

## **Tax Aspects of Refinancing Your Home Mortgage**

Given all the turmoil in the residential lending market of late, it may be worth-while or even necessary to refinance your mortgage. Refinancing your mortgage can be expensive, so you will want to avail yourself of any related tax breaks to offset your closing costs to the extent possible. Listed below are some of the tax implications of that refinancing decision.

### **Treatment of Points**

Points paid to refinance a home mortgage are nothing more than prepaid interest on the new loan. As such, the tax rules for home mortgage interest apply, but with a few twists because the interest in question is being prepaid.

When the new mortgage simply replaces the old one on a principal residence (i.e., no additional debt is taken out), the points paid for the new mortgage are capitalized and then amortized ratably over the life of the new loan. The resulting amortization deductions are then written-off on your tax return as qualified residence interest for both regular tax and alternative minimum tax (AMT) purposes.

Under an exception to this general rule, homeowners can immediately deduct refinancing points allocable to additional mortgage debt if the debt is used to pay for additions or improvements to the homeowner's principal residence. In this case, the debt must be secured by the residence and there is generally an overall limit of \$1 million on all debt qualifying as incurred to acquire, construct, or improve a qualified residence.

To claim an immediate deduction under this exception, cash-basis taxpayers must actually pay for the points out-of-pocket (they cannot be rolled over into the principal balance of the new loan). If the preceding conditions are satisfied, the allocable points can be deducted in full on your tax return in the year they are paid.

### **Other Refinancing Costs and Fees**

In addition to points, mortgage lenders usually charge a variety of fees for obtaining the loan. These fees are not deductible. You may also incur attorney, appraisal, and title fees, and pay other incidental expenses associated with a home purchase, such as recording fees and transfer taxes. These fees and expenses are added to the home's basis (the cost used to determine gain or loss when the home is sold).

### **Interest Expense on the New Loan**

Under both the regular tax and the AMT rules, interest expense is deductible to the extent the debt proceeds are used to (a) acquire, (b) construct, or (c) substantially improve your residence. Interest on a new mortgage taken out to refinance another mortgage is also qualified housing interest to the extent the principal of the original mortgage generated qualified housing interest. Thus, such a refinancing should have no effect on your ability to continue deducting the mortgage interest.

### **Unamortized Points from the Old Loan**

That brings us to a potentially big deduction related to the refinancing. If you previously refinanced your mortgage and were amortizing the related points, the unamortized balance can be immediately deducted when the related loan is refinanced with a new lender (to the extent the points were amortizable in the first place under the regular tax and AMT rules explained above).

Please don't hesitate to contact us if you would like to discuss the tax ramifications of refinancing your home mortgage.