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### INVESTMENT INTEREST REVISITED

By Victor Sy, CPA, MBA

With personal interest on credit cards and personal loans gone, and with the new 3% reduction on mortgage interest, the subject of investment interest suddenly becomes more interesting. It is the only interest expense that is still 100% deductible. For this reason, let us learn a few things about investment interest.

#### First, let's hit the basics:

1. Investment interest expense includes all interest expense on debts used to carry or purchase investment properties such as stocks, bonds or land held for appreciation.
2. Investment interest is allowed only to the extent of net investment income.
3. Net investment income is defined as the excess of investment income over investment expenses.
4. Investment income includes interests, dividends, net gains from the sale of property held for investments, annuities, and certain royalties.
5. Any unused investment interest, because of this limitation, is carried forward to succeeding years. There is no limit to the number of years this disallowed interest can be carried forward to.

It is the future that makes investment interest desirable. We do not lose it. What is unused is simply carried over until we have enough net investment income to offset it.

The key to maximizing the deduction is to have investment income exceed investment interest. This is best done by ensuring that all items of investment income are properly classified as such.

#### The following is a list of specific investment income:

1. Interest on debt obligations.
2. Dividends on either C or S corporate stock.
3. Fees, royalties or other payments received for the use of intangible property.
4. Guaranteed payments made to a partner for the use of capital.
5. Income from real estate investment, trust, mutual funds, common trust funds or cooperative.

I suggest that you do not merely fill out your tax forms as you did in the past with regards to interest expense. The trick is to classify as much interest as you can to investment interest away from personal interest or even mortgage interest. Bring year-end statements from banks, stock brokerage companies, corporations and loan documents to your tax preparer and spend time in classifying them correctly.

**Cancellation of Debt (COD):** The IRS announced that discharge of debt on a loan traceable to investment property is investment income and can be used to help deduct investment interest. This development is a useful tool for taxpayers whose properties may be repossessed or foreclosed.