

Certified Public Accountants

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Dear Clients and friends:

H.R. 3221, the “American Housing Rescue and Foreclosure Prevention Act of 2008” was signed into law by the President on July 30, 2008. This sweeping measure is designed to shore up the ailing housing market as well as tighten lending practices and reform financial institutions associated with that market. It also contains a number of tax changes in Division C of H.R. 3221, the “Housing Assistance Tax Act of 2008,”—the 2008 Housing Act—including tax breaks for homebuyers and homeowners, relaxed requirements for tax-exempt bonds, eased AMT rules, tax changes for businesses, as well as highly specialized changes affecting low-income housing and special investment vehicles called Real Estate Investment Trusts (REITs). Included below are the provisions which we feel most effect our client base.

Property tax deduction for non-itemizers in the 2008 Housing Act

Included in the \$15.1 billion package of housing tax incentives in the recently enacted Housing Act is a measure creating a new, temporary property tax deduction for non-itemizers (i.e., for taxpayers who claim the standard deduction rather than itemizing their deductions). Here is a brief overview of this new provision:

- The provision creates a new standard deduction for state and local real property taxes paid by non-itemizers. Since most homeowners who are paying on a mortgage have enough deductions (e.g., mortgage interest and property taxes) to justify itemizing them on their return, this new provision chiefly benefits homeowners who have paid off their homes.
- **The deduction is available only for one year--for tax years beginning in 2008.**
- The amount of deduction is as much as \$500 for single filers and \$1,000 for joint filers. Since this is a deduction and not a credit (i.e., a dollar-for-dollar reduction in tax liability), the actual tax benefit will not be substantial, for example, a maximum of \$100 to a couple in the 10 percent tax bracket and \$150 to a couple in the 15 percent bracket (and only \$50 and \$75, respectively, to singles in these brackets).

- The deduction isn't limited to taxes paid on a principal residence. Thus, for example, it may be claimed for state and local taxes paid on a vacation home as well as a principal residence.

Credit for first-time homebuyers in the 2008 Housing Act

The single largest provision in the \$15.1 billion package of housing tax incentives in the recently enacted Housing Act is a measure allowing individuals buying their first home to take a tax credit of up to \$7,500 of the purchase price. Qualified homebuyers can subtract the credit amount from their federal income tax when they buy a home and even get a refund if the credit exceeds the tax. **However, they are then required to pay the credit back over 15 years.** The result is that the credit resembles an interest-free loan that must be repaid to the government. Here are the details of the new credit:

- The home must be located in the U.S. and must be the taxpayer's principal residence (main home). The taxpayer (and the taxpayer's spouse if married) must not have owned another principal residence in the U.S. in the three-year period before purchasing the new home. Thus, the home doesn't literally have to be the taxpayer's first home.
- The home must have been purchased from April 9, 2008 through June 30, 2009, inclusive. Purchases from certain related persons and acquisitions by gift or inheritance don't qualify. A home constructed by the taxpayer does qualify if the taxpayer moves in from April 9, 2008 through June 30, 2009.
- A special rule allows taxpayers who purchase a principal residence in the first six months of 2009 to treat the purchase as if made on Dec. 31, 2008. This allows the taxpayer to claim the credit for 2008 rather than 2009.
- The credit is equal to 10% of the price paid for the home, up to a maximum of \$7,500. The \$7,500 maximum credit applies both to individuals and married couples filing a joint return. A married individual filing separately can claim a maximum credit of \$3,750.
- The credit is phased out for individual taxpayers with modified adjusted gross income (AGI) between \$75,000 and \$95,000 (\$150,000 and \$170,000 for joint filers) for the year of purchase. Taxpayers with modified AGI over \$95,000 (\$170,000 for joint filers) can't claim the credit.
- The credit is refundable, meaning that households with incomes too low to owe income tax can benefit from it.
- In the second year after purchase, taxpayers who took the credit must start paying back the credit in equal installments over 15 years, with no interest charge. This works as follows. Suppose a first-time homebuyer purchases a home for \$100,000 this coming December and claims the maximum credit of \$7,500 on his 2008 tax return. He would then be required to pay back \$500 (one-fifteenth of the credit) on his tax return for 2010 and for each of the following 14 years, through 2024.
- **If the taxpayer sells the home (or the home ceases to be the principal residence of the taxpayer or the taxpayer's spouse) before complete**

repayment of the credit, any remaining credit is due on the tax return for the year in which the home is sold (or ceases to be the principal residence). If the home was sold at a loss to an unrelated person, repayment of the remaining credit is forgiven to the extent of the loss.

- No credit is allowed if: the taxpayer was ever entitled to a D.C. homebuyer credit; the home purchase was financed through tax-exempt mortgage revenue bonds; the taxpayer is a nonresident alien; or the taxpayer disposes of the residence (or it ceases to be a principal residence) in the year of purchase.

Tightened homesale exclusion and other revenue raisers in the 2008 Housing Act

To pay for the \$15.1 billion of housing tax incentives in the recently enacted Housing Act, Congress passed several offsetting revenue raisers, including a requirement that banks provide information returns reporting annual credit card sales to IRS and to merchants, a provision requiring homeowners to pay tax on gains made from the sale of a second home to reflect the portion of time the home was used as a vacation or rental property, and a provision delaying for one year a “worldwide interest allocation provision” that would result in lower taxes for some multinational companies. Here are the details of these revenue-raising provisions.

Payment card and third party network information reporting

For returns for calendar years beginning after 2010, the new law requires banks and online payment networks to file an information return with IRS reporting the gross amount of credit and debit card payments a merchant receives during the year, along with the merchant's name, address, and taxpayer identification number (TIN). Reporting is also required for third party network transactions. Information reporting for third party network transactions will be required only for merchants that have (1) annual credit and debit card transactions exceeding \$20,000 in the aggregate, and (2) an aggregate number of such transactions during the year that exceeds 200.

Home sale exclusion rules tightened

Most homeowners are aware of the home sale exclusion, a provision of the tax laws which provides that homeowners who sell their principal residence typically don't need to pay taxes on as much as \$500,000 of their gain if they meet certain conditions. (The \$500,000 exemption is the maximum exclusion for a married couple filing jointly; taxpayers filing individually get an exemption of up to \$250,000.) To be eligible for the full exclusion, a taxpayer must have owned the home—and lived in it as his or her principal residence—for at least two of the five years prior to the sale. Because of the “principal residence” requirement, vacation or second homes normally don't qualify for the exclusion. However, in what some saw as a loophole, the law permitted taxpayers to convert their second home to their principal residence, live in it for two years, sell it, and

take the full \$250,000/\$500,000 exclusion available for principal residences, even though portions of their gains were attributable to periods when the property was used as a vacation or second home, not a principal residence.

The new law closes that “loophole” by requiring homeowners to pay taxes on gains made from the sale of a second home to reflect the portion of time the home was not used as a principal residence (e.g, vacation or rental property). The amount taxed will be based on the portion of the time during which the taxpayer owned the home that the house was used as a vacation home or rented out. The rest of the gain remains eligible for the up-to-\$500,000 exclusion, as long as the two-out-of-five year usage and ownership tests are met. The new law in effect reduces the exclusion based on the ratio of years of use as a principal residence to the total time of ownership. For example, if a taxpayer owned a vacation home for ten years, but lived in it as a principal residence only for the final two years prior to sale, the maximum available exclusion would be reduced by four-fifths. Accordingly, a \$400,000 gain on the sale that would be eligible for the full exclusion under pre-Act law would be reduced by four-fifths, to \$80,000.

The good news for current owners of second homes is that the new law is not retroactive. The tightening applies only to sales after 2008. Plus, any periods of personal or rental use before 2009 are ignored for purposes of the provision. Also, the new law doesn't change the rule that allows homeowners to take advantage of the home sale exclusion every two years. Taxpayers can still “home hop” with full tax exclusion if they only own one home at a time. Moreover, the taxpayer still qualifies for capital gain treatment on the amount of gain that cannot be excluded.

Delayed implementation of worldwide allocation of interest

In 2004, Congress provided taxpayers with an election to take advantage of a liberalized rule for allocating interest expenses between U.S. sources and foreign sources for purposes of determining a taxpayer's foreign tax credit limitation. Although enacted in 2004, this election was not scheduled to be available to taxpayers until tax years beginning after 2008. The new law delays the phase-in of this new liberalized rule for two years (to tax years beginning after 2010). Special transition rules apply in the first year that the liberalized rule phases in.

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