TAX TIPS FOR HOMEOWNERS

Tax Tips for Homeowners

You may already know that you can deduct the mortgage interest you pay on your home, but what other tax advantages are lurking in that house?

One of the biggest challenges of owning a home is dealing with the tax laws, especially those around points and cost basis. Just a little bit of knowledge can really clear up these frequently confusing terms. Here’s the scoop on mortgage basis points and how they’re used in your home's value, cost basis, and tax burden.

What are Points?

Points are fees that you pay in order to enter into a mortgage. ***Points are considered to be prepaid interest, and as such, you can deduct them.*** The issue is, can you deduct the full amount up front, or must you divide your deductions out over the life of the loan?

You can deduct all the points the first year if all of the following are true:

- The loan is used to purchase or build your primary home.
- Paying points is customary in your area.
- The points aren’t paid for appraisal fees, title fees, property taxes, or similar fees.
- You didn’t borrow the money to pay the points.
- The points were based on a percentage of the loan and that fact is easy to see.

Cost Basis

Cost basis is the original value of an asset for tax purposes. The cost basis is quite easy to calculate; it is simply the price you paid for the home plus any capital improvements that have been made. Then you would subtract any seller-paid points, depreciation, and losses.

Capital improvements would be anything that increases the home's value. Capital improvements would include such things as swimming pools and adding a room.

Understanding the Tax Burden When You Sell

If you owned the home (and lived in it) for at least two out of the last 5 years, you most likely don't owe any tax at all. A single person doesn’t pay tax on capital gains of less than $250,000;

for married couples the limit is $500,000. So as a married couple, you could purchase a home for $100,000 and sell it for $600,000 and not owe any tax on the proceeds.

There are circumstances under which the two-year requirement is waived, such as health issues, divorce, change of employment, and more.

In these cases, the amount of the exemption is based on the number of months the home was lived in. So if you were single and lived there for 12 months, you would be entitled to an exemption of $125,000, or half of the deduction allowed if you had lived there the required two years.

Inherited Property

The cost basis on inherited property is the market value *at the time of the owner's death.*

This is great, because it doesn't matter how much your grandmother paid for her home back in 1960. If you inherited the home she paid $20,000 for, and it’s now worth $175,000 (when she died), you would not owe any tax on the proceeds even if you were to sell the home immediately.

While it’s likely that the related tax laws will change again (they always do), it’s always a good idea to understand your home's cost basis and your potential tax liability. Sooner or later the information may be pertinent to your tax situation, so keep abreast of the tax implications and deductions for your home.