Mortgage Tax Credit Certificate (MCC)

OVERVIEW

State HFAs may also manage a program that provides home purchasers with a significant tax credit in connection with their home loans. The credit can be used in a manner that assists people in making their monthly payments more affordable (affecting underwriting) for as long as the home remains their primary residence. Participating bankers provide information to their customers about the tax credit and apply to the HFA for the certificate on the borrower's behalf.

The Mortgage Tax Credit Certificate (MCC) program was established by the Deficit Reduction Act of 1984 and was modified by the Tax Reform Act of 1986.[8] Under the law, states can convert a portion of their federal allocation of private activity bonds (PABs) to MCC authority on a four-to-one basis. Mortgage tax credit certificates can help lenders increase their appeal to first-time homebuyers and help more borrowers qualify for homes by reducing their mortgage payments. MCCs are not a loan product, but rather a federal tax credit. MCCs are certificates issued by HFAs that increase the federal tax benefits of owning a home and helps low- and moderate-income, first-time homebuyers offset a portion of the amount they owe in mortgage interest.

An MCC is not a tax deduction, but rather it provides a dollar-for-dollar tax credit to recipients to increase housing payment affordability. In some cases, MCCs can also help borrowers who might not otherwise qualify for a loan by reducing their net monthly mortgage payment.

MCCs are issued directly to qualifying homebuyers who are then entitled to take a nonrefundable federal tax credit equal to a specified percentage of the interest paid on their mortgage loan each year. These tax credits can be taken at the time the borrowers file their tax returns. Alternatively, borrowers can amend their W-4 tax withholding forms from their employer to reduce the amount of federal income tax withheld from their paychecks in order to receive the benefit on a monthly basis.

The tax credit percentages vary by state, but are generally in the amount of 20 percent to 40 percent of the total mortgage interest. The remaining interest obligation may be deducted (by those who itemize deductions) as a standard home mortgage interest deduction. Regardless of the tax credit percentage issued, the Internal Revenue Service caps the maximum tax credit that may be taken for any given year at $2,000 for each MCC recipient. The MCC tax credit remains in place for the life of the mortgage, so long as the residence remains the borrower's principal residence.

The total MCC tax credit for each year cannot exceed the recipient's total federal income tax liability for that year, after accounting for all other credits and deductions. Credits in excess of the current year tax liability may be carried forward for use in the subsequent three years. Therefore, it is important to consider the potential limitations of the credit for those homebuyers with a minimal tax obligation.

Unlike down payment and closing cost assistance programs, MCC programs generally do not restrict the type of mortgage financing with which they are coupled. In particular, MCCs do not have to be combined with an HFA first-lien mortgage. First mortgages originated in connection with MCCs but not originated under an HFA first-lien mortgage program are retained by the lender (rather than sold to the HFA) and can be held or sold at the discretion of the lender.

[8] Tax Reform Act of 1986, Pub L. 99-514, 100 Stat. 2085, enacted October 22, 1986.

MCC EXAMPLE

Joe and Sylvia are purchasing their first home. Their annual income is $50,000. The mortgage interest that they will owe in the first year of owning their new home is $10,000.

Without an MCC, Joe and Sylvia would be able to deduct all of the $10,000 in mortgage interest that they paid during year one, assuming their other deductions are high enough that taking the standard deduction is not a better tax strategy. However, if Joe and Sylvia get an MCC for 20 percent of the interest on the mortgage, they will be able to deduct $8,000 of their mortgage interest AND also receive a $2,000 dollar-for-dollar credit.

The tables below show an extremely simplified illustration of Joe and Sylvia's federal tax obligation with and without a mortgage tax credit certificate.[9] It is important to note that if Joe and Silvia do not itemize deductions, they will get no tax benefit from the mortgage without the MCC.

WITHOUT AN MCC	
Annual income	$50,000
Mortgage interest to deduct	$10,000
Taxable income (assume 15% tax rate)	$40,000
Federal income tax	$6,000
Total Income Tax Owed	**$6,000**

WITH AN MCC	
Annual income	$50,000
Mortgage interest to deduct (80% total)	$8,000
Taxable income (assume 15% tax rate)	$42,000
Federal income tax	$6,300
Minus 20% MCC tax credit	($2,000)
Total Income Tax Owed	$4,300
Net gain from MCC (first year)	**$1,700**

In this example, Joe and Sylvia would save $1,700 in federal taxes in the first year they received a mortgage tax credit. This annual credit could also be added to their annual income for the purpose of qualifying for a mortgage by amending their W-4 tax withholding forms, which may boost their chances of loan approval. They would also continue receiving the annual MCC benefit, albeit in a smaller amount as the interest they pay on the mortgage declines, for as long as they keep their mortgage.

[9] This simplified illustration is intended to show how a tax credit can be applied and does not account for individual financial circumstances. For instance, the assumed 15 percent tax rate applied to the taxable income does not account for personal exemptions or other deductions and credits that may apply. It is important to analyze the financial circumstances of each potential tax credit recipient in order to properly advise.

POTENTIAL BENEFITS

Mortgage Tax Credits increase borrowers' payment affordability.

Mortgage Tax Credits help lenders reach and qualify more low- and moderate-income borrowers.

Mortgage Tax Credits can be coupled with most first mort gage loans.

POTENTIAL CHALLENGES

The application, benefits, and limitations of the Mortgage Tax Credit Certificate program can be difficult to explain to borrowers.

Borrowers may be subject to recapture tax (although this is a low risk).

State HFA MCC programs are subject to funding availability and may run out when the bond funds allocated to MCCs are expended.

RECAPTURE TAX

A portion of the MCC benefit is subject to recapture by the Internal Revenue Service if a recipient meets *all three* of the following conditions:

1. the borrower sells the home within nine years of purchase;
2. the borrower earns significantly more income than when he/she bought the home;[10] and
3. the borrower has a gain from the sale of the home.

Only borrowers who meet all three criteria will be subject to recapture. MCC borrowers are not subject to recapture if they sell, give away, or dispose of the home more than nine full years after closing. The maximum amount of recapture, which is payable on the sale of the home, is 6.25 percent of the original principal balance of the loan or 50 percent of the gain on the sale of the home, whichever is less.

Most HFAs report that the majority of their program recipients are not subject to tax recapture. Nevertheless, many HFAs have Reimbursement Recapture Tax programs that will reimburse borrowers for any recapture tax incurred. [11]

Number of HFAs that Offer MCCs

Of the 54 HFAs found in this Guide, 33 HFAs offer mortgage tax credit certificates.

BANK ELIGIBILITY AND APPLICATION PROCESS

HFA MCC program approval requirements are generally more streamlined than the process to become an approved first mortgage and down payment assistance approved lender. To use MCC programs, lenders need to be approved by the insuring agency for which they originate loans, i.e., the Federal Housing Administration (FHA), the U.S. Department of Veterans Affairs (VA), the U.S. Department of Agriculture's Rural Housing Services (RHS), Fannie Mae, or Freddie Mac and have an office physically located in the state for which it is approved. Minimum net asset requirements may apply. Generally, lenders will need to sign a participation agreement that outlines the lender's responsibilities and requirements associated with the program, such as submitting documents for approval to the HFA and record-keeping responsibilities. Participation agreements generally outline the documentation and borrower certification requirements associated with the program. In many cases, the HFAs charge an annual fee for lenders to participate in the program.

BORROWER CRITERIA

Income and sales price limits: Income and sales price limits are standard eligibility requirements for all MCC programs. These limits vary by state.

First-time homebuyers: MCC programs are limited to first-time homebuyers (borrowers who have not had an ownership interest in a principal residence in three years). The first-time homebuyer requirement is waived for those borrowers purchasing a home in targeted areas as defined by the U.S. Department of Housing and Urban Affairs (HUD) at the census tract level or designated as such by state governments, as well as for active military and veterans.

Occupancy: Borrowers must use the home as their principal/primary residence.

Homeownership counseling: Many HFA programs require some form of pre-purchase homebuyer education. These requirements vary by state.

PROGRAM CRITERIA

First loan purpose combined with MCCs: MCCs are restricted to use in combination with purchase loans (refinances are not eligible). However, if a borrower currently has an MCC, and decides to refinance into a new mortgage, many programs allow the borrower to apply to receive a new MCC issued against their refinanced mortgage.

---

[10] A borrower will not meet this condition for recapture unless they earn the maximum income limit that would have applied to their qualifying household size at the time of purchase, compounded by 5 percent per year from the date of purchase until the home is sold or transferred.

[11] The following HFAs offer a recapture tax reimbursement program: Connecticut, Idaho, Maine, Massachusetts, New York, North Dakota, Ohio, and South Dakota. Check with your state HFA to determine whether they offer a recapture tax reimbursement program.

First loan type with MCCs: Most fixed-rate loan types are eligible. Loans must be underwritten according to FHA, VA, RHS, or conventional loan criteria as appropriate and offered at prevailing market rates.

Combination with other HFA programs: Some states allow the MCC program to be combined with other HFA programs on the same transaction, such as allowing a borrower to receive an HFA first-lien mortgage loan and down payment assistance and also receive an MCC. Other states limit the degree to which HFA subsidy programs can be combined.

HFA MCC fees: HFAs typically charge a one-time MCC fee to the borrower, which is applied at the time of closing. In some programs, this fee is waived or reduced if the MCC is being issued in combination with an HFA first-lien mortgage product. Fees vary by state.

Lender MCC fees: Lender MCC fees are generally allowed, but capped at a specific amount. Fee caps vary by state.

Other lender fees: The loan origination and other service-related fees may be capped on loans receiving an MCC in some states.

Potential Benefits

- Mortgage Tax Credits increase borrowers' payment affordability.
- Mortgage Tax Credits help lenders reach and qualify more low- and moderate-income borrowers.
- Mortgage Tax Credits can be coupled with most first mortgage loans.

Potential Challenges

- The application, benefits, and limitations of the Mortgage Tax Credit Certificate program can be difficult to explain to borrowers.
- Borrowers may be subject to recapture tax (although this is a low risk).
- State HFA MCC programs are subject to funding availability and may run out when the bond funds allocated to MCCs are expended.

A COMMUNITY BANKER CONVERSATION

Using the Mortgage Tax Credit Certificate program

A banker from Kentucky helps her customers take advantage of the Mortgage Tax Credit Certificate (MCC) program offered by the HFA. She said she uses MCCs, which are certificates issued to qualifying homebuyers that increase the federal tax benefits of owning a home. This helps low- and moderate-income, first-time homebuyers offset a portion of the amount they owe in mortgage interest by providing a tax credit that can increase housing payment affordability. In some cases, an MCC may also help borrowers qualify for a higher loan amount by increasing the monthly income that can be used toward qualifying. "The MCC represents an unclaimed pool of resources that even those of us who have been doing this for a long time don't always think about. People think it's a lot of extra work but it's not; it's just a few extra documents."

RESOURCES

IRS MCC form
https://www.irs.gov/pub/irs-pdf/f8396.pdf

IRS Federal Recapture Tax information
https://www.irs.gov/instructions/i8828/ch01.html

See individual state HFA descriptions in Appendix A for helpful mortgage tax credit certificate resources related to the housing finance agency in each state.