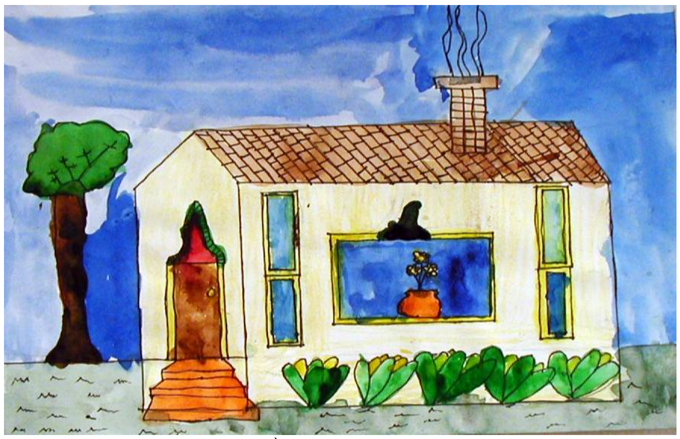
A Guide to Recapture

QUESTIONS AND ANSWERS

Nevada Housing Divison



Drawing by Tino Ragone, 4th grade, Martha P. King Elementary School.
From the Nevada Housing Division's School Arts Competition, "Where I Live."

On January 1, 1991 a new provision of federal law became effective, commonly known as "recapture." It applies to borrowers who purchase their homes using financing from tax-exempt mortgage revenue bonds such as those issued by the Nevada Housing Division. This provision is administered by the Internal Revenue Service and applies nationwide.

Recapture allows the federal government to recover lost sale of transfer revenues from the gain on sale or transfer of the home. However, not all sales or transfers are subject to recapture.

Recapture has generated concerns among lenders, real estate professionals, and prospective borrowers. Their perception is that recapture is confusing and complicated. In reality, with the correct information the confusion and complication is removed. A few straight answers to some of the most commonly asked questions will help dispel these concerns.

1. **What exactly is recapture?**
   Basically, it is a tax that the borrower may have to pay if he/she sells or transfer the home. Recapture applies only to homes financed on or after January 1st, 1991.

2. **Why did the federal government institute the tax?**
   Borrowers of tax-exempt financing receive the benefit of below-market interest rates. The federal government considers this to be, in effect, an indirect subsidy. The federal government uses the recapture tax to recoup some of this subsidy from the gain, if any, on the sale or transfer of the home.
3. **What are the conditions where recapture does apply?**

First, a sale or transfer of the home must occur within nine years of the sate of purchase; after that time, there is no recapture tax. Second, a borrower's income must be above the "Adjusted Qualifying Income" limit as calculated below. Third, a gain on the sale or transfer of the home must occur. If there is no gain, then there is no recapture tax.

4. **How do you calculate the "Adjusted Qualifying Income"?**
   Determine the borrower's household size at the time the home is sold or transferred. Refer to the Recapture Tax Notice you receive at escrow closing or contact the Division to determine the "Adjusted Qualifying Income."

5. **What is the maximum recapture tax?**
   The maximum recapture tax is 6.25% of the original principal balance of the loan, but cannot exceed 50% of the gain.

6. **Will recapture completely eliminate a borrower's gain from the sale of the home?**
   Fortunately, no. The recapture tax can never exceed 50% of the gain. Remember: If there is no gain on the sale, no recapture tax is due.

7. **What determines how much the actual recapture tax will be?**
   First, the date of the sale or transfer. Second, the borrower's income in relation to the "Adjusted Qualifying Income" in the year of sale or transfer, and third, the gain from sale or transfer.

8. **Are there advantages to selling the home later in the nine-year period?**
   Yes. The maximum recapture amount increases during the first five years of ownership to its maximum in the fifth year. The amount then decreases 20% per year through the ninth year. If the sale or transfer occurs after the ninth year, there is no recapture tax.

9. **Does a homeowner always have to pay the maximum recapture?**
   Fortunately, no. There are three factors which may adjust or reduce the amount of recapture due: the amount of the gain on the sale; the date of the sale; and the homeowner's income and family size in the year that the sale is completed.

   The actual recapture amount, if any, will be the lesser of the amounts derived from these three adjustments.
   If any one of the three calculations yields a zero recapture amount, the homeowner will be exempt from the recapture tax.

10. **Does income and family size affect the amount of recapture?**
    Income/family size is the third adjustment. If the sale of the home does not yield a profit, or if the home is sold after the nine-year period, an increase in income or family has no bearing. No recapture is due anyway.

    When calculating the actual recapture amount under this adjustment, however; two factors apply: the borrower's annual income in the year of the sale of the home; and the income limits set by the federal government for participants in a MRB program. This amount is determined by law and varies by county. Recapture applies only when the borrower's income is greater than the federal income limit in the year of the sale.

11. **How many borrowers in NHD's First Time Homebuyer Program will be affected by the recapture provision?**
    Most borrowers enter the program with an average annual income far below that of the program's maximum. For recapture purposes, "Adjusted Qualifying Income" limits start at the program's maximum limits and are increased by 5% compounded annually. As an example, in Clark County, for recapture purposes the income limits for a 1-2 persons household is $72,120. If the borrower exited the program in year 4 the applicable "Adjusted Qualifying Income" would be $87,662. The wide margin between the average borrower's incomes upon entering the program versus the borrower's income upon exiting the program makes it unlikely that many borrowers will have to pay any recapture tax.

12. **On assumptions, does recapture tax affect new buyers assuming the loan from the previous owner?**
    If the loan being assumed is a NHD loan closed after January 1, 1991, recapture applies. The original borrower is responsible for any applicable recapture tax and a new nine-year period begins for the purpose of applying a new recapture tax to the assuming purchaser.

13. **Is recapture due if the borrower dies before the tenth year of the home ownership?**
    If the deceased borrower is the sole owner of the home, no recapture will be due. If, however, the home is owned jointly with a spouse or other person, he or she may be responsible for paying the recapture tax if the home is sold during the first nine years of ownership.

14. **In case of a divorce, who is responsible for recapture?**
    Whoever receives the home in the divorce settlement pays the recapture, if any.

15. **In the event I refinance, does recapture apply?**
    No recapture tax will be imposed as a result of a refinancing or other prepayment of your mortgage loan within the nine year Recapture Tax period unless you also dispose of your interest within the same nine year period.

16. **What if a NHD-financed home is destroyed as the result of a fire, flood, or other natural disaster?**
    If a home subject to recapture is destroyed, and the borrower rebuilds on the same site within two years after the year in which he or she received the insurance proceeds – no recapture is due.

17. **How will the IRS track the amount of recapture tax due upon the sale of a NHD-financed home?**
    Recapture tax will be tracked by the IRS through the use of homeowners' Social Security numbers as reported on 1099 forms issued by the title companies in the year of sale. If required to pay a recapture amount, each homeowner must report it on his or her federal income tax return.

18. **Where do you find the necessary IRS forms?**
    IRS form 8828 "Recapture of Federal Mortgage Subsidy" and Instructions for Form 8828 may be found on the web site for the Internal Revenue service at www.irs.gov.

    Consultation with an accountant or tax attorney is recommended.
    The Division strongly recommends that you consult with an accountant or tax attorney, who is familiar with the recapture tax imposed under §143(m) of the Internal Revenue Code, so that he or she may advise you as to whether the disposition of your home will subject you to the recapture tax and the amount of the recapture tax.

NEVADA HOUSING DIVISION
First Time Homebuyer Program

The principal purpose of the Housing Division's tax-exempt bond program is to provide a source of mortgage fund, which cannot be supplied by the private sector, to qualifying families and individuals of low and moderate income. The Nevada Housing Finance Law passed in May 1975, established the Nevada Housing Division to:

> "…encourage the investment of private capital and to stimulate the use of public financing, to provide mortgage loans and to make loans to and purchase mortgage loans from mortgage lenders."

Under the powers of this mandate, the Housing Division reaffirms its commitment to aid in the elimination of:

> "…serious shortage of decent, safe and sanitary housing…available to persons and families of low and moderate incomes."

The First Time Homebuyer Program provides mortgage loans to qualified buyers at interest rates that are below conventional market interest rates, making home ownership affordable to a broader range of Nevada's citizens.

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