First-Time Home Buyer Savings Account Guidelines

Introduction

During the 2014 Session, the Virginia General Assembly enacted House Bill 331 (2014 Acts of Assembly, Chapter 729), which allows an individual to designate an account at a financial institution as a first-time home buyer savings account. Distributions from such accounts must then be used for the purpose of paying or reimbursing the down payment and allowable closing costs for the purchase of a single-family residence in Virginia by a qualified beneficiary. An account holder may subtract any interest, capital gains, or other income attributable to such account to the extent it is subject to federal income taxation.

These guidelines are published by the Department to provide guidance to taxpayers regarding first-time home buyer savings accounts as required by *Va. Code* § 55-556. These guidelines are exempt from the provisions of the Administrative Process Act (*Va. Code* § 2.2-4000 et seq.) according to the provisions outlined in *Va. Code* § 55-556. As necessary, additional information will be published and posted on the Department's website, www.tax.virginia.gov.

These guidelines represent the Department's interpretation of the relevant laws. They do not constitute formal rulemaking and hence do not have the force and effect of law or regulation. In the event that the final determination of any court holds that any provision of these guidelines is contrary to law, taxpayers who follow these guidelines will be treated as relying on erroneous written advice for purposes of waiving penalty and interest under *Va. Code* §§ 58.1-105, 58.1-1835, and 58.1-1845. To the extent there is a question regarding the application of these guidelines, taxpayers are encouraged to write to the Department and seek a written response to their question.

Designating an Account as a First-Time Home Buyer Savings Account

An individual may designate an account as a first-time home buyer savings account by submitting an attachment with his or her Virginia income tax return for the first taxable year in which such individual claims the subtraction for interest, capital gains, or other income attributable to an account. For an account to be designated as a first-time home buyer savings account, such attachment must include:

- The name and address of the financial institution that maintains the account;
- The names of any other individuals with an ownership interest in the account;
- The account number or other account identifier;
- The type of principal (cash or marketable securities) contributed to the account;
- The amount of principal and interest in the account as of the last day of the taxable year;
- The amount of any withdrawals from the account during the taxable year; and
- The account beneficiary or beneficiaries.

To claim the subtraction, an account holder must designate an account as a first-time home buyer savings account in the year during which he or she is claiming the subtraction or must have designated such account as a first-time home buyer savings account in a prior taxable year.

If an individual intends to designate more than one account as a first-time home buyer savings account, he or she is required to submit a separate attachment for each account. Once an account has been designated as a first-time home buyer savings account, the account will remain a first-time home buyer savings account until it is closed or its status as a first-time home buyer savings account is terminated.

After designating an account as a first-time home buyer savings account, the account holder is required to include an attachment with updated account information for all future taxable years in which he or she is required to file a Virginia income tax return, or until such account is closed or its status as a first-time home buyer savings account is terminated. If an account holder has designated more than one existing first-time home buyer savings account, the account holder is required to submit a separate attachment with updated information for each account.

An account owned by two or more individuals may be designated as a first-time home buyer savings account. An account owned by two or more individuals will only be considered a first-time home buyer savings account for the individuals with an ownership interest in such account who have designated it as a first-time home buyer savings account.

Accounts Eligible to be First-Time Home Buyer Savings Accounts

An individual may designate any account with a financial institution as a first-time home buyer savings account, including an account that was opened prior to January 1, 2014. A "financial institution" includes any bank, trust company, savings institution, industrial loan association, consumer finance company, credit union, or any benefit association, insurance company, safe deposit company, money market mutual fund, or similar entity that is authorized to do business in Virginia. Only cash and marketable securities may be contributed to an account. Examples of accounts that may be designated as first-time home buyer savings accounts include, but are not limited to, bank accounts, mutual funds, certificate of deposits ("CDs"), brokerage accounts, and money market accounts.

There are no limitations as to the number of first-time home buyer savings accounts one individual may establish.

Qualified Beneficiaries

Definition of Qualified Beneficiary

A "qualified beneficiary" is an individual who resides in Virginia at the time of settlement on the purchase of a single-family residence in Virginia who:

- Has never owned or purchased under contract for deed, individually or jointly, a single-family residence;
- Is designated as the beneficiary of a first-time home buyer savings account; and
- May use funds in such account to pay eligible costs.

For an individual to be a qualified beneficiary, he or she may not have owned or purchased a single-family residence anywhere, within Virginia, or elsewhere. An individual is considered to own a single-family residence, and is therefore disqualified from being designated as a beneficiary, even if he or she did not purchase the residence. For example, an individual who owns or has owned land acquired by a gift or inheritance is not considered a qualified beneficiary.

An individual who has owned or purchased land or commercial real estate may be designated as a qualified beneficiary as long as he or she has not owned or purchased a single-family residence. An individual who is otherwise eligible to be a qualified beneficiary may still be designated as a qualified beneficiary even if he or she marries a person who is not eligible to be a qualified beneficiary, so long as such individual does not become a co-owner of a single-family residence as a result of the marriage.

Designating a Qualified Beneficiary

To establish a first-time home buyer savings account, an account owner must designate a qualified beneficiary or qualified beneficiaries for such account on the attachment submitted with his or her Virginia income tax return. By designating a beneficiary, the account holder certifies that each designated individual meets the requirements of a qualified beneficiary. The account holder is not required to notify an individual that he or she has been designated as a beneficiary of an account.

If the account holder does not designate a beneficiary or if he or she designates an individual who is not qualified, the account will not qualify as a first-time home buyer savings account and the account holder cannot claim the subtraction for any interest, capital gains, or other income attributable to such account.

An account holder may be designated as the beneficiary of his or her own account. The same individual may be designated as the beneficiary for multiple first-time home buyer savings accounts.

An account holder is required to submit an updated list of beneficiaries each year after the designation of a first-time home buyer savings account, and may change the beneficiary of an existing account at such time. If an individual becomes ineligible to be a qualified beneficiary after being designated as such, the account holder is required to remove such individual from the list of designated beneficiaries when submitting his or her tax return for the taxable year during which the beneficiary was disqualified.

Principal and Interest Limits

Only cash and marketable securities may be contributed as principal to a first-time home buyer savings account. No more than $50,000 in principal may be retained within a first-time home buyer savings account at any time. No interest, capital gains, or other income attributable to a first-time home buyer savings account may be subtracted to the extent generated while the principal in the account was in excess of $50,000 or consisted of anything other than cash and marketable securities.

In aggregate, no more than $150,000 of principal and interest may be retained within a first-time home buyer savings account at any time. No interest, capital gains, or other income attributable to a first-time home buyer savings account may be subtracted to the extent generated while the aggregate principal and interest in the account was in excess of $150,000.

For an individual that has established more than one first-time home buyer savings account, the principal and interest limitations apply separately to each of his or her first-time home buyer savings accounts.

Claiming the Subtraction for Interest, Capital Gains, and Other Income

To the extent it was included in his or her federal adjusted gross income, an account holder may subtract any income attributable to a first-time home buyer savings account that was taxed as interest, capital gains, or as other income for federal income tax purposes when computing his or her Virginia taxable income. The subtraction reduces the account holder's Virginia taxable income by the amount of account-related income that is subject to federal income taxation. If such income is exempt from federal income taxation, it has already been excluded from Virginia taxable income and may not be subtracted on the Virginia return.

An account holder may not subtract any income attributable to a first-time home buyer savings account that was included in another account holder's federal adjusted gross income. An individual with an ownership interest in an account may only subtract income attributable to the account if he or she has designated such account as a first-time home buyer savings account by attaching the required information to the return.

Required Addition for Capital Losses

For all taxable years after establishing a first-time home buyer savings account, an account holder is required to add back any loss attributable to such account that was deducted as a capital loss for federal income tax purposes. This addition is required even if an account holder cannot claim the subtraction for the same taxable year.

Use of Account Funds

Eligible Costs

Distributions from a first-time home buyer savings account may only be used for the purpose of paying or reimbursing the down payment and allowable closing costs for the purchase of a single-family residence in Virginia by a qualified beneficiary. "Allowable closing costs" consist of disbursements listed on a settlement statement for the purchase of a single-family residence in Virginia by a qualified beneficiary. Such disbursements include, but are not limited to, closing costs, inspection fees, and lender fees.

An account holder may not use funds held in a first-time home buyer savings account to pay expenses related to the administration of such account. However, a financial institution may deduct a service fee from a first-time home buyer savings account without subjecting the account holder to recapture or penalties.

It is the account holder's responsibility to collect and maintain documentation substantiating that distributions from a first-time home buyer savings account were used solely to pay eligible costs. Such document must be made available to the Department upon request.

Recapture of the Subtraction

Any subtractions taken by an account holder are subject to recapture if account funds are withdrawn for a purpose other than paying eligible costs. Such recapture is accomplished by adding the amount of the subtraction to the account holder's federal adjusted gross income in the taxable year or years in which account funds were withdrawn for an ineligible purpose. The recapture requirement applies to all account holders who have designated the account as a first-time home buyer savings account, regardless of who withdrew account funds for a purpose other than to pay eligible costs. This applies even if the individual who withdrew account funds for a purpose other than to pay eligible costs has not designated the account as a first-time home buyer savings account.

If an individual has established more than one first-time home buyer savings account, the recapture requirement applies separately to each of his or her accounts.

The amount subject to recapture is determined separately for each individual who has designated the account as a first-time home buyer savings account. Such amount is determined by multiplying the amount withdrawn from an account for an ineligible purpose by a fraction, the numerator of which is equal to the aggregate earnings in the first-time home buyer savings account at the time of the withdrawal, and the denominator of which is equal to the total amount of funds in such account at the time of the withdrawal:

$$\text{Amount Withdrawn for an Ineligible Purpose} \times \frac{\text{Aggregate Account Earnings}}{\text{Total Account Balance}}$$

Aggregate account earnings include the total amount of income earned by an account since its designation as a first-time home buyer savings account by the account holder, to the extent such earnings were subtracted by that account holder.

The amount subject to recapture in a particular taxable year will be limited to the amount of account funds that were withdrawn for an ineligible purpose during the taxable year. The total amount subject to recapture for an account holder in all taxable years cannot exceed the total subtraction amount claimed by such account holder since the account was designated as a first-time home buyer savings account.

If an account holder claims the subtraction for a taxable year and withdraws account funds for a purpose other than paying eligible costs in a later taxable year, he or she is required to recapture such subtraction even if the withdrawal occurred after the expiration of the statute of limitations under *Va. Code* § 58.1-312.

Example 1:

Taxpayer A designated an account as a first-time home buyer savings account on his Virginia income tax return for Taxable Year 2014 with an initial principal amount of $50,000. For Taxable Years 2014 through 2018, Taxpayer A subtracted a total of $5,000 of income attributable to such account. In Taxable Year 2019, Taxpayer A used a withdrawal of $27,500 from the account for an ineligible purpose. At the time of the withdrawal, Taxpayer A's account contained funds of $55,000, of which $5,000 was interest.

Taxpayer A's recapture is computed as follows:

$$\$27{,}500 \times \frac{\$5{,}000}{\$55{,}000} = \$2{,}500$$

Therefore, Taxpayer A would be subject to the recapture of $2,500.

Example 2:

Assume the same facts as in Example 1, except Taxpayer A used a distribution of $55,000 from his account for a purpose other than paying eligible costs.

Taxpayer A's recapture is computed as follows:

$$\$55{,}000 \times \frac{\$5{,}000}{\$55{,}000} = \$5{,}000$$

Therefore, Taxpayer A would be subject to the recapture of $5,000, the total amount of subtractions he claimed.

Example 3:

Taxpayer B designated an account as a first-time home buyer savings account on his Virginia income tax return for Taxable Year 2014 with an initial principal contribution of $20,000. For Taxable Years 2015 through 2018, Taxpayer B subtracted an aggregate of $10,000 of income attributable to such account.

During Taxable Year 2019, Taxpayer B used a withdrawal of $25,000 from the account to pay eligible costs.

During Taxable Year 2020, Taxpayer B used a withdrawal of $5,000 from the account for an ineligible purpose. At the time of the withdrawal, Taxpayer B's account contained funds of $5,000.

Taxpayer B's recapture is computed as follows:

$$\$5{,}000 \times \frac{\$10{,}000}{\$5{,}000} = \$10{,}000$$

Because the amount of the recapture cannot exceed the amount withdrawn to pay ineligible costs, Taxpayer B is subject to the recapture of $5,000.

Penalty for Ineligible Withdrawal of Account Funds

If funds are withdrawn from a first-time home buyer savings account for any purpose other than the payment of eligible costs, each account holder will be subject to a penalty equal to 5 percent of the amount required to be recaptured. Such penalty is to be paid in the taxable year in which funds were withdrawn from an account for a purpose other than paying eligible costs on the account holder's Virginia income tax return.

Example 4:

During Taxable Year 2020, Taxpayer C withdrew funds from a first-time home buyer savings account for an ineligible purpose, and was required to recapture subtractions totaling $10,000. Taxpayer C would be subject to a penalty computed as follows:

5% x $10,000 = $500.

Exceptions to the Recapture and Penalty Provisions

Neither the recapture nor penalty provisions apply to the extent funds are:

- Withdrawn by reason of the qualified beneficiary's death or disability;
- Disbursed pursuant to a filing for protection under federal bankruptcy law (United States Bankruptcy Code, 11 U.S.C. §§ 101 through 1330);
- Transferred from one first-time home buyer savings account to another first-time home buyer savings account; or
- Distributed by a financial institution by reason of the account holder's death.

Additional Information

These guidelines are available online under the Laws, Rules and Decisions section of the Department's website, located at http://www.policylibrary.tax.virginia.gov. For additional information, please contact the Department at (804) 367-8031.