A GUIDE TO RECAPTURE

It's Not as Bad as you think
Did you know:

Sell after 9 years…
No recapture

No gain…
No recapture

Income within Federal Limits…
No recapture

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 (MRBs) such as those issued by the California Housing Finance Agency (CHFA). This provision is administered by the Internal Revenue Service (IRS) and applies nationwide.

Recapture allows the federal government to recover lost tax 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. On first review, it might appear to be complicated, confusing and time consuming to calculate. However, answers to commonly asked questions may help to dispel some of these concerns.

Q. What is recapture?
A. A tax that the borrower may have to pay if he/she sells or transfers the home. Recapture applies only to homes financed on or after January 1, 1991.

Q. Why did the federal government institute this tax?
A. Borrowers of tax-exempt financing receive the benefit of a below-market interest rate. 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.

Q. Generally, what conditions make a borrower liable for recapture?
A. **First**: A sale or transfer of the home must occur within nine years from the later of date of purchase or the date of bond issuance; **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**.

Q. How do you calculate the "Adjusted Qualifying Income"?
A. **First**: Determine the borrower's household size at the time the home is sold or transferred.
Second: Select the maximum income limit that would have applied to that household size at the time the home was purchased. This number, compounded by 5% per year from the date of purchase until the date the home is sold or transferred, is the "Adjusted Qualifying Income".

Q. What is the maximum recapture tax?

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

Q. Will recapture completely eliminate a borrower's gain from the sale of the home?

A. **Fortunately No**. The recapture tax can never exceed 50% of the gain.

Q. What determines how much the actual recapture tax will be?

A. **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.

Q. Are there advantages to selling the home later in the nine-year recapture period?

A. **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 occurs after the ninth year, **there is no recapture tax**.

Q. What happens if the loan is assumed?

A. If the sale or transfer occurs within the first nine years of ownership, the original borrower pays the recapture tax and a new nine-year period begins for the purpose of applying a new recapture tax to the assuming purchaser.

Q. How does IRS track the amount of recapture tax due?

A. **CHFA is required** to report to the IRS the name, address, and social security numbers of all recipients of MRB loans**. The borrower is required** to file IRS Form 8828 with his/her Federal income tax return for the tax year in which the home is sold or transferred.

Q. Is recapture due if the borrower dies within the nine-year period?

A. **No**. A death transfer is not a sale or transfer for the purposes of recapture.

Q. In the case of a divorce, who is responsible for the recapture tax?

A. A divorce settlement is not a sale or transfer for the purposes of recapture. Whoever receives the home in the divorce settlement pays any recapture tax due as a result of a subsequent sale or transfer if within the nine-year period.

Q. What if the home is destroyed as the result of a fire, flood, or other natural disaster?

A. If the home is destroyed and borrower rebuilds on the same site within two years after the year in which the insurance proceeds are received, **no recapture is due at that time**.

Q. What is the formula for recapture?

A. The formula for recapture is as follows:
To complete the formula, you will need to know:

- Original loan amount,
- Program income limits, when loan was closed at time of purchase (CHFA provided, at time of closing, a special recapture notice that includes the income limits), and
- Borrower's Modified Adjusted Gross Income at time of sale.

FORMULA FOR RECAPTURE

A: Compute your "Modified Adjusted Gross Income"

Adjusted Gross Income For Year You Sold or Transferred Property	plus	Any Interest that was Excluded from that year	less	Any Taxable Gain From Sale of Residence	equals	Modified Adjusted Gross Income
________________	+	______________	-	_____________	=	**A**_________________

B: Multiply the Program Income Limit when loan was made (adjusted for family size at time of sale or transfer) by 5%, compounded annually, for each full year of loan

Income Limit	times	1.05*	equals	Adjusted Qualifying Income
________________	x	____________________	=	**N**_____________________

*number of full years of the loan

NOTE: If **A** is less than **N** …STOP…No recapture tax is due. If **A** is more than **N** …continue

A_________ - **N**__________ = ____________ ÷ 5,000 = **B**____________________**
(Income Percentage)

**Always round to nearest percent (%). If 0.5%, round up. May not exceed 100%
The adjusted % in recapture based on income at time of sale of the property.

C: Multiply your Original Loan Amount by 6.25%

___________________________ x 6.25% = **C**______________________
(Federal Subsidy)

Amount the government has paid to buy down your interest rate.

D: Look at the chart below and select the percentage that corresponds to the year in which your home is sold.

(Any fraction of year qualifies as full year)

Year 1 - 20%	Year 2 - 40%	Year 3 - 60%	Year 4 - 80%	Year 5 - 100%
Year 6 - 80%	Year 7 - 60%	Year 8 - 40%	Year 9 - 20%	

Percentage based on number of years since you purchased your home = **D**_________________
(Holding Period Percentage)

E: Multiply B (income percentage) times C (Federal Subsidy) times D (holding period percentage)

B_________________ x **C**__________________ x **D**______________________ =
(Income Percentage) (Federal Subsidy) (Holding Period Percentage)

$________________________**Recapture Tax Due,**
if there is a gain on sale (in no event to exceed 50% of gain)

Q. What if the loan is refinanced?

A. How a refinancing or repayment of the loan in full affects recapture depends on when the refinancing or repayment in full occurs. If the borrower refinances or repays the loan in full **within four years of the closing date of the loan** and sells the home at a later date during the nine-year recapture period, the "**HOLDING PERIOD PERCENTAGE**" used in determining the recapture tax is calculated in the manner set forth below. In general, the holding period percentage from Section D (Formula for Recapture) that would have applied if the borrower had actually sold the home on the date of refinancing is adjusted downward ratably over a five-year period following the year of the refinancing.

FORMULA FOR ADJUSTED HOLDING PERIOD PERCENTAGE

Example: Assume a borrower closes on the loan on January 1, 2000. The loan is repaid in full on June 15, 2003, and the borrower sells the home on December 31, 2006.

A. Closing date of loan — A $\boxed{\text{January 1, 2000}}$

B. Repayment date of Loan — B $\boxed{\text{June 15, 2003}}$

(If the repayment date on Line B is more than four years after the closing date on Line A, **the holding period percentage is not subject to adjustment.)**

C. Enter the number of years between the Dates on Lines A and B (Round up to the nearest whole year) — C $\boxed{\text{4 years}}$

D. If the number of Years on Line C is:

If the number of Years on Line C is:	Enter this % on Line D
1	20%
2	40%
3	60%
4	80%

D $\boxed{80\%}$

E. Sale date of home — E $\boxed{\text{December 31, 2006}}$

F. Enter the number of years between the Dates on lines B and E. (Round up to the nearest whole year) — F $\boxed{\text{4 years}}$

G. If the number of Years on Line F is:

If the number of Years on Line F is:	Enter this % on Line G
1	100%
2	80%
3	60%
4	40%
5	20%
6 or more	0%

G $\boxed{40\%}$

H. Multiply the percentage on Line D by the percentage on Line G. (Round to the nearest whole percentage.) This is the Adjusted Holding Period Percentage. — H $\boxed{32\%}$

If borrower refinances or repays the loan in full more than four years from date of the loan closing, the holding period percentage is not subject to adjustment and is determined by referring to Section D under the regular "**Formula for Recapture**".

Use these above formulas to determine tax liability or consult your tax advisor.

Subject to tax law interpretation