Tax Credit for Principal Residence: Clearing the Housing Glut

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It is old news, today, to talk about a slow housing market. The discussion centers on when the housing market will gain new life, leading, it is hoped, to a strong uptick in the overall United States economy. In an attempt to provide a boost to the housing market and all its related services and industries, and to slow the number of defaults on existing mortgages, Congress passed legislation offering a federal income tax credit as a stimulus to home purchase.

The First-Time Homebuyer Credit (now expanded beyond first-time buyers) expired on April 30, 2010. That's the final date for a binding contract; the closing must be prior to July 1. The debate over its effect on the housing market will continue long past its expiration. Was it just a short-term stimulus or did it set in motion a long-term revival of residential sales? To be determined. What also lingers past its expiration is the need for qualifying buyers to determine how to take the credit on their tax filings. Because of the credit's various time extensions, qualifier expansions, assorted requirements and computations, the details related to claiming the credit can be difficult to assemble. This article lays out the pieces in an attempt to create a basic summary of the details.

A brief review of the initial legislation is needed because those who purchased homes under the first set of rules are still guided by those. The Housing and Economic Recovery Act passed by Congress in 2008 allowed a tax credit of up to $7,500 for first-time homebuyers. The term "credit" was a mislabeling, as it was actually an interest-free loan. The taxpayer was required to pay the $7,500 back to the government, at the rate of $500 per year, for 15 years. (If the home was sold during the payback period, the un-repaid credit was due in full in the year of the sale.) In 2009 Congress passed legislation making various changes to the credit, including an expanded time frame for eligibility and an increase to $8,000. Buried rather far down in a related Internal Revenue Service press release was that taxpayers "do not have to repay the credit, provided the home remains their main home for 36 months after the purchase date."

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One might observe that while the Feds could be faulted for downplaying the initial repayment factor, they were equally low-key about the switch to a "real" credit.

As stated above, the credit initially allowed first-time homebuyers an amount of $7,500. At the end of 2009, the credit became the lesser of: 1) $8,000, with $4,000 allowed to a married couple filing separately; or 2) ten percent of the purchase price of the principal residence, assuming that the taxpayer otherwise qualified for the credit. In all cases related to the credit, only a principal residence qualifies. A first-time homebuyer is defined as having no home ownership in general, or no home ownership as a principal residence in the U.S., within a three-year period prior to the purchase for which the credit would be claimed.

The credit was due to expire Nov. 30, 2009, and thus there was concern that the stimulus for the market would be lost. Congress chose to extend the credit along with making other changes under the 2009 Worker, Home Ownership and Business Assistance Act (WHOBA), signed into law on Nov. 6, 2009.

This Act was explained by the Joint Committee on Taxation in its release entitled "Technical Explanation of Certain Revenue Provisions of the Worker, Home Ownership and Business Assistance Act of 2009" (JCX-44-09) dated Nov. 3, 2009. That release provides additional explanation about the home ownership credit as well as other matters. (See *www.jct.gov*.)

Under the new law, Congress amended Section 36 of the Internal Revenue Code with changes relating to qualifying for the credit, extension of the time frame allowed for home purchase, and repayment of the credit. The credit was expanded to include "repeat buyers" who purchased a different principal residence. Qualifying taxpayers who bought a home before Dec. 1, 2009, can claim the credit on either their 2008 or 2009 tax returns and are not required to repay the credit if the home remains their principal residence for 36 months after the purchase date.

Under the provisions of WHOBA 2009 the credit continues to be applicable only to the principal residence. The credit applies to those purchases that are qualified if a binding contract is entered before May 1, 2010; closing must be before July 1 (except as noted below).

For repeat homebuyers, if a taxpayer was a long-time resident of the principal residence the following applies: if the taxpayer is married and has maintained the principal residence for any five-consecutive-year period during the eight-year period that ended on the date the new home is purchased and the settlement date was after Nov. 6, 2009, the credit is $6,500.

There are other limitations. For example, the taxpayer will be eliminated from qualifying for the credit if the taxpayer's modified adjusted gross income (AGI) exceeds ceilings set by Congress. In general, the credit cannot be taken by married couples filing jointly if they have a modified AGI exceeding $245,000 in the year they purchase the residence. If one is single, the maximum modified AGI allowed is $145,000.

There are additional requirements to earn the credit as well as some special definitions and interpretations. For example, one must be at least 18 years of age as of the date the property is acquired to qualify for the credit. Couples qualify if one spouse is at least 18.

Other qualifications:

- There is an $800,000 maximum purchase price;
- The taxpayer cannot be claimed as a dependent by another taxpayer;
- The property cannot be acquired from one who is a disqualified related party, such as a parent;
- Some of the rules are relaxed or limited for those in extended-duty positions in the Armed Services or are outside the U.S. on official military duty;
- A copy of the settlement statement for the purchase of the property must be attached to the income tax return.

The new law does not affect those who purchased a home after April 8, 2008, and on or before Dec. 31, 2008. For these taxpayers who are claiming the credit on their 2008 tax returns, the maximum credit remains 10 percent of the purchase price, up to $7,500, or $3,750 for married individuals filing separately. In addition, the credit for these 2008 purchases must be repaid in 15 equal installments over 15 years, beginning with the 2010 tax year.

These new rules give many taxpayers the opportunity to buy a house with financial assistance from the federal government. This incentive may have motivated those hesitating on the purchase of a home, given the weakness in the marketplace, concern with employment, other debt issues and so forth. However, taxpayers need to carefully consider all of the requirements to qualify for the credit.

In addition to helping homeowners, the credit helps move inventory off the market. This of course benefits many groups in the home building and furnishing industries. Thus, the credit was clearly designed to stimulate the economy at a time when the market has been very slow in many areas of the country. ■

REFERENCE

The Code Section is Internal Revenue Code of 1986, as amended; Code Section 121 to define the principal residence; Code Section 36 for credit.