

HOUSING COUNSEL

Homeowners have more than interest to consider at tax time

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"We contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself up by the handle."

— Winston Churchill

Interest rates gain the most attention from mortgage borrowers, but two other expenses, points and mortgage insurance premiums, are significant, as well. And both may come into play as you fill out your tax returns this year.

When you shop for a mortgage loan — which is something every potential home buyer should do — you will be given a lot of information. Loan points are among the items that must be listed on the good-faith estimate of closing costs given to you before you commit to the loan. The GFE attempts to explain — in simple English — all of the terms and conditions of the mortgage loan you are considering.

Each point is 1 percent of the amount of your mortgage loan.

So if you were to borrow \$375,000, each point would cost \$3,750. Lenders can charge as many points as they want, but at some level, the loan becomes usurious and could represent what is commonly known as "loan sharking."

Typically, for every point you pay, you should be able to reduce your interest rate by an eighth of a percentage point. Points are often disguised with different names — such as loan discounts or origination fees — but regardless of their name, they represent money that you — the consumer — will pay. And the payment is often upfront, in cash, although lenders can include it in the loan amount if your credit score and the appraisal permit this.

Points paid to obtain a new mortgage are fully deductible in the year they are paid by the borrower. The Internal Revenue Service originally required that the borrower write a separate check to the lender for these points, but in recent years, the IRS has backed off of this position. However, it still makes

sense to have the settlement statement (the HUD-1 form) clearly reflect the number of points and the corresponding dollar amount of the points you are paying.

If you pay points to obtain a refinance loan, however, in most circumstances those points are not deductible in full for the year they are paid. Rather, the IRS requires that you allocate the points by the number of years of your mortgage loan. For example, let's say you refinance into a loan in the amount of \$375,000. To get this new loan at a reduced interest rate, you opt to pay one point, or \$3,750. If your loan is for 30 years, you can deduct only one-thirtieth of the point each year — or \$125. However, if you pay off this loan early, either by selling your house or refinancing again, the balance of the non-deducted points can then be deducted on your income tax return for that year.

Seller-paid points

Everything in real estate is negotiable, especially in a slow market. Often, a potential buyer

presents a sales contract and asks the seller to make certain financial concessions in order to make the sale go through. Such concessions could include the seller paying some or all of the buyer's closing costs, the seller giving a cash credit at settlement, or the seller paying some or all of the buyer's points. The IRS allows seller-paid points to be deducted by the purchaser. The seller cannot deduct this expense, but it is considered a sales expense that will reduce the profit made on the sale. And although the buyer can deduct the points in the year they were paid, this will reduce the tax basis of the home by the amount of the points paid by the seller. If you are involved in a seller-paid-points transaction, discuss your situation with your own financial advisers.

PMI premiums

If you pay 20 percent or more as a down payment on your home, most lenders are comfortable that there will be sufficient equity so that they would not lose money if they had

to foreclose on the loan.

However, if you are unable or unwilling to put down a lot of money and want a larger loan, the lender can require that you obtain private mortgage insurance, or PMI. This is coverage — which the home buyer pays for — to compensate the lender should there be a shortfall between the amount of the money received at a foreclosure sale and the loan balance. Private mortgage insurance is an alternative to government-backed low-down-payment mortgages from the Federal Housing Administration or Department of Veterans Affairs.

If, after Jan. 1, 2007, you entered into a transaction that included PMI, you may have the right to deduct your mortgage insurance payments as home mortgage interest. However, there are two restrictions. First, the insurance must be in connection with home acquisition debt. This means that the loan is secured either by your principal residence or a vacation home that is not rented out for

more than 14 days a year. Second, the deduction is reduced by 10 percent for each \$1,000 that your adjusted gross income exceeds \$100,000 (or \$50,000 if you file an individual tax return). If your AGI is more than \$109,000 (\$54,500 if filing separately) then you cannot take advantage of this deduction.

If you sold your house last year — or refinanced it — thereby canceling the PMI, you cannot claim a deduction for the unamortized balance of the premium. For more information, go to the IRS Web site, IRS.gov, and print Publication 936, "Home Mortgage Interest Deduction." This information is general in nature. Every taxpayer has different situations. You must consult your financial advisor on your set of facts.

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