

Take a Little Off the Top

Homeownership helps consumers legally avoid taxes

By M. Anthony Carr



One of the benefits I love the most about homeownership is the ability to avoid taxes. My house is a wonderful provider of deductions that save me thousands of dollars each year on my tax bill. Here are some deductions and tax reduction strategies you should be aware of as you approach April 15.

Mortgage Interest: Oh yeah -- here's the biggie.

Homeowners with a mortgage should have received a Form 1098 from their mortgage service provider. If you have been making payments to an owner financier, then you need to make sure the note holder fills out this form and sends it to you. On my mortgage, this is going to turn into a \$13,000-plus deduction right off the top.

Government statistics reveal I'm in good company: Nearly 36 million taxpayers claimed the deduction in 2001, providing a cumulative deduction of \$330.7 billion -- or about \$9,100 per taxpayer. This one deduction represented more than a third of all itemized deductions. Since 1980, the amount deducted has been growing at about 8.5 percent each year.

Points: If you bought or refinanced a house this last year (and with the low interest rates, nearly half of all homeowners refinanced), you now have some deductions from the points you may have paid in the financing process. A point is a fee paid to the mortgage originator equal to one percent of the loan. If you bought your house last year and financed the purchase, you may deduct the full value of the points paid at the time of the purchase. For those who refinanced, the points are amortized over the life of the loan. Also, if you refinanced and are deducting a fraction of the points over the term of the loan, once you sell the house and pay off the mortgage, the remainder of the points are fully deductible.

Real Estate Taxes: My real estate taxes paid through the mortgage company are also listed on the Form 1098 and they total more than \$3,500 for the year. Combining this figure with my mortgage interest I have a \$16,500 deduction. Woohoo! Kind of takes the pain out of writing that monthly payment (well, just a little).

Home Office: If you are making money through a home-based business, you can reduce your taxable income from that activity by deducting expenses connected to a home office. (This deduction is also available to renters, not just homeowners.) The home office opens up a lot of expenses on the house that would not otherwise be deductible. For instance, if you carpet the whole house and your home office makes up 10 percent of your living area, then 10 percent of the carpet job is deductible. Don't overlook this valuable deduction.

Capital Gains Roll Over: For my real estate investor friends, don't forget that you can avoid capital gains taxes when you sell one investment property and buy another property. This is called a 1031 Exchange or Starker Exchange. It allows you to roll over all the gain from one property to the next without paying capital gains taxes. An investor **MUST** use a qualified intermediary for this process, which ensures the investor does not gain access to the funds during the transaction. If the investor gains access to the funds before settling on the replacement property, then capital gains taxes are required to be paid. (After settlement, however, the investor can refinance with a cash-out program to gain access to the equity.)

Monitor Your Basis: Tax time provides a great opportunity each year to keep up with the ongoing growing basis of your largest investment. The basis is the bottom line number you'll use once you sell your house to determine if you own capital gains taxes. It is the combination of the acquisition cost of buying the house, plus any capital improvements over the years, which can include items such as:

- Adding a new foundation or facade.
- Installing new floors or replacing current floors with tile.
- Replacing or reshingling the roof (but not repairing the roof).
- Installing a fire escape.
- Installing new wiring (but not replacing old or defective wiring).

New Capital Gains Tax Rates: If, through the sale of real estate you experience capital gains, your tax bill was reduced thanks to the 2003 Tax Act. The new rates are now 15 percent and 5 percent, depending on your income.