FIRST-TIME HOMEBUYER TAX CREDIT

Frequently Asked Questions

As part of its major housing legislation (H.R. 3221), Congress has created a tax credit to provide an incentive for first-time homebuyers. The $7500 credit will be available for the purchase of a principal residence on or after April 8, 2008 and before July 1, 2009.

The Basics

Who qualifies for the new tax credit?

Only first-time homebuyers are eligible for the credit. A first-time homebuyer is defined as an individual who has not had an ownership interest in a principal residence in the previous three years. The 3-year period is measured as of the date of the purchase of the eligible principal residence.

Is there an income restriction?

Yes. The income restriction is based on the tax filing status of the tax return the purchaser files. Individuals whose Form 1040 filing status is Single are eligible for the credit if their adjusted gross income is no more than $75,000. Individuals who file a Joint return may have income of no more than $150,000.

Do individuals with incomes greater than the $75,000 or $150,000 limits lose all the benefit of the credit?

No. The credit has a phase-out. A formula is provided so that the credit is gradually reduced as an individual's income reaches $95,000 (single return) or $170,000 (joint return). Adjusted gross income above $95,000 ($170,000 joint) will receive no tax credit.

Is the amount of the credit tied to the price of the home?

Yes. The credit is for 10 percent of the cost of the home, up to a limit of $7500.

What's the definition of "principal residence?"

Generally, a principal residence is the home where an individual spends most of his/her time. The term includes single-family detached housing, condos or co-ops, townhouses or any similar type of dwelling.

Are there restrictions on the location of the property?

Yes. Eligible property must be located in the United States. Property outside the US is not eligible for the credit.

What if the purchaser is eligible for a $7500 credit but owes only $6000 of income tax?

The tax credit is a so-called "refundable" credit. Thus, in this example, the purchaser would receive an income tax refund of $1500. The refundable amount is the difference between $7500 and the amount of tax owed.

Why is the credit sometimes referred to as an interest-free loan?

Unlike most other tax credits, this tax incentive must be paid back. Eligible purchasers will be required to repay the tax credit over 15 years. The statute specifies that the repayment amount will be 6.67% of the credit amount each year. Thus, a buyer who qualifies for the full $7500 credit will repay $502.50 each year. There will be no interest charge on outstanding balances.

Some Practical Questions

How do I apply for the credit?

There is no application or approval process. Eligible purchasers will claim the credit on the appropriate IRS Form 1040 tax return and/or on any special forms the IRS might devise.

So I can't use the credit amount as part of my downpayment?

Presently, there is no mechanism available for claiming the credit any earlier than the 2008 tax return that will be filed in 2009. Congress tried to devise a mechanism that would allow pre-funding of the credit, but found that pre-funding would require cumbersome processes that would, in effect, bring the IRS into the purchase and settlement phase of the transaction.

So there's no way to get any cash flow benefits before I file my 2008 tax return?

Any first-time homebuyers who believe they would be eligible for all or part of the credit would be allowed to make adjustments to their income tax withholding (through their employers) or to their quarterly estimated tax payments. Individuals subject to income tax withholding would get an IRS Form W-4 from their employer, follow the instructions on the schedules provided and give the completed Form W-4 back to the employer. In many cases their take-home pay would increase.

If I don't make an eligible purchase until 2009, do I claim the credit when I file my 2009 tax return in 2010?

Qualified first-time homebuyers who make their purchase between January 1, 2009 and before July 1, 2009 are permitted to make an election to treat the purchase as if it had occurred on December 31, 2008. This election allows them (depending on the timing of the sale) to claim the credit on their 2008 tax return that is due on April 15, 2009. They may also elect to extend their 2008 tax return by filing for an automatic extension. If they file their 2008 return before they have purchased the home, they may utilize this election and file an amended 2008 tax return.

My sister and I are both single and want to purchase a home together. Will we each receive a $7500 credit?

No. The purchase of a residence will generate a tax credit amount that will total up to $7500, no matter how many unmarried purchasers are buying the house.

My sister and I wish to purchase a home together. She previously owned a principal residence but sold it 2 years ago. I've never owned a residence. Can I qualify for a partial credit?

Possibly. The statute is somewhat ambiguous. It specifically provides that for a married couple to be eligible for the credit, both must be first-time homebuyers. Similarly, the statute provides that if a married couple files their tax return as Married Filing Separate, then the credit is limited to $3750 each. By contrast, the statute directs the IRS to determine how the credit can be shared when two or more unrelated individuals purchase a home. In that case, the statute does not specify whether all the unrelated purchasers must be first-time homebuyers.

I made an eligible purchase of a principal residence in May 2008. If my brother, also a first-time homebuyer, wishes to move in with me and purchase a partial interest in the home in 2009, will he qualify for the credit, as well?

No. Any purchase of a principal residence from a related party such as a sibling, parent, grandparent, aunt or uncle is ineligible for the tax credit. Since you and your brother are related in this way, he cannot qualify for the credit on any interest in the home that he purchases from you.

I'll be working outside the US for part of 2008, so part of my income will be eligible to be excluded from tax. I want to buy a home when I come back. Can I disregard my non-taxable overseas income when figuring whether I am eligible for the credit?

No. To determine whether you are eligible for the tax credit, you are required to combine your non-taxable overseas income with any US income you earn in 2008. Thus, if you are single and had $45,000 of non-taxable overseas income and $55,000 of US income, you would be ineligible for the tax credit because your 2008 income ($100,000) exceeded even the $95,000 phase-out amount. If you had $45,000 of non-taxable overseas income and $40,000 US income, you would qualify for a partial credit because your total income would be $80,000. If you had $45,000 non-taxable overseas income and $20,000 US income, you would qualify for the full credit (assuming you met all of the other requirements). Similar rules would apply if you had non-taxable overseas income in 2009 and wished to purchase then.

I live in the District of Columbia and am eligible for the DC Homebuyer Tax Credit. Can I use both credits?

No. You must choose one or the other. Note that the $5000 DC credit has no repayment feature, while the new $7500 credit must be repaid as an interest-free loan.

Repaying the Credit

What is the repayment feature of the credit?

The repayment feature of the credit is similar to a recapture provision: the tax system takes back all or part of a tax benefit. In this case, there is no precedent for repayment of an individual tax credit, so not much is known about how the repayment will occur, how it will be reflected at settlement or on the sales forms or how the IRS will collect and enforce the payments. The repayment is the equivalent of converting the tax credit into an interest-free loan.

What are the terms for repayment?

The credit amount is repaid in increments of 6.67% of the credit amount over 15 years. For individuals who take the full $7500 credit, the repayment will be $502.50 a year. Individuals who claim a credit of less than $7500 will also have a 15-year repayment period and will pay 6.67% of their credit each year. For example, an individual who claims a credit of $6000 will repay $400.20 a year ($6000 x .0667).

When do I make the payment?

The mechanics are not specified. Payments for credits claimed on 2008 tax returns will go into effect for the 2010 tax year. Payments for credits claimed on 2009 returns will go into effect for the 2011 tax year.

What if I sell my house before the 15-year repayment period is complete?

When the person who utilized the credit sells the home, any amount of tax credit that has not been repaid will be due in the year of sale. For example, if an individual still “owed” $4000 in repayments and realized $25,000 of proceeds from the sale, the $25,000 of proceeds would be reduced to $21,000 and $4000 will be remitted to the IRS.

What if there’s very little (or no) gain on the sale and the proceeds won’t cover the repayment amount?

If the proceeds of the sale don’t cover the amount that must be repaid, part of the liability is forgiven. For example, if the individual still “owed” $4000 but the gain on the sale was only $3500, then the seller would not be required to repay the IRS the $500 shortfall.

Are there any other exceptions to the repayment rules?

Yes. If the person who utilized the credit dies before the full credit amount has been repaid, then any balance that remains unpaid is disregarded. Special rules are provided that make adjustments for people who sell homes as part of a divorce before the credit has been fully repaid. Similarly, adjustments are made in the case of a home that is part of an involuntary conversion (property is destroyed in a natural disaster or subject to condemnation by eminent domain by an authorized agency).