First-time homebuyer tax credit FAQs (and answers)

Last year, Congress enacted a $7,500 tax credit designed to be an incentive for first-time homebuyers to purchase a home. The credit was designed as a mechanism to decrease the over-supply of homes for sale.

This year, Congress has increased the credit to $8,000 and made several additional improvements. This revised $8,000 tax credit applies to purchases on or after Jan. 1, 2009, and before Dec. 1, 2009.

Amy Clendenin, executive vice president of the Kanawha Valley Board of Realtors, suggests that area first-time homebuyers pondering taking advantage of this incentive seek professional assistance at the outset.

"I would definitely contact a Realtor first; they can help you plan and give you peace of mind and walk you through the process," said Clendenin. "I would also check with a financial advisor, to check the rates — they haven't been this low in forever — it's been a long time."

"Now's the time to jump," Clendenin added. "Trying to figure this out by yourself, it's tough. But with the stimulus package and current financial situation and mortgage rates where they are now, it's really a good time to move, whether you're buying or selling."

Below are some basic questions and answers on the first-time homebuyer tax credit, as listed on the National Association of Realtors' Web site:

1. What's this new homebuyer tax incentive for 2009?

The 2008 $7,500, repayable credit is increased to $8,000 and the repayment feature is eliminated for 2009 purchasers. Any home that is purchased for $80,000 or more qualifies for the full $8,000 amount. If the house costs less than $80,000, the credit will be 10 percent of the cost. 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 Jan. 1, 2009 and before Dec. 1, 2009.

2. Who is eligible?

Only first-time homebuyers are eligible. A person is considered a first-time buyer if he/she has not had any ownership interest in a home in the three years previous to the day of the 2009 purchase.

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 $9,500, an $8,000 credit would wipe out all but $1,500 of the tax due. ($9,500 - $8,000 = $1,500)

4. So what happens if the purchaser is eligible for an $8,000 credit but their entire income tax liability for the year is only $6,000?

This tax credit is what's called "refundable" credit. Thus, if the eligible purchaser's total tax liability was $6,000, the IRS would send the purchaser a check for $2,000. The refundable amount is the difference between $8,000 credit amount and the amount of tax liability. ($8,000 - $6,000 = $2,000) Most taxpayers determine their tax liability by referring to 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. The income restriction is based on the tax filing status the purchaser claims when filing his/her income tax return. Individuals filing Form 1040 as Single (or Head of Household) are eligible for the credit if their income is no more than $75,000. Married couples who file a Joint return may have income of no more than $150,000.

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 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 receive housing allowances while working outside the United States. 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. Do individuals with incomes higher than the $75,000 or $150,000 limits lose all the benefit of the credit?

Not always. The credit phases-out between $75,000-$95,000 for singles and $150,000-$170,000 for married filing joint. The closer a buyer comes to the maximum phase-out amount, the smaller the credit will be. The law provides a formula to gradually withdraw the credit. Thus, the credit will disappear after an individual's income reaches $95,000 (single return) or $170,000 (joint return). For example, if a married couple had income of $165,000, their credit would be reduced by 75 percent as shown:

Couple's income: $165,000

Income limit: $150,000

Excess income: $15,000

The excess income amount ($15,000 in this example) is used to form a fraction. The numerator of the fraction is the excess income amount ($15,000). The denominator is $20,000 (specified by the statute).

In this example, the disallowed portion of the credit is 75 percent of $8,000, or $6,000 ($15,000/$20,000 = 75 percent x $8,000 = $6,000) Stated another way, only 25 percent of the credit amount would be allowed. In this example, the allowable credit would be $2,000 (25 percent x $8,000 = $2,000)

10. What's the definition of "principal residence?"

Generally, a principal residence is the home where an individual spends most of his/her time (generally defined as more than 50 percent). 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.

11. Are there restrictions on the location of the property?

Yes. The home must be located in the United States. Property located outside the United States is not eligible for the credit.

12. 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 $7,500 credit if the financing was obtained by means of mortgage revenue bonds.) Now, mortgage-revenue bond financing will not disqualify an otherwise-eligible purchaser. (Mortgage revenue bonds are tax-exempt bonds issued by a state housing agency. Proceeds from the bonds must be used for below market loans to qualified buyers.)

13. Do I have to repay the 2009 tax credit?

NO. There is no repayment for 2009 tax credits.

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

YES. The $7,500 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

15. How do I apply for the credit?

There is no pre-purchase authorization, application or similar 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 the 1040. Form 5405 can be found at www.irs.gov.

16. So I can't use the credit amount as part of my down payment?

No. Congress tried hard to devise a mechanism that would make the funds available for closing costs, 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.

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

Yes, there is. Any first-time homebuyers who believe they are eligible for all or part of the credit can modify their income tax withholding (through their employers) or adjust 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 withholding would decrease and their take-home pay would increase. Those who make estimated tax payments would make similar adjustments.

Some "Real World" Examples

18. What if I purchase later this year but can't get to settlement before Dec. 1?

The credit is available for purchases before Dec. 1, 2009. A home is considered as "purchased" when all events have occurred that transfer the title from the seller to the new purchaser. Thus, closings must occur before Dec. 1, 2009 for purchases to be eligible for the credit.

19. I haven't even filed my 2008 tax return yet. If I buy in 2009, do I have to wait until next year to get the benefit of the credit?

You'll have a helpful choice that might speed up the process. Eligible homebuyers who make their purchase between Jan. 1, 2009 and Dec. 1, 2009 can treat the purchase as if it had occurred on Dec. 31, 2008. Thus, they can claim the credit on their 2008 tax return that is due on April 15, 2009. They actually have three filing options.

* If they purchase between Jan. 1, 2009 and April 15, 2009, they can claim the $8,000 credit on the 2008 return due on April 15.

* They can extend their 2008 income-tax filing until as late as Oct. 15, 2009. (The IRS grants automatic extensions, but the taxpayer must file for the extension. See www.irs.gov for instructions on how to obtain an extension.)

* If they have filed their 2008 return before they purchase the home, they may file an amended 2008 tax return on Form 1040X. (Form 1040X is available at www.irs.gov)

Of course, 2009 purchasers will always have the option of claiming the credit for the 2009 purchase on their 2009 return. Their 2009 tax return is due on April 15, 2010.

20. I purchased my home in early 2009 before the stimulus bill was enacted. I claimed a $7,500 tax credit on my 2008 return as prior law had permitted. Am I restricted to just a $7,500 credit?

No, you would qualify for the $8,000 credit. Eligible purchasers who have already claimed the $7,500 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.