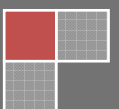


2009

Revised Home Buyer Tax Credit

Frequently Asked Questions and
Real World Examples

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In 2008 Congress enacted a \$7500 tax credit designated for first-time homebuyers to purchase a home. The credit was designed as a mechanism to decrease over-supply of homes for sale.

In February 2009 Congress increased the credit to \$8000 and made several additional improvements. This revised \$8000 tax credit applied to purchases on or after January 1st, 2009 and before December 1, 2009.

In November 2009 this tax credit was revised even further. The deadline was extended through June 30, 2010. Opportunities for tax benefits were also extended to long time homeowners. They are eligible for a \$6500 tax credit if they've lived in their home for at least 5 years.

Tax Credit – The Basics

1. *What's this new home buyer tax incentive and how is it different than the last one?*

The 2008 \$7500 repayable credit has been increased to \$8000 and the repayment feature is eliminated for 2009 purchasers.

For first time buyers: any home that is purchased for \$80,000 or more qualifies for the full \$8000 amount. If the house costs less than \$80,000 then that credit is 10% of the price of the home. Thus, if an individual purchased a home for \$75,000, the credit would be \$7,500. It is available for the purchase of a principal residence on or after January 1, 2009 and before June 30, 2010.

For long time home owners: The tax credit is equal to 10 percent of the home's purchase price up to a maximum of \$6,500. Purchases of homes priced above \$800,000 are not eligible for the tax credit.

2. *Who is eligible?*

First time home buyers and long time homeowners. A first time home buyer is defined as someone who has not had any ownership interest in a home in the three years prior to the day of purchase. A long time homeowner, or move-up home buyer, is defined as someone who has owned and resided in a home for at least five consecutive years of the eight years prior to the purchase date. For married taxpayers, the law tests the homeownership history of both the home buyer and his/her spouse. Repeat home buyers do not have to purchase a home that is more expensive than their previous home to qualify for the tax credit.



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3. *How does a tax credit work?*

Every dollar of a tax credit reduces income taxes by a dollar. Credits are claimed on an individual's income tax return. Thus, a qualified purchaser would figure out all the income items and exemptions and make all the calculations required to figure out his/her total tax due. Then, once the total tax owed has been computed, tax credits are applied to reduce the total tax bill. So, if before taking any credits on a tax return a person has total tax liability of \$9500, and \$8000 tax credit would wipe out all but \$1500 of the tax due.

4. *So what happens if the purchaser is eligible for an \$8000 credit but their entire income tax liability for the year is only \$6,000?*

This tax credit is what's called a "refundable" credit. Thus if the eligible purchaser's total tax liability was \$6000, the IRS would send the purchaser a check for \$2000. The refundable amount is the difference between the credit amount and the amount of tax liability. Most taxpayers determine their tax liability by referring to the tables that the IRS prepares each year.

5. *How does withholding affect my tax credit and my refund?*

A few examples are provided at the end of this document. There are several steps in this calculation, but most income tax software programs are equipped to make that determination.

6. *Is there an income restriction?*

Yes. As revised by the new credit, the income limit for single taxpayers is \$125,000; the limit is \$225,000 for married taxpayers filing a joint return. The tax credit amount is reduced for buyers with a modified adjusted gross income (MAGI) above those limits. The phase out range for the tax credit program is equal to \$20,000. That is, the tax credit amount is reduced to zero for taxpayers with MAGI of more than \$145,000 (single) or \$245,000 (married) and is reduced proportionally for taxpayers with MAGIs between these amounts.

7. *How is my "income" determined?*

For most individuals, income is defined and calculated in the same manner as their Adjusted Gross Income (AGI) on their 1040 income tax return. AGI includes items like wages, salaries, interest and dividends, pension and retirement earnings, rental income and a host of other



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elements. AGI is the final number that appears on the bottom line of the front page of an IRS Form 1040.

8. *What if I worked abroad for part of the year?*

Some individuals have earned income and/or received housing allowances while working outside of the U.S. Their income will be adjusted to reflect those items to measure Modified Adjusted Gross Income (MAGI). Their eligibility for the credit will be based on their MAGI.

9. *What's the definition of a "principal residence"?*

Generally, a principal residence is the home where an individual spends most of his/her time (generally defined as more than 50%). It is also defined as "owner-occupied" housing. The term includes single-family detached housing, condos or co-ops, townhouses or any similar type of new or existing dwelling. Even some houseboats or manufactured homes count as principal residences.

10. *Are there restrictions on the location of the property?*

Yes. The home must be located in the United States.

11. *Are there restrictions related to the financing for the mortgage on the property?*

In 2009, most financing arrangements are acceptable and will not affect eligibility for the credit. Congress eliminated the financing restriction that applied in 2008. (In 2008, purchasers were ineligible for the \$7500 credit if the financing was obtained by means of mortgage revenue bonds).

12. *Do I have to repay the 2009 tax credit?*

NO. There is no repayment for 2009 tax credits.

13. *Do 2008 purchasers still have to repay their tax credit?*

YES. The \$7500 credit in 2008 was more like an interest-free loan. All eligible purchasers who claimed the 2008 credit will still be required to repay it over 15 years, starting with their 2010 tax return.



Some Practical Questions

14. How do I apply for the credit?

There is no pre-purchase authorization, application, or approval process. All eligible purchasers simply claim the credit on their IRS Form 1040 tax return. The credit will be reflected on a new Form 5405 that will be attached to Form 1040. You can find these forms at www.irs.gov. Note that you cannot claim the credit on Form 5405 for an intended purchase for some future date; it must be a completed purchase. Home buyers must attach a copy of their HUD-1 settlement form (closing statement) to Form 5405 as proof of the completed home purchase.

15. So can I use the credit as part of my down payment?

Yes. Prospective home buyers who believe they qualify for the tax credit are permitted to reduce their income tax withholding. Reducing tax withholding (up to the amount of the credit) will enable the buyer to accumulate cash by raising his/her take home pay. This money can then be applied to the down payment.

Buyers should adjust their withholding amount on their W-4 via their employer or through their quarterly estimated tax payment. IRS Publication 919 contains rules and guidelines for income tax withholding. Prospective home buyers should note that if income tax withholding is reduced and the tax credit qualified purchase does not occur, then the individual would be liable for repayment to the IRS of income tax and possible interest charges and penalties.

In addition, rule changes made as part of the economic stimulus legislation allow home buyers to claim the tax credit and participate in a program financed by tax-exempt bonds. As a result, some state housing finance agencies have introduced programs that provide short-term second mortgage loans that may be used to fund a down payment. Prospective home buyers should check with their state housing finance agency to see if such a program is available in their community. To date, 18 state agencies have announced tax credit assistance programs, and more are expected to follow suit. The National Council of State Housing Agencies (NCSHA) has compiled a list of such programs.



Some Real World Examples

16. I purchased my home in early 2009 before the stimulus bill was enacted. I claimed a \$7500 tax credit on my 2008 return as prior law had permitted. Am I restricted to just a \$7500 credit?

No, you would qualify for the \$8000 credit. Eligible purchasers who have already claimed the \$7500 credit on a 2008 return for a 2009 purchase may file an amended return (IRS Form 1040x) for the 2008 tax year. This amended return will enable them to obtain the additional \$500 credit amount.

17. If I claim my 2009 \$8000 credit on my 2008 tax return, will I have to repay the credit just as the 2008 credits are repaid?

No. Congress anticipated this confusion and has made specific provision so that there would be no repayment of 2009 credits that are claimed on 2008 returns.

18. Will I ever have to repay any of the 2009 credit back to the government?

There is one situation which does require a recapture payment to the government. If you claim the credit but then sell the property within 3 years of the date of purchase, you are required to pay back the full amount of any credit, including any refund you received from it. A few exceptions apply. This provision is designed as an anti-flipping rule.

19. What if I die, or get divorced, or my property is ruined in a natural disaster within the 3 years?

The repayment rules are eased for many circumstances.

20. I have a home under construction. Am I eligible for the credit?

Yes, so long as you actually occupy the home before June 30, 2010.

If you have any additional questions about this federal tax provisions please give us a call or email us, we would happy to explain it further. If you are ready to start searching for the perfect home please visit our website www.prudentialprofessionalsrealty.com.