

# *Sy Accountancy Corporation*

Member, American Institute of CPAs

704 Mira Monte Place, Pasadena, California 91101

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

## REVERSE MORTGAGE – DOES IT MAKE SENSE FOR YOU?

By Victor Sy, CPA, MBA

Some folks are house-rich but cash-poor. They may be older individuals who purchased their homes many, many moons ago. Their home values appreciated. Loans were paid off. Despite the downturn in home values from the subprime meltdown, their homes retain huge equities.

Some of them may want to sell their homes to pay medical, travel, and grandchildren's college costs, or just to survive. But they are reluctant to sell because real estate prices have dropped dramatically. They also don't want to pay taxes on capital gains.

### Enter Reverse Mortgage:

This is an alternative to selling your home. You can pull out money from the equity of your home. Do you pay tax on loan proceeds? No. You don't sell, you don't pay. What about monthly mortgage payments that the elderly may not be able to afford? None. Unlike a traditional mortgage that you pay every month, a reverse mortgage does not require monthly payments. Payment is due only when the borrower dies or moves out of the property. At that time, the home is typically sold and the mortgage paid off from the sales proceeds. Remaining funds go to the estate or surviving spouse. In the meantime, interest charges accrue and are added to the principal, which gets larger instead of smaller; hence, the term "reverse mortgage." Loan proceeds from a reverse mortgage lender are made in installments over a period of time. Proceeds can also be made in lump sums, which I do not personally recommend, considering a possible loan requests from friends and relatives. They are also vulnerable to investment scams.

### Tax Consequences of Selling A Home:

This may not sound fair but gain from the sale of your home is taxable while loss is not deductible. Federal and state income taxes can be prohibitive. Fortunately, there is an Internal Revenue Code section that allows you to exclude capital gains up to \$250,000 (\$500,000 for married couples filing jointly). While home values shrank during the housing slump, there are senior citizens who have not used up their home equities and whose homes are located in neighborhoods that have remained relatively stable during economic downturns.

### The Great Step-Up Tax Advantage:

Not only do you save current income taxes, you also save estate taxes if the house is not sold until somebody dies. The basis of your house is stepped up to the fair market value at death. When the house is sold, there will be huge tax savings, courtesy of the \$250,000/\$500,000 exclusion and the stepped up value at death. This advantage is lost if you gift your home to a beneficiary who takes over your old basis – the old low cost that you paid for it.

### Drawbacks of Reverse Mortgage:

Fees to take out a reverse mortgage are considerably higher than a traditional mortgage. Some fees may also be based on the value of the home, instead of the amount borrowed. You may not be able to currently deduct any interest because, as a cash-basis taxpayer, you can only deduct interest paid. In a reverse mortgage, there is no requirement to pay current interest. Interest expense is limited to \$100,000 of home equity indebtedness.

### Beware If You Are A Single Person Who May Enter An Assisted Living Facility Or A Skilled Nursing Facility:

Reverse mortgage loans have prepayment clauses when you no longer occupy your residence. If you enter a facility and cannot return to your residence within one year, the loan may need to be repaid. This could force the sale of your residence, converting an exempt resource to an available asset that could cause you to lose long-term care Medi-Cal eligibility.

### Recent Developments:

Some lenders are now issuing reverse mortgages to borrowers under age 62 (used to be at least 62). They have also started to offer programs on jumbo mortgages, second homes, and fixed rates (used to be floating rates). Because reverse mortgages are relatively new and evolving rapidly, ask your loan agent for advice and your tax accountant for available case law and new developments. Good luck.