

THE MORTGAGE INTEREST TAX DEDUCTION: HOW CAN I CLAIM IT?

When you purchase a home, the interest paid on the mortgage loan is generally tax deductible, if certain qualifications are met.

A mortgage used to buy, build or improve a home is called an *acquisition loan*. Acquisition loans are limited to the cost of the home, plus improvements. The acquisition loan is limited to \$1 million for purposes of deducting mortgage interest. Any amount borrowed beyond \$1 million (\$500,000 if married filing separately) may qualify as a *home equity loan*, which is a loan against the equity in your home. (See *Is a Home Equity Loan Right For You?*)

How do you know if you can deduct the interest on your acquisition loan?

In order to claim a mortgage interest deduction, your loan must be for a *qualified home*, the loan must be *secured by your home*, and you must have *legal liability* for the loan.

A Qualified Home

Any property that has a sleeping area, kitchen and bathroom facilities is considered a qualified home – a house, condominium, cooperative, mobile home, trailer or boat. Mortgage interest is deductible on your main or second home only.

Secured Debt

The mortgage must be secured by the home, which means the home itself is put up as collateral to protect the needs of the lender. If the taxpayer defaults on the loan, the lending institution can take possession of the home in order to repay the debt. If the loan is secured by other assets, the interest is not tax deductible.

Legal Liability

The taxpayer must be personally and legally liable for repayment of the debt. That is, a true debtor/creditor relationship must exist.

EXAMPLE: Ms. Forest has a home mortgage loan. Her friend, Ms. Hill, moves in with her. Ms. Hill is in a higher tax bracket and therefore would prefer to make the mortgage payment in lieu of rent and take the mortgage interest deduction. Because Ms. Hill does not have legal liability to pay the mortgage, she cannot take the deduction. And if Ms. Forest has not made the payments, she cannot take the deduction, either.

One exception to the legal liability rule is for first-time homebuyers who rely on parents or another relative to secure the mortgage for them. Though the mortgage is in the parents' or relative's name, the occupant may take the mortgage interest deduction if he or she is responsible for the mortgage payments.

What if you refinance?

If you refinance your acquisition loan, your new loan is also considered acquisition debt, as long as it

does not exceed the amount of principal that remains on your original loan. If you borrow more than the amount of principal that remains, the excess debt may qualify as home equity debt.

The amount of mortgage interest that's tax deductible may be limited for taxpayers with adjusted gross income over \$142,700, (\$71,350 for married couples filing separately).

For more information, refer to IRS Publication 936 *Home Mortgage Interest Deduction*, at <http://www.irs.gov/pub/irs-pdf/p936.pdf>.

In many cases, the full amount of your home mortgage interest will be tax deductible, which makes this deduction a valuable tax break for homeowners.

— Jackie Perlman,
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