

Tax Benefits of Owning Real Estate

Expenses incurred to own real estate can be deducted on one's income taxes. The benefits vary based on the use of the property and one's particular tax situation. Outlined below is some general information regarding these concepts. Consult your tax advisor for specific questions and advice. If you need a referral, please contact us at 415.651.1156.

Primary Residences and Second Homes

Homeowners can deduct mortgage interest payments on loans up to 100 percent of the value of the home as long as those loans do not exceed the amount of the home loan plus \$100K. Deductions are figured on the Schedule A of the IRS Form 1040. Prepayment penalties, points, and prorated mortgage interest at closing are also deductible. Points paid on a purchase loan are fully deductible in the year paid; points paid on a refinance must be amortized over the loan term. If a refinanced loan in which you paid points is refinanced with a different lender, the unamortized points may be fully deducted; however, if the loan is refinanced with the same lender, the amortization must continue. The mortgage interest deduction should be estimated based on one's marginal tax bracket. For instance, if your marginal tax bracket is 34 percent and you have \$10,000 in mortgage interest that year, you save \$3,400 in taxes. Property taxes are also tax deductible expenses.

If you are looking for additional deductions in any given year, consult your tax advisor about paying your mortgage payment for January in December and both installments of property taxes by the calendar year-end. Also, consider paying points on a purchase loan.

If you live in a multiple-unit dwelling and rent out a portion, your deductions will vary. A portion of your interest will be deducted on your Schedule A and a portion will be considered on your Schedule E for rental income from real estate.

Upon sale, \$250K of capital gain for single people and \$500K for married people is excluded from taxes. The rest is taxed as capital gains.

These rules apply to federal and state returns. The biggest threat to being able to take these deductions is the alternative minimum tax (AMT).

Investment Properties

Income properties are treated as businesses when it comes to deductions. Calculations are made on a Schedule E. Rental income from the property is offset by the expenses for the property, including the mortgage interest, taxes, insurance, maintenance, etc. Net gains are added onto one's adjusted gross income (AGI). Net losses can reduce AGI until one's AGI exceeds \$100K, at which point the deduction phases out until it is eliminated at \$150K. Qualified real estate professionals can deduct all passive losses.

Upon sale, the gain on an investment property is taxed as capital gains unless a property of like kind is acquired within the time limits and rules of the IRS code (a 1031 exchange).

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