

# *Sy Accountancy Corporation*

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

Tel (626) 744-0200 • Fax (626) 744-0300 • vsy@victorsycpa.com • www.victorsycpa.com

## **MORTGAGE INTEREST DEDUCTION**

By Victor Sy, CPA, MBA

1. **Qualified Residence Interest** includes your principal and second homes. The homes could be a house, condo, mobile home, motor home, time share, or even a houseboat, as long as it has sleeping quarters, toilet and cooking facilities. You don't have to occupy your second house (vacant house is OK).
2. **Acquisition Debt** is incurred to buy, construct, or substantially improve your first or second home. The loan on both houses should not exceed \$1M (excess becomes personal interest & is not deductible).
3. **Home Equity Debt** is limited to \$100,000, regardless of what you use it for. (The previous medical or education use was repealed - even before we learned how to use it).
4. **Loan Fees (Points)** paid last year to refinance existing loans cannot be fully deducted last year. The amount has to be amortized over the life of the loan - usually 15 to 30 years.
  - A. "Points" are charges for the use of money. These are, in fact, interest paid in advance. (The term does not include broker fees or escrow fees).
  - B. Points paid to buy your main home in a certain year are all deductible in that same year.
  - C. Points paid to refinance an existing loan are amortized (spread out) over the term of the new loan. However, refinance points to improve your main home can all be deducted in 2001.
  - D. New: Points paid by seller for the buyer were not previously allowed as deductions. Under a new Revenue procedure 94-27, the Service decided that it will treat seller-paid mortgage points on a principal residence as paid by the buyers.
  - E. Points do not have to be actually paid by the borrower anymore. Merely deducting from the loan is now OK. Mortgage interest statements from banks must now show the amount of points.
5. **Prepayment Penalties** (for paying off a loan early) paid are fully deductible in the year paid - as interest. Caveat: Watch out for hidden prepayment penalty provisions on your loan documents.
6. If you **use a mortgage loan for business**, you may want to deduct interest on home equity loan on schedule C to reduce your self-employment tax. This move could also give an additional advantage: Avoiding the new 3% cutback on mortgage interest and other itemized deductions.
7. You may treat a **residence under construction** as a qualified residence for a period of 24 months, but only if it becomes your main residence.
8. Interest expense on a **mobile home, house trailer, boat, or trailer qualifies** if it is your first or second home.
9. You do **not** have to occupy your second home to qualify it for mortgage interest deduction.
10. Loan proceeds used for several **different projects have to be allocated** by tracing how the proceeds were used, not by the properties that secure the loan. The exception, of course, is home mortgage interest which can be deducted as such regardless of its use as long as the amount does not exceed the \$100,000/\$1M discussed earlier. For example, if you borrow \$100,000 in excess of the limits on your apartment rental and use \$50,000 for apartment repairs, \$30,000 for a personal car, and \$20,000 for mutual funds, interest will have to be allocated proportionally to 50% rental, 30% personal, and 20% investment.

**Development 1:** New law allowed deduction of mortgage insurance premiums in 2007-2009 (**extended to 2011**).

**Development 2:** IRS Chief Counsel concluded that acquisition indebtedness that is incurred by a taxpayer to acquire, construct, or substantially improve a qualified residence can also qualify as home equity indebtedness to the extent it exceeds \$1 million. As a result, you can immediately deduct interest on up to \$1.1 million (instead of \$1M) of the debt securing the purchase of your principal residence.