Summary of the Housing and Economic Recovery Act of 2008

Provided by:

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The Housing and Economic Recovery Act of 2008 was signed into law by President Bush on July 30, 2008.

The Housing and Economic Recovery Act was passed in response to the nation's continuing slump in home sales, together with rising unemployment and weakness in the credit markets. While the tax incentives in the Act are targeted primarily at home ownership and affordable housing, revenue raisers designed to offset the cost of the tax incentives are far reaching.

As you review the attached summary, pay particular attention to any provisions you feel may impact on your situation. If you would like additional information on the Housing and Economic Recovery Act of 2008 or to discuss the impact of specific provisions on your planning, please call my office.

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The Housing and Economic Recovery Act of 2008

The Housing and Economic Recovery Act of 2008 (the Act) was signed into law by President Bush on July 30, 2008. The legislation is designed to reduce home foreclosures, shore up the housing market and strengthen lending institutions. While some new homebuyers and existing homeowners will benefit from the tax incentives provided in the tax portion of the legislation, other taxpayers will help pay for it through higher taxes in the future. Other portions of the Act are designed to strengthen and modernize the housing government-sponsored entities, such as Fannie Mae and Freddie Mac, and to offer assistance to distressed homeowners facing possible home foreclosure.

First-Time Homebuyer Tax Credit:

First-time homebuyers receive a temporary tax credit equal to 10% of the purchase price of a home, up to $7,500 (reduced to $3,750 for married individuals filing separate returns). The credit begins to phase out for taxpayers with adjusted gross income in excess of $75,000 ($150,000 if married filing a joint return). The credit is available for homes purchased from April 9, 2008 but before July 1, 2009. The home is considered purchased when the title closes.

In an interesting twist, the first-time homebuyer tax credit is more of an interest-free loan from the government than a true tax credit. First-time homebuyers claiming the credit must repay it in equal installments over 15 years, beginning two years after the year in which the home is purchased.

First-Time Homebuyer Credit			
		Credit Phases Out for Modified AGI	
Filing Status	**Maximum Credit**	**From**	**To**
Single and Head of Household	$7,500	$75,000	$95,000
Married Filing Jointly	$7,500	$150,000	$170,000
Married Filing Separately	$3,750	$75,000	$95,000

- A person is considered a first-time homebuyer if he or she (or spouse) had no ownership interest in a principal residence during the three-year period prior to purchasing the new home.

- The credit must be claimed on a 2008 or 2009 tax return. If a first-time homebuyer purchases a home in 2009, after filing a 2008 tax return, the buyer has the option of filing an amended 2008 return in order to claim the credit.

- The credit will be disallowed if the taxpayer disposes of the residence, or the residence ceases to be the taxpayer's principal residence, before the close of the tax year for which the credit would be allowed (2008 or 2009).

- The first-time homebuyer credit must be repaid over 15 years, interest free. Repayments begin two years after the year in which the home is purchased and are made in equal installments over 15 years. For example, if a first-time homebuyer purchases a home in 2008 and qualifies for the full $7,500 credit, repayments would begin in 2010 at the rate of $500 per year and continue though 2024.

- If a taxpayer sells or no longer uses the home as the principal residence prior to repaying the full credit, the unpaid balance becomes due in the year in which the home is sold or no longer used as the principal residence. The amount of recaptured credit, however, cannot exceed the amount of gain from a sale to an unrelated person. Finally, the credit does not have to be repaid if a taxpayer dies prior to repaying the full credit.

Non-Itemizer Property Tax Deduction:

Only individuals who itemize deductions on their income tax returns may deduct real estate property taxes imposed by state and local governments. The Act, however, provides a temporary and limited deduction for real estate taxes for 2008 only. This new deduction is in addition to the standard deduction and is not an above-the-line deduction that lowers AGI.

- The standard deduction for non-itemizers who pay real estate property taxes is increased by the lesser of (1) the amount of real estate property taxes paid during the year and (2) $500 ($1,000 for a married couple filing jointly).

- This new temporary deduction is in addition to the standard deduction. For 2008, the standard deduction with the non-itemizer property tax deduction will be:
  - For joint filers and surviving spouses: $10,900 increasing to a maximum of $11,900.
  - For single taxpayers: $5,450 increasing to a maximum of $5,950.
  - For house-of-household taxpayers: $8,000 increasing to a maximum of $8,500.

Affordable Housing Enhancements:

Certain provisions of the Act are intended to encourage investment in low-income housing, including:

Low-Income Housing Tax Credit

The low-income housing tax (LIHTC Program) is an indirect Federal subsidy used to finance the development of affordable rental housing for low-income households. The LIHTC Program is quite technical but, in a nutshell, federal housing tax credits are awarded to developers of qualified projects. Developers then sell these credits to investors to raise capital (or equity) for their projects, which reduces the debt that the developer would otherwise have to borrow. Because the debt is lower, a tax credit property can in turn offer lower, more affordable rents.

The Act temporarily increases the amount each state will receive under the LIHTC Program from $2.00 per resident multiplied by the state's population (with a fixed minimum) to $2.20 per resident. This increase applies to 2008 and 2009 only. In addition, certain provisions of the LIHTC Program are simplified by the new law.

Tax-Exempt Housing Bonds

Tax-exempt housing bonds are issued by state and local governments to fund the acquisition, construction and rehabilitation of affordable housing, with the interest earned by the bondholder exempt from federal tax.

The Act simplifies the rules for tax-exempt housing bonds and, in some instances, aligns those rules with those of the LIHTC Program.

Mortgage Revenue Bonds

Mortgage revenue bonds are sold by state and local government housing finance agencies (HFAs) to finance below-market mortgages for first-time homebuyers. Homebuyers must meet income and purchase price requirements.

The Act temporarily expands the mortgage revenue bond program to permit refinancing of certain existing subprime mortgage loans. Subprime borrowers with an adjustable rate single-family mortgage loan made after December 31, 2001 and before January 1, 2008 may be able to use their state's mortgage revenue bond program to refinance into a loan with a more favorable interest rate.

REIT Reforms:

A real estate investment trust, or REIT, is a corporation or trust created under state law that holds passive investments in real property and mortgages. An REIT must satisfy complex organizational, distribution, record keeping, source of income and asset holding requirements. The Act makes certain changes in those requirements intended to maintain REITs as a viable investment vehicle.

Additional Incentives/Tax Provisions:

The Act includes a variety of additional incentives and tax provisions, including:

- Corporations benefit from enhanced Section 179 expensing and special bonus depreciation provisions.
- Tax-exempt bonds issued by Fannie Mae and Freddie Mac receive a favorable federal guarantee of the tax-exempt bonds they issue. That guarantee has been extended to bonds issued by federal home loan banks (FHLBs), which should lower borrowing costs and make more financing available to state and local governments for infrastructure projects.
- Tax-exempt interest on certain housing bonds is excluded from being a preference item for alternative minimum tax (AMT) purposes.
- The rehabilitation tax credit available for rehabilitating certified historic structures has been enhanced.

- At the request of a service member, mortgage lenders must reduce his or her interest rate to no more than 6% a year during the period of the service member's active military service and recalculate the payments to reflect the lower rate.

- So-called seller-funded down payment assistance programs (DAPs) have been banned as contributing to the high number of foreclosures.

Revenue Raisers:

In order to pay for the new tax incentives, a variety of revenue raisers were included in the Act, including:

Credit Card Information Reporting

Beginning on January 1, 2011, third-party processors of merchant credit and debit card transactions will be required to report to the IRS a merchant's annual gross payment card receipts. Since the IRS currently has no "paper trail" of a merchant's credit and debit card receipts, it is anticipated that this provision will assist the IRS in increasing the tax compliance rate among merchants.

The new law exempts small merchants from this new reporting requirement. If the aggregate value of third-party card transactions does not exceed $20,000 for the calendar year or 200 transactions, reporting to the IRS is not required.

Reduction in the Home Sale Exclusion

Taxpayers can exclude from federal tax up to $250,000 per person ($500,000 per married couple) in gains on the sale of a principal residence, with a personal residence defined as the place where the taxpayer has lived for at least two of the past five years. This meant that people with vacation or rental houses could move into the house for two years, sell the house, benefit from the $250,000 or $500,000 exclusion and then move back to their primary residence. The Act closes this loophole.

Beginning January 1, 2009, gain from the sale of a principal residence will no longer be excluded from gross income for periods that the home was not used as the principal residence. This means that taxpayers will have to divide the number of years lived in the residence by the number of years it was owned in order to determine what percentage of the gain is tax-free.

For example, let's say that Jim and Jan Johnson purchase a vacation home on January 1, 2009 for $300,000. They use it as a vacation home for three years, until January 1, 2012, when they move in and live there until January 1, 2014, when the home is sold for $450,000. Since the Johnsons owned the home for five years, but lived there for only two years, only 40% of the $150,000 gain will be tax free (2 years/5 years).

Note: Taxpayers who move into vacation or rental property prior to January 1, 2009 are not affected by this change in the home sale exclusion.

Regulation of Housing Government-Sponsored Entities:

The Act is designed to strengthen and modernize the regulation of housing government-sponsored enterprises (GSEs), including Fannie Mae and Freddie Mac and the Federal Home Loan Banks, as well as expand the housing mission of the GSEs.

- A new independent regulator is established for the GSEs, with broad authority to ensure the safe and sound operations of the GSEs.
- The number of families that can be served by Fannie Mae and Freddie Mac is expanded by increasing loan limits in high cost areas to 150% of the conforming loan limit. This would currently be $625,000.
- A new Housing Trust Fund and a Capital Magnet Fund are created. They will be financed by annual contributions from the GSEs and used for the construction of affordable rental housing.

Temporary FHA Program for Distressed Homeowners:

The Act creates the Hope for Homeowners Program, a new FHA program designed to help at least 400,000 homeowners save their homes from foreclosure by providing new FHA loans after the original lenders take deep discounts. While lenders will have to agree to take losses in order to have the loans refinanced through the FHA program, it's expected that those losses will be less than the losses associated with foreclosure. The program will begin on October 1, 2008 and end on September 30, 2011.

- The program is available only to owner-occupants who cannot afford their current mortgage payments and have a mortgage debt to income ratio greater than 31% as of March 1, 2008.
- The program is not available to investors or investor property.

- The new FHA loans will be 30-year, fixed rate loans and will be in an amount equal to the lesser of (1) the amount the borrower can afford to repay, as determined by the current FHA affordability requirements, or (2) 90% of the current value of the home.
- The borrower must share any newly created equity and future appreciation equally with the FHA, with this obligation continuing until the home is sold or the FHA-insured mortgage is refinanced. In addition, the homeowner's access to the newly created equity is phased in over five years.

Foreclosure Prevention Provisions:

The Act contains a variety of provisions designed to address the problems faced by homeowners and communities in light of the foreclosure crisis:

- The FHA loan limit is increased from 95% to 110% of area median home price, with a cap at 150% of the GSE limit (currently $625,000).
- Supplemental Community Development Block Grant Funds will be provided to communities hardest hit by foreclosures and delinquencies. The funds will be used to purchase foreclosed homes, at a discount, and rehabilitate the homes in order to stabilize neighborhoods.
- The Neighborhood Reinvestment Corporation will distribute funds to provide pre-foreclosure counseling to distressed borrowers.
- The length of time lenders must wait before starting foreclosure proceedings against soldiers returning from service is increased from three months to nine months. Returning soldiers also receive one year relief from increases in mortgage interest rates. The legislation also increases the VA loan guarantee amount, as well as provides a variety of other veterans benefits.

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