Raj Patel, CPA, LLC
Raj Patel, CPA PFS ACA M COM DTP LLB
1585 Oak Tree Road, Suite 203
Kumar Soni Plaza
Iselin, NJ 08830
(732) 283-9090
Fax: (732) 283-9091
Raj@RPatelCPA.com
www.RajPatelCPA.com

The Housing and Economic Recovery Act of 2008

H.R. 3221, the Housing and Economic Recovery Act of 2008 (the Act) was signed by the President on July 30, 2008. The legislation includes the following provisions.

First-time homebuyer tax credit

The first-time homebuyer credit is a temporary, refundable tax credit equal to 10% of the purchase price of a principal residence, up to $7,500 ($3,750 if married filing separately).

To qualify as a first-time homebuyer, you must not have had an ownership interest in a principal residence in the United States for the three-year period immediately preceding the purchase.

This "credit," however, is essentially an interest-free loan. Two years after you claim the credit, you must start paying it back. Repayments are made over 15 years in equal installments. So, if you claim a $7,500 credit on your 2008 tax return, you would start paying back $500 a year with your 2010 return.

If you sell the home during the 15-year period, any remaining credit payback will be due from the gain on the home sale. If there is insufficient gain or if you die during the 15-year period, the remaining credit payback will generally be forgiven (the remaining unpaid credit is subtracted from your adjusted basis to determine gain). If the home ceases to be the principal residence of you or your spouse during the repayment period, repayments will be accelerated.

The credit starts phasing out for taxpayers with $75,000 of modified adjusted gross income (MAGI) ($150,000 if married filing jointly). The credit is completely phased out for taxpayers with $95,000 MAGI ($170,000 if married filing jointly).

The qualifying home must be purchased on or after April 9, 2008, and before July 1, 2009, and eligible taxpayers must claim the credit on their 2008 or 2009 tax return. You can elect to treat the purchase of a home during the eligible portion of 2009 as if it took place on December 31, 2008.

Additional standard deduction for non-itemizers

The Act allows homeowners who do not itemize deductions to claim an additional standard deduction for real property taxes. The additional amount that can be claimed is the lower of:

- The amount of real estate property taxes paid during the year to state and local governments, or
- $500 ($1,000 if married filing jointly)

This additional standard deduction applies to tax year 2008 only--it is not available for any other tax year.

Modified homesale exclusion for nonqualifying use

When homeowners sell their primary residence, they can generally exclude from income up to $250,000 ($500,000 if married filing jointly) in capital gain. To qualify, the homeowner must have owned and lived in the home for at least two years out of the five years prior to the sale.

The Act changes the rules so that the exclusion amount will be reduced for any period of "nonqualifying use." Nonqualifying use essentially means any period of time beginning on or after January 1, 2009, that the home was not used as a principal residence by the homeowner or the homeowner's spouse (e.g., the home was rented out, or was used as a second or vacation home).

Special exceptions apply if the home ceases to be a primary residence during the five-year testing period (nonqualifying use doesn't include any period of time during the five-year testing period after the last date the home was used as a primary residence), and for certain temporary absences of up to two years.

The Act also authorizes the Treasury to make loans to and buy stock from the GSEs to make sure that Fannie Mae and Freddie Mac do not fail.

Fannie Mae and Freddie Mac reform

Fannie Mae and Freddie Mac are government-sponsored entities (GSEs). Their primary purpose is to purchase mortgage-backed securities. The Act creates an independent agency to regulate these GSEs. Further, the Act permanently sets the conforming loan limits (a conforming loan is a home loan that qualifies for purchase by a GSE) at the greater of $417,000 or 115% of the local area median home price (capped at $625,500), effective January 1, 2009. This also

See disclaimer on final page

sets the loan limits for jumbo loans (loans over the conforming limit) and reverse mortgages.

Federal Housing Authority (FHA) modification

The Act increases and permanently sets FHA loan limits to the greater of $271,050 or 115% of local area median home price, capped at $625,500, effective January 1, 2009. This allows more people to qualify for FHA financing. However, the Act also increases the down payment requirement on FHA loans to 3.5% (from 3%), and the Up-Front Mortgage Insurance Premium (UFMIP) to 3% (from 1.5%), effective July 30, 2008.

Foreclosure relief

The Act creates a temporary refinance program within the FHA for homebuyers at risk of foreclosure. Lenders can write down qualified mortgages to 85% of the current appraised value, and qualified borrowers can get a new 30-year fixed mortgage at 90% of the home's appraised value. The loan limit for the program is $550,440 nationwide. The program is effective on October 1, 2008, and expires September 30, 2011.

Be aware, however, that lenders are not required to participate in this program; they must volunteer. Further, the borrower must share the newly created equity and future appreciation equally with the FHA. This obligation will continue until the borrower sells the home or refinances the mortgage. Moreover, the homeowner's access to the newly created equity will be phased in over five years (see sidebar).

Special relief for veterans and servicemembers

The Act temporarily increases, through December 31, 2008, the VA home loan guarantee limit to the same level as the limit set under the Economic Stimulus Act of 2008, which is 125% of median home prices in the area, capped at between $417,000 and $729,750.

The Act also helps returning soldiers avoid foreclosure by lengthening the time a lender must wait before starting foreclosure procedures to nine months (from three months) after a soldier returns from service, and providing them with one-year relief from increases in mortgage interest rates.

The Act also:

- Eliminates seller-funded down payment assistance programs as of October 1, 2008
- Enhances counseling requirements to help provide for homeowners who are having trouble making their mortgage payments
- Temporarily increases mortgage revenue bonds to refinance subprime mortgages
- Temporarily increases the low-income housing tax credit and simplifies technical rules relating to the credit
- Allows the low-income housing tax credit and the rehabilitation tax credit to be used to offset the alternative minimum tax (AMT), and ensures that interest on tax-exempt housing bonds is not subject to the AMT

Equity share phase-in schedule under the HOPE for Homeowners Act:

- *If the home is sold within one year, the lender receives 90% of the appreciation and the homeowner receives 10%*
- *If the home is sold within two years, the lender receives 80% of the appreciation and the homeowner receives 20%*
- *If the home is sold within three years, the lender receives 70% of the appreciation and the homeowner receives 30%*
- *If the home is sold within four years, the lender receives 60% of the appreciation and the homeowner receives 40%*
- *If the home is sold after five years, the lender receives 50% of the appreciation and the homeowner receives 50%*

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