Itemized Deductions
Interest Paid

2016

Robert W. Craig, E.A. Tax Services
431 2nd Street, Suite 3
Solvang, CA 93463
Telephone: (805) 264-3305
Email: rcraig1044@aol.com
Website: www.SolvangTax.com or www.BobCraig.biz

Interest That Is Deductible as an Itemized Deduction

- Home mortgage interest paid, including acquisition debt and home equity debt.
- Points and loan origination fees to obtain a mortgage or to refinance a mortgage.
- Investment interest paid, such as margin interest on a brokerage account.

Mortgage Insurance Premiums

Premiums paid for acquisition indebtedness for insurance contracts after December 31, 2006, are treated as deductible mortgage insurance. The deduction is phased out for taxpayers with adjusted gross income over $100,000 ($50,000 for Married Filing Separately). The deduction is not allowed when adjusted gross income exceeds $109,000 ($54,500 Married Filing Separately).

Qualified mortgage insurance providers include the Veterans Administration, the Federal Housing Administration or Rural Housing Administration, and private mortgage insurance.

The deduction expires for premiums paid or accrued after December 31, 2016.

Prepaid Mortgage Insurance Premiums

For taxpayers who prepay a portion or all of the mortgage insurance premiums on a mortgage, IRS rules dictate that the prepaid amount cannot be deducted in the year paid. Instead, the amount is required to be spread out over the shorter of:

- The stated term of the mortgage, or
- 84 months (7 years), beginning with the month in which the mortgage insurance was obtained.

These allocation rules do not apply to mortgage insurance provided by the Department of Veterans Affairs or Rural Housing Administration.

Interest That Is Not Deductible as Itemized Deductions

- Personal interest, such as credit card interest on nonbusiness purchases, auto loans on vehicles not used for business, interest on home equity debt in excess of $100,000, and mortgage interest on a third home.
- Business interest is deductible against business income. Business interest is not deductible as an itemized deduction even if it is for employee business expenses. ***Example:*** Interest on a car loan where an employee uses the vehicle for business is nondeductible as personal interest.
- Interest on qualified student loans is deductible on line 33, Form 1040, rather than Schedule A.
- Investment interest on debt used to purchase or carry tax-exempt investments, such as municipal bonds.

Home Mortgage Interest Paid

Secured Debt

A home mortgage is any loan that is secured by the taxpayer's main or second home as collateral for the loan. Home mortgages include first and second mortgages, home equity loans, and refinanced mortgages. A loan secured by the taxpayer's third home is considered a personal loan, unless the third home is used exclusively for business (such as rental property) or investment purposes (such as an inherited house that sits vacant until sold). Debt not secured by the property is personal debt. For example, interest paid on money borrowed

from parents for the down payment to purchase a home is personal interest, unless the parents record the loan under state or local law and the home is collateral for the loan.

Home Defined

A home is defined as any house, condominium, cooperative, mobile home, boat, or similar property with basic living accommodations including, sleeping, toilet, and cooking facilities.

Grandfathered Debt

- Mortgage taken out on or before October 13, 1987.
- Interest paid on grandfathered debt is fully deductible regardless of what the funds were used for.

Acquisition Debt

- Mortgage taken out after October 13, 1987, to buy, build, or substantially improve a main or second home.
- Total acquisition debt on main and second home combined is limited to $1 million ($500,000 Married Filing Separately) at any time.
- Limit is reduced by any grandfathered debt.
- Debt over the limit may qualify as home equity debt.

Refinanced Debt

This may be considered grandfathered debt, acquisition debt, or home equity debt, depending on the following.

- Debt secured by the home and used to refinance acquisition debt is treated as acquisition debt up to the balance of the old mortgage principal just before the refinancing. Debt used to substantially improve the home is also acquisition debt.
- Refinanced debt in excess of the old acquisition debt mortgage principal may qualify as home equity debt.
- Debt to refinance grandfathered debt is treated as grandfathered debt up to the balance of the old mortgage, but only for the term left on the debt that was refinanced.
- Refinanced debt that does not qualify as grandfathered debt may be considered acquisition debt or home equity debt.

Home Equity Debt

Debt that does not qualify as grandfathered debt or acquisition debt. Total home equity debt on main and second home combined is limited to the smaller of:

- $100,000 ($50,000 Married Filing Separately), or
- Total of each home's fair market value reduced (but not below zero) by acquisition and grandfathered debt for each home on the date the last debt was secured by the home.

Legal Liability to Make Payments

A taxpayer must be legally liable for the loan to deduct interest on a home mortgage. Payments made on a loan in which the taxpayer is not directly liable are deductible only if the taxpayer is the legal or equitable owner of the real estate.

Reverse Mortgages

In a reverse mortgage, a lender pays the owner of a home while the owner continues to live in it. The payment can occur in a lump sum, a monthly advance, a line of credit, or a combination of the three. The amounts received are considered loan advances and are not taxable. The loan comes due, depending on the plan, when the loan period ends, the owner moves, reaches a certain age, sells the home, or dies. Mortgage interest accrued on the reverse mortgage proceeds is not deductible until it is paid, usually when the loan is paid in full. The deduction for reverse mortgage interest is subject to the home equity debt limits.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

Copyright © 2015 Tax Materials, Inc.
All Rights Reserved