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For more information or to schedule an interview contact:
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Buying a home is one of the most important decisions you will make in your lifetime. Your motivation to buy may be spurred, in part, by the tax advantages that will accrue to you. Among those advantages are two big tax deductions, the mortgage interest deduction and the real estate tax deduction.

— Jackie Perlman, CPA, Senior Tax Research Analyst

IS IT TIME TO BUY A HOME?

THE REAL TAX BREAK

How do tax deductions benefit you? Many people mistakenly believe that amounts paid for mortgage interest and real estate taxes can be subtracted, dollar for dollar, from their tax bills. First, it is important to understand the difference between a deduction and a credit. Tax credits, such as the child tax credit, directly reduce your *tax liability*. Tax deductions, on the other hand, reduce your *taxable income*.

EXAMPLE: Sam, a single taxpayer in the 25 percent bracket, pays $15,000 in mortgage interest and real estate taxes this year. His taxable income before the deductions is $45,000. His taxable income after the deductions is $30,000.

The prevailing wisdom is that in order to calculate the tax advantage of a tax deduction, multiply the deduction by your highest marginal tax rate. Sam in this example would, therefore, be expected to have tax savings of $3,750 ($15,000 _ 25%). Should Sam look forward to a $3,750 reduction in his tax bill? No, he will find that his savings are only $2,537.

What happened? The deductions for mortgage interest, real estate taxes, and points are *itemized deductions*. Itemized deductions are claimed on Schedule A of Form 1040 and are in lieu of the standard deduction, which is generally available to most taxpayers. The *real* break to Sam is the *difference* between his itemized and standard deductions, multiplied by his marginal tax rate. In this case, the savings are $2,537 ($15,000 - $4,850 _ 25%).

STILL A GOOD DEAL

Even though the size of your savings may be a disappointment, a reduction in your tax bill is good news. The fact that you can itemize means that, in addition to the deductions discussed, a number of smaller deductions, which were of no benefit to you in the past, now come into play.

Consider the following example. Fred and Ginger have adjusted gross income of $75,000. In addition to mortgage interest of $8,500 and real estate taxes of $2,000 they paid this year, they donated $1,500 to charities, and paid $3,000 in state income taxes and $900 in personal property tax. Fred and Ginger have one child. The difference in their tax liability is illustrated below:

	STANDARD DEDUCTION	ITEMIZED DEDUCTIONS
AGI	$75,000	$75,000
DEDUCTIONS	$ 9,700	$15,900
EXEMPTIONS	$ 9,300	$ 9,300
TAXABLE INCOME	$56,000	$49,800
TAX	$ 7,685	$ 6,755

Note that the itemized deductions without the mortgage interest and real estate tax deductions only add up to $4,400 - not enough to beat the 2004 standard deduction of $9,700.

THE FIRST YEAR

Depending on the size of the mortgage and the time of year the purchase is closed, you may find that in the first year of homeownership your itemized deductions are still less than the standard deduction. Therefore, you may never get any tax savings from your first year's mortgage payments and real estate taxes. In addition, the benefit of the additional mortgage and taxes paid with your closing statement may be lost as well.

TAX TIP: If possible, postpone the closing until after the first of the year.

TAX TIP: If you cannot itemize the first year, do not expense your points. You are better off amortizing the points over the life of the loan so that you will get some tax advantage from them in future years.

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MAKING THE DECISION

For many people, a home is the biggest investment they'll ever make. Keep in mind that even if homeownership does not provide much of a tax break, it might still make financial sense because of the equity that builds up in the home.

If you're considering the purchase of your first home, check out our web site http://hrblock.com/mortgages/ for some useful calculators to help you determine what kind of mortgage you can afford and whether buying vs. renting is a good idea.