

Mortgage Certificate Tax Credits – Doubling Your Borrowers' Tax Benefits

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It seems like as much as things have changed, the more they stay the same. It never ceases to amaze me how the programs we used to use, are making a come back in today's lending environment.

Mortgage Credit Certificates (MCC's) are such a program.

An MCC is a dollar for dollar tax credit on a borrower's federal tax return. This credit is used to offset a tax liability. That means in order to get the full benefit of the credit your client must have a tax liability at the end of the year.

In a nutshell, this liability is "washed" away by the tax credit.

Most borrowers create a tax liability by changing their withholdings out of their paycheck. That means more money in every paycheck. Because the amount of tax withheld from the borrowers check is decreased, this should lead to a tax liability at the end of the year. The tax liability can be washed away dollar for dollar by the MCC credit.

Read the examples, how it works. Download copies of the IRS forms, IRS Publication 530. And always, always, refer clients to a tax advisor.

MCC's are generally issued by State/Local Housing Finance Agencies (HFA's) but are not offered in all states. MCC's are generally limited to First Time Homebuyers, while some HFA's may allow buyers in targeted geographic areas to be non-first time buyers. Generally, MCC's are limited to low to moderate income borrowers. Income limits vary according to the geographic location of the property and are determined by the HFA that is issuing the MCC.

An MCC credit is equal to a minimum of 10% of the interest paid by a borrower during the year and can be as high as 50% of the interest paid for some borrowers. In most cases, the MCC credit is 10 to 25% of the interest paid on a mortgage during the calendar year. The percentage of the credit is set by the HFA that issues it.

If a borrower pays \$5,000 a year in interest and has a 20% MCC credit, that credit amounts to an extra \$1,000 for the borrower over the year. That equals an extra \$83.33 per month in the borrowers pocket and can mean as much as an extra \$5k to \$10k in buying power for a client. In addition for borrowers with higher debt ratios the MCC credit may help them qualify.

Borrowers using an MCC credit are qualified differently depending on the type of loan they are doing. Conventional mortgage borrowers can have the amount of the credit added back into their monthly income to help them qualify.

Borrowers using an FHA loan can choose to either have the MCC added to monthly income or used as a direct offset against the monthly payment (greatest impact on debt ratios). In most cases, you will need a copy of the commitment to issue the MCC from the Housing Finance Agency prior to closing as well as a copy of a revised W-4 showing the borrower has modified their withholding's accordingly to create the necessary tax liability to take full advantage of the credit.

Let's take a look at an example:

Prior to buying a home, borrower gets a tax refund of approximately \$1,500 every year.

The Buyer has an estimated \$5,000 per year in mortgage interest and will have an MCC for 20%. The value of the MCC is \$1,000 for the year (\$5,000 x 20%). In order to get the full benefit of the tax credit, the borrower must have a tax liability of \$1,000. If they are currently getting approximately \$1,500 per year in refund they must modify their withholdings to reflect \$2,500 (\$1,500 anticipated tax refund + \$1,000 MCC credit).

Past Tax Return Estimate:	\$1500
MCC Tax Credit	\$1000
Total Tax Credit	\$2500

Divided by 12 months = \$208.33

By getting the extra \$2,500 over the year the borrower will have an extra \$208.33 per month in their check to use toward their house payment. At the end of the year when they file their tax return they would have a "tax liability" of \$1,000. The value of the MCC would eliminate the tax liability and the borrower would get no refund but had the extra \$208.33 per month to use toward their dream home.

By filing a new W-4 form with their employer; using the \$208 estimate, the employer will include that extra money in the clients' paycheck. If you've even seen a W-4 form, it's a 2-page form, with lots of questions and figures. However, your client does not have to go thru the formulas—they can just write down a flat dollar amount on the page where they sign their name.

As for couples, filing jointly, who are both employed, they can split that dollar amount any way they choose. —Again by filing a new W-4 form. One person may file for \$150 and the other for \$58.33.

Sure beats giving the government an interest free loan!

Keep in mind, the amount of interest that can be claimed on a borrowers Schedule A is reduced by the value of the MCC credit. In this example, the borrower paid \$5,000 in interest over the year. However, the value of the MCC was \$1,000. Schedule A mortgage interest deduction is limited to \$4,000 (\$5,000 interest paid - \$1,000 MCC benefit).

So what happens is they don't use the entire tax credit? If the borrower does not withhold correctly and they do not get the full benefit of the entire tax credit, they can carry the value of that credit forward for as long as three years and take advantage of it next year. If the MCC credit rate is higher than 20%, the maximum credit is \$2,000 per year. In addition, any amount over \$2,000 cannot be carried forward to following years for borrowers whose credit exceeds 20%.

If a homeowner refinances, some HFA's will reissue the MCC for the new loan but will likely limit the amount of the benefit to mirror at best the original loan terms. In no cases will the IRS allow the credit on a refinanced loan to exceed the original MCC credit. In addition, not all HFA's will allow a borrower who refinances to maintain their MCC.

Like a mortgage bond program, if the home is sold within the first nine years the borrower may be subject to a recapture tax depending on if the home was sold for a profit and what their income is at the time of sale.

Most Housing Finance agencies have a fee for issuing a MCC. The fee can vary from agency to agency. Check with your local or state Housing Finance Agency to see if an MCC is available in your area.

By learning what the terms and guidelines are, you can use this as a tool to get more lead from first time buyers.

Supporting Resources Included Below are IRS Forms:
 Tax Information for Homeowners – Publication 530 – See pages 7 & 8
 Form 8396 – Mortgage Interest Credit
 Form 8329 – Lender's Information Return for MCC's
 W-4 Form