

## RECAPTURE TAX

In 1990, Congress passed a law that provides for a recapture tax on the gain from the sale of a residence financed with mortgage revenue bond proceeds. The recapture tax applies to all loans closed after December 1, 1990 and is an additional tax liability, payable with the homeowner's federal income tax, in accordance with the Internal Revenue Code of 1986.

### Why a recapture tax?

The objective of recapture tax is to enable the federal government to collect or "recapture" the subsidy received by the borrower in below-market interest rates and down payment assistance, financed with tax-exempt mortgage revenue bonds.

Generally, recapture tax is due on the sale or disposition of the property; however, NO recapture tax is due if one or more of the following conditions are met:

- 1) The property is transferred to a spouse or a former spouse as a result of divorce.
- 2) The property is transferred as a result of the borrower's death.
- 3) There is an involuntary transfer or a destruction of the property due to fire or other casualty, as long as a replacement home is purchased on the site of the original residence.
- 4) There is no gain on the sale of the property.
- 5) The borrower's actual gross income in the year the property is sold does not exceed the modified adjusted gross income (as defined below).
- 6) The sale occurs more than nine years after the mortgage loan was closed.

### TO SUMMARIZE RECAPTURE TAX

#### Recapture Tax is Due If

- ◆ the property is sold within 9 years after the mortgage closed;
- AND
- ◆ there is a gain (net profit) on the sale of the home;
- AND
- ◆ borrowers experience substantial increases in their income, above the modified adjusted gross income

#### NO Recapture Tax is Due if

- ◆ the property is sold 9 years or more after the mortgage closed;
- OR
- ◆ there is no gain on the sale of the property;
- OR
- ◆ borrowers actual gross income in the year the property sells does not exceed the modified adjusted gross income

Note: The borrower should consult a tax advisor or the local office of the IRS for any in-depth questions about recapture-or when the property is sold or otherwise disposed of-to determine the amount, if any, of the recapture tax owed.

**Calculation of Recapture Tax**

The maximum recapture tax that can ever be paid is the lesser of:

- ◆ 6.25% of the original mortgage amount OR
- ◆ 50% of the gain realized on the sale of the residence.

Recapture tax is calculated when the home is sold. The following information is needed:

- 1) Original loan amount
- 2) Original borrower income when the loan was made
- 3) Program income limit when the loan was made
- 4) Number of years the loan was outstanding
- 5) Borrower's adjusted gross income from tax returns
- 6) Borrower's gain on the sale of the property

**Steps in Calculating the Actual Recapture Tax**

**Step 1**

Calculate the **Maximum Recapture Tax** by multiplying the original mortgage loan amount by the maximum recapture percentage of 6.25%.

\_\_\_\_\_ (Loan Amount) X 6.25% = \_\_\_\_\_ (Maximum Recapture Tax)

**Step 2**

Find the **Holding Period Percentage** from the table below. To do this, round up the number of years the loan was held from the date of closing (i.e., If held for 6 years and 2 months, then the holding period would be based on 7 years or 60% of the maximum recapture).

Number of Years Held	Appropriate Holding Period Percentages
1 Year	20% of the maximum recapture
2 Years	40% of the maximum recapture
3 Years	60% of the maximum recapture
4 Years	80% of the maximum recapture
5 Years	100% of the maximum recapture
6 Years	80% of the maximum recapture
7 Years	60% of the maximum recapture
8 Years	40% of the maximum recapture
9 Years	20% of the maximum recapture
10 Years	Recapture no longer applicable

\_\_\_\_\_ (Maximum Recapture Tax from Step 1) X \_\_\_\_\_ (Holding Period Percentage)  
= \_\_\_\_\_ (Maximum Recapture Tax for Holding Period)

### Step 3

Adjust the qualifying income limit that was in effect at the time the loan was made upward by a factor of 1.05 for each year the loan was held. This is referred to as the Adjusted Qualifying Income.

Example:   \$40,400.00 (Year 0 to 1)  
              \$40,400.00 x 1.05 = \$42,420.00 (Year 1 to 2)  
              \$42,420.00 x 1.05 = \$44,541.00 (Year 2 to 3)  
              \$44,541.00 x 1.05 = \$46,768.05 (Year 3 to 4)

If the program limit at the time the loan was closed was \$40,400.00 and you held the mortgage for 3 1/2 years, then the Adjusted Qualifying Income would be \$46,768.05.

### Step 4

Subtract the Adjusted Qualifying Income calculated in Step 3 above from the borrower's Modified Adjusted Gross Income at the time of sale or disposition. The Modified Gross Income is the Adjusted Gross Income reflected on the borrower's tax return, increased by any interest earned on tax-exempt bonds that was excluded in calculating Adjusted Gross Income and decreased by the amount of any gain included in income by reason of the sale of the residence.

- ◆ If the Modified Adjusted Gross Income at the time the property is sold is less than the applicable Adjusted Qualifying Income, then the Income Percentage is zero; and, thus, no recapture tax is owed by the borrower.
- ◆ If the Modified Adjusted Gross Income exceeds the Adjusted Qualifying Income by less than \$5,000, then divide the difference by \$5,000 to obtain the Income Percentage (rounded to the nearest whole percentage point).
- ◆ If the Modified Adjusted Gross Income equals or exceeds the Adjusted Qualifying Income by \$5,000, then the Income Percentage is 100%; and the Maximum Recapture Tax is, therefore, equal to the Maximum Recapture Tax for the holding period, calculated in Step 2 above.

### Step 5

**The Actual Recapture Tax the borrower must pay is the lesser of:**

- ◆ 50% of the gain on the sale of the home OR
- ◆ The recapture amount determined by multiplying the Maximum Recapture Tax for Holding Period (Step 2) by the Income Percentage (Step 4).

**RECAPTURE TAX WORKSHEET**

Original Loan Amount \_\_\_\_\_  
 Adjusted Gross Income Per Tax Return \_\_\_\_\_  
 Program Qualify Income Limit at Time Loan Close \_\_\_\_\_  
 Number of Years Loan Held (Round Up) \_\_\_\_\_  
 Borrower's Gain on the Sale \_\_\_\_\_

\_\_\_\_\_ (Loan Amount) X 6.25% = \_\_\_\_\_ (Maximum Recapture Tax)  
 \_\_\_\_\_ (Maximum Recapture Tax) X \_\_\_\_\_ (Holding Period Percentage)  
 = \_\_\_\_\_ (Maximum Recapture Tax for Holding Period)

To calculate the Adjusted Qualifying Income multiply the initial Program Qualifying Income Limit by a factor of 1.05 for each year the loan was held.

Number of Years	Family Size/Original Limit	
	2 or Less	3 or More
0	_____	_____
1	_____	_____
2	_____	_____
3	_____	_____
4	_____	_____
5	_____	_____
6	_____	_____
7	_____	_____
8	_____	_____
9	_____	_____

Enter Adjusted Gross Income Per Tax Return \_\_\_\_\_  
 Less: Adjusted Qualifying Income - \_\_\_\_\_  
 Difference = \_\_\_\_\_

Divide Difference by \$5,000 to obtain Income Percentage  
 (However, if the difference is less then \$0, then Income Percentage is zero;  
 and if the difference is greater than \$5,000 then the Income Percentage is 100%)

\_\_\_\_\_ (Maximum Recapture Tax For Holding Period) X \_\_\_\_\_ (Income Percentage)  
 = \_\_\_\_\_ (Maximum Recapture Tax to be paid)

The actual recapture tax the borrower must pay is the lesser of.  
 50% of the gain on the sales of the home OR the recapture amount determined above  
**IN NO EVENT MAY THE AMOUNT OF RECAPTURE TAX EXCEED 50% OF THE GAIN ON  
 THE SALE OR DISPOSITION OF THE PROPERTY.**

**Recapture Tax to be paid based on the lesser of the two:** \_\_\_\_\_

**EXAMPLES OF RECAPTURE TAX**

***Example 1***

**Income Increase/Gain on the House Sale/Sold in the Fourth Year**

Original Loan Amount	\$65,000
Adjusted Gross Income Per Tax Return	\$52,000
Program Qualify Income Limit at Time Loan Close	\$39,500 NT & \$45,425 T
Number of Years Loan Held (Round Up)	4
Borrower's Gain on the Sale	\$8,700 (50% = \$4,350)

$$\begin{array}{r}
 \$65,000 \text{ (Loan Amount)} \times 6.25\% = \$4,062.50 \text{ (Maximum Recapture Tax)} \\
 \$4,062.50 \text{ (Maximum Recapture Tax)} \times 80\% \text{ (Holding Period Percentage)} \\
 = \underline{\$3,250.00} \text{ (Maximum Recapture Tax for Holding Period)}
 \end{array}$$

To calculate the Adjusted Qualifying Income multiply the initial Program Qualifying Income Limit by a factor of 1.05 for each year the loan was held.

Number of Years	Family Size/Original Limit	
	2 or Less	3 or More
0	\$39,500.00	\$45,425.00
1	\$41,475.00	\$47,696.25
2	\$43,548.75	\$50,081.06
3	\$45,726.19	\$52,585.12
4	\$48,012.50	\$55,214.37
5	\$50,413.12	\$57,975.09
6	\$52,933.78	\$60,873.84
7	\$55,580.47	\$63,917.54
8	\$58,359.49	\$67,113.41
9	\$61,277.46	\$70,469.08

Enter Adjusted Gross Income Per Tax Return	\$52,000.00
Less: Adjusted Qualifying Income	- \$48,012.50
Difference	= \$3,987.50

Divide Difference by \$5,000 to obtain Income Percentage 80%  
 (However, if the difference is less than \$0, then Income Percentage is zero;  
 and if the difference is greater than \$5,000 then the Income Percentage is 100%)

$$\begin{array}{r}
 \$3,250.00 \text{ (Maximum Recapture Tax For Holding Period)} \times 80\% \text{ (Income Percentage)} \\
 = \underline{\$2,600.00} \text{ (Maximum Recapture Tax to be paid)}
 \end{array}$$

The actual recapture tax the borrower must pay is the lesser of.  
 50% of the gain on the sales of the home OR the recapture amount determined above  
**IN NO EVENT MAY THE AMOUNT OF RECAPTURE TAX EXCEED 50% OF THE GAIN ON  
 THE SALE OR DISPOSITION OF THE PROPERTY.**

**Recapture Tax to be paid based on the lesser of the two:** \$2,600.00

**EXAMPLES OF RECAPTURE TAX**

***Example 2***

**No Income Increase/Gain on House Sale/Sold in the Fifth Year**

Original Loan Amount	\$65,000
Adjusted Gross Income Per Tax Return	<u>\$38,000</u>
Program Qualify Income Limit at Time Loan Close	<u>\$39,500 NT &amp; \$45,425 T</u>
Number of Years Loan Held (Round Up)	<u>5</u>
Borrower's Gain on the Sale	<u>\$10,000 (50% = \$5,000)</u>

$$\frac{\$65,000}{\$4,062.50} \text{ (Loan Amount) } \times 6.25\% = \$4,062.50 \text{ (Maximum Recapture Tax)}$$

$$\frac{\$4,062.50}{\$4,062.50} \text{ (Maximum Recapture Tax) } \times 100\% = 100\% \text{ (Holding Period Percentage)}$$

$$= \frac{\$4,062.50}{\$4,062.50} \text{ (Maximum Recapture Tax for Holding Period)}$$

To calculate the Adjusted Qualifying Income multiply the initial Program Qualifying Income Limit by a factor of 1.05 for each year the loan was held.

Number of Years	Family Size/Original Limit	
	2 or Less	3 or More
0	<u>\$39,500.00</u>	<u>\$45,425.00</u>
1	<u>\$41,475.00</u>	<u>\$47,696.25</u>
2	<u>\$43,548.75</u>	<u>\$50,081.06</u>
3	<u>\$45,726.19</u>	<u>\$52,585.12</u>
4	<u>\$48,012.50</u>	<u>\$55,214.37</u>
5	<u>\$50,413.12</u>	<u>\$57,975.09</u>
6	<u>\$52,933.78</u>	<u>\$60,873.84</u>
7	<u>\$55,580.47</u>	<u>\$63,917.54</u>
8	<u>\$58,359.49</u>	<u>\$67,113.41</u>
9	<u>\$61,277.46</u>	<u>\$70,469.08</u>

Enter Adjusted Gross Income Per Tax Return	\$38,000.00
Less: Adjusted Qualifying Income	<u>- \$50,413.12</u>
Difference	<u>= (\$12,413.12)</u>

Divide Difference by \$5,000 to obtain Income Percentage 0%  
 (However, if the difference is less than \$0, then Income Percentage is zero;  
 and if the difference is greater than \$5,000 then the Income Percentage is 100%)

$$\frac{\$4,062.50}{\$4,062.50} \text{ (Maximum Recapture Tax For Holding Period) } \times 0\% \text{ (Income Percentage)}$$

$$= \frac{\$0.00}{\$4,062.50} \text{ (Maximum Recapture Tax to be paid)}$$

The actual recapture tax the borrower must pay is the lesser of.  
 50% of the gain on the sales of the home OR the recapture amount determined above  
**IN NO EVENT MAY THE AMOUNT OF RECAPTURE TAX EXCEED 50% OF THE GAIN ON  
 THE SALE OR DISPOSITION OF THE PROPERTY.**

**Recapture Tax to be paid based on the lesser of the two:** \$0.00

**EXAMPLES OF RECAPTURE TAX**

***Example 3***

**Income Increase/Gain on House Sale/Sold in the Eighth Year**

Original Loan Amount	\$65,000
Adjusted Gross Income Per Tax Return	<u>\$70,000</u>
Program Qualify Income Limit at Time Loan Close	<u>\$39,500 NT &amp; \$45,425 T</u>
Number of Years Loan Held (Round Up)	<u>8</u>
Borrower's Gain on the Sale	<u>\$9,500 (50% = \$4,750)</u>

$$\begin{array}{r}
 \$65,000 \text{ (Loan Amount)} \times 6.25\% = \$4,062.50 \text{ (Maximum Recapture Tax)} \\
 \$4,062.50 \text{ (Maximum Recapture Tax)} \times 40\% \text{ (Holding Period Percentage)} \\
 = \underline{\$1,625.00} \text{ (Maximum Recapture Tax for Holding Period)}
 \end{array}$$

To calculate the Adjusted Qualifying Income multiply the initial Program Qualifying Income Limit by a factor of 1.05 for each year the loan was held.

Number of Years	Family Size/Original Limit	
	2 or Less	3 or More
0	<u>\$39,500.00</u>	<u>\$45,425.00</u>
1	<u>\$41,475.00</u>	<u>\$47,696.25</u>
2	<u>\$43,548.75</u>	<u>\$50,081.06</u>
3	<u>\$45,726.19</u>	<u>\$52,585.12</u>
4	<u>\$48,012.50</u>	<u>\$55,214.37</u>
5	<u>\$50,413.12</u>	<u>\$57,975.09</u>
6	<u>\$52,933.78</u>	<u>\$60,873.84</u>
7	<u>\$55,580.47</u>	<u>\$63,917.54</u>
8	<u>\$58,359.49</u>	<u>\$67,113.41</u>
9	<u>\$61,277.46</u>	<u>\$70,469.08</u>

Enter Adjusted Gross Income Per Tax Return	\$70,000.00
Less: Adjusted Qualifying Income	<u>- \$58,359.49</u>
Difference	<u>= \$11,640.51</u>

Divide Difference by \$5,000 to obtain Income Percentage 100%  
 (However, if the difference is less than \$0, then Income Percentage is zero;  
 and if the difference is greater than \$5,000 then the Income Percentage is 100%)

$$\begin{array}{r}
 \$1,625.00 \text{ (Maximum Recapture Tax For Holding Period)} \times 0\% \text{ (Income Percentage)} \\
 = \underline{\$1,625.00} \text{ (Maximum Recapture Tax to be paid)}
 \end{array}$$

The actual recapture tax the borrower must pay is the lesser of.  
 50% of the gain on the sales of the home OR the recapture amount determined above  
**IN NO EVENT MAY THE AMOUNT OF RECAPTURE TAX EXCEED 50% OF THE GAIN ON  
 THE SALE OR DISPOSITION OF THE PROPERTY.**

**Recapture Tax to be paid based on the lesser of the two:** \$1,625.00