



OHFA GOLD

Down Payment Assistance Product

Recapture Tax 101

Federal Recapture Tax Made Simple

Some homebuyers, builders, Realtors® and mortgage lenders who want to use the Oklahoma Housing Finance Agency's low interest rate loans are concerned about the federal "recapture tax". This simple explanation may alleviate those needless worries and help more people who could benefit from our OHFA Gold Mortgage Revenue Bond (MRB) programs.

HISTORY of RECAPTURE TAX

A federal law commonly known as "recapture tax" applies to borrowers who buy their homes using MRBs like those issued by the Oklahoma Housing Finance Agency.

Recapture tax requires some mortgagors to repay the government a portion of their gain upon the sale of the home if they financed their home with an OHFA Gold loan. The Internal Revenue Service (IRS) administers this provision. If any recapture tax is due, the mortgagor pays it to the IRS after selling the home. At OHFA Gold loan closings, OHFA provides a "Recapture Settlement Disclosure" form showing the maximum recapture tax which could be due, if any.

Simplifying the Puzzle

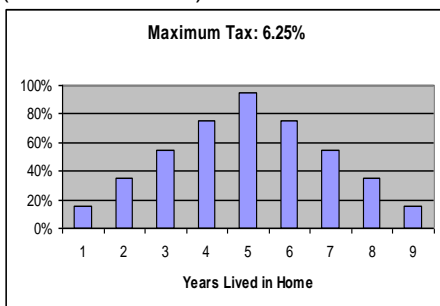
In reality, most borrowers will not have to pay any recapture tax. For others, the amount will be minimal. In any case, the tax will never exceed one-half of the gain on the sale of the home, or 6.25% of the original mortgage, whichever is less.

This may sound complicated, but in many cases, no tax is due. For example:

- If the household income does not rise significantly over the life of the loan (generally more than 5 percent per year), there is no recapture.
- If you sell your home any time after nine years, there is no recapture.
- If you sell your home within nine years but there is no gain, there is no recapture.

In other words, to owe any recapture tax at all, you must sell your home within nine years, earn significantly more income than when you bought the home, **and** gain from the sale. **All three of these criteria must be met.**

The basis of recapture is this: Mortgagors will never pay more than 6.25 percent of the original loan amount and usually will pay less, if they pay at all. Recapture tax is figured on a scale based on the number of years the homebuyer has lived in the house, with the fifth year being the worst time to sell (see chart below).



The maximum recapture tax due is only 6.25 percent in year five of homeownership.

But that's not the end of the story. The tax guidelines are structured to help mortgagors even if they do have to pay.

- The 5 percent increase in income that makes a mortgagor a candidate for recapture is figured from the maximum income limit for the OHFA Gold loan programs at the time of purchase. For example, Fred earned \$40,000 per year when he purchased his home. At the time, the maximum income limit was \$50,000. The 5 percent increase would be figured from \$50,000, not \$40,000. Fred would actually have to receive in excess of a 5 percent increase in salary each year to be considered for recapture. The reality of recapture there is no recapture.
- Recapture tax may not exceed 50 percent of the gain the mortgagor realizes upon the sale of the home. Even if Fred sold his home in year five, his income increased significantly, and he made \$2,000 off the sale, the maximum he could owe is \$1,000. And the gain is calculated after items such as Realtor, legal and closing fees are subtracted.
- If the mortgagor's income exceeds the maximum income limit, but not by more than \$5,000, only a percentage of the tax must be paid. When the program serves those it's intended for, recapture tax is seldom a threat. For most people, the financial benefits of homeownership—deductions for mortgage interest and taxes as well as the OHFA Gold program benefits—far outweigh the risks of recapture.

Q & A of Recapture:

Q: Will recapture 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 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 applying a new recapture tax to the assuming purchaser.

Q: Does a refinance activate the Recapture Tax?

A: No, however, it does not eliminate the Recapture Tax. 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.

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

A: OHFA is required to report to the IRS the name, address, and Social Security numbers of all recipients of OHFA Gold 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 tax 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: What if the home is destroyed because of 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 tax is due at that time.