The First-Time Homebuyer Tax Credit

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Summary

Homebuyers who were unable to close on their properties by the June 30, 2010, deadline imposed by the Worker, Homeownership, and Business Assistance Act of 2009 (P.L. 111-92) may still be able to receive the first-time homebuyer tax credit if they close before October 1, 2010, so long as they had a binding contract for the property before May 1, 2010, and that contract required closing before July 1, 2010, and they meet all other requirements for the credit. P.L. 111-198, enacted July 2, 2010, and effective for closings after June 30, 2010, provides the additional time for closing. It makes no other changes to the credit—§ 36 of the Internal Revenue Code.

The first-time homebuyer credit was established in 2008 by P.L. 110-289. It was modified and extended by P.L. 111-5 in February 2009. It was further extended by P.L. 111-92 in November 2009, and expanded to include some homebuyers who did not qualify under the credit's original definition of a first-time homebuyer. These homebuyers—called "long-time residents"—must have owned and lived in their principal residence for at least five consecutive years during the eight-year period that ends on the date they purchase a subsequent property to use as their principal residence.

The credit is based on 10% of the purchase price of property that is used as the purchaser's principal residence. For purchases before 2009, it is limited to $7,500, which generally must be repaid over a 15-year period that begins with the second tax year following the tax year for the year of purchase. For purchases after 2008, the credit is generally limited to $8,000, but that limit is reduced to $6,500 for "long-time residents." Repayment is not required unless taxpayers cease to use the property as their principal residences within three years of the date of purchase.

Regardless of the year of purchase, the credit may be reduced or eliminated for those with incomes over a threshold amount. For purchases before November 7, 2009, the threshold amount is $150,000 for joint filers and $75,000 for all others. For purchases after November 6, 2009, the threshold is increased to $225,000 for joint filers and $125,000 for others.

There are some limitations on qualifying for the credit. No credit is allowed for property (1) located outside the United States; (2) inherited; (3) purchased from a close relative; or (4) purchased by a non-resident alien. Property purchased in 2008 will not qualify if financed with the proceeds of tax-exempt mortgage revenue bonds, or if the purchaser qualified for the first-time homebuyer credit in the District of Columbia in 2008 or earlier. Certain additional restrictions apply to purchases made after November 6, 2009: (1) residences costing more than $800,000 will not qualify; (2) purchasers must be at least 18 years old; and (3) purchasers cannot be eligible to be claimed as a dependent on another taxpayer's tax return.

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. The purchase must have been completed before the credit is claimed on a tax return, but it can be claimed on an amended return for the tax year prior to the year of purchase. Generally credits claimed on tax returns for 2009 and later must be documented with a copy of the settlement statement attached to the return.

There are special provisions regarding both the eligible purchase dates and the repayment provisions for members of the military, foreign service, and intelligence communities.

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Background and Introduction

Homebuyers who were unable to close on their purchases by the June 30, 2010, deadline imposed by the Worker, Homeownership, and Business Assistance Act of 2009 (P.L. 111-92) have been granted an additional three months in which to complete their sales and still qualify for the first-time homebuyer tax credit. On July 2, 2010, President Obama signed H.R. 5623 (P.L. 111-198), which was introduced and passed by the House on June 29, 2010, and passed in the Senate by unanimous consent on June 30, 2010. The law's provisions to extend the homebuyer tax credit mirror those contained in an amendment to H.R. 4213 that was offered by Senator Reid.[1] The law only affects those people who would have qualified for the credit if they had completed their purchase before July 1, 2010. This means that before May 1, 2010, they must have entered into a binding contract to purchase a residence and that contract must have called for closing before July 1, 2010. Those who had such contracts, but were unable to close on the sales by June 30, 2010, are allowed to close before October 1, 2010, and treat the purchase as if it had occurred before July 1, 2010.

The new law modifies a provision of The Worker, Homeownership, and Business Assistance Act of 2009 (P.L. 111-92) that extended the eligible dates of purchase to include purchases before May 1, 2010, as well as those that were under a binding contract on that date if the contract provided for closing the sale before July 1, 2010, and the sale was completed before that date. Previously, there had been no exception that allowed closing after the statutory deadline for the purchase.

The credit was created in 2008 as part of the Housing and Economic Recovery Act of 2008 (P.L. 110-289) in response to the housing crisis in 2007 and 2008. As originally 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,[2] and it was repayable; however, the repayment requirement was subject to certain exceptions. The American Recovery and Reinvestment Act of 2009[3] (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 through November 30, 2009, and generally eliminating the repayment provision for purchases after 2008.

In addition to extending the eligible dates of purchase and allowing an additional two months in which to complete the purchase, the Worker, Homeownership, and Business Assistance Act of 2009 expanded the statutory definition of "first-time homebuyer" by introducing an exception for those who have owned and used the same residence as their principal residence for any period of five consecutive years during the eight-year period that ends on the date they purchase a subsequent property to use as their principal residence.[4] These "long-time residents" generally are

[1] S. Amndt. 4425 to the House amendment to the Senate amendment to H.R. 4213.

[2] 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.

[3] P.L. 111-5, § 1006.

[4] These individuals are referred to in the law as "long-time residents of the same principal residence." P.L. 111-92 § 11(b).

treated as first-time residents; however, their credit is capped at $6,500. P.L. 111-92 also raised the income limitation for all qualifying purchases, making more buyers eligible to claim the full credit. However, the law imposed new restrictions on qualifying for the credit. For purchases after November 6, 2009, property costing more than $800,000 is no longer eligible for the credit. Eligible purchasers must be at least 18 years old and cannot be eligible to be claimed as a dependent on another taxpayer's tax return. For all tax returns for calendar year 2009 and later, taxpayers must attach a copy of their settlement statement to their tax returns.

Certain members of the military, foreign service, and intelligence communities received special consideration under P.L. 111-92. For those who either sold or ceased using their property as their principal residence as a result of official government orders, the repayment requirement was virtually eliminated. Those who served on qualified official extended duty outside the United States for a period of at least 90 days during the period beginning January 1, 2009, and ending April 30, 2010, may qualify for the credit if they purchase a residence before May 1, 2011, or have entered into a binding contract by that date; if the contract calls for closing before July 1, 2011; and if they close before July 1, 2011. The recent three-month extension for closing provided by P.L. 111-198 does not apply to allow them the credit if they close after June 30, 2011, and before October 1, 2011.

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 "first-time homebuyer" as provided in the law. Beginning on November 7, 2009, some who did not previously meet the statutory definition will qualify for the credit; however, their credit will be subject to a lower dollar limit.

For purchases after November 6, 2009, qualified purchasers must be at least 18 years old[5] and cannot be eligible to be claimed as dependents on any other taxpayer's return. Additionally, taxpayers will not qualify for the credit if the purchase price of the residence is more than $800,000 and it is purchased after November 6, 2009.

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.[6] If the individual is married at the time the property is purchased, neither spouse may have had such an interest in the three-year period. However, unmarried individuals who buy property as co-owners are not

[5] Married taxpayers will be deemed to have met the age requirement even if not yet 18 years old.

[6] 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. (26 U.S.C. § 1400C(c)(1)) It is also less lenient than the one used to exclude early distributions from qualified retirement plans from the 10% additional tax. (26 U.S.C. § 72(t)(2)(F), (8)(D)(i)(I)) 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.

"tainted" by another co-owner's recent ownership interest in a principal residence—each unmarried co-owner's status as a first-time homebuyer is determined independently. 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.

For residences purchased after November 6, 2009, P.L. 111-92 introduced an exception to the general definition of first-time homebuyer as described above.[7] The exception applies to "long-time residents of the same principal residence" (long-time residents).[8] These individuals are those who have both owned and used the same property as their principal residence for five consecutive years during the eight-year period that ends on the day a subsequent principal residence is purchased. Long-time residents will be treated as first-time homebuyers and be eligible for the tax credit[9] if they otherwise qualify and purchase a new property after November 6, 2009, that they will begin using as their principal residence. The law specifically requires that, in the case of married taxpayers, both taxpayers have owned and used the same property as their principal residence for the required five consecutive years. It does not include a provision for imputing the five-year period of ownership to a non-owner spouse nor for allowing any portion of the credit when only one spouse meets the usage requirement.[10]

The marital status of the purchasers on the date of purchase determines whether they must each qualify for the credit that is claimed. Unlike those who are married when they purchase a new residence, two people who are unmarried on the date of purchase could each qualify as long-time residents using different prior residences. Similarly if one unmarried person who was a long-time resident purchased a new residence with another unmarried person who had not owned a home within the last three years, each person could qualify for the homebuyer credit—the first as a long-time resident and the second as a first-time homebuyer. In that case, the credit could be divided between them so long as the long-time resident claimed no more than $6,500. The party who had not owned a home in the last three years would be able to claim a maximum credit of $8,000, but would be required to reduce it by the amount claimed by the long-time resident.

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"[11] 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

[7] 26 U.S.C § 36(c)(1).

[8] 26 U.S.C. § 36(c)(6).

[9] For these taxpayers, the credit would be limited to $6,500 rather than $8,000.

[10] Compare with 26 U.S.C. § 121(b)(2) (allowing ownership to be imputed to a non-owner spouse and, where either or both spouse has not met the usage requirement, allowing each to claim the exclusion that would have been allowed if filing as unmarried people even though filing a joint return).

[11] 26 U.S.C. § 36(c)(2).

nonetheless be considered one.[12] However, a Treasury regulation provides guidance regarding property that may be considered a principal residence.[13]

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"[14] may be a residence, but personal property that is not a fixture under local law is not included.

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.[15]

What Is a Purchase?

The law defines a purchase as generally being "any acquisition,"[16] but excludes certain acquisitions—notably, those acquired by inheritance or from a related party. As it is interpreted by the Internal Revenue Service, the exclusion on purchases from related parties applies even if the buyer paid fair market value for the property.[17] For purchases made before November 7, 2009, a

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[12] 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).

[13] 26 C.F.R. § 1.121-1.

[14] 26 C.F.R. § 1.121-1(b)(1).

[15] 26 U.S.C. § 36(d)(4).

[16] 26 U.S.C. § 36(c)(3)(A).

[17] As written, the law may be a bit ambiguous. Section 36(c)(3) is very similar to § 1400C(e)(2), which pertains to purchases qualifying for the "first-time homebuyer credit for District of Columbia." 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 (Stand. Tax Rep. (CCH) ¶ 32,429.035. Available at http://tax.cchgroup.com. It also notes that any property whose basis (continued...)

related party includes the lineal ancestors (father, mother, grandfather, great grandmother, etc.) or lineal descendents (child, grandchild, etc.) of the taxpayer as well as the taxpayer's spouse and certain corporations or partnerships in which the taxpayer has a direct or indirect interest of more than 50%. For purchases after November 6, 2009, "related party" also includes lineal ancestors or descendents of the taxpayer's spouse.[18]

When Must the Property Be Purchased?

With notable exceptions, the credit generally is available only for principal residences purchased after April 8, 2008, and before May 1, 2010.[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 occupancy but must also be occupied by the taxpayer as the principal residence before May 1, 2010.

P.L. 111-92 introduced two exceptions to the ending purchase date. The first affects those who have entered into a binding purchase contract before May 1, 2010, that provides for closing on the sale before July 1, 2010. These purchasers will qualify for the credit if the sale is closed on or before June 30, 2010. The second exception affects members of the military, foreign service, or intelligence communities who were on qualified official extended duty service[21] outside the United States for at least 90 days during the period beginning January 1, 2009, and ending April 30, 2010. For these taxpayers, purchases of a principal residence will qualify for the credit if the taxpayers enter into a binding purchase contract by April 30, 2011, and close by June 30, 2011.

P.L. 111-198 enacted an exception to the first exception noted above for P.L. 111-92. Purchasers may qualify for the credit if they entered into a binding contract before May 1, 2010, that contract called for closing before July 1, 2010, and they closed on the property before October 1, 2010.

An additional exception created by P.L. 111-92 applies only to property purchased by "long-time residents." To qualify for the $6,500 credit, these taxpayers must purchase the property after November 6, 2009—the date that the law was signed by the president. The last purchase date that is available for "long-time residents" who want to take the credit is the same as that for others taking the credit.

(...continued)

is determined by the seller's basis or through a step-up in basis when inherited does not qualify for the credit.) However, soon after enactment of the § 36 credit, that same tax authority interpreted the similar provision in § 36 to mean that purchases from related parties were only disqualified if either of the basis provisions applies (Housing Assistance Tax Act of 2008: Law, Explanation, and Analysis (CCH) ¶ 205. Available at http://tax.cchgroup.com.)

[18] 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. P.L. 111-92 extended the purchase period to include December 1, 2009, through April 30, 2010.

[20] 26 U.S.C. § 36(c)(3)(B).

[21] Defined in 26 U.S.C. § 121(d)(9)(C)(i).

How Much Is the Credit?

The credit is calculated as 10% of the residence's purchase price,[22] which is defined as its adjusted basis in the taxpayer's hands on the date of acquisition.[23] However, the amount of the credit is limited in two ways—by dollar amount[24] and by modified adjusted gross income.[25]

Dollar Limitation

The credit is limited to $7,500 for qualifying 2008 purchases and $8,000 for most qualifying purchases after December 31, 2008. However, the credit is limited to $6,500 for long-time residents who qualify for the 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.[26] 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."[27] 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."

Purchases After 2008

In February 2009, the dollar limitation was raised to $8,000 for purchases made after December 31, 2008. Under the new provisions that extended the eligible dates of purchase, the $8,000 limitation will continue to apply to most qualifying purchases, but long-time residents will be limited to $6,500. Married couples filing separate returns may allocate no more than half of the maximum credit amount. Unmarried individuals may allocate the entire amount of their credit using "any reasonable method." If one unmarried homebuyer qualifies as a long-time resident and the other qualifies for the $8,000 credit, they may allocate a total of $8,000 between them with no more than $6,500 allocated to the long-time resident.

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[22] 26 U.S.C. § 36(a).

[23] 26 U.S.C. § 36(c)(4).

[24] 26 U.S.C. § 36(b)(1).

[25] 26 U.S.C. § 36(b)(2).

[26] 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.

[27] 26 U.S.C. § 36(b)(1)(C).

Limitation Based on Modified Adjusted Gross Income

The credit may be reduced or eliminated for taxpayers whose "modified adjusted gross income" (MAGI)[28] exceeds the statutory thresholds. For purchases prior to November 7, 2009, the threshold is $150,000 for taxpayers who are married and file a joint federal tax return. For all other taxpayers buying before November 7, 2009, the threshold is $75,000. Effective for purchases on or after November 7, 2009, the thresholds have been raised to $225,000 for joint filers and $125,000 for all others.

For all purchases, 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.

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 on October 30, 2009. Since 10% of the purchase price is more than $8,000, their credit is limited to $8,000. If their MAGI is $154,000, their credit would be $6,400. These are the calculations:

MAGI - threshold = $154,000 - $150,000 = $4,000
$4,000/$20,000 = 20% [reduction ratio]
$8,000 x 20% = $1,600 [reduction]
$8,000 - $1,600 = $6,400 [allowable credit]

If the property had been purchased on November 15, 2009, the income threshold would have been $225,000. In that case, the couple would have been able claim the entire $8,000.

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 on July 15, 2009. The credit is limited to $8,000 since 10% of the purchase price would be greater than $8,000. 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]
$8,000 x 100% = $8,000 [reduction]
$8,000 - $8,000 = $0 [allowable credit]

If the property had been purchased December 3, 2009, the income threshold would have been $125,000, and the taxpayer would have been able to claim the entire $8,000 credit.

[28] "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 may be claimed on the tax return for the tax year in which the property is purchased.[29] However, taxpayers may choose to treat the property as if it had been purchased on December 31 of the prior calendar year.[30] Since most individual taxpayers are calendar year taxpayers, this provision generally means that taxpayers may choose to claim their credit on the tax return for the tax year prior to the tax year in which they actually make the purchase. A taxpayer purchasing an eligible property before filing the prior year's tax return would be able to claim the credit on that year's original return. If a taxpayer had already filed the prior year's 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. Likewise, long-term residents would be able to claim their credit (up to $6,500) on the tax return for the year prior to the year in which they purchased their subsequent principal residence.

The advantage to claiming the credit on the prior year's tax return is that the credit could produce a refund sooner than if it were claimed on the return for the year of purchase. In the case of a taxpayer who would otherwise have a balance due on the prior year's return, claiming the credit for that prior year would reduce or eliminate the balance due. The credit for a purchase after December 31, 2008, 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 purchase on their prior year's tax return could still effectively receive their credit before filing their return for the year of purchase. 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.[31] FHA-approved entities and federal, state, and local governmental agencies may "purchase" the credits. A number of state housing finance agencies (HFAs)[32] 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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[29] 26 U.S.C. § 36(a).

[30] 26 U.S.C. § 36(g).

[31] 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.

[32] 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. In some cases, the purchase date of the principal residence will determine whether a particular factor will disqualify the purchaser from taking the credit. For purchases made in any year, the following taxpayers do not qualify for the credit:

- non-resident aliens;[33]
- those whose home is located outside the United States;
- those who inherited their principal residence; and
- those who purchased their principal residence from a related party.[34]

Those purchasing their residence in 2008 would not qualify for the credit if they financed their new residence with the proceeds of a tax-exempt mortgage revenue bond[35] or if they (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.[36]

However, taxpayers who purchase their principal residence after 2008 will still qualify for the credit even if their new residence was financed with the proceeds of tax-exempt mortgage revenue bonds.[37] Additionally, taxpayers purchasing their property after 2008 would be eligible for the § 36 credit even if they had been eligible to claim the D.C. credit in an earlier year.[38] Purchases after 2008 will not be eligible for the D.C. credit if they are eligible for the § 36 credit.[39]

P.L. 111-92 imposed several limitations regarding purchases after November 6, 2009. Individuals will not qualify for the credit if they are eligible to be claimed as a dependent on another taxpayer's tax return (whether or not they actually are claimed). Taxpayers who are under 18 years old at the time of purchase are not eligible for the credit unless married at that time. Additionally, taxpayers will not be eligible for the credit if their principal residence cost more than $800,000.

Effective for all tax returns for tax years ending after November 6, 2009, as a matter of procedure, taxpayers will not be eligible for the credit unless their tax return includes "a properly executed copy of the settlement statement used to complete such purchase"[40] as an attachment to the

[33] 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)).

[34] See section "What Is a Purchase?" for discussion of who is a related party.

[35] 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).

[36] 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.

[37] P.L. 111-5, § 1006(e).

[38] P.L. 111-5, § 1006(d)(2).

[39] 26 U.S.C. § 1400C(e)(4).

[40] 26 U.S.C. § 36(d)(4).

return.[41] For credits claimed on the 2009 calendar year tax return, this provision applies to all purchases, including those occurring before November 7, 2009.

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.[42] 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.[43] 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.

P.L. 111-92 eliminated the repayment provisions for certain members of the military,[44] foreign service, or intelligence community who cease to use their property in connection with government orders for qualified official extended duty received by either the taxpayer or the taxpayer's spouse.

2008 Purchases

When and How Is the Credit Repaid?

The standard repayment for credits based on property purchased in 2008 is structured by recapturing one-fifteenth of the allowed first-time homebuyer tax credit on the taxpayer's tax returns for each of 15 consecutive tax years.[45] For taxpayers who were allowed the maximum credit, $500 would be added to their tax return as a liability in each of 15 consecutive tax years. This recapture begins two years after the tax year in which the property is purchased or deemed to be purchased.[46] 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.[47]

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[41] On the IRS website, the pdf file for Form 5405 includes a cover sheet with a "Note Regarding Settlement Statement." This note advises taxpayers whose signature does not already appear on the settlement statement (due to the particular requirements of the taxpayer's jurisdiction) to sign the copy of the settlement statement that is being attached to the tax return even if the settlement form does not include a signature line.

[42] 26 U.S.C. § 36(f).

[43] 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).

[44] Includes all uniformed services.

[45] 26 U.S.C. § 36(f)(1), (7).

[46] 26 U.S.C. § 36(f)(7).

[47] 26 U.S.C. § 36(f)(6).

Recapture may be accelerated if the property is sold or is no longer used by the taxpayer as the taxpayer's principal residence.[48] 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. However, there are two situations in which repayment is waived. There are two other situations in which repayment is not accelerated when the taxpayer ceases to use the property as the principal residence. Additionally, there is an exception for certain members of the military, foreign service, and intelligence community who receive government orders for qualifying official extended duty service.

When Is Repayment Waived?

Recapture of the outstanding credit may be waived in three situations: (1) a sale with no gain,[49] (2) the death of the taxpayer,[50] or (3) relocation related to government orders.

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.[51] 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 -

[48] 26 U.S.C. § 36(f)(2).

[49] 26 U.S.C. § 36(f)(3). This provision does not apply to sales to related parties. *Id.*

[50] 26 U.S.C. § 36(f)(4)(A).

[51] 26 U.S.C. § 1001.

$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

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.

Relocation Related to Government Orders

When government orders for qualified official extended duty service for the taxpayer or the taxpayer's spouse lead to relocation, the property purchased to qualify the taxpayer for the homebuyer tax credit may be sold or converted to another use. Generally, such a change in use would result in accelerated recapture of any outstanding credit or, if accelerated recapture was not required, continued repayment of the outstanding balance of the credit. However, P.L. 111-92 provides an exception from both the accelerated recapture provision as well as the repayment provision of § 36. The exception applies to members of the uniformed services or the Foreign Service of the United States as well as employees of the intelligence community. Additionally, the exception applies to spouses (unlike the death waiver discussed above).

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 three circumstances exists: (1) involuntary conversion, (2) transfer between spouses or incident to divorce, or (3) relocation related to government orders.

Involuntary Conversions

When property is destroyed, it is involuntarily converted.[52] 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.[53] 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

[52] *See* 26 U.S.C. § 1033(a).

[53] 26 U.S.C. § 36(f)(4)(B).

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.[54] The recapture provisions of the first-time homebuyer tax credit allow 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.[55] 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.

Relocation Related to Government Orders

For certain government personnel, repayment will not be accelerated when property is no longer used by the taxpayer or spouse as the principal residence so long as the change in use occurs after December 31, 2008, and is related to government orders for qualified official extended duty service for the taxpayer or the taxpayer's spouse. This applies to members of the uniformed services or the Foreign Service of the United States and to employees of the intelligence community. For married taxpayers, neither half of the total credit (or its outstanding balance) will be subject to the accelerated repayment provision.

Exception for Members of the Military, Foreign Service or Intelligence Community

Certain members of the uniformed services or the Foreign Service of the United States who cease to use their property as their principal residence after December 31, 2008, will not be subject to the accelerated recapture requirements if the change in use was related to government orders. P.L. 111-92 established an exception to the repayment provisions for these taxpayers and their spouses as well as for employees of the intelligence communities and their spouses. To qualify taxpayers for the exception, the government orders must be for qualified official extended duty service for either the taxpayer or the taxpayer's spouse.

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[54] *See* 26 U.S.C. § 1041(a).

[55] 26 U.S.C. § 36(f)(4)(C)(i).

Those qualifying taxpayers (and their spouses) whose credit was based on a 2008 purchase not only will be excepted from accelerated recapture of their credit, but will also be excepted from any further repayment of the outstanding credit. This differs from other situations in which acceleration is not triggered but scheduled repayment continues. The exception applies whether the property is sold or is converted to a use other than as the principal residence so long as the change is in connection with qualifying government orders.

No Special Provisions for 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, divorce, and qualified official extended duty service. However, that section also includes a provision for 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[56] 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.

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 ratio 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.

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.

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

[57] 26 U.S.C. § 121(c)(2)(B).

[58] 26 U.S.C. § 121(c)(1)(A).

Purchases after 2008

When and How is the Credit Repaid?

So long as a principal residence purchased after 2008 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 ceases 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 post-2008 purchases 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; a transfer incident to a divorce; and for those in the uniformed services, Foreign Service, and intelligence community.

Effect on Basis

Taxpayers who receive the first-time homebuyer 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 post-2008 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.

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[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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