Taxpayers who must pay quarterly estimated taxes can make similar adjustments to their quarterly payments. However, to avoid a possible penalty on underpayment of estimated taxes, they should adjust the payments equally rather than reducing the payment in early quarters by the entire amount of the credit.

In mid-2009, the FHA announced a program that would allow homebuyers to "sell" their tax credits and thereby effectively receive the money prior to the purchase so that it could be used toward the down payment, prepaid expenses, and closing costs.[30] FHA-approved entities and federal, state, and local governmental agencies may "purchase" the credits. A number of state housing finance agencies (HFAs)[31] are offering short-term loans that can be repaid with the credit when the taxpayer receives it. Some loans may have no interest, and others may have very low interest. Additionally, some may require a monthly payment, but others may be "silent" and require only a lump sum payment when the credit is received.

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[28] 26 U.S.C. § 36(a).

[29] 26 U.S.C. § 36(g).

[30] *See* FHA First-Time Homebuyer Tax Credit Mortgagee Letter 2009-15 at http://portal.hud.gov/portal/page/portal/FHA_Home/lenders/mortgagee_letters/2009_mortgagee_letters/09-ML-15%20Using%20First-Time%20Homebuyer%20Tax%20Credits.pdf.

[31] For a listing, by state, of available loan programs, see http://www.ncsha.org/about-hfas/hfa-programs/-first-time-homebuyer-tax-credit-loan-programs.

Who Does Not Qualify for the Credit?

Even those who meet the definition of first-time homebuyer and purchase property to use as a principal residence within the time frame required by the statute may not qualify for the credit. Those not qualifying for the credit for purchases made in 2008 include

- non-resident aliens;[32]
- purchasers who finance their new residence with the proceeds of a tax-exempt mortgage revenue bond;[33] and
- those taxpayers (or their spouses) who also qualified for the first-time homebuyer credit in the District of Columbia in the current taxable year or in any prior taxable year.[34]

However, taxpayers who purchase their principal residence in 2009 will still qualify for the credit even if their new residence was financed with the proceeds of tax-exempt mortgage revenue bonds.[35] Additionally, taxpayers purchasing their property in 2009 would be eligible for the § 36 credit even if they had been eligible to claim the D.C. credit in an earlier year.[36] Purchases in 2009 will not be eligible for the D.C. credit if they are eligible for the § 36 credit.[37]

The Repayment Provision

As enacted by the Housing Assistance Tax Act of 2008, the first-time homebuyer tax credit was essentially a no-interest loan with a 15-year repayment period. This repayment provision is called "recapture" in the statute.[38] This is a term that is used for other credits; however, for those credits recapture generally is required only when the taxpayer ceases to qualify for the credit.[39] In contrast, for credits based on property purchased in 2008, the entire amount of the allowed first-time homebuyer credit must be repaid even if the taxpayer continues to live in the property as a principal residence for 30 years. The American Recovery and Reinvestment Act of 2009 modified the recapture requirement so that it more closely resembles the recapture provisions for other credits. For credits based on property purchased in 2009, no recapture of the credit is required unless, within 36 months of the purchase date, the taxpayer ceases to use the property as the taxpayer's principal residence.

[32] 26 U.S.C. § 36(d)(1) (before passage of P.L. 111-5, this provision was at 26 U.S.C. § 36(d)(3)).

[33] P.L. 110-289, § 3011(a) (creating 26 U.S.C. § 36(d)(2), which was deleted by P.L. 111-5, § 1006(e) for purchases made after December 31, 2008).

[34] P.L. 110-289, § 3011(a) (creating 26 U.S.C. § 36(d)(1), which was deleted by P.L. 111-5, § 1006(d)(2) for purchases made after December 31, 2008). The statute is unclear regarding whether qualification for the D.C. credit (§ 1400C) for an earlier residence would disqualify the taxpayer for the § 36 credit on a new residence; however, the instructions for Form 5405 indicate that any prior qualification for the D.C. credit would disqualify the taxpayer for the § 36 credit.

[35] P.L. 111-5, § 1006(e).

[36] P.L. 111-5, § 1006(d)(2).

[37] 26 U.S.C. § 1400C(e)(4).

[38] 26 U.S.C. § 36(f).

[39] *See, e.g.,* 26 U.S.C. § 50 (recapture of some or all of the allowed investment credit when property ceases to be investment credit property within five years of being placed in service).

Two bills, H.R. 525 and H.R. 2905, have been introduced in the 111th Congress that would eliminate the repayment provision completely. Under the bills, taxpayers who purchased their properties in 2008 would no longer be required to repay the credit they had received. Additionally, no repayment would be required from any purchasers who ceased using their properties as their principal residences within 36 months of purchase.

2008 Purchases

When and How Is the Credit Repaid?

The standard repayment for credits based on property purchased in 2008 is structured by recapturing 1/15 of the allowed first-time homebuyer tax credit on the taxpayer's tax returns for each of fifteen consecutive tax years.[40] For taxpayers who were allowed the maximum credit, $500 would be added to their tax return as a liability in each of fifteen consecutive tax years. This recapture begins two years after the tax year in which the property is purchased or deemed to be purchased.[41] Since recapture is reported on the taxpayer's tax return, the taxpayer is required to file a tax return for each year in which repayment is due even if otherwise not required to file a return.[42]

Recapture may be accelerated if the property is sold or is no longer used by the taxpayer as the taxpayer's principal residence.[43] Generally, this means that any allowed credit that has not already been recaptured, must be recaptured in full on the tax return for the tax year in which the house is sold or otherwise ceases to be used as the taxpayer's principal residence.

There are two situations in which repayment is waived completely. There are two other situations in which repayment is not accelerated when the taxpayer ceases to use the property as the principal residence. Notably, there is no provision applicable to military personnel on active duty who experience a permanent change of station and must abandon the qualifying property as their principal residence. Other housing-related provisions of the IRC have included special treatment for military personnel in that situation.[44]

When Is Repayment Waived?

Recapture of the outstanding credit may be waived in either of two situations: (1) a sale with no gain[45] or (2) the death of the taxpayer.[46]

[40] 26 U.S.C. § 36(f)(1), (7).
[41] 26 U.S.C. § 36(f)(7).
[42] 26 U.S.C. § 36(f)(6).
[43] 26 U.S.C. § 36(f)(2).
[44] *See* 26 U.S.C. § 121.
[45] 26 U.S.C. § 36(f)(3).
[46] 26 U.S.C. § 36(f)(4)(A).

Sale of Property with No Taxable Gain

Generally, gain on the sale of property is determined by subtracting the adjusted basis of the property from the sale price and then subtracting the sales expenses.[47] This remains the same for determining the taxable gain for properties for which the first-time homebuyer tax credit was allowed. However, another calculation is required to determine whether the outstanding credit must be recaptured. In this case, the outstanding credit is subtracted from the adjusted basis of the property, reducing it. The taxpayer must use this amount as the adjusted basis for a new calculation of gain to determine whether the outstanding credit must be recaptured in the year of sale. If the new calculation results in gain, the outstanding credit, up to the amount of gain, must be recaptured. For this reason, taxpayers who make improvements to their property would be well-advised to keep careful record of the costs incurred since those costs would increase their adjusted basis in the property and possibly eliminate the need to repay the credit when the property is sold.

Example 1—Outstanding Credit Must Be Recaptured. Taxpayer purchases a house for $250,000 and reports $7,500 as the first-time homebuyer credit on Form 1040 in the year of purchase. Two years later, before repaying any of the credit and without doing anything that would change the basis of the property, the taxpayer moves to another state and must sell the property. The sales price is $265,000. Expenses of sale are $15,000. The taxpayer has no gain from the sale for income tax purposes:

$265,000	Sales Price
-$250,000	Adjusted Basis
-$15,000	Sales Expense
$0	Gain

However, to determine the extent to which the credit must be repaid, another gain calculation is required. For this calculation, the property's basis is reduced by the amount of the credit that has not yet been repaid; therefore for this calculation, the adjusted basis is $242,500 ($250,000 - $7,500 [the outstanding credit]). Using this number, there is a gain of $7,500, so the entire $7,500 credit must be recaptured on the tax return for the year in which the property is sold.

$265,000	Sales Price
-$242,500	Adjusted Basis
-$15,000	Sales Expense
$7,500	Gain

[47] 26 U.S.C. § 1001.

Example 2—Outstanding Credit Must Be Partially Recaptured. Assume the same facts as in the first example except that the sales price is $260,000 and the property is sold four years after purchase. For both the second and third years after purchase, $500 of the $7,500 credit would have been recaptured on the taxpayer's tax returns each year. Thus, $1,000 has been recaptured, and the outstanding credit is $6,500. Again, for tax purposes there is no gain.

$260,000	Sales Price
-$250,000	Adjusted Basis
-$15,000	Sales Expense
-$5,000	Loss

However, the basis must be reduced by the outstanding credit to determine the amount of outstanding credit that must be recaptured. Since $1,000 has been recaptured, only $6,500 of the credit is still outstanding. When the basis is reduced by $6,500, the result is $243,500 ($250,000 - $6,500). Using this number in the gain calculation, there is a $1,500 gain. Therefore, $1,500 of the outstanding credit must be recaptured on the tax return in the year of sale, but the remaining $5,000 will never be recaptured.

$260,000	Sales Price
-$243,500	Adjusted Basis
-$15,000	Sales Expense
$1,500	Gain

Example 3—No Recapture of Outstanding Credit. Use the same facts as in example 2, except that the sales expense is $17,000. Again, there would be no gain for tax purposes:

$260,000	Sales Price
-$250,000	Adjusted Basis
-$17,000	Sales Expense
-$7,000	Loss

Again, the basis as reduced by the outstanding credit would be $243,500 ($250,000-$6,500). In this case, however, the gain calculation to determine the required recapture of the outstanding credit would result in no gain. Therefore, none of the outstanding credit would be recaptured in the year of sale.

$260,000	Sales Price
-$243,500	Adjusted Basis
-$17,000	Sales Expense
-$500	Loss

Death of the Taxpayer

Repayment of the outstanding credit is also waived if the taxpayer dies. For property owned by a single taxpayer, this provision is clear—recapture of any outstanding credit is waived for tax years ending after the death of the taxpayer. For property that was purchased by more than one taxpayer, it appears that only the individual decedent's portion of the outstanding credit is free from recapture, even if the credit was claimed by a married couple on a joint return.

The statute states that half of the credit allowed on a joint return is allocated to each spouse for purposes of the recapture provision. The instructions for Form 5405 indicate that when the credit was claimed on a joint return, the death of one spouse cancels only that spouse's half of any remaining repayment amount.

Where unmarried individuals purchased property together and allocated the credit between them, each has a separate repayment obligation based on the credit claimed. The death of one of the co-owners would not change the remaining owner's own repayment obligation. Similarly, when couples who are married file separate returns, they each claim a specific amount of credit on which their separate repayment obligation would be based.

When Is Recapture not Accelerated?

Even though the taxpayer ceases to use the property as a principal residence, recapture of the credit is not accelerated if either of two circumstances exists: (1) involuntary conversion or (2) transfer between spouses or incident to divorce.

Involuntary Conversions

When property is destroyed, it is involuntarily converted.[48] Likewise, if the property is taken under eminent domain, it is involuntarily converted. An involuntary conversion also occurs when a property owner agrees to sell property that is under "threat of condemnation," which means that the property will be taken by eminent domain if the owner does not agree to sell. In each of these situations the taxpayer will cease to use the property as the principal residence. However, recapture will not be accelerated if a new principal residence is acquired within two years after the original property was sold or ceased being used as a principal residence.[49] The new principal residence would be substituted for the one that was involuntarily converted, and recapture of the outstanding credit would proceed along the 15-year scheduled payback period just as if there had been no disruption in usage. Note that the new principal residence cannot be property that was owned by the taxpayer before the qualifying residence was involuntarily converted.

Transfers Between Spouses or Incident to Divorce

Generally, property can be freely transferred between spouses with no recognition of gain or loss. Transfers between former spouses enjoy this benefit only when the transfer is incident to the divorce between the two.[50] The recapture provisions of the first-time homebuyer tax credit allow

[48] *See* 26 U.S.C. § 1033(a).

[49] 26 U.S.C. § 36(f)(4)(B).

[50] *See* 26 U.S.C. § 1041(a).

such transfers to occur without accelerating recapture of the outstanding credit, even when one of the parties ceases to use the property as a principal residence.[51] Additionally, the party who transferred the property is relieved of all subsequent repayment obligations. The party to whom the property was transferred becomes responsible for both the yearly recapture of the outstanding credit as well as accelerated recapture if the property is later sold or ceases to be used as a principal residence.

There is no parallel provision to allow unmarried co-owners to transfer the repayment obligations to another owner if the property is transferred to the other owner. Additionally, unmarried taxpayers who transferred their share of the property to a co-owner would have to repay their share of the credit, to the extent that it was still outstanding, in the tax year in which the transfer occurred.

No Special Provisions for Military Personnel or Taxpayers with Job Transfers or Changes in Health

As with the first-time homebuyer credit, another housing-related section of the IRC includes special provisions for the death of a taxpayer, involuntary conversions, and divorce. However, that section also includes provisions for military personnel and taxpayers with job transfers or changes in health. Section 121 of the IRC generally allows taxpayers to exclude the gain from the sale of a principal residence[52] so long as that gain is not more than $250,000 ($500,000 if married filing jointly) and the taxpayer meets three other conditions:

1. The taxpayer or spouse owns the property for at least two years in the five years preceding the sale of the property;.
2. The property has been used as the principal residence of either the taxpayer or spouse for at least two years in the five years preceding the sale of the property.
3. Neither the taxpayer nor the spouse has excluded gain from the sale of another principal residence within the two years preceding the sale of the property.

The section includes exceptions to the strict application of these requirements for certain taxpayers, including military personnel and taxpayers who sell their property as the result of a job transfer or change in health. No similar exceptions that would either waive or delay immediate repayment are included in the First-time Homebuyer Tax Credit.

Military Personnel

Historically,[53] members of the military have been given special consideration regarding the sale of their principal residences. Military personnel[54] serving on qualified official[55] extended duty are

[51] 26 U.S.C. § 36(f)(4)(C)(i).

[52] Beginning in 2009, taxpayers cannot exclude gain allocated to "unqualified use" of the property. 26 U.S.C. § 121(b)(4).

[53] Currently, IRC § 121 contains provisions for military personnel who sell their principal residences; however, prior to the enactment of the Taxpayer Relief Act of 2007 (P.L. 105-34), § 121 applied only to taxpayers over age 55 and provided them with a once in a lifetime exclusion of the gain from the sale of a principal residence (for sales after July 20, 1981, the exclusion was limited to $125,000). For other taxpayers selling their principal residences, any gain realized upon sale was taxable in the year of sale unless the taxpayer qualified to defer the gain by rolling it over into a new principal residence. Generally, to avoid current taxation, taxpayers were required to purchase another principal (continued...)

allowed to suspend the running of the five-year test period for use and ownership[56] required by § 121 for excluding gain from the sale of their principal residence.

There is no provision in the first-time homebuyer tax credit that would waive the immediate repayment requirement for military personnel who were serving on extended active duty outside of the geographical area where they had purchased their principal residence and who, therefore, had ceased using that property as their principal residence. Several bills have been introduced in the 111th Congress that would provide military personnel with relief from the immediate repayment requirement. These include H.R. 1119, H.R. 2398, H.R. 3389, H.R. 3573, and H.R. 3590.

Taxpayers Experiencing Job Transfers or Changes in Health

Under § 121 taxpayers who do not meet the time requirements for excluding the gain from the sale of their principal residence may, nonetheless, exclude some or all of that gain when the sale is due to "a change in the place of employment, health, or ... unforeseen circumstances."[57] In those cases, the taxpayer is allowed to prorate the exclusion according to the ration by which the time-based requirements are met.[58] The proration is based on the entire exclusion limit—$250,000 or $500,000 for couples who are married and file jointly. In many cases, this means that the taxpayer may exclude the entire gain realized on the sale.

As with military personnel, taxpayers who experience job transfers or changes in health requiring a move subsequent to their purchase of a principal residence qualifying for the first-time homebuyer tax credit, find no relief in the provisions of the credit that parallels the relief they find in § 121 for the exclusion of gain on the sale. CRS is unaware of any bills introduced in the 111th Congress that would provide such relief for these taxpayers.

(...continued)

residence within two years of the date on which the old residence was sold. 26 U.S.C. § 1034 (repealed 2007). However, this provision also had special provisions for military personnel on extended active duty after the old residence was sold. These taxpayers could suspend the running of the two-year replacement period while on active duty, but the suspension period ended no more than four years after the date of sale; 26 U.S.C. § 1034(h)(1) (repealed 2007); unless the taxpayer was either stationed outside the United States or was required to live in government quarters. For taxpayers living overseas or required to live in government quarters within the United States, the suspension period could extend to eight years beyond the date on which the old residence was sold. 26 U.S.C. § 1034(h)(2) (repealed 2007).

[54] As used here, "military" includes any of the uniformed services (as defined in 10 U.S.C. § 101(a)(5)).

[55] "Qualified official extended duty" is defined in 26 U.S.C. § 121(d)(9)(C). It generally involves being on active duty for more than 90 days at a duty station that is at least 50 miles from the location of the property that had been used as a principal residence.

[56] 26 U.S.C. § 121(d)(9). This provision is also extended to members of the foreign service and intelligence communities, *id.*, and a similar provision is available for certain Peace Corps employees and volunteers. 26 U.S.C. § 121(d)(12).

[57] 26 U.S.C. § 121(c)(2)(B).

[58] 26 U.S.C. § 121(c)(1)(A).

2009 Purchases

When and How is the Credit Repaid?

So long as a principal residence purchased in 2009 continues to be used as the taxpayer's principal residence for at least 36 months following the date of purchase, no repayment of the credit is required.[59] However, if this continuing use requirement is not met, the entire credit must generally be repaid on the tax return for the tax year in which the taxpayer ceased using the property as her principal residence, even if the property is not sold.

Sale or Change in Use Within 36 Months of Purchase

Generally, taxpayers claiming a credit for a 2009 purchase must repay the entire credit if they cease to use the property as their principal residence within 36 months of the date of purchase. However, just as with credits based on 2008 purchases, in some cases, these taxpayers may be relieved of some or all of the recapture requirement. These situations are discussed in detail in the section on 2008 purchases. They include a sale with no taxable gain, the death of the taxpayer, an involuntary conversion of the property, a transfer between spouses, and a transfer incident to a divorce.

Effect on Basis

Taxpayers who receive the first-time homebuyers tax credit are not required to reduce the basis of their residence by the amount of the credit. This differs from most tax credits, which generally have required taxpayers to reduce the basis of assets on which a credit was based by the amount of the credit.[60] However, there is no general section of the Internal Revenue Code that requires this basis reduction when claiming a credit. Generally, the sections specific to the credit have a subsection requiring basis reduction. There is nothing in § 36 that would require an adjustment to basis.

Since credits based on 2008 purchases must be repaid, there being no adjustment to basis is harmonious with other tax law[61]—long-term the taxpayer's investment is the full amount paid for the property. However, since the 2009 credit is generally not repaid by the taxpayer, arguably the taxpayer's actual investment is less than the amount paid for the property, and basis should be reduced to reflect the credit received. Nevertheless, § 36 does not require basis adjustment for these purchases. It is unclear whether the lack of basis adjustment was intentional or inadvertent.

[59] The statutory language refers to this as a "waiver of recapture," stating that 26 U.S.C. § 36(f)(1) will not apply for credits allowed for 2009 purchases and 26 U.S.C. § 36(f)(2) will apply only if the property ceases to be used as the taxpayer's principal residence within 36 months after the date of purchase. 26 U.S.C. § 36(f)(4)(D). Section 36(f)(1) is the section under which credits based on 2008 purchases must be repaid over a 15-year period. Section 36(f)(2) is the section that accelerates repayment of the credit when the property is no longer in use as the taxpayer's principal residence.

[60] *See, e.g.,* 26 U.S.C. §§ 25D(f), 50(c), 1400C(h).

[61] 26 U.S.C. § 50(c)(4) includes a provision that the basis reduction be reduced by any amount of investment credit that must be repaid if the asset is disposed of before the end of the recapture period.

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