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Not a first-time homebuyer? You can still save $8,000

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If you're like millions of American families, the college funds you have salted away in 529 plans or other accounts suffered a 40 percent haircut since August, leaving you to wonder how to pay for your teenagers' educations. Financial aid? College tax credits? Forget them—in the government's eyes, you have too much money already.

Dr. Jose of Norristown, Pennsylvania, discovered an answer to his dilemma. Jose's son Bob, age 18, a freshman in the University of Pittsburgh's six-year engineering program, wants to escape from university housing with his buddies next year. The Joses realized that if they purchased a home near the university for $240,000 and rented it to the students, the asset would provide rent-free housing for their son and give them extra income.

Even better for the Joses: Their purchase is eligible for a new $8,000 federal tax credit available to "first-time homeowners." Married couples are eligible only if they earn less than $175,000, but Dr. and Mrs. Jose already own a home, and their income exceeds $175,000. Their son, however, is single, has never owned a home, and earns much less than $95,000—the threshold for a single person's credit entitlement.

As part of the stimulus bill passed this year, the allowable credit for first-home purchases between January 1 and November 30 is 10 percent of the first $80,000 of the home's purchase price. The fact that Bob's parents do not qualify does not disqualify Bob. By structuring the purchase so that Bob owns one-third of the property, Bob's share of the price is $80,000. He will co-sign the mortgage with his parents and therefore can take the full $8,000 credit based upon his portion of the price.

POWER POINTS

The federal stimulus bill offers a tax credit up to $8,000 for first-time homeowners.

The credit could be valuable to young physicians or grown children of older physicians.

The beneficiary must co-sign for the mortgage, but needn't invest his own money in the home.

By law, a first-time homeowner is someone who has not owned a home for three years prior to the purchase of the qualifying residence. Furthermore, the property acquired must become the principal residence of the owner for at least three years. In this way, the $8,000 credit could also be appealing to new physicians seeking their first permanent residences.

The law allows Bob to take the credit for either the 2008 or 2009 tax year. During 2008, he earned approximately $3,000 as a lifeguard. How does an $8,000 credit help? Unlike prior home credits, the new stimulus law makes the credit "refundable," meaning that even if you have no tax obligation, you get a check from the government for the maximum credit to which you are entitled. For example, Bob had $400 withheld for 2008 federal taxes, yet had a total federal tax liability of $303. With the $8,000 credit, he will receive a refund of $8,097 (the $97 overpayment plus the $8,000 credit).

The only reason not to file for the credit in 2008 would be if Bob had exceeded the maximum income limit that year but did not in 2009. If you already filed your 2008 return, you can claim the credit by filing Form 1040X. When filing, you must also file Form 5405 and enter the credit on line 69, page 2 of your child's return. A Form 1040—not the short forms 1040A or 1040EZ—is required to take the credit.

The credit is based on the whole or a portion of the purchase price and the ownership by the qualifying person, regardless of the amount financed. Your child does not have to come up with his share of the purchase price. Even though you cannot gift the real estate to the child, you can gift your child's share of the down payment and structure it to avoid gift taxes.

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To learn about 529 college savings plans, go to memag.com/529.

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