TAX YEAR
2018

Itemized Deductions
Interest Paid

Interest That Is Deductible as an Itemized Deduction

- Home mortgage interest paid that is acquisition debt, subject to limitations.
- Points and loan origination fees to obtain a mortgage or to refinance a mortgage.
- Mortgage insurance premiums, subject to limitations. (Expired after December 31, 2017.)
- Investment interest paid, such as margin interest on a brokerage account.

Interest That Is Not Deductible as Itemized Deductions

- Interest on home equity debt (debt not used to buy, build, or substantially improve a home).
- Personal interest, such as credit card interest on nonbusiness purchases, auto loans on vehicles not used for business, and mortgage interest on a third home.
- Business interest is deductible against business income. Business interest is not deductible as an itemized deduction even if it is for employee business expenses. ***Example:*** Interest on a car loan where an employee uses the vehicle for business is nondeductible as personal interest.
- Interest on qualified student loans is deductible on line 33, Form 1040, rather than Schedule A.
- Investment interest on debt used to purchase or carry tax-exempt investments, such as municipal bonds.

Home Mortgage Interest Paid

Secured Debt

A home mortgage is any loan that is secured by the taxpayer's main or second home as collateral for the loan. Home mortgages include first and second mortgages, and refinanced mortgages. A loan secured by the taxpayer's third home is considered a personal loan, unless the third home is used exclusively for business (such as rental property) or investment purposes (such as an inherited house that sits vacant until sold). Debt not secured by the property is personal debt. For example, interest paid on money borrowed from parents for the down payment to purchase a home is personal interest, unless the parents record the loan under state or local law and the home is collateral for the loan.

Home Defined

A home is defined as any house, condominium, cooperative, mobile home, boat, or similar property with basic living accommodations including, sleeping, toilet, and cooking facilities.

Grandfathered Debt

- Mortgage taken out on or before October 13, 1987.
- Interest paid on grandfathered debt is fully deductible regardless of what the funds were used for.

Acquisition Debt

- Mortgage taken out after October 13, 1987, to buy, build, or substantially improve a main or second home.
- **Acquisition debt incurred on or after December 15, 2017:** Total acquisition debt on main and second home combined is limited to $750,000 ($375,000 Married Filing Separately).
- **Acquisition debt incurred before December 15, 2017:** Total acquisition debt on main and second home combined is limited to $1 million ($500,000 Married Filing Separately).
- Limit is reduced by any grandfathered debt.
- Debt over the limit may be considered home equity debt, which is not deductible.

Itemized Deductions

Interest Paid

Refinanced Debt

This may be considered grandfathered debt, acquisition debt, or home equity debt, depending on the following.

- Debt secured by the home and used to refinance acquisition debt is treated as acquisition debt up to the balance of the old mortgage principal just before the refinancing. Debt used to substantially improve the home is also acquisition debt.
- Refinanced debt in excess of the old acquisition debt mortgage principal may be considered home equity debt, which is not deductible.
- Debt to refinance grandfathered debt is treated as grandfathered debt up to the balance of the old mortgage, but only for the term left on the debt that was refinanced.
- Refinanced debt that does not qualify as grandfathered debt may be considered acquisition debt or home equity debt.
- The $1 million ($500,000 Married Filing Separately) limit, above, continues to apply to refinanced acquisition debt that was incurred before December 15, 2017.

Legal Liability to Make Payments

A taxpayer must be legally liable for the loan to deduct interest on a home mortgage. Payments made on a loan in which the taxpayer is not directly liable are deductible only if the taxpayer is the legal or equitable owner of the real estate. A taxpayer may become an equitable owner if he or she assumes the benefits and burdens of ownership.

Home Equity Debt

Home equity debt is debt that does not qualify as grandfathered debt or acquisition debt. It is generally any indebtedness other than acquisition debt (debt used to buy, build, or substantially improve a home). Home equity debt includes reverse mortgages and home equity lines of credit (HELOC). All types of home equity loans essentially convert a taxpayer's home equity into cash to pay for a variety of expenses. Interest on home equity debt is not deductible as home mortgage interest.

Reverse Mortgages

In a reverse mortgage, a lender pays the owner of a home while the owner continues to live in it. The payment can occur in a lump sum, a monthly advance, a line of credit, or a combination of the three. The amounts received are considered loan advances and are not taxable. The loan comes due, depending on the plan, when the loan period ends, the owner moves, reaches a certain age, sells the home, or dies. Mortgage interest accrued on the reverse mortgage proceeds is not deductible.

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Investment Interest

Interest paid on a loan to buy property held for investment is deductible. Investment interest does not include home mortgage interest or any interest taken into account in computing income or loss from a passive activity.

Investment Property

Property held for investment includes property that produces interest, dividends, annuities, or royalties not derived in the ordinary course of a trade or business.

Investment Interest

- If money is borrowed for business, personal, or investment purposes, the debt must be allocated among those purposes. Only the interest expense on the part of the debt used for investment purposes is treated as investment interest.
- Interest paid on margin accounts to buy taxable securities is deductible as investment interest.

Limitation

The deduction is limited to a taxpayer's net investment income. A taxpayer is allowed to carry over the amount of investment interest he or she is not able to deduct because of the limit. Net investment income is determined by subtracting investment expenses (other than interest expense) from investment income (interest, dividends, annuities, and royalties). Investment income does not generally include qualified dividends or net capital gain.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of $5,000.