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**First-Time Homebuyer Tax Credit May be Allowed as a Down Payment & New Tax Incentives**

**First-time homebuyer tax credit may be allowed as a down payment**

Individuals may soon be allowed to use the first-time homebuyer tax credit as a down payment on the purchase of a home. According to the U.S. Department of Housing and Urban Development (HUD), the Federal Housing Authority will shortly announce a new policy providing for the "monetization" of the credit.

There is no word yet on whether the IRS will change its course and permit the credit to be used as a down payment. According to an IRS spokesperson, although the credit is only available for a completed purchase and a purchaser cannot receive an advance payment of the credit before claiming it on their federal tax return, the credit does not preclude taxpayers from securing down payment assistance through any legally available means.

**IRS updates information on credit**

The IRS has also updated its online Frequently Asked Questions (FAQs) about the first-time homebuyer credit, including information on inherited homes, acquisitions from step-relatives, the recapture rules, and mortgage-payers.

**Recapture of credit**

The entire amount of the first-time homebuyer credit must be recaptured (i.e. repaid) in full on the tax return filed for the year the property stopped being the principal residence within the first three years. The IRS will revise Form 5405, First-Time Homebuyer Credit, for 2009 to discuss recapture.

**Inherited homes**

Inheriting a home and living in the home as a principal residence precludes an individual from being considered a "first-time homebuyer," either on that inherited property or on his or her next home. According to the IRS, there is no exception for taxpayers who did not buy their previous residence. Under the rules, to qualify as a first-time homebuyer the taxpayer and spouse (if applicable) must not have owned their principal residence for three years before purchasing the qualifying home.

**Step-relatives**

Acquiring a home from a related person is not a qualified purchase for purposes of the first-time homebuyer credit. Step-relatives are *not* related persons, the IRS clarifies.

**Mortgage payor**

The first-time homebuyer credit is

allowed to be taken by a taxpayer who buys a home, puts the deed and mortgage in the taxpayer's name, and lives in the home as the principal residence, even if the taxpayer does not make the mortgage payments.

**HUD Announces Monetization of First-Time Homebuyer Credit**

Individuals will be able to secure short-term bridge loans to monetize the first-time homebuyer credit, the U.S. Department of Housing and Urban Development (HUD) announced on May 29. The IRS told CCH that taxpayers may secure assistance, such as the program announced by HUD, but they cannot claim the credit for federal income tax purposes before their home is purchased.

**\$8,000 Credit**

The first-time credit reaches \$8,000 for homes purchased by eligible taxpayers before December 1, 2009. Individuals who purchase a home in 2009 can claim the credit on either their 2008 return or their 2009 return. The credit cannot be claimed in advance of a completed purchase. Consequently, individuals cannot use the credit toward a down payment or for expenses, such as closing costs and fees.

**Monetization**

To allow taxpayers to use the credit toward the costs of a home purchase,

state housing finance agencies and certain nonprofits can now monetize the credit. Home buyers using Federal Housing Administration (FHA)-approved lenders can apply the tax credit to their down payment in excess of 3.5 percent of appraised value or their closing costs. Generally, individuals will not be able to use the credit to meet the 3.5 percent minimum down payment required by the FHA.

Individuals will need to draft and provide the IRS Form 5405, First-Time Homebuyer Credit, to the FHA-approved lender. Individuals also must submit previous tax returns and IRS tax assessment letters, if any, to determine that the borrower does not have any outstanding tax obligations.

## **President Obama releases details about tax incentives for individuals**

President Barack Obama is releasing more details about his tax policies. The Treasury Department's recently published "Green Book" (which is called green for the color of its cover) describes the president's tax proposals. As expected, many of the proposals build on the president's campaign promises to cut taxes for middle-income individuals. Congress has already begun drafting legislation and debating the president's proposals, which could be enacted into law later this year.

### **Making Work Pay credit**

The centerpiece of President Obama's individual tax incentives is the Making Work Pay credit. Many individuals are already receiving the benefit of this credit in their paychecks. The credit reaches \$400 for single taxpayers and \$800 for married couples filing joint returns if they fall below certain income limits. The credit, however, is temporary and will expire after 2010. President Obama is asking Congress to make the credit permanent but many in Congress worry that a permanent

credit would be too expensive.

### **More middle-income Incentives**

Several other incentives are also targeted to middle-income taxpayers. These include marriage penalty relief, a permanent American opportunity education tax credit and permanent extension of lower individual marginal income tax rates (except for the 36 and 39.6 percent rates). The president has also proposed extending the state and local sales tax deduction, the higher education tuition deduction, the teacher's classroom expense deduction, the saver's credit, and the deduction for charitable contributions of IRA funds. These proposals enjoy significant support in Congress and are expected to pass.

President Obama did not propose extending several new tax breaks. These include the first-time homebuyer credit, which sunsets after December 1, 2009, and the deduction for state and local taxes paid on motor vehicles, which expires after December 31, 2009. The first-time homebuyer is popular in Congress and lawmakers may extend it one or two more years, especially if home sales remain slow.

### **Higher-income taxpayers**

More controversial are the president's proposals for higher income individuals. As mentioned, the top two individual marginal income tax rates would revert to 36 and 39.6 percent after 2010. President Obama has also proposed reinstating and expanding limitations on itemized deductions for higher-income individuals along with reinstating the personal exemption phaseout for higher-income individuals. The White House generally defines higher-income taxpayers as individuals with incomes above \$200,000 and families with incomes above \$250,000. It is unclear if these amounts refer to taxable income or adjusted gross income. More details are expected to be released when legislation is introduced in Congress.

### **Children**

One of the most popular federal tax incentives is the child tax credit. The 2009 Recovery Act expanded the credit. President Obama has proposed making the enhanced child tax credit permanent.

The president has also recommended a permanent enhanced earned income tax credit (EITC). Under current law, more families are eligible for the EITC. However, the president has proposed eliminating the advanced EITC, which provides the credit in advance through payroll.

### **Capital gains**

Under current law, the maximum tax rate on qualified capital gains and dividends is 15 percent. Some taxpayers may be eligible for a zero percent rate. These rates are temporary and will expire after 2010. President Obama has asked Congress to extend the lower rates for middle-income taxpayers. However, higher income individuals would be taxed at 20 percent on qualified dividends and capital gains under the president's plan.

### **Health care**

Congress has just started debating comprehensive health care reform. Lawmakers are looking for ways to fund health care reform. Under current law, the amount that an employer contributes to an employee's health coverage is generally excluded from the employee's taxable income. One idea being floated in Congress is to cap the tax exclusion for employment-based health care coverage. Administration officials have generally indicated their support for continuing the exclusion.

*Congress has a lot of tax legislation on its agenda and is expected to enact much of it into law in late summer or early fall, maybe sooner. Our office will keep you posted of developments and please contact us if you have any questions.*