

What You Can and Cannot Deduct

To deduct expenses of owning a home, you must file Form 1040 and itemize your deductions on Schedule A (Form 1040). If you itemize, you cannot take the standard deduction. See the Form 1040 instructions if you have questions about whether to itemize your deductions or claim the standard deduction.

This section explains what expenses you can deduct as a homeowner. It also points out expenses that you cannot deduct. There are two primary discussions: real estate taxes and home mortgage interest. Generally, your real estate taxes and home mortgage interest are included in your house payment.

Home Mortgage Interest

This section of the publication gives you basic information about home mortgage interest, including information on interest paid at settlement, points, and Form 1098, *Mortgage Interest Statement*.

Most home buyers take out a mortgage (loan) to buy their home. They then make monthly house payments to either the mortgage holder or someone collecting the payments for the mortgage holder. (See *Your house payment*, earlier, under *What You Can and Cannot Deduct*.)

Usually, you can deduct the entire part of your house payment that is for mortgage interest, if you itemize your deductions on Schedule A (Form 1040). However, your deduction may be limited if:

- Your total mortgage balance is more than \$1 million (\$500,000 if married filing separately), or
- You took out a mortgage for reasons other than to buy, build, or improve your home.

If either of these situations applies to you, you will need to get [Publication 936](#). You may also need [Publication 936](#) if you later refinance your mortgage or buy a second home.

Refund of home mortgage interest. If you receive a refund of home mortgage interest that you deducted in an earlier year and that reduced your tax, you generally must include the refund in income in the year you receive it. For more information, see *Recoveries* in [Publication 525](#). The amount of the refund will usually be shown on the mortgage interest statement you receive from your mortgage lender. See *Mortgage Interest Statement*, later.

Deductible Mortgage Interest

To be deductible, the interest you pay must be on a loan secured by your main home or a second home. The loan can be a first or second mortgage, a home improvement loan, or a home equity loan.

Prepaid interest. If you pay interest in advance for a period that goes beyond the end of the tax year, you must spread this interest over the tax years to which it applies. You can deduct in each year only the interest that qualifies as home mortgage interest for that year. However, there is an exception that applies to points, discussed later.

Late payment charge on mortgage payment. You can deduct as home mortgage interest a late payment charge if it was not for a specific service in connection with your mortgage loan.

Mortgage prepayment penalty. If you pay off your home mortgage early, you may have to pay a penalty. You can deduct that penalty as home mortgage interest provided the penalty is not for a specific service performed or cost incurred in connection with your mortgage loan.

Points

The term **points** is used to describe certain charges paid, or treated as paid, by a borrower to obtain a home mortgage. Points may also be called loan origination fees, maximum loan charges, loan discount, or discount points.

A borrower is treated as paying any points that a home seller pays for the borrower's mortgage. See *Points paid by the seller*, later.

General rule. You cannot deduct the full amount of points in the year paid. Because they are prepaid interest, you generally must deduct them over the life (term) of the mortgage.

Exception. You can fully deduct points in the year paid if you meet all the following tests.

1. Your loan is secured by your main home. (Your main home is the one you live in most of the time.)
2. Paying points is an established business practice in the area where the loan was made.
3. The points paid were not more than the points generally charged in that area.
4. You use the cash method of accounting. This means you report income in the year you receive it and deduct expenses in the year you pay them. Most individuals use this method.
5. The points were not paid in place of amounts that ordinarily are stated separately on the settlement statement, such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes.
6. The funds you provided at or before closing, plus any points the seller paid, were at least as much as the points charged. The funds you provided do not have to have been applied to the points. They can include a down payment, an escrow deposit, earnest money, and other funds you paid at or before closing for any purpose. You cannot have borrowed these funds from your lender or mortgage broker.
7. You use your loan to buy or build your main home.
8. The points were computed as a percentage of the principal amount of the mortgage.
9. The amount is clearly shown on the settlement statement (such as the Uniform Settlement Statement, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.

Note. If you meet all of the tests listed above and you itemize your deductions in the year you get the loan, you can either deduct the full amount of points in the year paid or deduct them over the life of the loan, beginning in the year you get the loan. If you do not itemize your deductions in the year you get the loan, you can spread the points over the life of the loan and deduct the appropriate amount in each future year, if any, when you do itemize your deductions.

Home improvement loan. You can also fully deduct in the year paid points paid on a loan to improve your main home, if tests (1) through (6) are met.

Points not fully deductible in year paid. If you do not qualify under the exception to deduct the full amount of points in the year paid (or choose not to do so), see *Points* in chapter 5 of [Publication 535](#), *Business Expenses*, for the rules on when and how much you can deduct.

Figure A. You can use *Figure A* as a quick guide to see whether your points are fully deductible in the year paid.

<http://www.irs.gov/formspubs/display/0,,i1%3D50%26genericId%3D11955,00.html>

Complete reference:

<http://www.irs.gov/formspubs/display/0,,i1%3D50%26genericId%3D11963,00.html>



Internal Revenue Service

DEPARTMENT OF THE TREASURY

The
Digital
Daily