Office of Chief Counsel
Internal Revenue Service
memorandum
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subject: Section 6015 and the First-Time Homebuyer Credit

This Program Manager Technical Assistance Memorandum responds to your request for assistance dated April 11, 2011. This advice may not be used or cited as precedent.

ISSUES

1. When the first-time homebuyer credit (FTHBC) is denied, should the Service treat it as an underpayment or deficiency for purposes of section 6015?

2. Should the Service allocate a denied FTHBC 50-50 between the requesting spouse (RS) and nonrequesting spouse (NRS), or treat it as a joint liability?

3. Is the answer to Question 2 above affected if only one spouse purchases the property for which the FTHBC is claimed on a joint return?

4. How should the liability be treated for purposes of section 6015 if the taxpayer fails to pay or report the part of the FTHBC subject to recapture?

CONCLUSIONS

1. Treat the liability as an understatement and deficiency pursuant to section 6211(b)(4)

2. The answer will depend on both the reason the Service reduced or denied the FTHBC and the particular subsection of section 6015 under which relief is

considered. If the credit was reduced or disallowed because an erroneous item of a one of the spouses caused the couple's joint income to exceed the statutory limits in section 36, the liability for the understatement can be attributed to such spouse.

If the Service disallowed the FTHBC because the property did not qualify as the couple's principal residence, the couple rented, rather than owned, the property for which they claimed the FTHBC, or some other reason unrelated to either spouse's items of income or deduction, treat it as a joint liability and the attribution/allocation rules of section 6015 will control.

3. If only one spouse purchased the home and would have solely been entitled to the FTHBC on a separate return, then the liability for the disallowed FTHBC should be attributed solely to that spouse.

4. Treat the liability as an underpayment if the return lists the amount of the FTHBC subject to recapture but such liability is not paid. If the joint return does not show the amount subject to recapture, treat it as a deficiency (understatement).

FACTS & LAW

This is in response to your request of April 11, 2011 in regard to the correct treatment of disallowed FTHBCs when making allocations as part of the review process of claims for relief from joint and several liability under section 6015.

The First-time Homebuyer Tax Credit

Congress enacted the FTHBC as part of the Housing Assistance Tax Act of 2008 ("Housing Assistance Act"), P.L. 110-289, § 3011(a), 122 Stat. 2654. The FTHBC is a refundable credit equal to 10% of the purchase price of a residence, not to exceed $7,500. The FTHBC under the Housing Assistance Act is essentially an interest-free loan because it must be repaid over a 15-year period, with no interest, beginning with the second taxable year following purchase of the residence.

The amount allowable as a FTHBC would begin to phase out if the taxpayer received modified adjusted gross income (AGI) exceeding $75,000 ($150,000 in the case of a joint return). The FTHBC under the Housing Assistance Act applied to residences purchased on or after April 9, 2008 through December 31, 2008. I.R.C. § 36(h)(1). A "first-time homebuyer" was defined by the Housing Assistance Act as an individual and if married, the individual's spouse, who did not have a present ownership interest in a principal residence in the 3-year period ending on the date of the purchase to which the credit applies. This definition was not changed in subsequent amendments to section 36(c). If the taxpayer sold or disposed of his residence or ceased using it as his principal residence during the 15-year recapture period, the entire credit had to be

repaid in full for the taxable year of sale or non-use as the taxpayer's principal residence.
Congress extended the FTHBC, increased the maximum amount of the FTHBC from $7,500 to $8,000 and waived the requirement that it be repaid under the American Recovery and Investment Tax Act of 2009, P.L. 111-5, § 1006, 123 Stat. 115, 316. Under this legislation, applicable to residences purchased after December 31, 2008 and before May 1, 2010,[1] the taxpayer did not have to repay the FTHBC so long as he did not dispose of the residence within 3 years of purchase or cease using it as his principal residence in that time period.

Later in 2009, as part of the Worker, Homeownership and Business Assistance Act of 2009, P.L. 111-92, § 11, 123 Stat. 2984 ("Homeownership Assistance Act"), Congress again amended the FTHBC by increasing to $125,000 ($225,000 for joint returns) the modified AGI at which the credit would begin to phase out. The Homeownership Assistance Act also created a refundable credit, not to exceed $6,500, for longtime homeowners who owned and used a home or other structure as a principal residence for at least 5 of the 8 years immediately before purchasing a replacement home. The Homeownership Assistance Act added the requirement that the homebuyer be at least 18 years of age as of the date of purchase. These amendments were effective for residences purchased after November 6, 2009 and before May 1, 2010.

We have identified three general fact patterns respecting FTHBCs, each requiring separate analysis under the rules related to relief from joint and several liability under section 6015.

In the first category of cases, one or more facts related to the property for which the credit was claimed, the identity of the seller or some other fact (i.e., a fact or item other than an error in the couple's reported income, claimed deductions, exemptions, etc.) precludes the allowance of any part of the FTHBC on the joint return. The following is a non-exhaustive list of situations falling into this category of cases:

- The property acquired by the couple is rented to a third party during the year for which the FTHBC is claimed.
- A person related to RS (requesting spouse) or NRS (non-requesting spouse) sells the property to the RS and NRS who claim the FTHBC.
- The purchase price of the residence exceeds $800,000.
- Neither RS nor NRS has attained the age 18 on the date they purchased the residence.

[1] If the taxpayer entered into a binding contract before May 1, 2010 to purchase a residence, he qualified for the FTHBC so long as closing took place and he purchased the home before July 1, 2010. Congress later extended the closing deadline to September 30, 2010.

- RS and NRS claim the FTHBC for a residence they purchased on or after May 1, 2010.[2]
- RS and NRS claim the FTHBC for the purchase of a home located outside the United States.
- The RS or NRS uses tax-exempt mortgage revenue bonds to finance the purchase of the home

The second category of cases involve incorrect or incomplete reporting of income, deductions, losses or other items on the tax return that cause the couple's modified AGI to increase and thereby exceed the imitations in section 36(b)(2). Under section 36(b)(2), the allowable FTHBC begins to phase out when the couple's modified AGI on a joint return exceeds $150,000 for residences purchased from April 9, 2008 through November 6, 2009, and $225,000 for residences purchased between November 7, 2009 and April 30, 2010.[3]

A third category of cases involves questions about how the liability for the recapture of the FTHBC impacts the determination of whether a RS is entitled to innocent spouse relief.

DISCUSSION

Issue 1

You initially asked whether a denied FTHBC should be treated as a deficiency or underpayment for purposes of section 6015.

The disallowed FTHBC gives rise to a "deficiency" because of this term's definition in section 6211. When defining a "deficiency" in section 6211, Congress expressly included in such definition a reference to ". . . excess credits under section . . . 36 . . .," which means a disallowed FTHBC. Consequently, a disallowed FTHBC should be treated as a deficiency (understatement) when analyzing a request for 6015 relief. Whether the Service has determined that the FTHBC should be disallowed before or after a refund was paid to the RS and NRS for the taxable year in question will be irrelevant for this purpose.

Issues 2 and 3

Your second question concerns whether the denied FTHBC should be allocated "50-50" or treated as a joint liability. The answer to this question depends on the reason the

[2] The requirement that the home be purchased before May 1, 2010 is subject to the exception described above in footnote 1.

[3] The credit phase out that is triggered when a couple's modified AGI for the year exceeds $225,000 also applies to home purchases described in footnote 1.

FTHBC is disallowed and the subsection of section 6015 under which relief is considered.

Phase-Out of FTHBC Because Of Increase to AGI

If the FTHBC is disallowed or reduced because the couple's AGI increased above the "phase-out" limitations, then the rules provided in IRM 25.15.3.5.6 would be applicable. IRM 25.15.3.5.6 (1) states, in part:

> If an erroneous item (as defined in IRM 25.15.3.4.1.2) attributable to the NRS that increases the adjusted gross income (AGI) results in disallowance of another item on the return because of the increase to AGI, then any understatement caused by the disallowance of the other item will also be attributable to the NRS. This rule is applicable whether or not the RS received a refund (or a portion of the refund) due to the claim . . .

An example in the IRM involves a couple who claimed the EITC on their joint return, but it was later determined that H had unreported income. When the Service considered the unreported income, this caused the couple's AGI to increase, which in turn resulted in the disallowance of the EITC because the revised AGI exceeded the maximum amount allowable.

Similarly, undertake the following when considering a request for relief under section 6015 in connection with a return on which the couple claimed the FTHBC. If another erroneous item on the return solely attributable to the NRS caused the couple's joint income to increase to the point it results in a reduced or eliminated FTHBC, the resulting deficiency can be attributed to the NRS. As discussed in the example under IRM 25.15.3.5.6.1, the RS will satisfy the attribution requirements of section 6015(b) and (f), and for purposes of section 6015(c), the deficiency will be initially allocated to the NRS. Likewise, the RS's knowledge of the other item causing the increase in AGI will control the RS's knowledge regarding the disallowed FTHBC. [redacted]

FTHBC Disallowed Due To Substantive Reason

If the FTHBC is disallowed for substantive reasons, such as those in the first category of cases listed above, then attribution or allocation of the deficiency will depend on the facts of the case and the subsection under which relief is considered.

Section 6015(b): In applying section 6015(b), unless the facts demonstrate that the understatement of tax is solely attributable to the NRS, both spouses remain jointly liable and no relief is available. Analyze a case involving the FTHBC just as any other request for relief under section 6015(b). If the RS had an ownership interest in property that gave rise to the FTHBC then the understatement of tax due to the disallowance of the FTHBC would not be "solely" attributable to the NRS and the RS would not be entitled to relief under section 6015(b). See Capehart v. Commissioner, T.C. Memo. 2004-268 (requesting spouse could not meet 6015(b)(1)(B) because she held a part

ownership interest in Hoyt partnership, which item caused understatement of tax); Ellison v. Commissioner, T.C. Memo. 2004-57 (same). For a discussion of situations where the RS might have an ownership interest in the property, see the discussion of section 6015(c) below.

Section 6015(c): For purposes of allocating a deficiency under section 6015(c), section 6015(d)(3)(A) provides that items giving rise to a deficiency on a joint return (erroneous items) are allocated to each spouse as though each had filed a separate return for the taxable year, subject to the exceptions listed in Treas. Reg. § 1.6015-3(d)(2)(i)-(v)(benefit on return to RS, fraud, erroneous items of income or deduction). An erroneous item is allocated to the spouse to whom the erroneous item is attributed. Estate of Capehart v. Commissioner, 125 T.C. 211, 215 (2005).

The allocation of certain items - separate treatment items - are handled separate from the rest of the deficiency. Under section 6015(d)(2) a separate treatment item is the part of a deficiency attributable to a disallowed credit, a tax (other than tax imposed by section 1 or section 55), or an addition to tax required to be included with a joint return. The FTHBC would be a separate treatment item. To the extent that a separate treatment item is allocated to one spouse under section 6015(d)(3), the deficiency related to the item is allocated to that spouse. If the separate treatment item ". . ..is attributable in whole or in part to both spouses, then the IRS will determine on a case-by-case basis how such item will be allocated." Treas. Reg. § 1.6015-3(d)(4)(ii). The disallowance of the FTHBC would be attributable to both spouses if both spouses had an ownership interest in the property giving rise to the credit. Consider the following example:

> *Example 1. – FTHBC denied for jointly owned property*
>
> H and RS were married during all of taxable year 2010 and during such year they decided to buy a home as their principal residence. In March 2010 H and RS jointly purchase a home in State A. Both H's and RS's names are on the deed for the property and both are liable for the mortgage. By July 2010, though, the couple decides to rent the home for the remaining part of 2010. H and RS file a joint 2010 Form 1040 on which they claim $8,000 as a FTHBC. The Service denies the FTHBC, which results in a balance due, rather than an overpayment, for the couple's 2010 taxable year.

It seems appropriate that the deficiency in *Example 1* be allocated 50% to each spouse because this is the way the item would have been allocated if the spouses had filed separate returns. If the RS disagrees with the allocation, he or she will bear the burden of showing that some other allocation of the deficiency is more accurate. I.R.C. § 6015(c)(2).[4]

[4] It should be noted that the "tax benefit" exception in section 6015(d)(3)(B) could come into to play to alter the allocation if one of the spouses did not fully benefit from the credit. To the extent that the

By contrast, if the Service reduces or denies the FTHBC on property solely owned by one of the spouses, the resulting deficiency is allocated to such spouse. Treas. Reg. § 1.6015-3(d)(4)(ii). Consider the following example.

> *Example 2 –Allocation when property purchased by one spouse*
>
> H purchases a home in March 2010. Only H's name appears on the deed and mortgage documents. In October 2010, H and RS get married and maintain the home H purchased as their principal residence. H and RS claim a FTHBC of $8,000 on their joint 2010 return. The Service later disallows the FTHBC pursuant to section 36(b)(3) because the purchase price for the home exceeded $800,000.

In this example the FTHBC was based on a home purchased solely by H. Because H purchased the home (and RS was not also a purchaser) for a price too high to qualify for the FTHBC, it follows that the deficiency is entirely allocable to H. Section 6015(d)(3)(A) and (d)(4) support this conclusion in this situation. Under subsection (d)(3)(A), an item giving rise to a deficiency on a joint return is allocated to the individuals filing the joint return in the same manner as it would have been allocated if the individuals had filed separate returns for the year.

If H and RS in *Example 2* had filed separate returns, only H would have been eligible for a FTHBC (assuming the purchase price was less than $800,000), and he would have been limited to receiving a credit not greater than $4,000. I.R.C § 36(b)(1)(B). RS was not a home purchaser in 2010 and if she had filed a separate tax return for the 2010 taxable year, she would not be eligible for any FTHBC. As a result, no part of the understatement resulting from the disallowed FTHBC is allocated to RS.

Section 6015(d)(4) states that "<u>If an item of</u> deduction or <u>credit is disallowed in its entirety solely because a separate return is filed</u>, such disallowance shall be disregarded and the item shall be computed as if a joint return had been filed and then allocated between the spouses appropriately." (emphasis added). Subsection (d)(4) should not apply to *Example 2* because the FTHBC would not be "disallowed in its entirety solely because a separate return is filed." However, the rule in subsection (d)(4) supports the conclusion that the deficiency relating to the disallowance of the $8,000 FTHBC should be fully allocated to the NRS in this example[5].

FTHBC resulted in a refund, however, both spouses would be allocated 50% of the refund amount as that amount did not provide "tax benefit on the joint return."

[5] Of course, if the home giving rise to the FTHBC in *Example 2* was purchased solely by the RS, then the deficiency attributable to the FTHBC would be fully allocated to the RS.

Section 6015(f): Finally, if it is determined that the RS is not eligible for relief from the disallowed FTHBC under section 6015(b) or (c), the next step is to consider whether the RS is entitled to equitable relief under subsection (f) for all or part of the deficiency related to the disallowed FTHBC. As attribution is a threshold factor (see Rev. Proc. 2003-61, section 4.01(7)), the analysis is very similar to that for section 6015(b), with one notable exception. Under section 6015(f) the item doesn't have to be solely attributable to the NRS for the RS to be considered for relief, however, any relief would be limited to the amount attributable to the NRS. In situations where the FTHBC related to a jointly-owned property is disallowed, 50% of the deficiency would be attributable to each spouse, similar to the allocation used for purposes of section 6015(c). If the RS already obtained relief under section 6015(c) for the 50% of the deficiency attributable to the NRS, then no additional relief would be available under section 6015(f) as the remaining portion of the deficiency would be attributable to the RS. If the RS was not entitled to relief under section 6015(c) for the 50% of the deficiency attributable to the NRS (for example ifthe RS had actual knowledge), then the RS could be considered for relief under section 6015(f) for the portion attributable to the NRS. If the property that gave rise to the FTHBC was owned solely by the NRS, then the deficiency resulting from the denial of the credit would be fully attributable to the NRS and the RS could be considered for relief under section 6015(f) from the entire deficiency.

Issue 4

Finally, we address the fourth issue and third category of cases from above, which relate to the recapture provisions of section 36. Such provisions require certain taxpayers to repay the FTHBCs. In this situation the FTHBC was properly taken on a joint return for a prior tax year.

Under section 36(f), a taxpayer who claimed the FTHBC for a residence purchased between April 9, 2008 and December 31, 2008 is required to repay the credit to the government (interest-free) over a 15-year recapture period, beginning in the second tax year following the year when the residence was purchased. Respecting residences purchased January 1, 2009 through April 30, 2010, for which the FTHBC need not be repaid, recapture applies if the taxpayer disposes of the residence or ceases to use it as his principal residence in the 36 months following purchase.

Section 36(f)(5) indicates how the recapture liability is treated when the FTHBC was allowed to taxpayers filing a joint return. This states:

> (5) Joint Returns. – In the case of a credit allowed under subsection (a) with respect to a joint return, *half of such credit shall be treated as having been allowed to each individual* filing such return for purposes of this subsection. (emphasis added)

Under this provision if the spouses filed separate returns in years in which the credit must be repaid, each spouse would have to report and pay one-half of the recapture amount.[6] Obviously, if separate returns are filed there are no section 6015 issues, so the assumption for the discussion below is that the spouses file a joint return for the years in which recapture must be reported and paid.[7]

Failure to Pay a Properly Reported Recapture Amount

If the couple files a joint tax return showing the correct portion of the FTHBC subject to recapture for the tax year but does not pay it, treat the liability as an underpayment. This will mean that the Service should analyze the request for relief only under section 6015(f) and Rev. Proc. 2003-61. The seventh threshold requirement of Rev. Proc. 2003-61 is that the income tax liability from which the RS seeks relief be attributable to an item of the other spouse.

If the spouses filed a joint return claiming the FTHBC then file a joint return properly reporting the recapture amount but not paying the amount due, pursuant to section 36(f)(5) 50% of the recapture amount would be attributable to each spouse. Thus, the RS would only be able to be considered for relief from the 50% attributable to the NRS. If the spouses filed separate returns claiming the FTHBC (or only one spouse claimed the credit) then later file a joint return properly reporting the recapture amounts, the liability for failure to pay the recapture amounts would be attributable to each spouse based on the amount of the FTHBC taken previously on his or her separate return. If only the NRS took the FTHBC on the NRS's separate return, then the liability for the recapture amount would be fully attributable to the NRS. The RS may only be considered for relief for the amount attributable to the NRS.[8]

Failure to Properly Report Recapture Amount

If the couple does not include the recapture liability on their joint return and the Service discovers the omission, treat the liability as a deficiency (understatement). Use the analysis above to determine whether all or part of the unreported recapture liability can be attributed to the NRS. For purposes of section 6015(b), if any portion of the

[6] Because this rule is in the recapture provisions of section 36(f), we do not think that it controls the analysis of section 6015 when the credit was disallowed. This is why this provision was not discussed above.

[7] If the spouses divorce and then marry a new spouse and fail to properly handle the recapture, any liability for that failure would be solely attributable to the spouse that filed the prior joint return with the former spouse that claimed the credit and not the new spouse.

[8] It is possible that the spouses could owe tax on the joint return in addition to the amount of the recapture, so that it is not clear whether any payments made with the return that do not fully satisfy the entire liability were intended to satisfy the non-recapture tax liability or a portion of the recapture amount.

[redacted]

understatement related to the FTHBC is attributable to the RS, then relief is not available under section 6015(b).

For purposes of section 6015(c), if the spouses filed a joint return in a prior year claiming the FTHBC, then pursuant to section 36(f)(5), 50% of the deficiency related to the credit would be allocated to each spouse. If the spouses filed separate returns in the prior year claiming the FTHBC, then the portion of deficiency allocated to each spouse depends on the amount of the recapture that had to be reported from each spouse's earlier filed separate return (including 100% allocated to the NRS if only the NRS claimed the credit).

Notwithstanding this allocation, if the Service could establish that the RS had actual knowledge of the deficiency resulting from the failure to include the recapture amount, the RS would remain liable for the entire deficiency stemming from the omission of the recapture amount. As the recapture amount is reported on the return as additional tax (see Forms 5405 and 1040), the RS would have actual knowledge if the RS actually knew about the FTHBC. This would be established easily in the situation where the spouses took the credit on a jointly filed return as the RS signed the joint return and is charged with knowledge of the contents of the return. See Pullins v. Commissioner, 136 T.C. No. 20, slip op. at 19-20 (May 5, 2011) (citing Porter v. Commissioner, 132 T.C. 203, 211-212 (2009) ("We impute to a taxpayer knowledge of what she could have gleaned form the tax returns she signed, if she had taken the time to review them.")).

For residences purchased between April 9, 2008, and December 31, 2008, any argument that the RS did not know that the credit would have to be recaptured in later years would be unavailing as the actual knowledge standard "does not require the electing spouse to possess knowledge of the tax consequences arising from the item giving rise to the deficiency." Cheshire v. Commissioner, 115 T.C. 183 (2000), aff'd, 282 F.3d 326 (5th Cir. 2002). For residences purchased January 1, 2009 through April 30, 2010, because there was no recapture unless certain events took place, the Service would have to show that the RS was aware of the reason why the credit would be recaptured (i.e., disposing of the property or ceasing to use it as a principal residence in the 36 months following purchase).

Finally, for purposes of section 6015(f), attribution of the deficiency from the failure to report the recapture amount would be 50% for each if the credit was taken on a joint return or would depend on the amount of the recapture that had to be reported from each spouse's separate return (including 100% allocated to the NRS if only the NRS claimed the credit) if the spouses filed separate returns.

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Please call (202) 622-4910 if you have any further questions.