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FIRST-TIME HOMEBUYER TAX CREDIT

Taxpayers' Use of the Credit and Implementation and Compliance Challenges

Statement of James R. White, Director
Strategic Issues

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Mr. Chairman and Members of the Subcommittee:

I appreciate this opportunity to comment on taxpayers' use of the First-time Homebuyer Credit (FTHBC) and the Internal Revenue Service's (IRS) implementation and compliance challenges.

As an important part of the recent economic stimulus efforts, Congress enacted the FTHBC to assist the struggling real estate market and encourage taxpayers to purchase their first home. The credit initially was enacted by the Housing and Economic Recovery Act of 2008 (Housing Act) and revised by the American Recovery and Reinvestment Act of 2009 (Recovery Act).[1] The 2008 FTHBC provided taxpayers a credit of up to $7,500 that must be paid back over 15 years. The Recovery Act increased the maximum credit for the 2009 FTHBC to $8,000, with no payback required unless the home ceases to be the taxpayer's principal residence within 3 years. This $8,000 credit is a refundable tax credit that is paid out even if there is no tax liability or the credit exceeds the amount of any tax due.

The 2009 FTHBC was enacted into law on February 17, 2009, but eligibility was made retroactive for homes purchased beginning January 1, 2009. See appendix I for a comparison of the 2008 and 2009 FTHBC.

My testimony today, based on on-going work, describes two issues:

- the extent to which taxpayers are using the FTHBC, including breakouts by state and income; and
- IRS's implementation and compliance challenges associated with both the 2008 and 2009 credits.

To describe the extent to which taxpayers are using the FTHBC, we obtained and analyzed data from IRS about the use of the FTHBC and reviewed IRS documents. We ensured these data were reliable by reviewing IRS's computer programs for capturing the data and discussing the computer programming and verification processes with IRS officials. While combined 2008 and 2009 data appear reliable, the data for each of the years do not. This is because some claims were filed by taxpayers for

[1]Pub. L. No. 110-289, 122 Stat. 2654 (2008) and Pub. L. No. 111-5, 123 Stat. 115 (2009). The 2008 FTHBC applies to purchases made between April 9, 2008 and June 30, 2009. The 2008 FTHBC was amended by the 2009 credit, which applies to purchases made between January 1, 2009 and November 30, 2009.

the 2008 credit who actually could have claimed the 2009 credit, and IRS did not flag the problem. In following up on 47,276 electronically filed returns that appeared not to have claimed the whole FTHBC, the Treasury Inspector General for Tax Administration (TIGTA) found that 93 percent, or 43,967, were not coded as a 2009 FTHBC even though the purchase had occurred in 2009. It is likely that the errors are a result of (1) taxpayers who purchased a house in 2009 prior to the passage of the Recovery Act and claimed the 2008 credit, when, in fact, they are eligible for the expanded benefits of the 2009 credit; and (2) IRS's not properly coding the purchase date as a 2009 FTHBC on some returns. IRS has plans to monitor instances where taxpayers claimed the 2008 instead of the 2009 credit. When those taxpayers do not file an amended return, IRS has plans to notify them as to their eligibility for the expanded benefits of the 2009 credit. According to IRS officials, IRS plans to correct the other errors when it begins enforcing the 2008 FTHBC payback provisions. At that time, IRS plans to verify the date of purchase and make any adjustments.

To describe IRS's implementation and compliance challenges, we reviewed IRS documents and interviewed IRS officials to identify the guidance, outreach, and programming changes instituted to implement the credit. For this objective, we used several approaches to identify compliance challenges. Primarily, we reviewed IRS documents—including a risk assessment questionnaire, mitigation plan, and program decision document—to determine the risks associated with the credit and IRS's plans for mitigating them, and we reviewed previous GAO reports. We also consulted ongoing TIGTA audits on the credit. In addition, we interviewed officials from the Department of the Treasury and IRS's Wage and Investment division.

We have been conducting performance audits on the 2008 filing season and on the tax provisions in the Recovery Act since January 2009, and June 2009, respectively, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Over 1.4 Million Taxpayers Have Claimed about $10 Billion in FTHBC

According to preliminary data from IRS, as of August 22, 2009, over 1.4 million taxpayers have claimed the FTHBC for homes purchased in 2008 and 2009, as shown in table 1. This represents total foregone tax revenue of about $10 billion through August 22.

While the combined 2008 and 2009 data appear reliable, as we noted the data for each year may be subject to revision because some claims made by taxpayers for the 2008 credit could have been made for the 2009 credit. In addition, the figures for 2009 are incomplete for several reasons. First, the figures do not include some returns that have been received by IRS but not processed. Second, some taxpayers have already purchased a home but have not yet filed for the credit. Taxpayers can claim the 2009 FTHBC on their 2008 or 2009 tax return. Last, the 2009 FTHBC does not expire until December 1, 2009, so taxpayers still have time to purchase homes and qualify for the credit. The Joint Committee on Taxation estimates that a majority of claims will occur in 2010 when taxpayers file their 2009 tax returns.

With these caveats in mind, table 1 shows the 2008 and 2009 FTHBC claims. The 2008 credit numbers, while subject to revision as noted above, are likely to be of the correct order of magnitude. The 2009 numbers should be interpreted as interim and are likely to change substantially.

Table 1: Taxpayers Claiming the FTHBC in 2008 and 2009

	Taxpayers claiming homes purchased in 2008	Taxpayers claiming homes purchased in 2009	Total
Number of taxpayers claiming the FTHBC	1,041,361	385,193	**1,426,554**
Dollar amount of credit claimed (in billions)	$7.108	$2.89	**$9.998**

Source: IRS data.

Note: Data as of August 22, 2009.

Taxpayer Use of the FTHBC Varied by Income and State

Based on claims made to IRS as of August 22, 2009, 59 percent of taxpayers who claimed the FTHBC had an adjusted gross income (AGI) of less than $50,000, as shown in table 2. The FTHBC was disproportionately claimed by taxpayers in the $25,000 to $100,000 AGI range. About 74 percent of credit claimants were in this AGI range, as compared to 46 percent of all taxpayers who filed a tax return in 2007. The low percentage of taxpayers claiming the credit with over $100,000 AGI reflects, in part, the income cap, for the FTHBC. For example, for joint filers the credit phases out between $150,000 and $170,000 (see app. I).

Table 2: AGI of Taxpayers Who Claimed the FTHBC (2008 and 2009 Combined) Compared to the AGI of All Taxpayers Who Filed a Tax Return in 2007

	AGI Ranges						
	Zero or less[a]	$1 to $25,000	$25,001 to $50,000	$50,001 to $75,000	$75,001 to $100,000	Greater than $100,000	Total
Total number of FTHBC claims[b]	25,200	265,283	543,996	352,474	152,054	87,547	**1,426,554**
Percentage of total FTHBC claims	2	19	38	25	11	6	**100**
Percentage of total taxpayers filing a tax return in 2007[c]	1	40	24	14	8	13	**100**

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding.

[a]Taxpayers in the zero or less AGI range may be purchasing a home using savings or have income that varies across years.

[b]Data as of August 22, 2009.

[c]The 2007 data were the most current available for comparison purposes.

Looking at credit claims for each year separately must be done with caution because of the data issues described earlier. Comparing the preliminary 2009 data to the 2008 data shows an increase in the use of the credit by taxpayers with an AGI under $50,000 and especially by taxpayers with AGI under $25,000. For example, 18 percent of taxpayers who claimed the 2008 credit had an AGI of less than $25,000 compared to 27 percent of taxpayers claiming the 2009 credit. See appendix II for more detail. It is not possible to know whether these patterns will change as more complete and accurate 2009 data become available.

There are also differences in FTHBC claim rates among the states, as shown in appendix III. The highest number of FTHBC claims per capita is in Nevada, which has about three times the number of claims per capita than New York and Hawaii. Appendix III also shows the aggregate dollars claimed in each state and per capita dollars claimed. There is a strong correlation between state ranking of claims per capita and dollars per capita.

IRS Faces Significant Implementation and Compliance Challenges Related to the FTHBC

IRS had to balance quick implementation of the FTHBC with enforcement of the laws' requirements. Although IRS routinely implements tax legislation, the 2008 and 2009 FTHBC pose significant implementation challenges because they occurred during the filing season and in conjunction with other multifaceted tax law changes. IRS quickly implemented the complex FTHBC legislation, allowing taxpayers to claim about $10 billion as of August 2009. For example, IRS

- issued a new form, the Form 5405—"First-Time Homebuyer Credit"—and new instructions for the Form 5405, and revised other related forms and instructions;
- communicated with taxpayers and tax return preparers through a variety of avenues, such as news releases, postings on irs.gov, podcasts, and YouTube videos; and
- made computer programming changes to enable processing for paper and electronically filed returns. For example, the 2009 credit required programming changes to accommodate the differences in the eligibility rules for the 2008 and 2009 credits.[2]

IRS faces significant challenges in determining if taxpayers are complying with the numerous conditions for the credit. For example, to determine eligibility, IRS must verify that taxpayers have not owned a house in the previous 3 years and verify the closing date on home purchases. Other challenges include enforcing the $500 per year payback provision in the 2008 credit. According to recent IRS data, up to $7 billion could be repaid to the federal treasury over the 15-year period of this provision.

One reason assuring compliance is a challenge is that IRS did not require substantiation, either by the taxpayer or from a third-party source, to validate the information on the Form 5405. For example, IRS decided that requiring taxpayers to attach supplemental documentation about a home sale to a tax return would be burdensome. Further, according to IRS officials, IRS does not have the ability to accept such documentation

[2]IRS made minimal computer programming changes directly pertaining to the 2009 FTHBC. Officials said changes were implemented as part of Recovery Act programming changes, which resulted in IRS having to shut down its computers one weekend during the middle of the filing season—a first for IRS in several officials' memories.

electronically, which could impede taxpayers' ability to file tax returns electronically.[3]

Initially, IRS put procedures in place to stop some FTHBC fraud and detect common mistakes so that returns could be sent back to taxpayers for amendment. The results of IRS's review of early FTHBC filings prompted IRS to implement new computer filters to further determine eligibility up front, prior to refund issuance. As a result of up-front pre-refund checks as of September 30, 2009, IRS had (1) frozen more than 110,000 refunds pending civil or criminal examinations, (2) identified 167 criminal schemes, and (3) begun 115 criminal investigations.

IRS is also conducting post-refund FTHBC audits, but such audits are labor intensive for IRS, burdensome for taxpayers, and conducted after refunds are issued, making it more difficult for IRS to recoup the money. These audits address not only eligibility issues, but also recapture and payback issues for the 2009 and 2008 credits, respectively.[4] Because of the complicated provisions governing the credits, IRS is still determining the extent to which enforcement will have to be done through post-refund audits versus pre-refund compliance checks.

To reduce IRS's reliance on costly and burdensome audits, in a recent report we suggested the Congress consider providing IRS with additional legislative authority known as math error authority (MEA).[5] MEA, which IRS has for some tax provisions, must be granted by statute for specified purposes. Using MEA, IRS identifies calculation errors and checks for obvious noncompliance, such as claims above income and credit limits. IRS corrects these errors during tax return processing, which avoids the need for audits. Specifically, we suggested that Congress consider giving IRS MEA to use tax return information to automatically verify taxpayers'

[3]One potential example of supplemental documentation would be a copy of the Housing and Urban Development (HUD) form, HUD 1, Settlement Statement, required to be provided by settlement agents to the borrower at the time of closing. The form provides the date and sale price, which could help determine eligibility for the credit. However, it does not include a Social Security number, which makes matching to tax returns a challenge and it would be burdensome for closing agents to provide to IRS.

[4]The 2009 tax credit has a recapture provision. If a house is resold within 3 years, the credit must be repaid, under certain conditions.

[5]GAO, *Tax Administration: Opportunities Exist for IRS to Enhance Taxpayer Service and Enforcement for the 2010 Filing Season*, GAO-09-1026 (Washington, D.C.: Sept. 23, 2009).

compliance with the 2008 FTHBC payback provision and ensure that taxpayers do not improperly claim the credit in multiple years.

It is too early to tell whether IRS's enforcement actions and the proposed new legal authorities will be enough to protect federal revenue. Because of the complexities and multi-year compliance issues associated with the credit, along with the potential for significant burden on taxpayers, continued oversight of IRS's enforcement efforts will be necessary.

Agency Comments

In commenting on a draft of this testimony, IRS stated that the statement is very fair, presents a balanced picture, and gives a good perspective of where the agency is in the overall compliance cycle. IRS also provided technical comments which we incorporated where appropriate.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to questions that you or other Members of the Subcommittee may have at this time.

Contacts and Acknowledgments

For further information regarding this testimony, please contact James R. White, Director, Strategic Issues, on (202) 512-9110 or whitej@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this statement. Individuals making key contributions to this testimony include Libby Mixon, Assistant Director; Joanna M. Stamatiades, Assistant Director; Sherwin D. Chapman; Andrea S. Clark; John P. Dell'Osso; Rachel Dunsmoor; Kirsten B. Lauber; Lawrence M. Korb; Natalie L. Maddox; Karen V. O'Conor; Neil A. Pinney; and Sabrina C. Streagle.

Appendix I: Requirements for the 2008 and 2009 First-time Homebuyer Credit (FTHBC)

The 2008 and 2009 FTHBC have complex requirements. Regarding the amount of the credit, taxpayers generally can claim the smaller of

- $7,500 for the 2008 credit and $8,000 for the 2009 credit, or
- 10 percent of the purchase price of the home.

Virtually all eligibility requirements for the 2008 and 2009 FTHBC are identical, as noted in table 3. However, there are three key differences, the primary one being the purchase date.

Table 3: Eligibility Requirements for the FTHBC

Eligibility requirements	2008 FTHBC	2009 FTHBC
Date of purchase must be between April 9, 2008 and June 30, 2009	x	
Date of purchase must be between January 1, 2009 and November 30, 2009		x
Home must be principal residence[a]	x	x
Taxpayer must have no prior homeownership within the past 3 years	x	x
Home cannot be a gift or inheritance	x	x
Home cannot be acquired from a relative	x	x
Home must be located in the United States	x	x
Single filers: Modified adjusted gross income (MAGI) must be less than $95,000[b] Between $75,000 and $95,000 the credit phases out.	x	x
Married filing jointly filers: MAGI must be less than $170,000 Between $150,000 and $170,000 the credit phases out.	x	x
Cannot claim the FTHBC in both 2008 and 2009	x	x
Taxpayer cannot be a non-resident alien	x	x
Taxpayer must not be or must not have been eligible to claim the District of Columbia homebuyer credit for any tax year	x	
Home financing cannot come from tax-exempt mortgage revenue bonds	x	

Source: GAO analysis of FTHBC information.

Note: The “x” indicates if the related eligibility requirement applies to FTHBC for homes purchased in 2008 or 2009.

[a]A principal residence is the main home a taxpayer lives in most of the time. It can be a house, houseboat, housetrailer, cooperative apartment, condominium, or other type of residence.

[b]MAGI is modified adjusted gross income (AGI), as figured on an income tax return, plus various amounts excluded from the income tax return, such as some types of foreign income that would have to be added to AGI to yield MAGI.

In addition to eligibility requirements, the 2008 credit has a 15-year payback provision, but the payback may be accelerated if the home is sold or is no longer the principal residence. In addition, payback is waived if certain conditions are met, such as when a taxpayer is deceased and not a joint filer.

The 2009 tax credit has a recapture provision. If a house is resold or ceases to be the primary residence of the taxpayer within 3 years, the credit must be repaid. However, the recapture provision is limited to the amount of gain on the sale, so a taxpayer could sell within 3 years and still not owe repayment. There are exceptions to the recapture provision in the case of death, divorce, and involuntary conversion. Bills are currently under consideration in the Congress that would waive the recapture provision for members of the Armed Services if they are required to move.

Appendix II: Number of 2008 and 2009 FTHBC Claims and Adjusted Gross Income (AGI) Ranges

Table 4: Number of 2008 FTHBC Claims Filed and AGI Ranges

	Zero or less	$1 to $25,000	$25,001 to $50,000	$50,001 to $75,000	$75,001 to $100,000	Greater than $100,000	Total
Number of 2008 FTHBC claims	12,021	174,026	393,039	269,676	121,844	70,755	**1,041,361**
Percentage of claims	1	17	38	26	12	7	**100**

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding; data as of August 22, 2009.

Table 5: Number of 2009 FTHBC Claims Filed and AGI Ranges

	Zero or less	$1 to $25,000	$25,001 to $50,000	$50,001 to $75,000	$75,001 to $100,000	Greater than $100,000	Total
Number of 2009 FTHBC claims	13,179	91,257	150,957	82,798	30,210	16,792	**385,193**
Percentage of claims	3	24	39	21	8	4	**100**

Source: GAO analysis of IRS data.

Note: Percentages may not add due to rounding; data as of August 22, 2009.

Appendix III: State-level Data on FTHBC Claims

Table 6: State-level Claims for the FTHBC for 2008 and 2009 Compared with Census Population Data as of July 1, 2008, Sorted by Claims per Capita

Rank	State	Number of filers claiming FTHBC	Population	Claims per capita	Total dollars claimed	Dollars per capita
1	Nevada	20,177	2,600,167	0.00776	$146,370,293	$56
2	Utah	17,568	2,736,424	0.00642	$129,687,371	$47
3	Arizona	38,130	6,500,180	0.00587	$275,499,450	$42
4	Florida	105,865	18,328,340	0.00578	$770,495,882	$42
5	Tennessee	35,836	6,214,888	0.00577	$256,184,764	$41
6	Georgia	55,840	9,685,744	0.00577	$398,493,119	$41
7	Nebraska	10,149	1,783,432	0.00569	$70,893,504	$40
8	Idaho	8,525	1,523,816	0.00559	$61,971,426	$41
9	Minnesota	28,780	5,220,393	0.00551	$200,222,141	$38
10	Michigan	55,116	10,003,422	0.00551	$362,430,212	$36
11	Iowa	16,532	3,002,555	0.00551	$111,307,663	$37
12	Colorado	27,121	4,939,456	0.00549	$193,220,686	$39
13	Alabama	25,303	4,661,900	0.00543	$177,395,844	$38
14	Texas	131,472	24,326,974	0.00540	$932,461,608	$38
15	Oklahoma	19,554	3,642,361	0.00537	$133,377,012	$37
16	Wyoming	2,812	532,668	0.00528	$19,719,986	$37
17	Virginia	40,597	7,769,089	0.00523	$287,768,731	$37
18	Mississippi	15,142	2,938,618	0.00515	$104,257,573	$35
19	Arkansas	14,670	2,855,390	0.00514	$99,872,964	$35
20	Missouri	30,120	5,911,605	0.00510	$207,974,834	$35
21	Louisiana	21,781	4,410,796	0.00494	$150,314,448	$34
22	Kansas	13,836	2,802,134	0.00494	$94,205,713	$34
23	South Carolina	21,876	4,479,800	0.00488	$153,971,018	$34
24	North Carolina	44,785	9,222,414	0.00486	$320,122,059	$35
25	Indiana	30,834	6,376,792	0.00484	$209,073,724	$33
26	Alaska	3,153	686,293	0.00459	$21,767,374	$32
27	Kentucky	19,230	4,269,245	0.00450	$132,955,896	$31
28	Delaware	3,886	873,092	0.00445	$27,412,020	$31
29	Montana	4,272	967,440	0.00442	$29,631,226	$31
30	Wisconsin	24,685	5,627,967	0.00439	$171,136,305	$30
31	California	160,785	36,756,666	0.00437	$1,151,605,634	$31
32	Pennsylvania	53,521	12,448,279	0.00430	$366,475,016	$29
33	Ohio	48,776	11,485,910	0.00425	$326,460,385	$28
34	Maryland	23,831	5,633,597	0.00423	$166,204,408	$30

Rank	State	Number of filers claiming FTHBC	Population	Claims per capita	Total dollars claimed	Dollars per capita
35	North Dakota	2,699	641,481	0.00421	$18,139,186	$28
36	South Dakota	3,343	804,194	0.00416	$22,630,645	$28
37	Washington	26,604	6,549,224	0.00406	$189,408,939	$29
38	Illinois	51,794	12,901,563	0.00401	$357,438,259	$28
39	Rhode Island	4,190	1,050,788	0.00399	$29,762,911	$28
40	New Hampshire	5,145	1,315,809	0.00391	$35,402,421	$27
41	Massachusetts	25,090	6,497,967	0.00386	$172,308,588	$27
42	Maine	5,080	1,316,456	0.00386	$34,907,560	$27
43	Oregon	14,248	3,790,060	0.00376	$101,012,536	$27
44	New Mexico	7,262	1,984,356	0.00366	$51,382,080	$26
45	New Jersey	30,471	8,682,661	0.00351	$209,133,493	$24
46	Connecticut	12,223	3,501,252	0.00349	$84,964,985	$24
47	Vermont	2,100	621,270	0.00338	$14,183,146	$23
48	West Virginia	5,536	1,814,468	0.00305	$36,203,272	$20
49	New York	50,673	19,490,297	0.00260	$341,384,040	$18
50	Hawaii	3,207	1,288,198	0.00249	$22,391,318	$17
51	District of Columbia	1,383	591,833	0.00234	$9,480,535	$16

Source: GAO analysis of IRS and Census data.

Note: FTHBC data are for 2008 and 2009 claims as of August 22, 2009.

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