UNDERSTANDING RECAPTURE TAX

WHAT IS THE RECAPTURE TAX? In 1989, a federal law was passed which provides for a "recapture tax" on the gain from a borrower's sale of a residence financed with a Mortgage Revenue Bond (MRB). This provision is administered by the Internal Revenue Service ("IRS"). When you receive a Mortgage Revenue Bond ("MRB") loan or a Mortgage Credit Certificate ("MCC"), you are receiving the benefit of a federal income tax credit. The law mandates a "recapture" of some of the benefit of the program that is not customarily available with other mortgage loans.

WHAT CONDITIONS MAKE A BORROWER LIABLE FOR RECAPTURE TAX? If "Recapture Tax" is owed, it is computed and paid to the IRS for the tax year in which the home is sold. To owe any recapture tax at all, you must (1) sell your MCC or MRB financed home within nine years, **AND** (2) earn significantly more income than when you bought the home, and **AND** (3) gain from the sale. All three of these criteria must be met. Note:

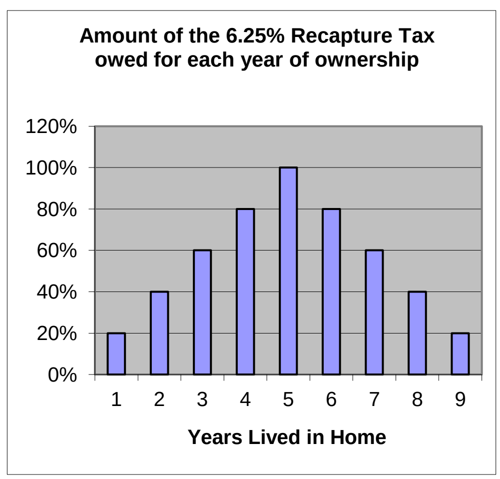
- If your household income does not rise significantly over the life of the loan (generally more than five percent per year), there is no recapture tax due.
- If you sell your home anytime after nine years, there is no recapture tax due.
- If you sell your home within nine years but there is no gain, there is no recapture tax due.

You may not have to pay recapture tax if your home is destroyed by fire, storm, flood or other casualty, there is generally no recapture tax if within two years if you build or rehab for use as your principal residence on the site of the home financed with your original subsidized mortgage loan.

You are not subject to the recapture tax if you sell or give away or dispose of your home later than 9 full years after you close on your mortgage loan, or your home is disposed of as a result of your death, or you transfer your home to your spouse or your former spouse as an agreement of your divorce and you not have a not gain or loss included in your income as a result of the transfer.

HOW MUCH IS THE RECAPTURE TAX? If the three criteria listed above are met, then a portion of the gain received will be due as a recapture tax. The tax is calculated based on the amount of the original mortgage, the length of time the borrower lived in the home and the amount of income increase since the purchase of the home. The tax will never exceed one-half of the gain on the sale of the home, or 6.25% of the original mortgage, whichever is less.

Recapture taxes are figured on a scale based on the number of years the borrower has lived in the house, with the fifth year potentially being the costliest time to sell as that is when the maximum recapture tax due rises to 6.25% percent.



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The five percent increase in income that makes a borrower a candidate for recapture is figured from the maximum income limit for the MRB program or MCC at the time of purchase. For example, if a borrower earned $40,000 per year when the home was purchased, and at that time the maximum income limit was $50,000, then the five percent increase would be figured from $50,000, not $40,000.

The borrower would actually have to earn in excess of a five percent increase in salary each year to trigger the recapture tax. If the borrower's income exceeds the maximum income limit, but not by more than $5,000, the amount of the recapture tax will be reduced.

The amount of potential recapture tax could further be reduced by items such as realtor, legal and closing fees accrued in connection with the sale. These items are deducted from the gain on the sale before computing the fifty percent of gain limitation. For example, a borrower may have a substantially increased income, sell the home in year five, and realize a gain on the sale. Yet the recapture tax would be limited to fifty percent of the gain after deduction of transaction expenses.

HOW HIGH IS THE RISK OF THE RECAPTURE TAX? When the program serves those it's intended for, recapture is seldom a threat. For most people, the financial benefits of homeownership – deductions for mortgage interest and taxes, as well as the MCC or MRB program's lower interest rates and down payment assistance, far outweigh the risks of recapture.

INFORMATION YOU WILL NEED IN THE FUTURE

A Notice of Potential Recapture Tax on Sale of Home will be provided to you at closing. This document should be kept with your other mortgage documents. The notice contains information that you will need in order to complete IRS Form 8828, such as:

- The loan amount (the highest principal amount on the loan)
- Closing Date
- Name of the Issuer of the Bonds/MCC
- Name of the original lender that made the loan, and
- Chart that details data necessary to complete IRS Form 8828

OTHER FREQUENTLY ASKED QUESTIONS……

Can TDHCA tell me exactly what my Recapture Tax will be? No. Because all Staff comments are subject to tax law interpretation, TDHCA's staff cannot assist you in determining the exact amount of the tax.

When is the Recapture Tax paid? Any Recapture Tax due is to be submitted with the individual tax return for the year in which the property was sold. For instance, if the property was sold in 2015, the Recapture Tax, if any, along with IRS Form 8828, must be submitted with IRS Form 1040 in 2016. **It is strongly recommended that the services of a tax preparer be obtained for the tax year the Recapture Tax form is required to be submitted.**

Will recapture eliminate a borrower's gain from the sale of the home? No. A gain is required for a Recapture Tax to be assessed; however, the amount of the gain can only cause the Recapture Tax to be reduced, never increased. The formula looks at 50% of the gain to see if it is less than the calculated Recapture Tax, and, if it is, you pay that lower amount.

What happens if the loan is assumed? 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.

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

Does a refinance activate the Recapture Tax? No, however, it does not eliminate the Recapture Tax either. If the mortgage is refinanced and then the home is sold within the first nine years of ownership, the potential for Recapture Tax still exists. If you have a Mortgage Credit Certificate ("MCC") with TDHCA, you will need to complete an MCC refinancing application.

Is recapture tax due if the borrower gives away the residence? Yes. The recapture tax must be calculated as if the residence was sold at fair market value.

What is needed to calculate Recapture Tax? The closing statement from when the home was purchased, the closing statement from when the home was sold, the closing statement from the first of any refinances, and the Recapture Notice the borrower would have received when the loan originally closed.

FOR MORE INFORMATION

Contact the IRS and request Form 8828 and the instructions for Form 8828 (both available on the IRS Website: http://www.irs.gov In the Forms and Publications search box, type "8828" and click). Review the form and instructions now. Consult your tax advisor. In the year that you sell your home, you are required to complete Form 8828 and submit it with your federal income tax return (even after the full 9 years). The income that will be considered in that year will be your modified adjusted gross income from your federal income tax return.