FIRST-TIME HOMEBUYER TAX CREDIT

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Q 1. ***What, in a nutshell, is the $8,000 tax credit for first-time homebuyers under the new law?***

A A first-time homebuyer as defined may receive a refundable tax credit up to $8,000 for purchasing a principal residence in the U.S. from January 1, 2009 to November 30, 2009, inclusive (see Questions 5 to 16). No repayment is required if the buyer owns and occupies the property for 36 months (see Question 17). This new law enhances the preexisting $7,500 tax credit enacted in 2008 which still applies for purchases from April 9, 2008 to December 31, 2008 (see Questions 18 and 19).

Q 2. ***How will the new $8,000 tax credit affect REALTORS® and their clients?***

A The new $8,000 tax credit provides a monetary incentive for first-time homebuyers to purchase homes. First time homebuyers represent a significant segment of U.S. homebuyers. According to the U.S. Department of the Treasury, nearly half of the homebuyers in 2008 were first-time homebuyers. Hence, the new tax credit for first-time homebuyers, along with affordable home prices and historically low mortgage rates, should help spur the housing market.

Q 3. ***What is a tax credit?***

A A tax credit is a dollar-for-dollar reduction of tax owed. In contrast to a tax credit, a tax deduction is merely a reduction of taxable income. Hence, a tax credit is generally more valuable to the taxpayer than a tax deduction. To illustrate, an $8,000 tax deduction for a taxpayer in a 25% tax bracket would only save the taxpayer $2,000 in taxes, whereas an $8,000 tax credit would save the taxpayer $8,000 in taxes.

Q 4. ***What is the significance of a "refundable" tax credit?***

A That a tax credit is "refundable" means that any credit amount not used to reduce the tax owed may be added to the taxpayer's tax refund check. In other words, a taxpayer may receive a tax credit even if he or she has no tax liability to offset that credit.

As an example, let's say a taxpayer filing his tax returns on April 15 would have owed $2,000 to the IRS. If the taxpayer can now claim an $8,000 refundable tax credit, he can expect to receive a refund check from the IRS for $6,000.

Q 5. ***Who is eligible as a "first-time homebuyer" for the $8,000 tax credit?***

A For purposes of the $8,000 tax credit, a "first-time homebuyer" is defined as any individual (or spouse) with no present ownership interest in a principal residence during the 3-year period ending on the date of the purchase of the principal residence to which the tax credit applies (26 U.S.C. § 36(c)(1)). For income restrictions, see Question 9.

As an example, an unmarried buyer who closes escrow on a purchase on June 30, 2009, would qualify as a "first-time homebuyer" as long as the buyer did not own a principal residence during the period from July 1, 2006 to June 30, 2009. Even if the taxpayer owned another principal residence in the past, he or she can still qualify as a "first-time homebuyer" as long as the taxpayer transferred off title to that other home over three years ago.

Q 6. ***What constitutes a "principal residence" under the $8,000 tax credit?***

A A "principal residence" is generally the home the taxpayer lives in most of the time (26 U.S.C. § 121). It can be a house, condominium, townhome, manufactured home, or similar type of property located in the U.S. To qualify for the federal $8,000 tax credit, the property can be new construction or a resale. It cannot, however, be a vacation home or rental property.

Q 7. ***What constitutes a "purchase" to be eligible for the $8,000 tax credit?***

A A "purchase" for purposes of this tax credit is defined as any acquisition, except as set forth in Question 15 (26 U.S.C. § 36(c)(3)). For a home that the taxpayer constructs, the purchase date is the date the taxpayer first occupies the home (26 U.S.C. § 36(c)(3)(B)).

Because a purchase is defined as an acquisition, it generally occurs when escrow closes and title to the property transfers to the buyer, and not when the underlying purchase contract is signed. To illustrate, a buyer who enters into a contract to purchase a property on November 13, 2009, but closes escrow on December 23, 2009, would not qualify for the $8,000 tax credit because, based on the law as it is currently written, acquisition does not occur before the law expires on November 30, 2009.

Q 8. ***How is the amount of the tax credit calculated?***

A The maximum tax credit for an individual first-time homebuyer is 10 percent of the purchase price, not to exceed $8,000 (26 U.S.C. § 36(b)(1)(A)). For married individuals filing separate tax returns, the tax credit is capped at $4,000 (26 U.S.C. § 36(b)(1)(B)).

For a purchase price over $80,000, as is often the case in California, the first-time homebuyer tax credit will be capped off at $8,000. "Purchase price" under this law is defined as the adjusted basis of the principal residence on the date such residence is purchased (26 U.S.C. § 36(c)(4)).

Q 9. ***Is there an income restriction to be eligible for the $8,000 tax credit?***

A Yes. The first-time homebuyer tax credit may be restricted by the taxpayer's income. The tax credit starts to phase out for an individual taxpayer with a modified adjusted gross income from $75,001 to $95,000 (or $150,001 to $170,000 for joint filers). The tax credit is eliminated entirely if an individual's modified adjusted gross income is over $95,000 (or $170,000 for joint filers). (26 U.S.C. § 36(b)(2).)

Q 10. ***What is a modified adjusted gross income?***

A First, a modified adjusted gross income or MAGI is a taxpayer's adjusted gross income (AGI) plus certain items, such as IRA deductions, student loan deductions, higher education costs, foreign income, and foreign housing deductions, among other things. Second, an adjusted gross income (AGI) is a taxpayer's gross income minus certain deductions, which are often called "above the line" deductions. Most tax deductions are "above the line" deductions, except itemized deductions from Schedule A and personal exemptions.

Q 11. ***When must a first-time homebuyer purchase a property to qualify for the $8,000 tax credit?***

A To be eligible for the $8,000 tax credit, a first-time homebuyer must purchase a principal residence from January 1, 2009 to November 30, 2009, inclusive (26 U.S.C. § 36(f) and (h)). The deadline is November 30, 2009, and not December 31, 2009. That the deadline is not at the end of the year may work as a trap for unwary buyers.

For the first-time homebuyer tax credit for acquisitions from April 9, 2008 to December 31, 2008, see Question 18.

Q 12. ***When can a taxpayer claim the $8,000 tax credit?***

A According to an IRS announcement on February 25, 2009, first-time homebuyers who qualify for the $8,000 tax credit by purchasing a home before December 1, 2009 have a special option of claiming the tax credit on either their 2008 or 2009 tax returns (IR 2009 14).

Q 13. ***Does a married person qualify for the $8,000 tax credit if his or her spouse has owned a principal residence in the last three years?***

A No. For a married taxpayer to qualify for the $8,000 tax credit, both spouses must be "first-time homebuyers" as defined in Question 5. In other words, neither spouse qualifies for the $8,000 tax credit unless both of them have not owned a principal residence over the last three years.

Q 14. ***Are two unmarried individuals both eligible for the first-time homebuyer tax credit if they buy a house together?***

A Yes. Two or more unmarried individuals can buy a principal residence together, but the maximum tax credit for all of them is only $8,000. If all co-owners qualify as first-time homebuyers, they must allocate the $8,000 tax credit between themselves in any reasonable manner. According to the IRS, 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 (see IRS Form 5405).

Q 15. ***Who cannot claim the first-time homebuyer tax credit?***

A The first-time homebuyer tax credit is not allowed under any of the following circumstances:

• The property is acquired from a related person as defined (26 U.S.C. § 36(c)(3)(A)) (see Question 16);

• The property is acquired by gift or inheritance (26 U.S.C. § 36(c)(3)(A));

• The buyer is a nonresident alien (26 U.S.C. § 36(d)(1)); or

• The buyer disposes of the property (or the property ceases to be the principal residence of the buyer and, if married, the buyer's spouse) before the end of such taxable year (26 U.S.C. § 36(d)(2)).

Q 16. ***What acquisitions from related persons do not qualify for the first-time homebuyer tax credit?***

A A buyer is ineligible for the first-time homebuyer tax credit if the property is acquired from certain related persons, including, but not limited to, the following:

• The buyer's spouse, ancestors (such as parents and grandparents), or lineal descendants (such as children or grandchildren);

• A corporation in which the buyer owns more than 50% of the outstanding stock; or

• A partnership in which the buyer owns more than 50% interest.

(26 U.S.C. § 36(c)(3)(A) (citing §§ 267 and 707).)

Q 17. ***Is a first-time homebuyer required to repay the $8,000 tax credit?***

A No, the tax credit need not be repaid if the buyer owns and occupies the property for at least 36 months. If, however, the buyer disposes of the property or it ceases to be the buyer's principal residence within 36 months of purchase, the buyer may be required to repay the tax credit (26 U.S.C. § 36(f)(4)). This includes situations where the buyer sells the home, converts it into a rental property or business, or the home is destroyed, condemned, or disposed of under threat of condemnation. In these situations, the tax credit must generally be repaid by including it as additional tax for the year the home ceases to be the buyer's principal residence (26 U.S.C. § 36(f)(4)(D)).

Q 18. ***What is the $7,500 first-time homebuyer tax credit for a principal residence purchased in 2008?***

A With certain exceptions, a first-time homebuyer may receive a 10% tax credit not to exceed $7,500 for purchasing a principal residence from April 9, 2008 to December 31, 2008 (26 U.S.C. § 36(a) and (b)). This tax credit was enacted as part of the federal Housing and Economic Recovery Act of 2008. As with the $8,000 tax credit discussed above, the $7,500 tax credit phases out if an individual's modified adjusted gross income exceeds $75,000 (or $150,000 for joint filers) (26 U.S.C. § 36(b)(2)). The $7,500 tax credit phases out completely if an individual's modified adjusted gross income exceeds $95,000 (or 170,000 for joint filers) (26 U.S.C. § 36(b)(2)).

The $7,500 tax credit must generally be repaid like an interest-free loan in equal annual installments over a 15-year period, or in full if the homebuyer sells the property for a gain (26 U.S.C. § 36(f)). For example, to repay a $7,500 tax credit for 2008, about $500 should be added to the buyer's income tax liability every year for 15 years starting 2010.

Q 19. ***What are the major differences between the new $8,000 tax credit and the previous $7,500 tax credit?***

A The $8,000 tax credit is $500 more and applicable to first-time homebuyers who purchase a principal residence from January 1, 2009 to November 30, 2009. The $8,000 tax credit need not be repaid if the buyer stays in the property for 36 months.

On the other hand, the $7,500 tax credit applies to first-time homebuyers who purchased a principal residence from April 9, 2008 to December 31, 2008. The $7,500 tax credit must generally be repaid over 15 years.

Q 20. ***How does a first-time homebuyer apply for the tax credit?***

A A first-time buyer may claim the tax credit on their federal tax returns using IRS Form 5405, which is available at http://www.irs.gov/pub/irs-pdf/f5405.pdf.

B. FHA, FANNIE MAE, AND FREDDIE MAC LOAN LIMITS

Q 21. ***What are the loan limits under the Recovery Act?***

A The Recovery Act has increased the maximum conforming loan limit from $625,500 to $729,750 for FHA, Fannie Mae and Freddie Mac loans. These higher loan limits are intended to ease the mortgage crisis of the late 2000s by helping homeowners and homebuyers get more affordable mortgage loans.

As background, the $729,750 loan limit was originally established in 2008, but dropped down to $625,500 on January 1, 2009. The new law reinstates the conforming loan limit to 125% of the 2008 local area median home price, not to exceed $729,750.

Q 22. ***What are the FHA loan limits in California?***

A The new FHA loan limit is 125% of the 2008 local area median home price or $271,050, whichever is greater, but not to exceed $729,750 for one-unit properties. The higher FHA loan limit will assist REALTORS® and their clients to obtain safe mortgage loans with fixed interest rates, low down payment requirements, and other affordable terms.

Counties in California at the maximum FHA loan limit of $729,750 are Alameda, Contra Costa, Los Angeles, Marin, Monterey, Napa, Orange, San Benito, San Francisco, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, and Ventura. The FHA loan limits for the other counties in California range from $271,050 to $679,500. For FHA's Mortgage Limits List, go to https://entp.hud.gov/idapp/html/hicost1.cfm.

The Secretary of the Department of Housing and Urban Development (HUD) has the discretionary authority to increase the FHA loan limit for any sub-area smaller than a county if the median home price in that sub-area warrants a higher loan limit.

Q 23. ***Which loans qualify for the new FHA loan limits?***

A The new FHA loan limits apply to loans for which credit is approved for the borrower in the calendar year 2009 (until December 31, 2009).

Q 24. ***Where can I obtain more information about FHA loans?***

A For more information about FHA loans, go to HUD's website at http://www.hud.gov/fha/choosefha.cfm or the FHA's website at http://portal.hud.gov/portal/page?_pageid=73,1&_dad=portal&_schema=PORTAL.

Q 25. ***What are the Fannie Mae and Freddie Mac loan limits in California?***

A The new Fannie Mae and Freddie Mac conforming loan limit is 125% of the median home price or $417,000, whichever is greater, but not to exceed $729,750. Counties in

California that are at the maximum loan limit of $729,750 are Alameda, Contra Costa, Los Angeles, Marin, Monterey, Napa, Orange, San Benito, San Francisco, San Mateo, Santa Barbara, Santa Clara, Santa Cruz, and Ventura. The loan limits for the other counties in California range from $417,000 to $679,500.

For more information about Fannie Mae and Freddie Mac, including lookup tables for the loan limits for specific counties and high-cost areas in California, go to the website of the Office of Federal Housing Enterprise Oversight at http://www.ofheo.gov/regulations.aspx?nav=128.

The director of the Federal Housing Finance Agency (FHFA) has the discretionary authority to increase the Fannie Mae or Freddie Mac loan limit for any sub-area smaller than a county if the median home price in that sub-area warrants a higher loan limit.

Q 26. ***Which loans qualify for the new Fannie Mae and Freddie Mac loan limits?***

A The new Fannie Mae and Freddie Mac loan limits apply to all loans originated in 2009. They also apply to loans purchased in 2009 that were originated from July 1, 2007 through December 31, 2008.

Q 27. ***Where can I obtain more information about Fannie Mae and Freddie Mac loans?***

A For more information about Fannie Mae and Freddie Mac, go to the website of the Federal Housing Finance Agency at http://www.fhfa.gov/. Fannie Mae's website is http://www.fanniemae.com/index.jhtml. Freddie Mac's website is http://www.freddiemac.com/.