

ABLE-WAGNER INC

DEDUCTING MORTGAGE INTEREST

HOW MUCH CAN YOU DEDUCT?

We have all gotten used to thinking that we can deduct all of the mortgage interest for one or more loans on our house. However, since 1987 there are rules that may limit the deduction that you can take.

Basically there are three types of debt that you can deduct:

1. Acquisition debt— This is the original loan taken out on your home. Generally, you can fully deduct interest on acquisition debt. However, acquisition debt declines each year the mortgage is in effect. The value, at any point in time, of the original acquisition debt is important in knowing how much you can deduct.
2. Improvement Debt—Additional debt to improve your home, such as putting in a pool or adding a room. This kind of debt is added to acquisition debt to determine deductibility.
3. Equity Debt—Everyone is allowed to have equity debt, up to \$100,000. This can be used for any purpose, paying for college, buying a car, going on vacation, etc.

THE MAIN RULES

- Debt incurred to acquire, construct or substantially improve your main, or second, home is deductible.
- Debt must be secured by the home.
- Indebtedness is limited to \$1,000,000.
- Refinancing of an existing acquisition debt is also considered acquisition debt, **but the loan amount cannot exceed the amount of the original loan, at the time of refinance** unless the proceeds are used as below:
 - Additional amounts borrowed to make substantial improvements can increase legal acquisition debt.
 - To increase indebtedness by up to \$100,000 of Equity debt (this kind of debt can be used for nay purpose)

The rules can be more complex, depending on your situation. Please contact us directly to learn more about your particular situation.

SPECIAL POINTS OF INTEREST:

- *There are three kinds of debt that can be used to deduct mortgage interest.*
- *There are limits on how much you can deduct.*
- *Unlimited refinancing may not qualify.*
- *See the chart on the next page for an example.*

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HOW MUCH CAN YOU DEDUCT? (CONTINUED)

The key to answering the question: How much can you deduct is knowing the answer to three questions:

1— Value of original Acquisition debt at end of year (even if original loan has been refinanced) :	
2 — Value of additional debt used to substantially improve the property:	
3— Equity debt, up to \$100,000:	\$ 100,000
Total:	

If the total is not greater than \$1,000,000, interest is fully deductible.

AN EXAMPLE

A house was purchased in 1995 and a \$500,000 mortgage was taken out. All of this is acquisition debt and the interest is fully deductible.

In 2005 the house was refinanced and a new \$500,000 mortgage was taken out. The original mortgage was paid off in the amount of \$418,000. No additional improvements were made so the additional \$82,000 of debt is equity debt and can still be deducted.

In 2010 the house is once again refinanced for \$700,000. In 2010 the original acquisition debt would have been

\$355,000. The difference between \$700,000 and \$355,000 is \$345,000.

Of that amount \$100,000 of equity debt is fully deductible, leaving \$245,000 of debt in question. If no improvements were made to the house with the additional debt, the interest on the \$245,000 is **NOT** deductible. If improvements were made, the amount of the improvements can be added to the allowed indebtedness.

Also note that if no additional improvements were made, Acquisition bet deductibility runs out in 2024, when the original loan would have been paid off.

