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The First-Time Homebuyer Tax Credit

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September 23, 2008

Abstract. The Housing Assistance Tax Act of 2008, part of the Housing and Economic Recovery Act of 2008 (P.L. 110-289), created a refundable tax credit for first-time homebuyers. First-time homebuyers generally include individuals who have not had a present interest in a principal residence within three years before buying the new property. The credit is based on 10% of the purchase price of the principal residence, but may not exceed \$7,500. The credit may be reduced or eliminated for married taxpayers with income over \$150,000 or other taxpayers with income over \$75,000. To be eligible for the credit, taxpayers must purchase property after April 8, 2008, and before July 1, 2009. The property must be used as the taxpayer's principal residence.

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The First-Time Homebuyer Tax Credit

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Summary

The Housing Assistance Tax Act of 2008, part of the Housing and Economic Recovery Act of 2008 (P.L. 110-289), created a refundable tax credit for first-time homebuyers. First-time homebuyers generally include individuals who have not had a present interest in a principal residence within three years before buying the new property. The credit is based on 10% of the purchase price of the principal residence, but may not exceed \$7,500. The credit may be reduced or eliminated for married taxpayers with income over \$150,000 or other taxpayers with income over \$75,000. To be eligible for the credit, taxpayers must purchase property after April 8, 2008, and before July 1, 2009. The property must be used as the taxpayer's principal residence.

The credit is refundable, but also must be repaid. Therefore it is similar to an interest-free loan. The payback period is fifteen years, but does not begin until two years after the purchase. So long as the taxpayer continues to own and use the property as a principal residence, the payback would be \$500 each year if the credit claimed had been \$7,500. However, if the taxpayer sells the property or ceases to use it as a principal residence, the entire outstanding credit generally becomes due for that tax year. Repayment may be waived if the taxpayer dies or if the sale of the property does not generate a gain under the special statutory calculation. Acceleration of the repayment will not be triggered if the property is transferred between spouses or between ex-spouses incident to a divorce. Involuntary conversion will also prevent acceleration of repayment if the property is replaced within two years.

Taxpayers must file a tax return in each year in which repayment of the credit is required even if they are not otherwise required to file a tax return for that year.

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Background and Introduction

In response to the housing crisis in 2007 and 2008, several bills in the 110th Congress proposed tax credits as a means of encouraging taxpayers to purchase a principal residence. The bills differed in some ways and were similar in others. Each required taxpayers to use the new property as their principal residence. Each also limited the credit to purchases within a prescribed time frame—generally one year or less. The maximum amount allowed for the credit ranged from \$7,000¹ to \$15,000,² with the largest amount credited over a three-year period. For one bill, only property that had been foreclosed would have qualified the buyer for a credit.³ For four others, actual foreclosure was not required. Instead, for seller-occupied property, the seller’s acquisition mortgage would have to be in default status for the buyer to qualify for the credit.⁴ Only one proposal required no link between the tax credit and some financial distress connected to the property.⁵ It, however, limited the credit to “first-time homebuyers”—a term that, as defined in the bill, includes some who have previously owned their own principal residence. This was the approach that was adopted by Congress in the Housing Assistance Tax Act of 2008. This act was included as Division C in the Housing and Economic Recovery Act of 2008, which became law on July 30, 2008.⁶ As enacted, the credit is available only for purchases made after April 8, 2008, and before July 1, 2009. Unlike the other proposed housing credits, the first-time homebuyer credit is refundable.⁷ Unlike other existing tax credits and the other proposed housing credits, in most cases the new first-time homebuyer tax credit is also repayable.

Who and What Qualifies for the Credit?

The credit is called the “First-time Homebuyer Credit.” Taxpayers must purchase property within a prescribed time period, use the property as their principal residence, and meet the definition of “first-time homebuyer” as provided in the law.

Who Is a First-time Homebuyer?

One might think that only someone who had never before purchased a principal residence could be considered a first-time homebuyer. However, the law is not that literal. A first-time homebuyer is an individual who, during the three-year period ending on the date of the purchase, has had no present interest in property used as that individual’s principal residence. If the individual is married, neither spouse may have had such an interest in the three-year period. Ownership of real

¹ H.R. 3221 § 603 (Engrossed Amendment as Agreed to by Senate) (hereinafter “H.R. 3221 EAS”). This provision was dropped from the final version of H.R. 3221 and replaced with the provision introduced in H.R. 5720.

² H.R. 5565 (companion to S. 2566); S. 12 § 303; S. 2566; S. 2734. H.R. 5720 § 131 proposed a maximum credit of \$7,500.

³ H.R. 3221 EAS.

⁴ H.R. 5565; S. 12; S. 2566; S. 2734.

⁵ H.R. 5720.

⁶ P.L. 110-289, § 3011.

⁷ Taxpayers may receive refunds of refundable credits. Additionally, these credits may be used against taxes other than income tax that are reported on Form 1040: self-employment tax, the additional tax on early distributions from IRAs and other retirement plans, household employment taxes, etc. In contrast, nonrefundable credits can only be used to reduce income tax (and, in some cases, alternative minimum tax) to zero. For most of these, any amount that exceeds income tax is simply lost. For a few, the unused portion can be carried forward to a subsequent year.

property that has not been used as a principal residence within the three-year period does not disqualify an individual for the tax credit. Examples of such property include vacation homes and rental or investment properties.

This definition of “first-time homebuyer” is less lenient than the one used for the credit for first-time homebuyers in the District of Columbia (D.C. Credit), which requires no present interest for only one year prior to the purchase.⁸ It is also less lenient than the one used to exclude early distributions from qualified retirement plans from the 10% additional tax.⁹ In that case, a first-time homebuyer is defined as one who has not had a present interest in a principal residence within the two-year period ending on the date the new property is acquired.

What Is a Principal Residence?

The code section that creates the credit does not explicitly define the term “principal residence.” The term is said to have “the same meaning as when used in section 121”¹⁰ of the Internal Revenue Code (IRC). Section 121 provides no explicit definition but uses the term and refers to situations in which property that might otherwise not be thought of as a principal residence will nonetheless be considered one.¹¹ However, a Treasury regulation provides guidance regarding property that may be considered a principal residence.¹²

According to regulation § 1.121-1, to be a principal residence, property must first be used as a residence. Facts and circumstances determine whether property is used as a residence. The regulation notes that “a houseboat, a house trailer, or the house or apartment that the taxpayer is entitled to occupy as a tenant-stockholder in a cooperative housing corporation”¹³ may be a residence, but personal property that is not a fixture under local law is not included.

A taxpayer may have more than one residence, but can have only one principal residence. When there is more than one residence, determining which of the residences is the principal one depends on facts and circumstances. Some of the factors that can be relevant are where the taxpayer works; where the taxpayer’s family lives; where the taxpayer banks; where the taxpayer attends religious services; where the taxpayer belongs to recreational clubs; the taxpayer’s usual mailing address for bills; and the addresses used on income tax returns, driver’s licenses, car registrations, and voter registrations. When a taxpayer relocates due to employment, the residence in the new location may or may not be the taxpayer’s principal residence. If the taxpayer’s family remains in the old location temporarily until a house is sold, a lease expires, or a school year is completed, the residence in the new location could be considered the taxpayer’s principal residence. However, if the taxpayer leaves the family indefinitely in the old location and lives in a small dwelling in the new location, it becomes more likely that the old residence will remain the taxpayer’s principal residence. Thus, if the taxpayer’s spouse and four children remain in a large rental property in another location, a small condominium purchased in the new location might not

⁸ 26 U.S.C. § 1400(c)(1).

⁹ 26 U.S.C. § 72(t)(2)(F), (8)(D)(i)(I).

¹⁰ 26 U.S.C. § 36(c)(2).

¹¹ See 26 U.S.C. § 121(d) (providing special rules for a variety of situations including use or ownership by only one spouse, ex-spouses, or decedents, as well as involuntary conversions, and non-use during periods of military service or when the taxpayer is incapable of self-care).

¹² 26 C.F.R. § 1.121-1.

¹³ 26 C.F.R. § 1.121-1(b)(1).

qualify as a principal residence. If it did not, the taxpayer would not be eligible for the first-time homebuyer's credit even if the condominium were the first real property ever purchased.

Even if a property is used as the taxpayer's principal residence when it is purchased, it will not qualify for the credit if it is not being used as the principal residence at the end of the tax year.¹⁴

What Is a Purchase?

The law defines a purchase as generally being “any acquisition,”¹⁵ but excludes certain acquisitions. As written, the law may be a bit ambiguous. It states the following:

36(c)(3) PURCHASE.—

(A) IN GENERAL.—The term “purchase” means any acquisition, but only if—

(i) the property is not acquired from a person related to the person acquiring such property, and

(ii) the basis of the property in the hands of the person acquiring such property is not determined—

(I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(II) under section 1014(a) (relating to property acquired from a decedent).

This can be read to mean that purchases from related parties do not qualify as purchases eligible for the tax credit if either of the basis provisions in § 36(c)(3)(A)(ii) applies, but could qualify if purchased from a related party at full fair market value. However, the provision could also be read to mean that any purchase from a related party is unqualified and that any purchase, even if not from a related party, is unqualified if either of the basis provisions applies.¹⁶

The “first-time homebuyer credit for District of Columbia” has a similar provision:

1400C(e)(2) PURCHASE.—

(A) IN GENERAL.—The term “purchase” means any acquisition, but only if—

(i) the property is not acquired from a person whose relationship to the person acquiring it would result in the disallowance of losses under section 267 or 707(b) (but, in applying section 267(b) and (c) for purposes of this section, paragraph (4) of section 267(c) shall be treated as providing that the family of an individual shall include only his spouse, ancestors, and lineal descendants), and

(ii) the basis of the property in the hands of the person acquiring it is not determined—

¹⁴ 26 U.S.C. § 36(d)(4).

¹⁵ 26 U.S.C. § 36(c)(3)(A).

¹⁶ For a discussion of basis, including times when the owner's basis may be determined by the basis of the previous holder, see CRS Report RL34662, *Tax Basis: What Is It? Why Is It Important?*, by Carol A. Pettit.

(I) in whole or in part by reference to the adjusted basis of such property in the hands of the person from whom acquired, or

(II) under section 1014(a) (relating to property acquired from a decedent).

A recognized tax commentary has interpreted this provision of the D.C. Credit to mean that purchases from related parties never qualify for that credit.¹⁷ However, it interpreted the similar provision in § 36 to mean that purchases from related parties were only disqualified if either of the basis provisions applies.¹⁸ The instructions for Form 8859, which is used to claim the D.C. Credit on the federal tax return, advise taxpayers, “[Y]ou *cannot* claim the credit if ... [y]ou acquired your home from certain related persons or by gift or inheritance.”

When Must the Property Be Purchased?

The credit is available only for principal residences purchased after April 8, 2008, and before July 1, 2009.¹⁹ If the residence is being constructed by the taxpayer, it will be considered purchased on the date when the taxpayer first occupies it.²⁰ Therefore, to qualify for the credit, new construction must be finished and occupied before July 1, 2009.

How Much Is the Credit?

The credit is calculated as 10% of the residence’s purchase price,²¹ which is defined as its adjusted basis in the taxpayer’s hands on the date of acquisition.²² However, the amount of the credit is limited in two ways—by dollar amount²³ and by modified adjusted gross income.²⁴

Dollar Limitation

The credit cannot be more than \$7,500. For married couples filing separate returns, it is limited to \$3,750 each.²⁵ When unmarried individuals purchase property together, with each using it as a principal residence, the total amount claimed between them cannot exceed \$7,500. The law states that the credit “shall be allocated among such individuals in such manner as the Secretary may prescribe.”²⁶ Currently there is no specific guidance to indicate whether the credit would be allocated according to each individual’s legal interest in the property, each individual’s financial

¹⁷ Stand. Tax Rep. (CCH) ¶ 32,429.035. Available at <http://tax.cchgroup.com>. It also notes that any property whose basis is determined by the seller’s basis or through a step-up in basis when inherited does not qualify for the credit.

¹⁸ Housing Assistance Tax Act of 2008: Law, Explanation, and Analysis (CCH) ¶ 205. Available at <http://tax.cchgroup.com>.

¹⁹ 26 U.S.C. § 36(h).

²⁰ 26 U.S.C. § 36(c)(3)(B).

²¹ 26 U.S.C. § 36(a).

²² 26 U.S.C. § 36(c)(4).

²³ 26 U.S.C. § 36(b)(1).

²⁴ 26 U.S.C. § 36(b)(2).

²⁵ There is no indication of how the total credit can be allocated within this limit. For a credit of \$7,500, the credit must be allocated equally between the spouses to remain within the limit. However, if the allowable credit is less than \$7,500, it would be possible to allocate a larger amount to one spouse than to the other without exceeding the limit.

²⁶ 26 U.S.C. § 36(b)(1)(C).

contribution to the purchase, or the individuals' own determination of allocation. However, the instructions for Form 8859—D.C. credit—say that “[i]f two or more unmarried individuals buy a main home, they can allocate the credit among the individual owners in any manner they choose” so long as the total amount allocated does not exceed the allowable credit.

Limitation Based on Modified Adjusted Gross Income

The credit may be reduced or eliminated for taxpayers whose “modified adjusted gross income” (MAGI)²⁷ exceeds the statutory thresholds. The threshold is \$150,000 for taxpayers who are married and file a joint federal tax return. For all other taxpayers, the threshold is \$75,000. The amount by which the credit is reduced is determined by a ratio, where \$20,000 is the denominator and the numerator is the difference between the taxpayer’s MAGI and the threshold amount. This ratio is multiplied by the otherwise allowable credit. If the MAGI exceeds the threshold amount by \$20,000 or more, the credit is reduced to zero.

Example of Credit Reduction for a Married Couple Who Files Jointly

Assume a married couple with no previous ownership interest in a principal residence purchases a house costing \$425,000. Since 10% of the purchase price is more than \$7,500, their credit is limited to \$7,500. If their MAGI is \$154,000, their credit would be \$6,000. These are the calculations:

$$\begin{aligned} \text{MAGI} - \text{threshold} &= \$154,000 - \$150,000 = \$4,000 \\ \$4,000/\$20,000 &= 20\% \text{ [reduction ratio]} \\ \$7,500 \times 20\% &= \$1,500 \text{ [reduction]} \\ \$7,500 - \$1,500 &= \$6,000 \text{ [allowable credit]} \end{aligned}$$

Example of Credit Elimination for a Single Taxpayer

Assume a single taxpayer with no previous ownership interest in a principal residence buys a condominium costing \$220,000. The credit is limited to \$7,500 since 10% of the purchase price would be greater than \$7,500. If the taxpayer’s MAGI is \$95,000, the credit would be eliminated. These are the calculations:

$$\begin{aligned} \text{MAGI} - \text{threshold} &= \$95,000 - \$75,000 = \$20,000 \\ \$20,000/\$20,000 &= 100\% \text{ [ratio]} \\ \$7,500 \times 100\% &= \$7,500 \text{ [reduction]} \\ \$7,500 - \$7,500 &= \$0 \text{ [allowable credit]} \end{aligned}$$

²⁷ “Modified adjusted gross income” (MAGI) is a term used in a number of tax situations and generally has a specific definition for each situation. Section 36 defines it as being adjusted gross income plus income earned abroad and excluded from income, 26 U.S.C. § 911; income excluded by residents of Guam, American Samoa, and the Northern Mariana Islands, 26 U.S.C. § 931; and income excluded by residents of Puerto Rico, 26 U.S.C. § 933. “Adjusted gross income” is total income minus adjustments (the bottom line of page 1 of Form 1040).

When Is the Credit Claimed?

The credit is claimed on the tax return for the tax year in which the property is purchased.²⁸ However, taxpayers who purchase a principal residence in the first six months of 2009 may choose to treat the property as if it had been purchased in 2008.²⁹ A taxpayer purchasing an eligible property before filing the 2008 tax return would be able to claim the credit on the original return for 2008. If a taxpayer had already filed the 2008 tax return, an amended return could be filed to claim the credit.

The advantage to claiming the credit on the 2008 tax return is that the credit could produce a refund sooner than if it were claimed on the 2009 return. In the case of a taxpayer who would otherwise have a balance due on the 2008 return, claiming the credit for 2008 would reduce or eliminate that balance due. The disadvantage of claiming the credit on the 2008 return is that the repayment period would begin one year sooner.

Taxpayers buying qualifying property in 2009 could effectively receive their credit before filing their 2009 return by adjusting the amount they pay in federal taxes for the remainder of the year. For taxpayers with wage income, this can be done by filing a new Form W-4 with the employer, increasing withholding allowances to adjust withholdings so that the total withheld for the year is reduced by an amount equal to their anticipated credit. Taxpayers who must pay quarterly estimated taxes can make similar adjustments to their quarterly payments. However, to avoid a possible penalty on underpayment of estimated taxes, they should adjust the payments equally rather than reducing the payment in early quarters by the entire amount of the credit.

Who Does Not Qualify for the Credit?

Even those who meet the definition of first-time homebuyer and purchase property to use as a principal residence within the time frame required by the statute may not qualify for the credit. Those not qualifying for the credit include

- non-resident aliens;³⁰
- purchasers who finance their new residence with the proceeds of a tax-exempt mortgage revenue bond;³¹ and
- those taxpayers (or their spouses) who also qualified for the first-time homebuyer credit in the District of Columbia in the current taxable year or in any prior taxable year.³²

²⁸ 26 U.S.C. § 36(a).

²⁹ 26 U.S.C. § 36(g).

³⁰ 26 U.S.C. § 36(d)(3).

³¹ 26 U.S.C. § 36(d)(2).

³² 26 U.S.C. § 36(d)(1). The statute is unclear regarding whether qualification for the D.C. credit (§ 1400C) for an earlier residence would disqualify the taxpayer for the § 36 credit on a new residence.

The Repayment Provision

The repayment provision for the first-time homebuyer tax credit is called “recapture” in the statute.³³ This is a term that is used for other credits; however, for those credits recapture generally is required only when the taxpayer ceases to qualify for the credit.³⁴ In contrast, the entire amount of the allowed first-time homebuyer credit must be repaid even if the taxpayer continues to live in the property as a principal residence for 30 years.

When and How Is the Credit Repaid?

The standard repayment is structured by recapturing 1/15 of the allowed first-time homebuyer tax credit on the taxpayer’s tax returns for each of fifteen consecutive tax years.³⁵ For taxpayers who were allowed the maximum credit, \$500 would be added to their tax return as a liability in each of fifteen consecutive tax years. This recapture begins two years after the tax year in which the property is purchased or deemed to be purchased.³⁶ Since recapture is reported on the taxpayer’s tax return, the taxpayer is required to file a tax return for each year in which repayment is due even if otherwise not required to file a return.³⁷

Recapture may be accelerated if the property is sold or is no longer used by the taxpayer as the taxpayer’s principal residence.³⁸ Generally, this means that any allowed credit that has not already been recaptured, must be recaptured in full on the tax return for the tax year in which the house is sold or otherwise ceases to be used as the taxpayer’s principal residence.

There are two situations in which repayment is waived completely. There are two other situations in which repayment is not accelerated when the taxpayer ceases to use the property as the principal residence.

When Is Repayment Waived?

Recapture of the outstanding credit may be waived in either of two situations: (1) a sale with no gain³⁹ or (2) the death of the taxpayer.⁴⁰

Sale of Property with No Taxable Gain

Generally, gain on the sale of property is determined by subtracting the adjusted basis of the property from the sale price and then subtracting the sales expenses.⁴¹ This remains the same for

³³ 26 U.S.C. § 36(f).

³⁴ See, e.g., 26 U.S.C. § 50 (recapture of some or all of the allowed investment credit when property ceases to be investment credit property within five years of being placed in service).

³⁵ 26 U.S.C. § 36(f)(1), (7).

³⁶ 26 U.S.C. § 36(f)(7).

³⁷ 26 U.S.C. § 36(f)(6).

³⁸ 26 U.S.C. § 36(f)(2).

³⁹ 26 U.S.C. § 36(f)(3).

⁴⁰ 26 U.S.C. § 36(f)(4)(A).

⁴¹ 26 U.S.C. § 1001.

determining the taxable gain for properties for which the first-time homebuyer tax credit was allowed. However, another calculation is required to determine whether the outstanding credit must be recaptured. In this case, the outstanding credit is subtracted from the adjusted basis of the property, reducing it. The taxpayer must use this amount as the adjusted basis for a new calculation of gain to determine whether the outstanding credit must be recaptured in the year of sale. If the new calculation results in gain, the outstanding credit, up to the amount of gain, must be recaptured. For this reason, taxpayers who make improvements to their property would be well-advised to keep careful record of the costs incurred since those costs would increase their adjusted basis in the property and possibly eliminate the need to repay the credit when the property is sold.

Example 1—Outstanding Credit Must Be Recaptured. Taxpayer purchases a house for \$250,000 and reports \$7,500 as the first-time homebuyer credit on Form 1040 in the year of purchase. Two years later, before repaying any of the credit and without doing anything that would change the basis of the property, the taxpayer moves to another state and must sell the property. The sales price is \$265,000. Expenses of sale are \$15,000. The taxpayer has no gain from the sale for income tax purposes:

\$265,000	Sales Price
-\$250,000	Adjusted Basis
-\$15,000	Sales Expense
\$0	Gain

However, to determine the extent to which the credit must be repaid, another gain calculation is required. For this calculation, the property’s basis is reduced by the amount of the credit that has not yet been repaid; therefore for this calculation, the adjusted basis is \$242,500 (\$250,000 - \$7,500 [the outstanding credit]). Using this number, there is a gain of \$7,500, so the entire \$7,500 credit must be recaptured on the tax return for the year in which the property is sold.

\$265,000	Sales Price
-\$242,500	Adjusted Basis
-\$15,000	Sales Expense
\$7,500	Gain

Example 2—Outstanding Credit Must Be Partially Recaptured. Assume the same facts as in the first example except that the sales price is \$260,000 and the property is sold four years after purchase. For both the second and third years after purchase, \$500 of the \$7,500 credit would have been recaptured on the taxpayer’s tax returns each year. Thus, \$1,000 has been recaptured, and the outstanding credit is \$6,500. Again, for tax purposes there is no gain.

\$260,000	Sales Price
-\$250,000	Adjusted Basis
-\$15,000	Sales Expense
-\$5,000	Loss

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However, the basis must be reduced by the outstanding credit to determine the amount of outstanding credit that must be recaptured. Since \$1,000 has been recaptured, only \$6,500 of the credit is still outstanding. When the basis is reduced by \$6,500, the result is \$243,500 (\$250,000 - \$6,500). Using this number in the gain calculation, there is a \$1,500 gain. Therefore, \$1,500 of the outstanding credit must be recaptured on the tax return in the year of sale, but the remaining \$5,000 will never be recaptured.

\$260,000	Sales Price
-\$243,500	Adjusted Basis
-\$15,000	Sales Expense
\$1,500	Gain

Example 3—No Recapture of Outstanding Credit. Use the same facts as in example 2, except that the sales expense is \$17,000. Again, there would be no gain for tax purposes:

\$260,000	Sales Price
-\$250,000	Adjusted Basis
-\$17,000	Sales Expense
-\$7,000	Loss

Again, the basis as reduced by the outstanding credit would be \$243,500 (\$250,000-\$6,500). In this case, however, the gain calculation to determine the required recapture of the outstanding credit would result in no gain. Therefore, none of the outstanding credit would be recaptured in the year of sale.

\$260,000	Sales Price
-\$243,500	Adjusted Basis
-\$17,000	Sales Expense
-\$500	Loss

Death of the Taxpayer

Repayment of the outstanding credit is also waived if the taxpayer dies. For property owned by a single taxpayer, this provision is clear—recapture of any outstanding credit is waived for tax years ending after the death of the taxpayer. For property that was purchased by more than one taxpayer, it appears that only the individual decedent’s portion of the outstanding credit is free from recapture, even if the credit was claimed by a married couple on a joint return.

The statute states that half of the credit allowed on a joint return is allocated to each spouse for purposes of the recapture provision. Therefore, it seems likely that, for these couples, only half of the outstanding credit will be free from recapture after the death of one spouse.

Where unmarried individuals purchased property together and allocated the credit between them, each has a separate repayment obligation based on the credit claimed. The death of one of the co-owners would not change the remaining owner’s own repayment obligation. Similarly, when

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couples who are married file separate returns, they each claim a specific amount of credit on which their separate repayment obligation would be based.

When Is Recapture not Accelerated?

Even though the taxpayer ceases to use the property as a principal residence, recapture of the credit is not accelerated if either of two circumstances exists: (1) involuntary conversion or (2) transfer between spouses or incident to divorce.

Involuntary Conversions

When property is destroyed, it is involuntarily converted.⁴² Likewise, if the property is taken under eminent domain, it is involuntarily converted. An involuntary conversion also occurs when a property owner agrees to sell property that is under “threat of condemnation,” which means that the property will be taken by eminent domain if the owner does not agree to sell. In each of these situations the taxpayer will cease to use the property as the principal residence. However, recapture will not be accelerated if a new principal residence is acquired within two years after the original property was sold or ceased being used as a principal residence.⁴³ The new principal residence would be substituted for the one that was involuntarily converted and recapture of the outstanding credit would proceed along the 15-year scheduled payback period just as if there had been no disruption in usage. Note that the new principal residence cannot be property that was owned by the taxpayer before the qualifying residence was involuntarily converted.

Transfers Between Spouses or Incident to Divorce

Generally, property can be freely transferred between spouses with no recognition of gain or loss. Transfers between former spouses enjoy this benefit only when the transfer is incident to the divorce between the two.⁴⁴ The recapture provisions of the first-time homebuyer tax credit allow such transfers to occur without accelerating recapture of the outstanding credit, even when one of the parties ceases to use the property as a principal residence.⁴⁵ Additionally, the party who transferred the property is relieved of all subsequent repayment obligations. The party to whom the property was transferred becomes responsible for both the yearly recapture of the outstanding credit as well as accelerated recapture if the property is later sold or ceases to be used as a principal residence.

There is no parallel provision to allow unmarried co-owners to transfer the repayment obligations to another owner if the property is transferred to the other owner. Additionally, for those taxpayers, their own outstanding credit generally would be repayable in the tax year in which the transfer occurred.

⁴² See 26 U.S.C. § 1033(a).

⁴³ 26 U.S.C. § 36(f)(4)(B).

⁴⁴ See 26 U.S.C. § 1041(a).

⁴⁵ 26 U.S.C. § 36(f)(4)(C)(i).

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