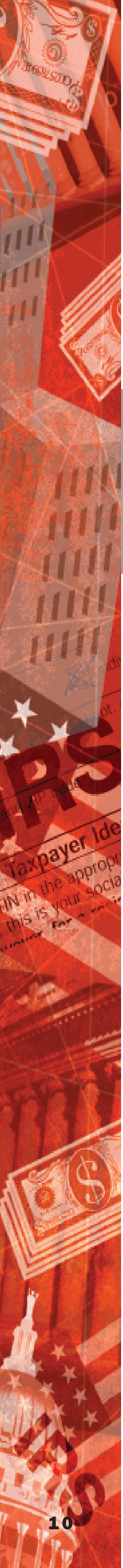
By Anthony P. Curatola



Housing Assistance Tax Act of 2008

The HAT Act passed in 2008 offers tax relief provisions for both first-time homebuyers and nonitemizing taxpayers, but there are some limitations and restrictions to watch out for.

The Housing Assistance Tax Act of 2008 (P.L. 110-289), or HAT Act, was signed into law on July 30, 2008. Two tax provisions in that Act pertain to tax relief for first-time home-buying taxpayers and nonitemizing taxpayers. As we have seen in so many acts signed into law these past few years, the window of opportunity for first-time home buyers is short lived. The window for nonitemizers, however, is permanent. So let's look at these two tax provisions in detail.

First-Time Home-Buying Provisions

HAT Act §3011(a) adds new Internal Revenue Code (IRC) §36, labeled the First-Time Homebuyer Credit, which provides an allowance of credit to first-time homebuyers. More specifically, new IRC §36(a) provides that "in the case of an individual who is a *first-time homebuyer* of a *principal residence* in the United States during a taxable year, there shall be allowed as a *credit* against the tax imposed… for such taxable year an amount equal to 10% of the purchase price of the residence" (emphasis added). (The original IRC §36, the Overpayment of Tax provision, has been redesigned as IRC §37.)

IRC §36(c)(1) defines a *first-time homebuyer* for this provision as any individual who had no present ownership interest in a principal residence during the three-year period ending on the date of the purchase of the principal residence to which this section applies. (If married, the same condition applies to the individual's spouse.) A *principal residence* has the same meaning as provided by IRC §121, which directs you to Treas. Reg. §1.121-1 for guidance on all the dependent facts and circumstances that may apply.

The *credit* provision is appealing on the surface, but deeper inspection shows that the taxpayer must pay it back. In fact, IRC §36(f) requires the credit to be recaptured annually over 15 years beginning with the second year of ownership. That is, the individual's tax liability is increased by 6.67% of the credit amount per year, which could be as much as $500 per year.

IRC §36 Basics

The first-time homebuyer tax credit is unique and interesting in a number of ways. It has a shelf life of slightly less than 15 months: The first-time homebuyer must purchase the principal residence on or after April 9, 2008, and before July 1, 2009. For those taxpayers having a home built, the date of occupancy is treated as the date of purchase. This short 15-month window of opportunity has a number of hurdles that the taxpayer needs to maneuver.

Additionally, the credit has a limitation of $7,500. In other words, if the home costs $75,000 or more, it's subject to the dollar limitation. If it costs less than $75,000, it's subject to the 10% purchase price limitation. The $7,500 limitation is further reduced to $3,750 in cases where the taxpayer is married but elects to file a separate return. Thus, a distinction is made at this point for the filing status of married individuals.

The tax credit is phased out for taxpayers over a certain modified adjusted gross income (MAGI) amount. The credit amount is reduced when the taxpayer's MAGI is $75,000 or more ($150,000 or more for married taxpayers filing a joint tax return). Again, the distinction pertains to the filing status of married individuals. Within the phase-out range, the credit amount is prorated. Thus, the credit amount claimed equals the max credit amount × (($95,000 – MAGI) / $20,000).

For example, Genie (single filing status) purchases a $100,000 principal residence in December 2008. She has a MAGI of $90,000 but otherwise qualifies for the first-time homebuyer credit. Genie would claim a credit amount of $1,875, which is calculated as: $7,500 × (($95,000 – $90,000) / $20,000).

IRC §36(g) provides the taxpayer an opportunity to claim the credit on the 2008 tax return if the home is purchased during the 2009 qualifying period. The Staff on the Joint Committee on Taxation (JCX 63-08, July 23, 2008) states that the taxpayer would be able to amend his or her tax return for this purpose. At this time, however, it isn't clear which MAGI amount (2008 or 2009) is used to determine the credit amount. Treasury most likely will address this issue.

Another peculiar aspect of this tax credit is that the taxpayer must repay the entire credit [IRC §36(f)], as mentioned previously. A taxpayer who claims a $7,500 credit in 2008 would increase his or her tax liability by $500 in 2010 and each year thereafter ($7,500 / 15 years) until the entire $7,500 is repaid to the federal government.

In the event the taxpayer disposes of (or converts) the principal residence prior to 15 years of ownership, the unrecovered tax credit is added to the gain to be recognized on the sale. If no gain is recognized on the sale or disposition of the home (i.e., the taxpayer qualifies to exclude up to $250,000 (or $500,000 for a couple filing a married joint return)), the unrecovered tax credit simply is added to the taxpayer's tax liability. Pursuant to IRC §36(f)(1), the unrecovered tax credit is recaptured at the rate of 6.67% of the credit amount taken for each tax year in the recapture period.

Returning to our example, if Genie sold her home in the tenth year of ownership, she would need to increase her tax liability by $3,000, which is six years × $500 per year (years 10 through 15), i.e., $7,500 × (0.0667 × 6 years).

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There is an exception to the recapture rule. A taxpayer who dies during the 15-year period isn't subject to the recapture provision. If a residence is transferred to a spouse (e.g., surviving spouse) or former spouse (i.e., divorce), the transferee spouse becomes responsible for any future recapture [B.1., JCX-63-08, July 23, 2008].

IRC §36(d) lists a few taxpayer situations that don't qualify for the first-time homebuyer tax credit. Included in this list are taxpayers who qualify for a credit under IRC §1400C (District of Columbia provision), taxpayers who are nonresident aliens, taxpayers who dispose of the residence before the close of the qualified tax period, or situations where the residence is financed by the proceeds of a qualified mortgage issue whereby the interest is tax exempt.

This 15-month tax credit provides qualified taxpayers with a tax liability reduction on one hand but then reclaims it over the next 15 years. As many have noted, it's really a noninterest bearing note and not a true tax credit.

Additional Standard Deduction Provision

Another attractive tax provision in the HAT Act pertains to taxpayers who use the standard deduction. A number of taxpayers reduce adjusted gross income by claiming a standard deduction in lieu of itemizing deductions because they either elect not to or aren't qualified to itemize deductions. In either event, the standard deduction is limited to a fixed amount (adjusted for inflation) each year.

New IRC §63(c)(1)(C), added by HAT Act §3212(a), provides taxpayers the opportunity to increase their standard deduction amount beginning in tax years 2008 by the lesser of the state and local tax deduction permitted if the taxpayer itemized or $500 ($1,000 in the case of a couple filing a joint tax return). A taxpayer in the 25% tax bracket can realize a tax liability reduction of up to $125 ($250). The good news about this provision is that, unlike the first-time homebuyer tax credit, it doesn't have a termination date. **SF**

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