

**Warady & Davis
 LLP**

1717 Deerfield Rd.
 Suite 300 South
 Deerfield, IL
 60015-3977
 p: 847.267.9600
 f: 847.267.9696

**W&D
 Consulting LLC**

1717 Deerfield Rd.
 Suite 300 South
 Deerfield, IL
 60015-3977
 p: 847.267.9600
 f: 847.267.9696

Contact:

Marc Heller
 CPA, JD
 Partner & Director
 of Technical Tax
 p: 847.267.9600
 mheller@
 waradydavis.com

Housing and Economic Recovery Act of 2008 Enacted

President George W. Bush recently signed the sweeping Housing and Economic Recovery Act of 2008 (H.R. 3221 Housing Act of 2008) into law. The Housing Bill is designed to help homeowners avoid foreclosure, spur home buying and prop up struggling mortgage giants Fannie Mae and Freddie Mac.

The bill takes several approaches to curing the ailing housing market.

1. It aims to spare an estimated 400,000 debt-strapped homeowners, many of whom owe more than their houses are worth, from foreclosure by allowing them to get more affordable mortgages backed by the Federal Housing Administration.

2. The FHA could insure \$300 billion in such mortgages, which would be available to homeowners who showed they could afford a new loan. Banks would first have to agree to take a large loss on the existing loans in exchange for avoiding an often-costly foreclosure.

3. The plan also is designed to relieve a broader credit crunch that has taken hold because of rising defaults and falling home values. To free up safer and more affordable mortgage credit, the bill permanently would increase to \$625,000 the size of home loans that Fannie Mae and Freddie Mac can buy and the FHA can insure. They also could buy and back mortgages 15% higher than the median home price in certain areas.

The bill goes far beyond just addressing the current crisis, however. The legislation overhauls the Depression-era FHA. It requires lenders to show how high a borrower's payments could get under the terms of their mortgages and it provides \$180 million in pre-foreclosure counseling for struggling homeowners.

The Treasury Department gains unlimited power, until the end of 2009, to lend money to Fannie Mae and Freddie Mac or buy their stock should they need it. The Federal Reserve takes on a new "consultative" role overseeing the companies.

Tax Incentives and Revenue Raisers

The measure includes \$15.1 billion in housing tax incentives, including a credit of up to \$7,500 for first-time home buyers for houses purchased between April 9, 2008, and July 1, 2009, a significant expansion of the low-income housing tax credit, new provisions for tax-exempt housing and mortgage revenue bonds and real estate investment trust (REIT) reform among other items.

First-time homebuyer tax credit.

One tax incentive in the new law, the first-time homebuyer tax credit, has been getting a lot of attention in the news but be careful. The credit, while generous, is essentially an interest-free loan from the government. Taxpayers who take the credit, which equals 10 percent of the purchase price (up to \$7,500 for single individuals and married couples filing jointly; \$3,750

for married individuals filing separate returns) must repay the credit. They will have 15 years to repay the credit in equal amounts. If a taxpayer sells his or her home before the end of the 15-year period, he or she will likely have to immediately repay any outstanding balance. Important income thresholds also apply. Additionally, the credit is temporary and applies to homes purchased on or after April 9, 2008 and before July 1, 2009. There are also complex rules about who can take it, when they can claim it and so on. Please contact your W&D representative if you have any questions about this potentially valuable but complicated new credit.



Property deduction for non-itemizers.

Significantly less complicated is a new standard property deduction for taxpayers who do not itemize deductions. Before the new law, only itemizers could deduct state and local property taxes. The housing act gives non-itemizers a limited deduction for state and local property taxes by increasing the amount of their standard deduction by the lesser of the amount

of property taxes they paid or \$500 (\$1,000 for a married couple filing jointly). If you have paid off your mortgage and no longer itemize, you might benefit from this new deduction. As now written, however, this is a one-year shot in the arm, available only for taxes paid in 2008.

Home sale exclusion. The home sale exclusion is one of the most popular tax breaks in the Tax Code. A married couple filing jointly can generally exclude up to \$500,000 in gain (single individuals up to \$250,000) provided they physically lived in the home for 2 of the previous 5 years. Savvy real estate investors used this tax rule by moving between residences every two years. Even "regular" homeowners were coached to stay in their homes for at least 2 years for tax reasons.

The housing act closes what some call a "loop hole." The new capital gains exclusion formula is not an all-or-nothing proposition. Instead, it's a ratio. In other words, if a home seller occupied a property as a primary residence in 2 of the last 5 years, under the new system, he would be entitled to 40% of his capital gains tax-free versus 100 percent of those gains. The new law pro-rates the exclusion between the time that a home is used as a principal residence and the total length of ownership, which includes any "non-qualifying" use as a rental or vacation property.

As good news to those who have already owned property for a while and have seen it appreciate, non-qualifying use before the January 1, 2009 effective date of the provision is not used in the calculation; neither are periods after a qualified use of the property or temporary absences of less than two years.

Down payment assistance. Seller-funded down payment assistance programs provide cash assistance to homebuyers who cannot afford to make the minimum down payment or pay the closing costs involved in obtaining a mortgage. Despite their

popularity, these programs have been criticized for helping to inflate home prices. In 2006, the IRS ruled that organizations that provide seller-funded down-payment assistance to home buyers do not qualify as tax-exempt charities. The new law bans seller-funded down payment assistance programs.

Military personnel. The housing bill includes many provisions to help military personnel on active duty and veterans avoid foreclosure. Under the new law, service members and veterans are protected from foreclosure for nine months following a period of military service (rather than the current 90 days). Congress also made the VA home loan program more attractive and provided funding for disabled veterans to make accommodations in their homes for their disabilities.



Businesses. The Economic Stimulus Act of 2008 included bonus depreciation to encourage businesses to increase investment. However, companies in a loss position cannot take advantage of bonus depreciation because they do not have any taxable income against which to take the deductions. The housing act allows taxpayers (corporations) to use accumulated alternative minimum tax (AMT) credits as well as research and development (R and D) tax credits to make investments that would qualify for bonus depreciation, if the taxpayers were profitable.

The new law also dramatically changes the information reporting requirements of banks and other processors

of merchant payment card transactions. Starting in 2011, they will be required to report a merchant's annual gross payment card receipts to the IRS and the merchant. Congress believes that enhanced information reporting will help close the \$300 billion tax gap, the difference between what taxpayers owe and what they actually pay.

Real estate investment trusts. A real estate investment trust (REIT) holds passive investments in real property equity and mortgages. Like the rules for tax-exempt bonds and the low-income housing tax credit (LIHTC), the rules for REITs are complex. If a REIT violates these rules, the tax consequences can be severe. The housing act clarifies some the rules, such as allowing REITs to treat certain foreign currency gains as qualified income for purposes of income tests. Congress also clarified other aspects of the income tests and authorized the IRS to determine if other items should be treated as qualified income for purposes of the income tests, among other changes.

Affordable housing. Tax-exempt housing bonds and the LIHTC help to fund the construction of affordable housing units. The rules for tax-exempt housing bonds and the LIHTC are extremely technical. The housing act simplifies these rules and makes other changes, such as excluding tax-exempt interest on certain housing bonds from being a preference item for AMT purposes. The housing act also allows taxpayers to use the LIHTC and the rehabilitation tax credit to offset AMT liability. Congress also enhanced the rehabilitation tax credit and some special tax breaks for taxpayers in the Gulf Opportunity Zone.

As you can see, the housing bill is far-reaching in scope. If you have any questions about the new law, please contact Marc Heller, CPA, JD, Director of Technical Tax at 847.267.9600. For a detailed special report on provisions of the new law visit:

<http://tax.cchgroup.com/legislation/2008-Housing-Assistance-Act.pdf>

