

LET'S TALK TAX
The Best Tax Shelter around—your Personal Residence!

If you're a homeowner, Uncle Sam has thrown you a tax shelter that's beyond compare. You may deduct the mortgage interest paid on your annual tax return and deduct the property taxes on your Schedule A. If you don't currently own a home, this tax benefit is significant enough to make you look seriously at home ownership.

“Points”

The concept is simple, but it starts to get a little more complicated when you add in “points.” Points are one type of fee paid at closing to your lender. If you pay points when you buy your new home, these may be deducted in full in the year of purchase. However, if you refinance your loan, the points must then be deducted over the life of the new loan. In the event you are deducting points annually and then decide to refinance again, you will be able to deduct the balance of the points when you pay off the old mortgage. Of course, all these deductions are based on being able to itemize your deductions on Schedule A.

There are some limitations.

- Points must not be more than amounts generally charged in geographic area of the home.
- Funds provided at closing must be at least equal to the points.
- Loan must be used to buy or build taxpayer's main home.
- Points are stated as a percentage of the principal amount of loan.
- Points are clearly stated on the settlement statement as charged for the mortgage.

Predictably, there are limits on mortgage interest deduction. Only the interest on the first \$1 million of home acquisition debt is deductible. (Acquisition debt is defined as debt to purchase, build or substantially improve the residence.) Home equity debt limits are the lesser of the fair market value of the home reduced by the acquisition debt or \$100,000 (\$50,000 if married filing separately). In other words, funds that are borrowed and not used for home acquisition or improvement, but borrowed for say an automobile, with funds coming from the equity in the home, have this limit. If you borrow more than the limit, the interest is considered personal interest and not deductible.

Probably the greatest advantage of home ownership occurs when you decide to sell your home. If you have owned and lived in your personal residence for two out of five years, you can sell the home and not be taxed on a profit up to \$250,000 for singles and \$500,000 for couples. The way home values have increased in recent years, this can be a tremendous investment opportunity. This rule seems very straight forward and simple, but beware! There are a number of exceptions.

Job related move—if you have to move out of your area (a 50-mile radius), and are unable to meet the two year time period, you can prorate the time based on a formula utilizing a ratio consisting of the number of days that you owned and lived in the home to the total number of days in the relevant 24-month period (approximately 730), multiplied by the exclusion amount.

Health problems requiring a sale—if health problems force you to move from your principal residence, you can prorate the time and exclusion based on the formula above.

Ideally, a couple that keeps good records of time of ownership could buy and live in a home for two years, sell for a profit and then repeat this process. Still, there are a number of pitfalls that cause tax problems, such as the special rules surrounding home offices and move out/rent/return situations that effect the two in five requirement (this involves adjusting for depreciation recapture). Given the many regulations and nuances of the tax laws, it is wise to opt to hire a licensed tax practitioner, such as myself, an enrolled agent, who would be able to assist you with the rules. with the proper way to get the most of the rules regarding home ownership.

The author is an enrolled agent, licensed by the US Department of the Treasury to represent taxpayers before the IRS for audits, collections and appeals. To attain the enrolled agent designation, candidates must demonstrate expertise in taxation, fulfill continuing education credits and adhere to a stringent code of ethics