

The Reason for Recapture

Minnesota Housing loans are financed with funds made available through the sale of federally tax exempt mortgage revenue bonds (MRB) which, in turn, allows Minnesota Housing to offer below market interest rates on our first-time homebuyer loans. The Internal Revenue Code enables the federal government to recoup some of the tax-exempt subsidy under certain conditions. This means that homebuyers who receive MRB loans may be required to pay a subsidy recapture tax if they sell or transfer their house during the first nine years of the loan and meet the other recapture conditions. These conditions are disclosed to the borrower by the lender at the time of closing.

For most homebuyers, the financial benefits of home ownership i.e., deductions for mortgage interest and taxes, as well as the MRB program's lower interest rate and downpayment assistance, far outweigh the risk of recapture.

What Triggers Recapture?

To owe recapture tax, all three of the following criteria must apply. The borrowers must:

- Sell their home within the first nine years after closing the loan,
- Earn significantly more income than when they bought the home, and
- Realize a gain from the sale of the home as defined by the IRS (*this is different from exposure to capital gains tax*)

While a refinance does not trigger payment of the tax, it also does not eliminate the recapture tax, which remains in place for the nine (9) year period from the original loan closing.

What If Recapture Tax Has To Be Paid?

Most homebuyers will never have to pay any recapture tax, but those few that do meet all three conditions, must pay the recapture tax to the IRS when they file their federal income tax return for the year in which the home is sold. However, the tax provisions are structured to limit the amount homeowners pay.

Borrowers will never pay more than 6.25% of the original note amount. In addition, the overall repayment may be reduced by the following factors:

- Holding period percentage (*the percentage of the recapture tax adjusts depending on how long the borrower has been in the home, with the fifth year having the highest percentage*).
- Income percentage (*if the borrower's income exceeds the maximum income limit, but not by more than \$5,000, only a percentage of the tax must be paid*).
- The repayment tax cannot exceed 50% of the gain on sale.

Questions about Recapture

For questions about paying the tax, homeowners should consult a tax specialist or contact the IRS directly at 1-800-829-1040.