

The Washington Post

This tax season, know the available deductions for homeowners

By Benny L. Kass

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"Tax reform is taking the taxes off things that have been taxed in the past and putting taxes on things that haven't been taxed before."

-- Art Buchwald

A mere 96 days remain before your federal income tax return must be sent to the Internal Revenue Service.

Now is the time to start preparing so you can take all of the deductions and credits authorized by law.

True, you can file IRS Form 4868 and receive a six-month filing extension, but you still have to pay the full amount of the tax you owe for last year, which means you at least have to prepare a careful estimate of your liability.

A good first step in determining your tax obligation is to go to the IRS Web site, where you will find a host of publications to download. Perhaps the most comprehensive publication is No. 17, a 280-page booklet titled "Your Federal Income Tax for Use in Preparing 2009 returns."

This column is the first in a series aimed at assisting homeowners in understanding basic tax rules and concepts.

First, a few definitions:

-- *Tax credits versus deductions.* According to Julian Block, tax attorney and author of "The Home Seller's Guide to Tax Savings," most people do not understand the difference between the two. Credits, he writes, "lower a person's taxes dollar for dollar, making them more valuable than deductions, which merely reduce the amount of income on which taxes are figured."

Block provides this example: "A deduction of \$1,000 saves \$350 in taxes for someone in the highest bracket of 35 percent, but only \$100 for someone in the lowest bracket of 10 percent. A credit of \$1,000 reduces taxes by that amount, whatever someone's bracket is."

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-- *Basis*. This is the initial cost of the property, plus any improvements you have made over the years.

-- *Gross profit*. The difference between what you paid for your house and what you get when it sells. -- *Net profit*. Gross profit minus the cost of improvements and real estate commissions. Also called "capital gain."

Here are some of the key deductions and credits that apply to homeowners filing their 2009 tax returns. In many cases, there are income limitations. -- *First-time-buyer credit*. If you bought a new home in 2009 or plan to do so before June 30, you may be able to take the first-time-home-buyer credit on your 2009 return.

-- *Energy-saving improvements*. If you installed qualifying home improvements -- such as windows and doors -- in your principal residence, you may also be able to take a credit up of up to \$1,500.

-- *Mortgage interest*. Interest paid on mortgage loans on a first or second home is fully deductible, subject to the following limitations: acquisition loans up to \$1 million and home-equity loans up to \$100,000. If you are married but file separately, the limits are split in half.

The concept of an acquisition loan, also

called "acquisition indebtedness," is very important and has confused -- and even trapped -- many homeowners. In order to qualify for such a loan, you must buy, build or substantially improve your home. If you refinance for more than the outstanding indebtedness, the excess amount does not qualify as an acquisition loan unless you use all of the excess to improve your home. However, at least part of the excess debt may qualify as a home-equity loan.

The IRS offers the following illustration about the deductibility of mortgage interest:

A taxpayer buys a principal residence for \$1.5 million, putting \$200,000 down and borrowing the difference of \$1.3 million. According to the IRS, the first million is acquisition indebtedness, and up to \$100,000 of any debt exceeding \$1 million will qualify as home-equity debt.

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Accordingly, the taxpayer would be allowed to deduct the interest paid up to \$1.1 million of the mortgage loan. Interest on the remaining debt is personal interest and is not deductible.

-- *Taxes.* Property taxes can be deducted, but only in the year they are paid to the government. Thus, if last year you escrowed money with your lender for taxes to be paid in 2010, you cannot take a deduction for these taxes when you file your 2009 return.

However, if you bought a house last year, you may have reimbursed your seller for a portion of the prepaid taxes through the end of 2009. Review your settlement sheet (the HUD-1). Line 106 on Page 1 should reflect this tax adjustment. Because this was a current payment by you for real estate taxes, it is a deductible item. Indeed, when you receive your annual statement from your lender showing the amount of taxes paid last year (Form 1098), that amount may not be included because it was just an adjustment between buyer and seller and not a payment collected by the lender. Lenders are required to send these annual statements to borrowers by the end of January, reflecting interest and taxes paid for the previous year.

-- *Points.* When you obtain a mortgage loan, you often have to pay one or more points. Whether referred to as "loan origination fees," "premium charges" or "discounts,"

they are still points and are considered deductible interest. Each point is 1 percent of the amount borrowed; if you obtain a loan of \$220,000, each point will cost you \$2,200. The new good-faith estimate and the revised HUD-1 that lenders are required to use will help you determine the cost of these items.

-- *Mortgage insurance premiums:* If you paid such premiums last year, you may be able to deduct that cost. They would have been paid under a private mortgage company or for loans backed by the Department of Veterans Affairs (which calls them a "funding fee") or the Federal Housing Administration. Discuss this with your tax advisers. There are income limitations that may preclude you from claiming these payments as deductions.

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Benny L. Kass is a Washington lawyer. For a free copy of the booklet "A Guide to Settlement on Your New Home," send a self-addressed stamped envelope to Benny L. Kass, 1050 17th St. NW, Suite 1100, Washington, D. C. 20036. He cannot guarantee to answer all questions.

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