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Many of our clients have been asking us about the provisions of the First-time Homebuyer tax credit which was part of the new housing legislation. Here is some information that you will hopefully find helpful:

First-Time Home Buyer Tax Credit at a Glance

- The tax credit is available for first-time home buyers only.
- The maximum credit amount is \$7,500.
- The credit is available for homes purchased on or after April 9, 2008 and before July 1, 2009.
- Single taxpayers with incomes up to \$75,000 and married couples with incomes up to \$150,000 qualify for the full tax credit.
- The tax credit works like an interest-free loan and must be repaid over a 15-year period.

In addition, the following contains answers to frequently asked questions:

1. Who is eligible to claim the \$7,500 tax credit?
First time home buyers purchasing any kind of home -- new or resale -- are eligible for the tax credit. To qualify for the tax credit, a home purchase must occur on or after April 9, 2008 and before July 1, 2009. For the purposes of the tax credit, the purchase date is the date when closing occurs.
2. What is the definition of a first-time home buyer?
The law defines "first-time home buyer" as a buyer who has not owned a principal residence during the three-year period prior to the purchase. For married taxpayers, the law tests homeownership history of both the home buyer and his/her spouse. For example, if you have not owned a home in the past three years but your spouse has owned a principal residence, neither you nor your spouse qualifies for the first-time home buyer tax credit.
3. What types of homes will qualify for the tax credit?
Any home purchased by an eligible first-time home buyer will qualify for the credit, provided that the home will be used as a principal residence and the buyer has not owned a home in the previous three years. This includes single-family detached homes, attached homes like townhouses, and condominiums.
4. Instead of buying a new home from a home builder, I have hired a contractor to construct a home on a lot that I already own. Do I still qualify for the tax credit?
Yes. For the purposes of the home buyer tax credit, a principal residence that is constructed by the home owner is treated by the tax code as having been "purchased" on the date the owner first occupies the house. In this situation, the date of first occupancy must be on or after April 9, 2008 and before July 1, 2009. In contrast, for newly-constructed homes bought from a home builder, eligibility for the tax credit is determined by the settlement date.
5. What is "modified adjusted gross income"?
Modified adjusted gross income or MAGI is defined by the IRS. To find it, a taxpayer must first determine "adjusted gross income" or AGI. AGI is total income for a year minus certain deductions (known as "adjustments" or "above-the-line deductions"), but before itemized deductions from Schedule A or personal exemptions are subtracted. On Forms 1040 and 1040A, AGI is the last number on page 1 and first number on page 2 of the form. For Form 1040-EZ, AGI appears on line 4 (as of 2007). Note that AGI includes all forms of income including wages, salaries, interest income, dividends and capital gains. To determine modified adjusted gross income (MAGI), add to AGI certain amounts such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions and deductions for higher-education costs.

6. If my modified adjusted gross income (MAGI) is above the limit, do I qualify for any tax credit?
Possibly. It depends on your income. Partial credits of less than \$7,500 are available for some taxpayers whose MAGI exceeds the phase-out limits. The credit becomes totally unavailable for individual taxpayers with a modified adjusted gross income of more than \$95,000 and for married taxpayers filing joint returns with an AGI of more than \$170,000.
7. Can you give me an example of how the partial tax credit is determined?
Just as an example, assume that a married couple has a modified adjusted gross income of \$160,000. The applicable phase-out to qualify for the tax credit is \$150,000, and the couple is \$10,000 over this amount. Dividing \$10,000 by \$20,000 yields 0.5. When you subtract 0.5 from 1.0, the result is 0.5. To determine the amount of the partial first-time home buyer tax credit that is available to this couple, multiply \$7,500 by 0.5. The result is \$3,750.

Here's another example:

Assume that an individual home buyer has a modified adjusted gross income of \$88,000. The buyer's income exceeds \$75,000 by \$13,000. Dividing \$13,000 by \$20,000 yields 0.65. When you subtract 0.65 from 1.0, the result is 0.35. Multiplying \$7,500 by 0.35 shows that the buyer is eligible for a partial tax credit of \$2,625. Please remember that these examples are intended to provide a general idea of how the tax credit might be applied in different circumstances. You should always consult your tax advisor for information relating to your specific circumstances.

8. Does the credit amount differ based on tax filing status?
No. The credit is in general equal to \$7,500 for a qualified home purchase, whether the home buyer files taxes as a single or married taxpayer. However, if a household files their taxes as "married filing separately" (in effect, filing two returns), then the credit of \$7,500 is claimed as a \$3,750 credit on each of the two returns.
9. Are there any circumstances for which buyers whose incomes are at or below the \$75,000 limit for singles or the \$150,000 limit for married taxpayers might not be able to claim the full \$7,500 tax credit?

In general, the tax credit is equal to 10% of the qualified home purchase price, but the credit amount is capped or limited at \$7,500. For most first-time home buyers, this means the credit will equal \$7,500. For home buyers purchasing a home priced less than \$75,000, the credit will equal 10% of the purchase price.

10. I heard that the tax credit is refundable. What does that mean?
The fact that the credit is refundable means that the home buyer credit can be claimed even if the taxpayer has little or no federal income tax liability to offset. Typically this involves the government sending the taxpayer a check for a portion or even all of the amount of the refundable tax credit. For example, if a qualified home buyer expected, notwithstanding the tax credit, federal income tax liability of \$5,000 and had tax withholding of \$4,000 for the year, then without the tax credit the taxpayer would owe the IRS \$1,000 on April 15th. Suppose now that taxpayer qualified for the \$7,500 home buyer tax credit. As a result, the taxpayer would receive a check for \$6,500 (\$7,500 minus the \$1,000 owed).
11. What is the difference between a tax credit and a tax deduction?
A tax credit is a dollar-for-dollar reduction in what the taxpayer owes. That means that a taxpayer who owes \$7,500 in income taxes and who receives a \$7,500 tax credit would owe nothing to the IRS. A tax deduction is subtracted from the amount of income that is taxed. Using the same example, assume the taxpayer is in the 15 percent tax bracket and owes \$7,500 in income taxes. If the taxpayer receives a \$7,500 deduction, the taxpayer's tax liability would be reduced by \$1,125 (15 percent of \$7,500), or lowered from \$7,500 to \$6,375.
12. Can I claim the tax credit if I finance the purchase of my home under a mortgage revenue bond (MRB) program?
No. The tax credit cannot be combined with the MRB home buyer program.
13. I live in the District of Columbia. Can I claim both the DC first-time home buyer credit and this new credit?

No. You can claim only one.

14. I am not a U. S. citizen. Can I claim the tax credit?
Maybe. Anyone who is not a nonresident alien (as defined by the IRS), who has not owned a principal residence in the previous three years and who meets the income limits test may claim the tax credit for a qualified home purchase. The IRS provides a definition of "nonresident alien" in IRS Publication 519.
15. Does the credit have to be paid back to the government? If so, what are the payback provisions?
Yes, the tax credit must be repaid. Home buyers will be required to repay the credit to the government, without interest, over 15 years or when they sell the house, if there is sufficient capital gain from the sale. For example, a home buyer claiming a \$7,500 credit would repay the credit at \$500 per year. The home owner does not have to begin making repayments on the credit until two years after the credit is claimed. So if the tax credit is claimed on the 2008 tax return, a \$500 payment is not due until the 2010 tax return is filed. If the home owner sold the home, then the remaining credit amount would be due from the profit on the home sale. If there was insufficient profit, then the remaining credit payback would be forgiven.
16. Why must the money be repaid?
Congress's intent was to provide as large a financial resource as possible for home buyers in the year that they purchase a home. In addition to helping first-time home buyers, this will maximize the stimulus for the housing market and the economy, will help stabilize home prices, and will increase home sales. The repayment requirement reduces the effect on the Federal Treasury and assumes that home buyers will benefit from stabilized and, eventually, increasing future housing prices.
17. Because the money must be repaid, isn't the first-time home buyer program really a zero-interest loan rather than a traditional tax credit?
Yes. Because the tax credit must be repaid, it operates like a zero-interest loan. Assuming an interest rate of 7, that means the home owner saves up to \$4,200 in interest payments over the 15-year repayment period. Compared to \$7,500 financed through a 30-year mortgage with a 7% interest rate, the home buyer tax credit saves home buyers over \$8,100 in interest payments. The program is called a tax credit because it operates through the tax code and is administered by the IRS. Also like a tax credit, it provides a reduction in tax liability in the year it is claimed.
18. If I'm qualified for the tax credit and buy a home in 2009, can I apply the tax credit against my 2008 tax return?
Yes. The law allows taxpayers to choose ("elect") to treat qualified home purchases in 2009 as if the purchase occurred on December 31, 2008. This means that the 2008 income limit (MAGI) applies and the election accelerates when the credit can be claimed (tax filing for 2008 returns instead of for 2009 returns). A benefit of this election is that a home buyer in 2009 will know their 2008 MAGI with certainty, thereby helping the buyer know whether the income limit will reduce their credit amount.
19. For a home purchase in 2009, can I choose whether to treat the purchase as occurring in 2008 or 2009, depending on in which year my credit amount is the largest?
Yes. If the applicable income phase-out would reduce your home buyer tax credit amount in 2009 and a larger credit would be available using the 2008 MAGI amounts, then you can choose the year that yields the largest credit amount.