

5 – RECAPTURE TAX



BACKGROUND

The Internal Revenue Code of 1986 established the recapture tax requirement for all loans closed after January 1991. The recapture tax requires certain borrowers to repay the government a portion of their gain upon the sale of the home if they financed their home with a mortgage loan from the proceeds of a tax-exempt bond.

APPLICATION OF TAX

The recapture tax is assessed only under the following circumstances:

- The home is sold or otherwise disposed of during the first nine years of ownership;
- The Borrower's income increases each year by 5 percent above the maximum federal income limit at the time of purchase; and
- The Borrower realizes a gain upon the sale of the home.

Because all of these events must occur for any tax to be paid, it is unlikely that most Borrowers will pay a recapture tax.

In the event that a recapture tax is due, it will be only a portion of the Borrower's gain on the sale of the home. The law states that the maximum recapture tax is either 50% of the gain on the sale or 6.25% of the original loan amount, whichever is less.

REFINANCING

If the Borrower refinances their loan which is subject to recapture tax, the refinancing does not trigger the calculation of recapture tax because the property has not been disposed of or sold.

BORROWER'S RESPONSIBILITY

All Borrowers will need to complete IRS Form 8828, Recapture of Federal Mortgage Subsidy, when they file their federal income taxes for the year in which the home is sold or disposed of. This form calculates any recapture tax that may be due. Borrowers having specific questions regarding the correct completion of this form should contact the IRS for assistance.

LENDER'S RESPONSIBILITY

At loan application, it is the Mortgage Lender's responsibility to make the applicant aware of the federally-imposed recapture tax by presenting to the applicant for signature the Notice to Buyers (Form 15.7). This form is included in the Forms section of this Program Manual. A copy of this form is provided to the applicant and the original form is submitted with the Pre-Closing Compliance Review file.

A sample worksheet entitled Notice to Mortgagor of Information Regarding Potential Federal Subsidy Recapture Tax (Form 15.10) should be attached to the applicant's copy of the Notice to Buyers form. This worksheet shows an example of how to calculate the recapture tax based on the total amount of federal subsidy the Borrower receives.

At loan closing, the Mortgage Lender must have the Borrower(s) sign the Notice of Potential Recapture Tax on Sale of Your Home (Form 15.14). This form, included in the Forms section of this Program Manual, once duly executed is submitted with the Post Closing Compliance Review loan file and a copy is provided to the Borrower.

If the Mortgage Lender does not sell the Mortgage Loan to the Commission, the Borrower must be notified that the recapture tax provisions no longer apply. A Notice of Cancellation of Recapture Tax form (Form 15.29) is provided in the Forms section of this Program Manual. This form must be provided to the Borrower on the Mortgage Lender's letterhead if the Mortgage Loan is not purchased by the Commission.

COMMISSION'S RESPONSIBILITY

Within 90 days after loan closing the Commission will provide a notice to the Borrower detailing the recapture tax calculation.