

Tax Tips

BUYING A HOME

Thinking about buying a home? How will this affect your tax situation? Your home purchase can be a wonderful tax advantage. You may be able to itemize your deductions. If so, you can deduct payments such as mortgage interest, real estate taxes, and most points paid by you or the seller in the year of purchase. The earlier in the year you purchase your home, the more months of mortgage interest you will have by tax time.

Most of the expenses incurred when buying a home are not deductible. However, there are certain closing costs that are added to the basis of your residence. Keep accurate records of all items that affect the basis of your property. When your home is sold, this will help you to determine if you have a gain or loss.

The following closing costs incurred at purchase are added to the basis of your residence:

- Attorney's fees
- Recording fees
- Abstract fees
- Surveys
- Title searches
- Owner's title insurance policy
- Transfer taxes

These items are generally found on your closing settlement statement. Once you've closed on your new home, keep your closing settlement statement (including the Form HUD-1) in a safe place. When it's time for tax preparation, the Form HUD-1 is the document you will need to determine the points and other deductible closing costs on your tax return.

OWNING A HOME

The IRS allows current-year deductions on certain expenses associated with owning your home.

Real Estate Taxes

You may deduct real estate taxes in the year paid. They are reported on Form 1098, the annual statement from the financial institution holding your mortgage. You should also deduct any prorated taxes collected from you at closing. These amounts are not always included on Form 1098.

Local Taxes and Assessments

Local taxes are deductible if they are for repairs and maintenance (not upgrading) of existing items on your property. Local assessments, such as for sidewalks, are not deductible but are an addition to your cost basis.

Mortgage Interest

The amount of mortgage interest you paid on your principal residence (or second home) is deductible. This amount is generally shown on Form 1098. You can also deduct all the "points" paid to purchase your residence, even though some may have been paid by the seller. If certain requirements are met, the points can be deducted in full in the year paid. Otherwise, they must be deducted over the life of the mortgage. Both the points paid by you and those paid by the seller are usually shown on your closing settlement statement. Seller-paid points you claim as an itemized deduction reduce the cost basis of your home. While you own your home, keep a record of the cost of improvements you make that add value to your home such as: landscaping, patios, swimming pools, decks, room additions, and roof replacements. These items are additions to your cost basis. Repairs such as fixing leaks, repairing roofs, and painting are not deductible and are not basis additions. The cost of your own labor is not deductible.

Repairs & Improvements

The terms 'repairs' and 'improvements' can be confusing as they apply to the value of your home. A repair or maintenance expense is not tax deductible and cannot be added to the basis of your home. An improvement adds to the value of your home and is added to the basis. Adding vinyl siding and installing a security system are examples of improvements.

Real Estate Refinancing - Loan Points

When interest rates drop, there's often a mad rush to refinance home mortgages. Many homeowners assume that they may also deduct their points. If you use the proceeds of your new loan to make home improvements, you generally may deduct the loan points in the year you refinance. If only a portion of the loan is used to improve the home, only that portion of points is deductible in the year paid. The remainder must be deducted over the life of the loan.

Real Estate Refinancing - Home Improvements

Are you thinking about refinancing your home mortgage? The portion of points paid to refinance a loan not used to substantially improve your main residence is generally deductible in equal amounts over the life of the loan. Any points not deducted by the year the loan is paid off are usually fully deducted in the payoff year.

Casualty or Theft Loss

If your home is damaged from a sudden, unexpected event such as a fire, a storm, vandalism, or theft, the loss that is not covered by insurance is deductible subject to a



\$100 reduction and a 10% of adjusted gross income floor. A deductible casualty loss reduces the cost basis of your home by the amount claimed as a deduction.

SELLING YOUR HOME

If you're getting ready to sell your home, it's time to figure the basis of your property for tax purposes. If you've saved your Form HUD-1 from closing, you can add the attorney's fees, surveys, agent's commissions, title searches, recording fees, and the transfer and stamp taxes to the basis. You may also add improvements you have made to the property.

Homeowners can avoid paying taxes on the first \$250,000 of profits on the sale of a principal residence (\$500,000 if they are married filing jointly). Generally, you must own and live in the home two of the last five years. In order to take the full exclusion, you must have used and owned your residence for 2 of the last 5 years before the sale. If you move before satisfying the requirement due to a change in place of employment or a change in health, your exclusion will be adjusted by a proration based on the time spent in the home. The exclusion or reduced exclusion can be taken an unlimited number of times by a seller of any age if all requirements are satisfied. Losses on a home sale are not deductible.

Consult your local Jackson Hewitt Tax Service professional for more information about home ownership.