

IS A HOME EQUITY LOAN RIGHT FOR YOU?

During the course of your home ownership, you may take out a loan that does *not* qualify as home acquisition debt. (See “The Mortgage Interest Tax Deduction: How Can I Claim it?”) This circumstance can occur when the loan:

- is not used to buy, build, or substantially improve your main or second home, or
- the amount of the loan exceeds the \$1 million (\$500,000 if married filing separately) acquisition limit.

EXAMPLE 1: Rob takes out a \$20,000 home equity loan in order to buy a car and pay off some credit card debts. The loan potentially qualifies as home equity debt.

EXAMPLE 2: Phil and Robin purchase a home costing \$1.5 million. Their home acquisition mortgage is for \$1.1 million. Only \$1 million qualifies as home acquisition debt. The rest is potentially home equity debt.

The interest paid on your home equity loan is deductible. Your loan must be secured by your qualified (main or second) home. The amount of qualified home equity debt is the smaller of:

- \$100,000 (\$50,000 if married filing separately), or
- The difference between the fair market value (FMV) and outstanding home acquisition debt of your qualified home(s).

EXAMPLE 3: In the first example above, suppose Rob’s outstanding mortgage is \$60,000 and his home has a FMV of \$100,000. His entire \$20,000 loan qualifies as home equity debt.

Similarly, note that the Phil and Robin in the second example can use the full \$100,000 home acquisition debt overage as home equity debt. There is a \$500,000 spread between the FMV and their acquisition debt balance.

If only part of a loan qualifies as home equity debt, the interest paid on the loan would have to be prorated:

EXAMPLE 4: Suppose Rob’s mortgage balance was \$90,000. In that case, only \$10,000 (\$100,000 - \$90,000) would be available as home

equity debt. Therefore, only 50 percent of the interest on his loan would be deductible.

The interest on home equity debt is taken as an itemized deduction on Schedule A of Form 1040. Another attractive aspect of a home equity loan, especially if your original mortgage was long ago paid up, is that itemizing may once again be worthwhile for you. However, as with any borrowing situation, you need to be cautious. Inability to pay a debt secured by your home can have disastrous results for you and your family. Be sure to review your entire financial situation and know what you can comfortably borrow.

AMT warning: Interest on home equity debt that is *not* used to buy or improve

your main or second home is *not* deductible for AMT purposes. Check with your tax professional to make sure a home equity loan doesn’t lead to an AMT problem for you.



A home equity loan is an attractive option for many homeowners. It provides needed cash and a potential tax break as well. The proceeds of the loan do not have to be used for the home – you can pay for your children’s education, pay off other debts, purchase investments and, of course, make needed repairs and improvements to your home.



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