

O'NEIL & STEINER, PLLC

MORTGAGE INTEREST DEDUCTION

In short, if you meet both of the following tests you will be able to claim an itemized deduction for all of your mortgage interest:

- a) All proceeds from loans incurred after 10/14/1987 were used to buy, build or improve the principal residence (or second home) that was used to secure the loan (reported on Form 1098, box 8).
- b) The total of the balances of your mortgages did not exceed \$750,000 during the year. (\$1 million if all debt was incurred on or before 12/15/17)
(If filing as Married Filing Separately \$375,000 or \$500,000 if on or before 12/15/17).

If both of the above are true in your case, you can deduct 100% of the mortgage interest reported on Forms 1098, Mortgage Interest Statement, issued by your lender. You can stop here or keep reading if you are curious.

If one or both of the above tests is not true in your case, we will need to schedule a consultation to discuss your loans in greater detail in order to calculate deductible interest and make notes for future tax years. Please call our office at (520) 836-7947 and ask a staff member to schedule a "mortgage interest consultation". Please be prepared to provide the following:

1. History of any prior mortgage loans that were refinanced including:
 - a. Date original debt was incurred,
 - b. Principal balance of original loan at time of refinance,
2. How each of your outstanding loan proceeds were used, and
3. End of tax year principal balances of each mortgage loan outstanding.

*Note: For each year after initial consultation, until your Acquisition Debt falls below the allowable limits, we will need to know the total ending balance of each loan.

For tax purposes mortgage debt is separated into three categories. Qualification is based on the details of the loan, not on the type of loan (home equity line of credits can qualify as acquisition debt, for example). Each loan is classified in the first category it qualifies under, as follows:

1. **Grandfathered Debt:** Mortgages incurred prior to 10/14/1987. These are rare since most mortgages are written for 30 years or less. If you have one or more outstanding balances on loans incurred prior to 10/14/1987:
 - a. Refinanced grandfathered debt loans are considered grandfathered debt for the remainder of the original loan term only if the new loan balance does not exceed the remaining balance on the original loan. If the new loan exceeds the outstanding balance of the original loan, any excess is classified as either Acquisition Debt or Home Equity Debt (depending on how the loan proceeds were used).
 - b. Interest on these mortgages is 100% deductible regardless of how loan proceeds were used and is not limited based on outstanding balance.
 - c. Any remaining balance on these loans reduces the maximum amount of acquisition debt that can be considered below.

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MORTGAGE INTEREST DEDUCTION

2. **Acquisition Debt:** Mortgage loan proceeds, incurred after 10/13/1987, if used to buy, build, or improve either:
- Primary residence used to secure the loan, and/or
 - One other home (second, vacation, etc.) used to secure the loan
 - No deduction is available for other mortgages if you have more than two.

Deductible interest for acquisition debt is limited to the interest charged on loan balances up to:

- \$1 million total for mortgages taken out on or before December 15, 2017. (For married couples filing separately this limit is \$500,000)
- \$750,000 total for mortgages taken out after December 15, 2017. (For married couples filing separately this limit is \$375,000)

If a mortgage from 12/15/17 or before was refinanced, the refinanced loan is subject to the higher limit for the remainder of the original loan term for the portion of the loan that does not exceed the remaining balance of the original loan.

Any loan proceeds in excess of outstanding principal and the entire principal balance once the original loan term has expired is:

- New acquisition debt subject to the lower \$750,000 limit (if used to buy, build, or improve the home securing the loan), or
- Home Equity Debt (see #3 below) if proceeds were used elsewhere

3. **Home Equity Debt:** All other mortgage loan proceeds either:
- a. Not used to buy, build, or improve the home securing the loan, or
 - b. In excess of limits for Acquisition Debt (see #2 above).

*Interest on home equity debt is not deductible.

Forms 1098, mortgage interest statement, do not determine deductible interest. Lenders are unable to distinguish between deductible and non-deductible interest since the rules may have changed since the loan began and because they may not know the following:

- How the proceeds were used (buy/build/improve the home securing the loan; or not)
- Principal balance of outstanding mortgage loans including those from other lenders

Taxpayers are responsible for filing accurate and complete tax returns. This includes limiting their mortgage interest deduction to only deductible interest each year.

If your total acquisition debt exceeds the limit based on when the loans were incurred, the following calculation must be performed to calculate your deductible interest:

1. Calculate average balance of acquisition debt for loans:

$$(\text{Beginning balance} + \text{Ending balance}) \div 2$$

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MORTGAGE INTEREST DEDUCTION

2. Calculate the deductible percentage of interest paid:

$$\frac{\text{Maximum acquisition debt allowed (based on when you incurred the loan)}}{\div \text{Average balance of acquisition debt from step \#1}}$$

3. Calculate deductible interest:

$$\frac{\text{Total interest paid for the year}}{\times \text{Deductible percentage from step \#2}} \\ \text{Deductible mortgage interest for the year}$$

As always, please don't hesitate to contact our office if you have questions about your taxes.