Buying Your Home - Tax Considerations

Where do I get information on IRS publications?
The Internal Revenue Service publishes a number of real estate publications. They are listed by number:
* 521 "Moving Expenses"
* 523 "Selling Your Home"
* 527 "Residential Rental Property"
* 534 "Depreciation"
* 541 "Tax Information on Partnerships"
* 551 "Basis of Assets"
* 555 "Federal Tax Information on Community Property"
* 561 "Determining the Value of Donated Property"
* 590 "Individual Retirement Arrangements"
* 908 "Bankruptcy and Other Debt Cancellation"
* 936 "Home Mortgage Interest Deduction"
Order by calling 1-800- TAX-FORM.

Are seller-paid points deductible?
As of Jan. 1, 1991, homeowners have been able to deduct points paid by the seller. This deduction previously was reserved only for points actually paid by the buyer.

When is the best time to buy?
Here are some frequently cited reasons for buying a house:
* You need a tax break. The mortgage interest deduction can make home ownership very appealing.
* You are not counting on price appreciation in the short term.
* You can afford the monthly payments.
* You plan to stay in the house long enough for the appreciation to cover your transaction costs. The costs of buying and selling a home include real estate commissions, lender fees and closing costs that can amount to more than 10 percent of the sales price.
* You prefer to be an owner rather than a renter.
* You can handle the maintenance expenses and headaches.
* You are not greatly concerned by dips in home values.

What home-buying costs are deductible?
Any points you or the seller pay to purchase your home loan are deductible for that year. Property taxes and interest are deductible every year. But while other home-buying costs (closing costs in particular) are not immediately tax-deductible, they can be figured into the adjusted cost basis of your home when you go to sell (any significant home improvements also can be calculated into your basis). These fees would include title insurance, loan-application fee, credit report, appraisal fee, service fee, settlement or closing fees, bank attorney's fee, attorney's fee,

document preparation fee and recording fees. Points paid when you refinance an existing mortgage must be deducted ratably over the life of the new loan.

What is the Mortgage Credit Certificate program?

The Mortgage Credit Certificate program allows first-time home buyers to take advantage of a special federal income tax credit. This program allows buyers credit in qualifying for the tax advantage they'll receive after they purchase the home. The amount of the credit is tied to a local formula that every city with an MCC program must follow. A MCC credit, which can total $2,000 or more, reduces the borrower's federal tax liability by an amount tied to how much one pays in annual mortgage interest. Both the borrower's income and the purchase price of the home must fall within established guidelines. To see if your community has an MCC program, call your local housing or redevelopment agency. You also may inquire with your real estate broker or the local association of Realtors.

What are the rules for mortgage credit certificates?

To qualify for a mortgage credit certificate, both your income and the purchase price of the home must fall within established city guidelines. These guidelines vary by city but generally only permit people who earn an average income or slightly higher than average income. A limited number of cities have authorized the MCC program. Contact your municipal housing department for more information.

Should I buy a vacation home?

Today a vacation home can be purchased for investment purposes as well as enjoyment. And yes, there are tax benefits. Some people buy a vacation home with the idea of turning it into a permanent retirement home down the road, which puts them ahead on their payments. Another benefit is that the interest and property taxes are tax deductible, which helps to offset the cost of paying for a second home. A vacation home also can be depreciated if you live in it fewer than 14 days a year, or 10 percent of the rented days - whichever is greater.

Resources:

* "Real Estate Investing From A to Z," William Pivar, Probus Publishing, Chicago; 1993.
* "The Ultimate Language of Real Estate," John Reilly, Dearborn Financial

How do I save on taxes?

Here are some ways to save money on taxes:

* Mortgage interest on loans up to $1 million is completely deductible for the year in which you pay it to buy, build or improve your principal residence plus a second home.
* Points, or loan origination fees, also are deductible no matter who pays them, the buyer or the seller.
* Most homeowners, except the wealthy and those living in high-priced markets, no longer need to worry about capital gains taxes. The exemption has been raised to $500,000 for married couples and $250,000 for single owners. It can be taken every two years. Homeowners should always keep all receipts of permanent home improvements and of mortgage closing costs. If you do have to pay capital gains taxes, these costs can be added to your adjusted cost basis. Consult your tax adviser for more information.

Resources:
* "Tax Information for First-Time Homeowners," IRS Publication 530, and "Selling Your Home," IRS Publication 523. Call (800) TAX-FORM to order.
Are taxes on second homes deductible?
Mortgage interest and property taxes are deductible on a second home if you itemize. Check with your accountant or tax adviser for specifics.

Are points deductible?
If you are a buyer, and you or the seller pays points, they are deductible for the year in which they are paid only. You also can deduct any points you pay when you refinance your home, but you must do so ratably over the life of the loan. Consult your tax or financial advisor.

How do you choose between buying and renting?
Home ownership offers tax benefits as well as the freedom to make decisions about your home. An advantage of renting is not worrying about maintenance and other financial obligations associated with owning property. There also are a number of economic considerations. Unlike renters, home owners who secure a fixed-rate loan can lock in their monthly housing costs and make prudent investment plans knowing these expenses will not increase substantially. Home ownership is a highly leveraged investment that can yield substantial profit on a nominal front-end investment. However, such returns depend on home-price appreciation.
"For some people, owning a home is a great feeling," writes Mitchell A. Levy in his book, "Home Ownership: The American Myth," Myth Breakers Press, Cupertino, Calif.; 1993. "It does, however, have a price. Besides the maintenance headache, the amount of after-tax money paid to the lender is usually greater than the amount of money otherwise paid in rent," Levy concludes. As for evaluating the risk associated with home ownership, David T. Schumacher and Erik Page Bucy write in their book "The Buy & Hold Real Estate Strategy," John Wiley & Sons, New York; 1992, that "good property located in growth areas should be regarded as an investment as opposed to a speculation or gamble." The authors recommend that prospective buyers spend a few months investigating a community. Many people make the mistake of buying in the wrong area. "Just because certain properties are high-priced doesn't necessarily mean they have some inherent advantage," the authors write. "One property may cost more than another today, but will it still be worth more down the line?"

Are there tax credits for first-time home buyers?
Many city and county governments offer Mortgage Credit Certificate programs, which allow first-time home buyers to take advantage of a special federal income tax write-off, which makes qualifying for a mortgage loan easier. Requirements vary from program to program. People wanting to apply should contact their local housing or community development office. Here is a list of four general requirements to keep in mind:
* Some credit may be claimed only on your owner- occupied principal residence.
*There are maximum income limits, which vary by locality and family size.

* You must be a first-time home buyer, which means you must not have had any kind of ownership interest in a principal residence during the past three years. This restriction may be waived, however, if you are buying property within certain target areas.
* Allocations must be available. A local MCC program may have to decline new applications when it runs out of funds.

Explain the home mortgage deduction…
The mortgage interest deduction entitles you to completely deduct the interest on your home loan for the year in which you paid it. Mortgage interest is not a dollar-for-dollar tax cut; it reduces taxable income. You must itemize deductions in order to do this, which means your total deductions must exceed the IRS's standard deduction. Another point to remember is that the amount of interest on your loan goes down each year you pay on your mortgage (all standard home-loan formulas pay off interest first before significantly paying into principal). That's why paying extra on your principal every year can help you pay off your loan early.

How are fees and assessments figured in a homeowners association?
Homeowners association fees are considered personal living expenses and are not tax-deductible. If, however, an association has a special assessment to make one or more capital improvements, condo owners may be able to add the expense to their cost basis. Cost basis is a term for the money an owner spends for permanent improvements throughout their time in the home and is used to reduce eventual capital gains taxes when the property is sold. For example, if the association puts a new roof on a building, the expense could be considered part of a condo owner's cost basis only if they lived directly underneath it. Overall improvements to common areas, such as the installation of a swimming pool, need to be considered on a case-by-case basis but most can be included in the cost basis of any owner who can show their home directly benefits from the work.

To find out more about how the IRS views condo association fees, look to IRS Publication 17, "Your Federal Income Tax," which includes a section on condos. Order a free copy by calling (800) TAX-FORM.

How do I reach the IRS?
To reach the Internal Revenue Service, call (800) TAX-1040.