



## Tax Action Memo® TAM-1300

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### Tax Changes in the New Housing Act

The American Housing Rescue and Foreclosure Prevention Act of 2008 (the Housing Act) became law on 7/30/08. The legislation includes a host of tax changes. Among them are three that will affect many individuals. Other provisions will affect various types of taxpayers. This letter summarizes what we think are the most important points.

#### Temporary Tax Credit for First-time Homebuyers

The Housing Act creates a temporary new federal income tax credit for so-called first-time homebuyers. The maximum credit equals the lesser of: (1) 10% of the purchase price of a principal residence or (2) \$7,500 (or \$3,750 for those who use married filing separate status). The credit is refundable, which means it can be used to offset your entire federal income tax liability with any remaining credit refunded to you. However, you are only eligible if you have not owned a principal residence in the U.S. during the three-year period that ends on the purchase date. According to Congress, this makes you a first-time homebuyer.

The credit is generally available for principal residence purchases after 4/8/08 and before 7/1/09. For a newly constructed home, the purchase date is considered to be the date you move in. However, if you purchase a residence from your spouse, ancestor (parent, grandparent, and so on), lineal descendant (child, grandchild, and so on), or certain other related parties, you will be ineligible for the credit.

If you make a qualified home purchase in 2009 (before the 7/1/09 deadline), you can choose to treat the transaction as if it happened in 2008 and get your credit sooner by claiming it on your 2008 Form 1040.

**Phased-out Rule Affects More-prosperous Individuals.** The credit is phased-out or completely eliminated if your adjusted gross income (AGI) is too high. The phase-out range for unmarried individuals and married individuals who file separately is between AGI of \$75,000 and \$95,000. The phase-out range for married joint filers is between AGI of \$150,000 and \$170,000.

**Credit Must Be Repaid.** Strangely enough, the new credit is really just a loan from the government. You must repay it (without interest) over 15 years starting with the second year after the year the credit is claimed on your Form 1040. Each year's repayment will be added to the tax bill shown on your Form 1040 for that year.

In addition, if you sell the home or stop using it as your principal residence before the credit has been repaid, an accelerated repayment rule may apply. If so, the unpaid credit balance must be paid with your Form 1040 for the year when the triggering event occurs.

#### Temporary Property Tax Deduction for Non-itemizers

For 2008 only, an unmarried taxpayer who doesn't itemize can add up to \$500 of state and local real property taxes to the normal standard deduction amount. The same \$500 allowance applies to a married person who files separately. Married joint filers can add up to \$1,000 to the standard deduction amount. However, the additional standard deduction can't exceed the amount of state and local property taxes you actually pay during 2008. Counting the new addition, the maximum 2008 standard deduction figures will generally be: (1) \$11,900 for married filing joint status, (2) \$5,950 for single and married filing separate filing status, and (3) \$8,500 for head of household filing status. (Amounts are higher for elderly and blind individuals.)

## **Unfavorable New Rule for Properties Converted into Principal Residences**

Under current law, you can convert a former rental property or vacation home into your principal residence, live in it for at least two years, sell it, and take advantage of the federal home-gain exclusion privilege. The maximum exclusion is \$250,000 for unmarried individuals and \$500,000 for married joint filers.

For sales that occur after 2008, however, an unfavorable new rule can delete some of the tax savings from the conversion strategy—based on the amount of post-2008 time that you don't use the property as your principal residence. More specifically, the new rule makes a portion of your gain from selling the residence ineligible for the gain exclusion privilege, as illustrated by the following example.

**Example:** Say you bought a vacation home in an exclusive area on 1/1/05. On 1/1/11, you convert the property into your principal residence. Then you and your spouse live there for all of 2011 and 2012. On 1/1/13, you sell the home for a \$450,000 gain. Your total ownership period is eight years (2005 - 2012). However, the two years of post-2008 use as a vacation home (2009 - 2010) count against you and result in a non-excludable gain of \$112,500 ( $2/8 \times \$450,000$ ). You must report the \$112,500 as capital gain income on your 2013 Schedule D and pay the resulting federal income tax hit. If you file jointly, you can claim the \$500,000 gain exclusion which will shelter the remaining \$337,500 of gain ( $\$450,000 - \$112,500$ ). However, if you sold the residence under the same circumstances in 2008, your \$450,000 gain would be entirely federal-income-tax-free.

## **Snapshots of Other Important Changes**

With the preceding "Big Three" tax changes covered, the remainder of this letter is devoted to necessarily brief descriptions of other changes that we think are the most likely to affect you, your business, and your investments.

- *Corporations Can Use R&D and MTC Carryovers Instead of Claiming Bonus Depreciation.* Effective for tax years ending after 3/31/08, corporations that are eligible to claim 50% first-year bonus depreciation can elect to forego it and instead utilize R&D and minimum tax credit (MTC) carryovers equal to 20% of the foregone depreciation. However, this option is only available with respect to bonus depreciation on qualified assets that are: (1) purchased after 3/31/08 and (2) placed in service by 12/31/08 (or by 12/31/09 for certain long-lived assets and transportation property). The foregone bonus depreciation amount cannot exceed the lesser of: (1) \$30 million or (2) 6% of the sum of the corporation's R&D credit carryover and MTC carryover from tax years beginning before 2006. The assets to which the election applies must be depreciated using the straight-line method.

**Note:** Making the election doesn't result in any lost depreciation deductions. It just postpones deductions for affected assets.

- *Required Information Reporting for Credit Card and Third-party Payment Network Sales.* Starting in 2011, new Form 1099 information reporting requirements will apply to payments to merchants that are made via: (1) credit and debit cards and (2) third-party settlement organizations that facilitate online sales transactions conducted under the auspices of third-party payment networks. For example, PayPal would be a third-party settlement organization, and eBay would be a third-party payment network. However, the third-party settlement organization reporting requirement will only apply to merchants that are paid over \$20,000 for the year and have over 200 transactions for the year. Information that must be reported on Form 1099 will include the gross amount paid to the merchant during the year along with the merchant's name, address, and taxpayer identification number.
- *Favorable Changes to Low-income Housing and Rehab Credit Rules.* Various taxpayer-friendly modifications and simplifications were made to the low-income housing and rehabilitation tax credit rules.
- *Low-income Housing and Rehab Credits Can Be Used against AMT.* Effective for buildings placed in service after 12/31/07, the low-income housing tax credit can be used to offset a taxpayer's alternative minimum tax (AMT) liability. Effective for qualified expenses taken into account after 12/31/07, the rehabilitation tax credit can also be used to offset the AMT.
- *Interest from Some Tax-exempt Bonds No Longer Added Back for AMT.* Interest income from the certain types of tax-exempt bonds issued after 7/30/08 will no longer constitute an individual AMT preference item or a corporate minimum tax adjusted current earnings (ACE) adjustment item. Bonds qualifying for this new rule are exempt facility bonds issued as part of an issue from which 95% or more of the proceeds are used for qualified residential rental projects, qualified mortgage bonds, and qualified veterans' mortgage bonds.
- *Interest from FHLB-backed State and Local Bonds Can Be Tax-exempt.* Provided certain financial safety and soundness standards are met, guarantees of state and local bonds by the Federal Home Loan Bank (FHLB) will no longer cause the interest income from the bonds to be taxable rather than tax-exempt.