Tax Credit Can Help Build Business

Brokers can increase closings by understanding the new incentive for first-time homebuyers

By **Gibran Nicholas,** founder and chairman, CMPS Institute

As part of the Housing and Economic Recovery Act of 2008, first-time homebuyers will receive some tax incentives for purchasing a home. Specifically, the act implements a tax credit for first-time homebuyers.

Mortgage brokers can close more deals if they understand and explain the nuances of the first-time-homebuyer tax credit to consumers, real estate agents, financial advisers and other referral sources in a way that is relevant to their specific situations. The idea is to position yourself as the go-to expert to generate new business and referral opportunities.

Credit vs. deduction

A tax credit is much different and more powerful than a tax deduction.

For example, let's assume that you earn $70,000 per year and pay $5,000 in annual mortgage interest. If the mortgage interest is deemed to be tax-deductible, you would deduct $5,000 from your income before calculating your income tax bill for the year.

In other words, instead of paying income tax on the entire $70,000, you would pay income taxes on $65,000. A $5,000 tax deduction simply reduces your taxable income by that amount.

A tax credit, on the other hand, is like a gift certificate that you can apply toward your total federal income tax bill. It does not reduce your taxable income; rather, it is a dollar-for-dollar reduction in your actual tax bill.

For example, if your income tax bill for the year is $5,000 and you have a tax credit for $5,000, the credit would cover your entire tax bill.

With the Housing and Economic Recovery Act, some first-time homebuyers can receive a tax credit of 10 percent of their home's purchase price, not to exceed $7,500.

If the purchase price of the home is, for example, $60,000, the tax credit would be $6,000. If the purchase price of the home is $200,000, the credit would be the maximum-allowable $7,500.

The credit is "refundable" in the sense that even if the homebuyers' income tax bill is less than $7,500, the Internal Revenue Service (IRS) will send them the difference in the form of a cash refund.

For example, if homebuyers are eligible for the maximum $7,500 credit and their total tax bill for the year is $5,000, their entire tax bill for the year would be wiped out. Plus, the IRS would send them a check for $2,500, bringing the total credit to $7,500.

Likewise, if homebuyers' entire tax bill for the year is $9,000, they would receive a $7,500 credit against this amount, and the actual tax bill will be reduced to $1,500.

It's important to understand that the tax credit is realized when homebuyers file their tax returns, not when they close on their home purchase.

Qualifying for the credit

For purposes of the Housing and Economic Recovery Act's tax credit, a first-time homebuyer is defined as someone who has not owned a home for the past three years. The home also must be the buyers' primary residence, and it cannot be purchased from a relative.

First-time buyers who purchase their home between April 9, 2008, and July 1, 2009, qualify. They can choose to take the credit either in the 2008 or the 2009 tax year, regardless of when they purchase the home.

For example, buyers who purchase a home in February 2009 can take the credit when they file their 2008 tax returns by April 2009 or when they file their 2009 tax returns the following year.

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One question that arises is: What happens when two or more buyers are purchasing the same home?

In this case, the total maximum allowable credit is still $7,500. If the buyers are married and filing a joint return, they would simply have a total credit of $7,500. If the buyers are married and filing separate returns or if they are unmarried, they could each probably qualify for a partial credit, but the total combined credit for all buyers cannot exceed $7,500.

There are also a few restrictions on qualifying for the tax credit. The credit does not apply if the home mortgage is financed through a state-housing-finance agency that issues tax-exempt bonds. Also, if buyers live in Washington, D.C., and are eligible for the district's $5,000 homebuyer credit, they cannot use both credits; they must choose one or the other.

Finally, the credit phases out if the buyer's modified adjusted gross income exceeds $75,000 ($150,000 if married and filing jointly), and it completely goes away if income reaches $95,000 ($170,000 if married and filing jointly).

Repaying the credit

Unlike most tax credits, this one actually needs to be repaid over 15 years. This means that starting the year after homebuyers take the credit,

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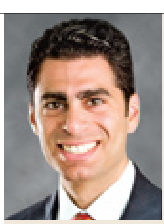

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they must add about $500 to their federal income tax bill each year for the next 15 years.

If the home ceases to be the buyer's primary home or if it is sold prior to the end of the 15-year period, the credit's repayment is accelerated.

For example, if buyers who received a $7,500 credit sell their home after paying five years' worth of the credit (equaling $2,500, or $500 per year for five years), they must add the remaining $5,000 to their income-tax bill for the year the home sells.

This only applies if the home is sold for a profit, however. In this example, if taxpayers only make a $3,000 profit when selling the home, then only that amount must be added to their income-tax bill that year. The remaining $2,000 would be forgiven.

Also, if homeowners don't realize a profit on the sale or if there is a loss, the entire remaining amount would be forgiven. In addition, the remaining credit would no longer need to be repaid if the buyer dies before 15 years is up, if the home is destroyed in a natural disaster or if an authorized government agency condemns the home by eminent domain.

The business opportunity

Savvy mortgage brokers can use their knowledge of the Housing and Economic Recovery Act's first-time-homebuyer tax credit to educate clients and to co- market with financial advisers, certified public accountants, attorneys, real estate agents, builders, employers and other referral sources.

By helping your referral partners understand the tax credit, you will be seen as an expert worthy of even more client recommendations. Those referrals, coupled with the knowledge to back it up, can elevate your position in the marketplace.

You will be viewed as an expert resource rather than just another loan salesperson. You also can use your valuable expertise as an opportunity to do business with companies that have in-house mortgage departments. Remember, you are not asking for a referral to close another mortgage deal. Rather, you are bringing value to the referral sources and their customers by showcasing how your knowledge can help them in their specific situation, regardless of whether they close a loan with you. This approach can open doors that were previously closed.

Now more than ever, consumers and referral partners are looking for experts to decipher all the changes in the mortgage and real estate industries.

By investing the time and resources to become a go-to expert, you can close more deals and leave behind your competition.

Past Article

by Gibran Nicholas

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