Tax Tips for Homebuyers: Raising the Downpayment

With analysts predicting a strengthening economy for 2015, many of your clients may be looking for a new home. In particular, millenials are expected to enter the housing market for the first time in 2015. But, even with the economy on the upswing, first-time homebuyers may find it necessary to tap a number of sources for that all-important downpayment. Here are some tax rules to keep in mind:

Family gifts. Many first-time homebuyers receive at least some assistance from their families. In the simplest situation, parents or other relatives will simply give the prospective homeowners gifts of cash to be used for the down payment and other homebuying expenses. In 2015, a taxpayer can give any individual up to $14,000 in a year without triggering a gift tax. If the taxpayer's spouse joins in the gift, the exempt amount doubles to $28,000 per individual. So, for example, parents can give a homebuying couple up to $56,000 in a single year free of gift tax. Larger gifts can be sheltered from tax by the unified estate and gift tax credit. For 2015, the credit effectively exempts up to $5.43 million of cumulative gift and estate tax transfers from tax.

Family loans. A parent or other relative may choose to help new homebuyers by making a no- or low-interest loan. The tax law normally imputes a market rate of interest on low- and no-interest loans between family members [IRC Sec. 7872]. That is, the lender is taxed as if he or she received taxable interest, which was then returned to the borrower as a gift. However, there are some important exceptions to this imputed interest rule:

- De minimis loans that do not exceed $10,000 are not subject to the imputed interest rule. However, bear in mind that for this purpose, a husband and wife are treated as one person. Therefore, parents cannot "double up" the exemption by making separate $10,000 loans to a child and the child's spouse. Similarly, parents can't increase the exemption by each making a $10,000 loan to the homebuying couple.

- Loans of up to $100,000 are subject to a special rule that limits the amount of imputed interest to the amount of investment income (i.e., interest and dividends) received by the homebuyers during the year. Thus, the imputed interest on such loans will be very low if the homebuyers have tapped their investments to purchase their new home.

Co-purchases. Some parents may want to consider co-purchasing a home with their children. A special break for "shared equity financing" can make this an attractive alternative for the parents. As long as a child pays fair-market rent, the parents are treated as landlords with respect to their share of the home.

Example. Susan Alcott wants to buy the condominium unit that she has been renting for $1,000 a month.
The owner will sell for $100,000, including a $10,000 down payment. Susan's father, Peter, agrees to split the purchase with Susan. Peter and Susan each pay $5,000 toward the down payment. They also split the mortgage payments, taxes, and other expenses on a 50-50 basis.
In addition, Susan pays Peter $500 a month as rent for his half of the unit. Peter uses the rent money to cover his share of the condo expenses.