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Beginner's Luck

Interest-Free Government Loans for First-Time Homebuyers

By Jerrold J. Stern

First-time homeowners may benefit from a \$7,500 interest-free loan available through the 2008 Housing Assistance Tax Act. The credit is equivalent to a 15-year interest-free loan with a term starting two years after purchase.

Technically called a "refundable tax credit" and provided through the tax system, 1/15th (6⅔ percent) of the "credit" must be paid back to the government each year for 15 years starting in 2010 (for 2008 purchases) or 2011 (for 2009 purchases). Qualifying homes must be purchased and occupied after April 8, 2008, and before July 1, 2009.

The loan principal is 10 percent of the purchase price up to a maximum of \$7,500. The maximum loan, which is \$3,750 for married taxpayers filing separate tax returns, is available on homes costing \$75,000 or more.

The loan's availability is phased out "ratably" (evenly) for taxpayers with adjusted gross income (salary, wages, commissions) between \$75,000 and \$95,000 (\$150,000 and \$170,000 for married taxpayers filing jointly). Taxpayers in the middle of these ranges are eligible for only one-half the loan amount. The credit can be taken against regular tax liability or alternative minimum tax liability.

The credit is refundable. For example, if tax liability is \$5,000 without the credit, a taxpayer with a \$7,500 credit would receive a refund of \$2,500 from the government.

If a home is purchased before July 1, 2009, the taxpayer may claim the purchase on the 2008 tax return and receive the benefits when that return (or an amended return) is filed. If the taxpayer's adjusted gross income is higher than the threshold in 2008 but is expected to be below the threshold in 2009, the taxpayer would likely be better off by including the transaction on the 2009 tax return.

If the home is sold before the loan is repaid, part or all of the credit balance

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is likely due at that time. For example, assume a \$7,500 credit was received in 2008 and the home is sold 12 years later. During those 12 years, ten years of loan payments have been made, or \$5,000 (ten years times 6⅔ percent of \$7,500).

If the home is sold at a gain of \$2,500 or more, the entire \$2,500 balance becomes due. If the home is sold at a loss, none of the remaining loan balance is payable. If the gain is less than \$2,500, then that is the amount due. The loan balance is not included in the home's cost basis when making the gain calculation.

In the example, if the home's cost basis is \$80,000, the basis becomes \$77,500 for

purposes of loan repayment computations. If the sale price is \$78,500, only \$1,000 of the loan balance must be repaid.

For the purpose of this tax credit, a first-time homebuyer is someone who, along with his or her spouse, has not owned a principal residence during the previous three years. Thus, a homeowner who owned Home No. 1 for ten years through November 2005, and then purchased Home No. 2 in December 2008 would be considered a first-time homebuyer with respect to Home No. 2. If the person's spouse owned a principal residence during the

three years prior to Home No. 2, neither spouse qualifies for the credit for Home No. 2 even if they file separate tax returns.

Only "principal residences" qualify for the credit. Such residences are those used as primary homes more than one-half of the year and include beach houses, condos, houseboats or house trailers as well as traditional single-family homes.

A residence does not qualify for the credit if it was acquired from a relative (other than a sibling) as a gift or as an inheritance. Special rules pertain to transactions that are part sale and part gift. There is no recapture if the taxpayer dies before the loan is repaid. In case of divorce, payback of the loan still applies to whichever spouse continues to own the home.

While an interest-free loan is valuable, details and special rules add complexity. Consultation with a tax accountant or tax attorney is recommended. ♣

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THE TAKEAWAY

First-time homeowners may benefit from a \$7,500 interest-free government loan for homes purchased and occupied after April 8, 2008, and before July 1, 2009. The loan is repaid over 15 years. The loan balance is forgiven if the home is sold at a loss before the 15-year term ends.



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