

Recapture Tax

THDA mortgage loans carry reduced interest rates to help persons of low and moderate income achieve the benefits of homeownership. If THDA borrowers have a great financial success and sell their THDA-financed home within nine years, Congress has determined a portion of the reduced interest rate benefit should be repaid to the federal treasury.

Very few Tennessee borrowers have been affected by this tax. All *three* of the following must be true for a THDA borrower to be affected:

- 1) The house must be sold within nine years of the original THDA mortgage loan closing;
- 2) The borrower must see a dramatic gain from the sale of the home; and
- 3) The borrower's income must have increased by 5% *each year* since closing the THDA mortgage loan.

Additional considerations which affect the tax calculation include the family size at time of sale, the number of years the home was owned, and whether the house is transferred to a spouse or former spouse as a result of a divorce. If the house is transferred due to the THDA borrower's death, there is no recapture tax liability.

THDA sends a descriptive worksheet within 90 days of closing to the borrower with the calculations specific to that mortgage. THDA suggests borrowers consult a tax preparer when selling is considered.

Other facts -

- Refinancing within nine years of closing the THDA mortgage does not initiate the recapture tax. Refinancing and paying off a THDA mortgage loan does not eliminate recapture tax liability if the house originally purchased with THDA mortgage loan is sold within the original nine-year period.
- Selling a house purchased with a THDA mortgage loan to someone who qualifies for and assumes the THDA mortgage loan does not eliminate recapture tax for the THDA borrower who is selling the house.
- A buyer who qualifies to assume a THDA mortgage loan also has a recapture tax liability that extends for nine years from the date they assume the THDA mortgage loan.
- The Internal Revenue Service (IRS) enforces the recapture tax requirement.
- IRS Form 8828 "Recapture of Federal Mortgage Subsidy" is used for calculating recapture tax. This form may be ordered from the IRS by calling: 1-800-829-3676 or through the IRS site: www.irs.gov.

Tennessee Housing Development Agency (THDA)
Notice to Applicants
FEDERAL RECAPTURE TAX REQUIREMENTS

IMPORTANT INFORMATION

APPLICATION DISCLOSURE

PLEASE READ

(to be provided to the Applicant at time of application)

The interest rate on your THDA loan is a below market rate due to a subsidy produced by THDA's issuance of tax-exempt bonds. As a result of a law passed by Congress in 1988, you may, under certain circumstances, be subject to a recapture tax designed to recover some amount of the subsidy reflected in your below market interest rate. This notice contains a brief description of this recapture tax and how it may affect you. THDA recommends, however, that you consult a tax advisor if you have questions about the recapture tax and that you consult a tax advisor at the time you sell or otherwise dispose of your home financed with a THDA loan.

There is no recapture tax if you own your home for more than nine years from the date you close your THDA loan. If you do sell or otherwise dispose of your home within nine years from the date you close your THDA loan, you are subject to the recapture tax and must determine whether you need to pay recapture tax to the federal government.

Several factors determine whether you must pay any recapture tax. These factors include your original loan amount, the length of time you own your home financed with the THDA loan, your income and family size at the time of sale, and the gain that you realize on the sale of your home. Since your income and family size may change during the time you own your home and since gain cannot be determined until an actual sale occurs, there is no way to predict whether you will have to pay recapture tax. Regardless of these factors, any recapture tax you may have to pay is limited to the lesser of (i) your original THDA loan amount times 6.25 or (ii) half of the actual gain from the sale or other disposition of your home financed with the THDA loan.

If you sell your home to a buyer eligible to assume the THDA loan, you must still determine whether you owe recapture tax. The buyer is also subject to the recapture tax for nine years beginning on the date your sale to the buyer is closed.

The recapture tax applies to any disposition of your home financed with the THDA loan, whether by sale, exchange, involuntary conversion, or any other transfer of any interest. If you refinance your THDA loan (without selling your home), no recapture tax is due at the time of refinancing, however, you may still owe recapture tax if you sell your house after the refinancing and the sale occurs within nine years from the date you closed your THDA loan.

If your home is damaged or destroyed by fire, storm, or other casualty, you may not owe recapture tax, if within two years, you rebuild your principle residence on the same site. Generally, you may not owe recapture tax if you transfer your home to a spouse, or a former spouse as a result of a divorce, or if your home is transferred as a result of your death.

The undersigned acknowledges that I/we have read and understand the above disclosure.

Applicant: _____

Date: _____

Applicant: _____

Date: _____

TO COMPUTE RECAPTURE TAX ON SALE OF HOME

A. Introduction.

1. General. When you sell your home you may have to pay a recapture tax as calculated below. The recapture tax may also apply if you dispose of your home in some other way. Any references in this notice to the 'sale;' of your home also includes other ways of disposing of your home. For instance, you may owe the recapture tax if you give your home to a relative.
2. Exceptions. In the following situations, no recapture tax is due and you do not need to do the calculations.
 - (a) You dispose of your home later than nine years after you close your mortgage loan;
 - (b) Your home is disposed of as a result of your death;
 - (c) You transfer your home either to your spouse or to your former spouse incident to divorce and you have no gain or loss included in your income under section 1041 of the Internal Revenue Code; or
 - (d) You dispose of your home at a loss.

B. Maximum Recapture Tax. The maximum recapture tax that you may be required to pay as an addition to your federal income tax is 6,380.75. This amount is 6.25% of the highest principal amount of your mortgage loan and is your federally subsidized amount with respect to the loan.

C. Actual Recapture Tax. The actual recapture tax, if any, can only be determined when you sell your home, and is the lesser of (1) 50% of your gain on the sale of your home, regardless of whether you have to include that gain in your income for federal income tax purposes, or (2) your recapture amount determined by multiplying the following three numbers: (i) 6,380.75 (the maximum recapture tax, as described in Paragraph B above), (ii) The holding period percentage, as listed in Column 1 in the Table, and (iii) The income percentage, as described in paragraph D below.

D. Income Percentage. You calculate the income percentage as follows: (i) Subtract the applicable adjusted qualifying income in the taxable year in which you sell your home, as listed in Column 2 in the Table, from your modified adjusted gross income in the taxable year in which you sell your home.

Your modified adjusted gross income means your adjusted gross income shown on your federal income tax return for the taxable year in which you sell your home, with the following two adjustments: (a) your adjusted gross income must be increased by the amount of any interest that you receive or accrue in the taxable year from tax-exempt bonds that is excluded from your gross income (under section 103 of the Internal Revenue Code); and (b) your adjusted gross income must be decreased by the amount of any gain included in your gross income by reason of the sale of your home. (ii) If the amount calculated in (i) above is zero or less, you owe no recapture tax and do not need to make any more calculations. If it is \$5,000 or more, your income percentage is 100%. If it is greater than zero but less than \$5,000, it must be divided by \$5,000. This

fraction, expressed as a percentage, represents your income percentage. For example, if the fraction is \$1,000/\$5,000, your income percentage is 20%.

E. Limitations and Special Rules on Recapture Tax.

1. If you give away your home (other than to your spouse or ex-spouse incident to divorce), you must determine your actual recapture tax as if you had sold your home for its fair market value.
2. If your home is destroyed by fire, storm flood, or other casualty, there generally is no recapture tax if, within two years, you purchase additional property for use as your principal residence on the site of the home financed with your original subsidized mortgage loan.
3. In general, except as provided in future regulations, if two or more persons own a home and are jointly liable for the subsidized mortgage loan, the actual recapture tax is determined separately for them based on their interest in the home.
4. If you repay your loan in full during the nine year recapture period and you sell your home during this period, your holding period percentage may be reduced under the special rule in section 143(m)(4)(C)(ii) of the Internal Revenue Code.
5. Other special rules may apply in particular circumstances. You may wish to consult with a tax advisor or the local office of the Internal Revenue Service when you sell or otherwise dispose of your home to determine the amount, if any, of your actual recapture tax. See section 143(m) of the Internal Revenue Code generally.

Please read the preceding requirements concerning recapture of federal subsidies and understand that if you sell, transfer or otherwise dispose of the home within 9 years after the date of your loan, you have the responsibility of computing and paying any recapture amount due to Internal Revenue Service.