## California Housing Finance Agency (CalHFA), "Issuer"
## Mortgage Credit Certificate Program

# NOTICE TO BORROWERS OF POTENTIAL RECAPTURE TAX

(To be completed by Lender and delivered to borrowers at the time of Closing of the Loan)

Because you have received Mortgage Credit Certificate (an "MCC"), pursuant to Section 143(m) of the Internal Revenue Code of 1986, you may, at the time you sell the residence for which you received an MCC, be subject to a special "recapture tax" for federal income tax purposes if you sell your house less than nine (9) years after its purchase and the issuance of the MCC. The following information is provided to assist you in determining whether you might owe a recapture tax on the sale of your home. However, you should consult your tax advisor at the time you sell the residence to determine the amount, if any, of such recapture tax you may owe.

**Name of Borrower(s):** ______________________________________________
______________________________________________

**Principal Amount of Mortgage:** $____________________ **Date of Closing:** __________________

**Property Address:** ______________________________________________
______________________________________________

**A. INFORMATION YOU WILL NEED IN THE FUTURE**

After you close your loan, you will receive a detailed letter from the Program Administrator or one that will be provided by your lender at closing. This letter should be kept with your other mortgage documents. It contains extremely important information that you will need to determine if you must pay recapture tax.

The letter contains information that you'll need in order to complete Form 8828 such as

1. The loan amount (the highest principal amount of the loan);
2. Closing Date;
3. Name of the Issuer of the Bonds;
4. Name of the original lender that made the loan, and
5. Chart that details data necessary to complete Form 8828.

**B. INTRODUCTION**

1. General. When you sell your home, you may have to pay a recapture tax as calculated below. The recapture tax may also apply if you dispose your home in some other way. Any reference in this notice to the "sale" of your home also includes other ways of disposing of your home. For instance, you may owe the recapture tax if you give your home to a relative.

2. Exceptions. In the following situations no recapture tax is due, and you do not need to do the calculations:
   a. You dispose of your home after nine (9) years after you close your mortgage loan;
   b. Your home is disposed as a result of your death;
   c. You transfer your home either to your spouse or to your former spouse incident to divorce and you have no gain or loss included in your income under section 1041 of the Internal Revenue Code (in which case the spouse or former spouse is treated as if he or she had been the owner from the date of closing of the home mortgage);
   d. You dispose of your home as a loss.

Remember, to owe any recapture tax, you must sell your home within nine years, make a net profit on the sale of your home AND have a significant increase in income (usually that means more than 5% per year). All three criteria must be met in order for recapture tax to be due.

## C. MAXIMUM RECAPTURE TAX

The maximum recapture tax that you may be required to pay as an addition to your federal income tax is $________. [Insert the actual dollar amount resulting from the product of 6.25% multiplied by the highest principal amount of the mortgage loan]

This amount is 6.25% of the highest principal amount of your mortgage loan and is your federally subsidized amount with respect to the loan.

## D. ACTUAL RECAPTURE TAX

The actual recapture tax, if any, can only be determined when you sell your home, and is the lesser of (1) 50% of your gain on the sale of your home, regardless of whether you have to include that gain in your income for federal income tax purposes, or (2) your recapture amount determined by multiplying the following three numbers:

1. The actual dollar amount resulting from the product of 6.25% multiplied by the highest principal amount of the mortgage loan (the maximum recapture tax as described in the paragraph C above): 6.25% x $______ = $____________
2. Holding period percentage, as listed in Column 1 in the table below: ____________%
3. The income percentage as described in Section D: ____________%

(1) x (2) x (3) = Actual Recapture Tax: $___________

| | **Column 1** | **Column 2** |
|---|---|---|
| **Disposition Within # Years of Closing** | **Holding Period Percentage** | **Adjusted Qualifying Income** |
| 1 | 20% | Determine the borrower's household size at the time the home is sold or transferred. Then select the maximum income limit that would have applied to the household size at the time the home was purchased. This number, compounded by 5% per year from the date of purchase until the date the home is sold or transferred, is the Adjusted Qualifying Income |
| 2 | 40% | |
| 3 | 60% | |
| 4 | 80% | |
| 5 | 100% | |
| 6 | 80% | |
| 7 | 60% | |
| 8 | 40% | |
| 9 | 20% | |
| 10 or More | No Recapture Tax | |

## E. INCOME PERCENTAGE

You calculate the income percentage as follows:

1. Subtract the applicable adjusted qualifying income (Column 2 in table above) for the taxable year in which you sell your home, from your modified adjusted gross income in the taxable year in which you sell your home.

   Your modified adjusted gross income means your adjusted gross income shown on your federal tax return for the taxable year in which you sell your home, with the following two adjustments: (a) your adjusted gross income must be increased by the amount of any interest that you receive or accrue in the taxable year from tax-exempt bonds that is excluded from your gross income (under Section 103 of the Internal Revenue Code); and (b) your adjusted gross income must be decreased by the amount of any gain included in your gross income by reason of sale of your home.

2. If the amount calculated in (1) above is zero (0) or less, you owe no recapture tax and do not need to make any more calculations. If it is $5,000 or more, your income percentage is 100%. If it is greater than zero (0) but less than $5,000, it must be divided by $5,000. This fraction, expressed as a percentage, represents your income percentage. For example, if the fraction is $1,000/$5,000, your income percentage is 20%.

## F. REFINANCING YOUR HOME

If you refinance your home and stay in it for a full nine years, you won't pay recapture tax. Recapture kicks in when the property ceases to be your principal residence before the full nine years, and then you may owe recapture tax. If you refinance in the first full four years and the property ceases to be your principal residence before the full nine years, there is a special calculation worksheet that must be used if you must pay recapture tax. See "For More Information" on the next page and instructions for Form 8828 for more detail.

## G. "NET PROFIT" ON THE SALE OF YOUR HOME

Consult your tax advisor but generally you will be considering the amount you received for the sale of your home and deducting the expenses of selling your home (i.e. commission paid to a real estate agent, advertising, legal fees, etc.). This is the "Amount Realized" from the sale of the home. From the "Amount Realized" you will subtract your "Adjusted Basis" of your interest in the home. The "Adjusted Basis" will be increased by any sales commission you paid when you bought the home and decreased by depreciation. Your tax advisor will be helpful in determining the exact amount. If the total of the "Amount Realized" minus the "Adjusted Basis" is "0" or lower, you did not realize a gain (make a profit) when you sold the home and you *DO NOT* owe recapture tax. You will still need to complete a form 8828 and send it to the IRS with your federal income tax return in the year you sell or dispose of the home.

## H. LIMITATIONS AND SPECIAL RULES ON RECAPTURE TAX

1. If you give away your home (other than to your spouse or former spouse incident to divorce), you must determine your actual recapture tax as if you had sold your home for its fair market value.

2. If your home is destroyed by fire, storm, flood, or other casualty, there generally is no recapture tax if, within two years, you purchase additional property for use as your principal residence on the site of the home financed with your original subsidized mortgage loan.

3. In general, except as provided in future regulations, if two or more persons own a home and are jointly liable for the subsidized mortgage loan, the actual recapture tax is determined separately for them based on their interests in the home.

4. If you repay your loan in full during the nine-year recapture period and you sell your home during this period, your holding period percentage may be reduced under the special rule Section 143(m)(4)(C)(ii) of the Internal Revenue Code.

5. Other special rules may apply in particular circumstances. You may wish to consult with a tax advisor or the local office of the Internal Revenue Service when you sell or otherwise dispose of your home to determine the amount, if any, of your actual recapture tax. See Section 143(m) of the Internal Revenue Code generally.

I. **<u>DISCLOSURE OF APPLICANT INFORMATION</u>**

The borrower(s) hereby consent and agree that all information furnished by the borrower(s) to the lender, the administrator and the Issuer, including, but not limited to, non public personal and financial information ("the information"), in connection with the application for mortgage loan(s) requesting an MCC under this program, may be disclosed to any person or other third parties in connection with the processing of the borrow(s) loan application, verification of information concerning the loan or the borrower(s), and for any other purpose in furtherance of or connected with the Issuer's program

The undersigned Borrower(s) has (have) received and read a duplicate copy of the foregoing Notice to Borrowers of Potential Recapture Tax:

Date: ______________________________________

______________________________________ ______________________________________

Borrower Signature Borrower Signature