

Taxes are something we all face every year. Homeownership is made affordable for many families because of how Uncle Sam's tax deductions result in the federal government contributing from 10% to 35% (depending on your tax bracket) toward monthly home mortgage interest and property tax payments.

Here are some basic home-related tax facts you should be aware of. Be sure to consult a tax professional for complete information applicable to your specific situation.

INTEREST

TAX FACTS: Interest payments on your original mortgage — assuming the mortgage isn't larger than the home's purchase price and improvement costs — are fully deductible for most homeowners. There is an overall limit on "home acquisition" mortgage debt for purposes of deducting interest on up to two homes. That's a key reason why homeownership is a superb tax shelter. Mortgage interest on a second home is also deductible, as explained in the "VACATION HOMES" section. If you own a third home for personal purposes, the mortgage interest is not deductible. Interest on home equity loans (see "EQUITY LOANS" section) is deductible with some limitations.

HELPFUL HINT: For mortgages taken out more than 90 days after a home purchase, your interest deduction is usually limited to the amount of the original (acquisition) mortgage plus \$100,000. However, if you use some of the new mortgage to improve your home, you can add that amount to the deduction limit.

GAINS

TAX FACTS: Taxpayers who sell their principal residence can pocket — tax-free — as much as \$500,000 in profit if they file federal taxes jointly, or \$250,000 if they file singly. The property must have been owned and used as their principal residence for any two of the prior five years. Homeowners can shelter the profits on the sale of a home as often as once every two years. If the two-year use and ownership tests are not met, but the home is sold because of special circumstances (i.e., health problem, job loss, etc.), the exclusion is prorated. Otherwise, gains above \$500,000 or \$250,000 are taxed at current capital gains rates.

Note: The Housing and Economic Recovery Act of 2008 changed the treatment of capital gains from the sale of a home that the owners sometimes used as a principal residence and sometimes used as a second home or rental property. Gains attributable to the period of second home or rental use on or after January 1, 2009 will be taxed at capital gains rates, while gains attributable to principal residence use may be excluded up to the \$500,000 or \$250,000 limits (providing ownership and use tests are met).

To compute the mixed-use gains tax, divide total days of property use as a second home or rental ("non-qualified" use) by total days the home was owned (from the original

purchase date). Then multiply your total gain from the sale by that ratio to calculate the taxable gain.

For example, you sell a home after owning it four years (1,460 days) and using it as a rental property or second home (rather than principal residence) for three months (say, 91 days). Your ratio: $91/1460 = .062$. If your total capital gain is \$50,000, then your taxable gain is \$3,100 ($\$50,000 \times .062 = \$3,100$).

Note: For sales or exchanges after December 31, 2007, surviving spouses now may exclude gains up to \$500,000 from a principal residence jointly owned with the deceased spouse, providing the property is sold or exchanged within two years of the spouse's death and standard ownership and use tests are met.

HELPFUL HINT: Homeowners should continue to maintain records of selling and improvement expenses because some states still tax capital gains on home sales. In addition, those expenses can be used to determine your tax basis once you sell or rent the home.

MORTGAGE INSURANCE

TAX FACTS: Qualified home mortgage insurance payments are deductible for homeowners who purchased or refinanced a home from January 1, 2007 through December 31, 2011. The full deduction is available to taxpayers with Adjusted Gross Income (AGI) not greater than \$100,000 or \$50,000 for married filing separately. Over those incomes, the deduction is phased out and disappears completely for AGIs of \$110,000 or \$55,000 (married filing separately). In order to take the deduction, you must itemize deductions on your tax return — see instructions on Schedule A (Form 1040) or IRS Publication 936 for details.

HELPFUL HINT: To find the amount of qualified mortgage insurance you paid (if any), see Box 4 on Form 1098 provided by your lender with amount of interest and mortgage-related expenses you paid during the year.

RENTALS

TAX FACTS: If you have an adjusted gross income of \$100,000 or less (not counting any loss from "passive activities," several adjustments to adjusted gross income or taxable Social Security benefits), you can deduct up to \$25,000 in losses from rental real estate against income from other sources. This is an allowable deduction if you owned at least 10% of the property and "actively participated" in its management. (If you chose the tenants and approved outlays for maintenance, for example, that's considered "active" participation.) If your adjusted gross income is between \$100,000 and \$150,000, you can still deduct some or all of your losses from rental real estate, depending on the amount of the loss.

HELPFUL HINT: Don't forget, if any rent losses were "suspended" in prior years, they are fully deductible in the year the property is sold.

FORGIVEN MORTGAGE DEBT

TAX FACTS: Mortgage debt on a principal residence that is forgiven by a lender is no longer taxable in many cases; previously, forgiven mortgage debt was considered taxable income. (Debt from buying or improving a principal residence may be forgiven in a short sale, foreclosure or debt restructuring of a property.) The exclusion only applies to indebtedness forgiven in tax years 2007 through 2012 and is limited to \$2 million or \$1 million for married filing separately.

HELPFUL HINT: Other restrictions apply; consult a knowledgeable tax professional for details. A newly revised Form 982 is used for reporting the exclusion.

POINTS

TAX FACTS: For home buyers, deductible expenses include settlement charges for points. Deductible points are upfront charges for the use of money (not services). One point equals 1% of the loan amount. Points paid by either the buyer or seller are deductible by the buyer in the year of the home purchase. Although some closing service fees are quoted as "points," they are not deductible.

If you paid discount points when refinancing your home, be aware that you may not deduct them in full during the tax-year of the refinancing. Instead, you must prorate the deduction over the life of the loan. For example, \$3,000 in points paid for a 15-year-term refinanced loan would equal a deduction of \$200 ($\$3,000 \div 15 = \200) per year — unless the home is sold before the end of the loan term or refinanced with another lender, at which time all remaining points can be deducted on that year's return.

HELPFUL HINT: Consider having sellers pay for as many points as possible to increase your tax deduction.

EQUITY LOANS

TAX FACTS: Unlike other types of loans, interest paid on home equity loans (including second mortgages, equity credit lines or some refinancings) is fully deductible up to \$100,000 — regardless of how you use the loan proceeds. If you use some or all of the proceeds for home improvements, that amount can be added to the \$100,000 limit. (Be sure to document costs for improvements to your home.) The above limits apply so long as all debt secured by the residence does not exceed the fair market value of the home.

HELPFUL HINT: Because interest paid on credit cards and other "consumer" loans, such as car loans, is not deductible, it makes tax sense for some homeowners to pay off this kind of debt using a home equity credit line or loan. Alternative Minimum Tax rules may apply, however. (Note: Some state laws restrict home equity loans. Consult your tax advisor to learn more.)

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