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## New Tax Breaks on the House

*by Broderick Perkins*

Talk about tax shelters.

Your home likely provides more tax relief than any other acquisition, thanks, in part, to new federal laws designed to ease financial suffering in the recessionary economy.

Building on a host of existing tax benefits for homeowners, new breaks help you save money on buying a home, owning a home and selling a home.

Check your state for specific rules on income tax breaks levied by your state or other jurisdiction. They don't all match the federal deals.

First up? Breaks made available from the federal "Mortgage Forgiveness Debt Relief Act of 2007".

- **Forgiveness of Debt Tax Break.** When a lender allows the homeowner to forego repayment of principal and or interest the borrower owes and discharges the debt, the debt is considered ordinary, taxable income. The new law allows certain taxpayers to exclude discharged debt from taxes, provided the lender discharges the debt in 2007, 2008 or 2009.

The amount of debt that can be excluded is limited to \$2 million and the exclusion is only available for loans used to buy, build or substantially improve a principal residence. Vacation homes, investment properties and other second homes don't qualify.

The is not a program, but a federal tax break that allows borrowers to avoid foreclosure, and related taxes, when they use a "short sale." A short sale occurs when a lender agrees to write off the portion of a mortgage that is higher than the value of your home (in an "upside down" mortgage), provided a buyer is willing to purchase the property or the lender is willing to finance the remaining balance. Previously, the forgiven portion could be considered income and taxed as such. The Mortgage Forgiveness Debt Relief Act of 2007, effective through 2010, removes federal taxes from forgiven debt for qualifying taxpayers.

Your certified public accountant, enrolled agent or other licensed tax professional can provide details about your qualification.

- **Mortgage Insurance Deduction.** The relief act also extends federal tax relief for qualified home owners who pay mortgage insurance. Qualified borrowers can deduct the full amount of their private or government mortgage insurance if their insured mortgage originates between 2007 and 2010.

Next? Another set of new tax breaks -- and one tax break take away -- come with the "Housing and Economic Recovery Act of 2008," (HERA) also called "Housing Assistance Tax Act of 2008".

- **First Time Homebuyer Tax Credit.** HERA's most notable provision is called a \$7,500 "tax credit," but it really is more like an interest-free loan.

This deal is for buyers or couples who have never owned a home or who haven't owned a home in the past three years and closed or close the deal from April 9, 2008 to July 1, 2009. Only single taxpayers with adjusted gross incomes up to \$75,000 and married couples filing a joint return with incomes up to \$150,000 qualify for the benefit. In a "married filing separately" household a maximum credit of \$3,750 can be claimed on each return.

Partial credits of less than \$7,500 are available for some taxpayers whose adjusted incomes exceeds the limits. The credit is not available for individual taxpayers with adjusted incomes of \$95,000 or more and for married taxpayers filing joint returns with incomes of more than \$170,000.

All or a portion of the home buyer credit can be claimed as a refund even if the taxpayer has little or no federal income tax owed.

Here's the kicker. Designed to provide a financial incentive to get more people to buy homes in the down market, the \$7,500 is actually a no-interest loan that must be repaid over 15 years, beginning two years after taking the credit. If the home is sold within 15 years, the balance of the tax credit payback is due, provided there is ample capital gains. The credit payback is forgiven if there's no capital gain at the time of the sale. (President Obama recently signed an economic stimulus package that boosted the credit to \$8,000 for homes purchased in 2009. The tax credit is a real credit that doesn't have to be paid back.)

A move is afoot, with backing from the National Association of Homebuilders to legislate a real tax credit for buyers, double the current interest-free loan amount or \$15,000.

Former real estate broker, U.S. Senator Johnny Isakson (R-Ga), introduced legislation to make the deal a real tax credit (not to be paid back) of the lesser of \$15,000 or 10 percent of the purchase price for any homebuyer purchasing any home. The legislation unanimously passed the Senate in early February.

- **Standard Deduction for Property Taxes.** HERA also allows homeowners to claim an additional standard deduction for property tax if they do not itemize deductions. The additional amount is limited to \$500 or \$1,000 for joint filers. The amount is claimed as an additional amount on top of their standard deduction. The deduction is valid for the 2008 tax year only.
- **Prorated Capital Gains Exclusion for Residential Real Estate.** Second homeowners are helping foot the bill for HERA.

Under current law, married homeowners can exclude from taxation, up to \$500,000 in gains from a home sale, provided the property was the primary residence for two out of the previous five years. The maximum exclusion for a single person is \$250,000.

Vacation and rental property owners can legally double dip the exclusion by first selling their primary residence and capturing the tax-free gain. Then, after moving into the second residence for two years to qualify it as their primary residence, they are able to cash in again on the tax-free gain after selling the second home.

That ends January 1, 2009 when HERA eliminates the capital gains exclusion for the portion of gain that came while the home served as a vacation or rental property. The act retains the tax benefit for any

gain achieved during the period when the property served as a principal residence.

Here's an example for a homeowner who sells a residence after 10 years of ownership and the home was a vacation property for eight years. If the home owner realizes a \$100,000 gain when the home is sold, \$80,000 would be subject to capital gains tax. The remaining \$20,000 would qualify for the exclusion. Of course, if the home is never used as a vacation property, and is the primary residence for two years out of the last five, the full \$100,000 gain would still be tax free.

Because the law doesn't take effect until 2009, home owners who move into the vacation home before the end of 2008 will still be eligible for the benefits of the old law.

Whenever it comes to taxes? See a professional.

For all the tax benefits that come with homeownership, see: [A dozen tax breaks, on the house](#)

For related reading, see: [Foreclosure prevention efforts grow Bush signs landmark housing act \\$700 billion bailout overshadows \\$300 billion 'Hope'](#)

### Tax Glossary

**Deduction** -- A tax "deduction" reduces your taxable income. Less income to tax means less taxes to pay. For example, a \$100 tax deduction reduces your \$50,000 taxable income to \$49,900.

**Credit** -- A tax "credit" is a dollar-for-dollar reduction in your actual taxes due. A \$100 tax credit reduces your \$1,000 tax bill to \$900.

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