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# Home Mortgage Interest Deduction

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**1997** Returns



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## Important Reminders

**Personal interest.** Personal interest is not deductible. Examples of personal interest include interest charged on credit cards, car loans, and installment plans.

But beginning in **1998**, you may be able to deduct interest you pay on a qualified education loan. For details, see Publication 553, *Highlights of 1997 Tax Changes*.

**Points paid by seller.** You may be able to deduct points paid on your mortgage by the person who sold you your home. See *Points* in *Part I*.

**Limit on itemized deductions.** Certain itemized deductions (including home mortgage interest) are limited if your adjusted gross income is more than \$121,200 (\$60,600 if you are married filing a separate return). For more information, see the instructions for Schedule A (Form 1040).

## Introduction

This publication discusses the rules for deducting home mortgage interest.

*Part I* contains general information on home mortgage interest, including points. It also explains how to report deductible interest on your tax return.

*Part II* explains how your deduction for home mortgage interest may be limited. It contains *Table 1*, which is a worksheet you may use to figure the limit on your deduction.

## Useful Items

You may want to see:

**Publication**

- 527** Residential Rental Property
- 530** Tax Information for First-Time Homeowners
- 535** Business Expenses

## Form (and Instructions)

- 8396** Mortgage Interest Credit

See *How To Get More Information* near the end of this publication for information about getting these publications and this form.

## Part I: Home Mortgage Interest

This part contains general information on home mortgage interest, including points, and explains how to report deductible interest on your tax return.

Generally, home mortgage interest is any interest you pay on a loan secured by your home (main home or a second home). The loan may be a mortgage to buy your home, a second mortgage, a line of credit, or a home equity loan.

You can deduct home mortgage interest only if you meet all the following tests.

- You must file Form 1040 and itemize deductions on Schedule A. (See *How To Report*, later, for details about reporting home mortgage interest on Schedule A.)
- You must be legally liable for the loan. You cannot deduct payments you make for someone else if you are not legally liable to make them. Both you and the lender must intend that the loan be repaid. In addition, there must be a true debtor-creditor relationship between you and the lender.
- The mortgage must be a secured debt on a qualified home. (See the explanations of "secured debt" and "qualified home" on this page.)

**Fully deductible interest.** In most cases, you will be able to deduct all of your home mortgage interest. Whether it is all deductible depends on the date you took out the mortgage, the amount of the mortgage, and your use of its proceeds. If all of your mortgages fit into one or more of the following three categories at all times during the year, you can deduct **all** of the interest on those mortgages. If any one mortgage fits into more than one category, add the debt that fits in each category to your other debt in the same category. If one or more of your mortgages does not fit into any of these categories, use *Part II* of this publication to figure the amount of interest you can deduct.

The three categories are:

- 1) Mortgages you took out on or before October 13, 1987 (called grandfathered debt).
- 2) Mortgages you took out after October 13, 1987, to buy, build, or improve your home (called home acquisition debt), but only if these mortgages plus any grandfathered debt totaled \$1 million or less (\$500,000 or less if married filing separately) throughout 1997.
- 3) Mortgages you took out after October 13, 1987, other than to buy, build, or improve your home (called home equity debt), but only if throughout 1997 these mortgages totaled \$100,000 or less (\$50,000 or less if married filing separately) and all mortgages on the home totaled no more than its fair market value.

The dollar limits for the second and third categories apply to the combined mortgages on your main home and second home.

See *Part II* of this publication for more detailed definitions of grandfathered, home acquisition, and home equity debt.

You can use *Figure A* in this publication to check whether your interest is fully deductible.

## Secured Debt

You can deduct your home mortgage interest only if your mortgage is a secured debt. A secured debt is one in which you sign an instrument (such as a mortgage, deed of trust, or land contract) that:

- 1) Makes your ownership in a qualified home security for payment of the debt,
- 2) Provides, in case of default, that your home could satisfy the debt, and
- 3) Is recorded or is otherwise perfected under any state or local law that applies.

In other words, your mortgage is a secured debt if you put your home up as collateral to protect the interests of the lender. If you cannot pay the debt, your home can then serve as payment to the lender to satisfy (pay) the debt. In this publication, **mortgage** will refer to secured debt.

**Debt not secured by home.** A debt is not secured by your home if it is secured solely because of a lien on your general assets or if it is a security interest that attaches to the property without your consent (such as a mechanic's lien or judgment lien).

**Wraparound mortgage.** This is not a secured debt unless it is recorded or otherwise perfected under state law.

**Example.** Beth owns a home subject to a mortgage of \$40,000. She sells the home for \$100,000 to John, who takes it subject to the \$40,000 mortgage. Beth continues to make the payments on the \$40,000 note. John pays \$10,000 down and gives Beth a \$90,000 note secured by a wraparound mortgage on the home. Beth does not record or otherwise perfect the \$90,000 mortgage under the state law that applies. Therefore, that mortgage is not a secured debt, and the interest John pays on it is not deductible as home mortgage interest.

**Choice to treat the debt as not secured by your home.** You can choose to treat any debt secured by your qualified home as not secured by the home. This treatment begins with the tax year for which you make the choice and continues for all later tax years. You may revoke your choice only with the consent of the Internal Revenue Service (IRS).

You may want to treat a debt as not secured by your home if the interest on that debt is fully deductible (for example, as a business expense) whether or not it qualifies as home mortgage interest. This may allow you, if the limits in *Part II* apply to you, more of a deduction for interest on other debts that are deductible only as home mortgage interest.

**Cooperative apartment owner.** If you own stock in a cooperative housing corporation, see the *Special Rule for Tenant-Stockholders in Cooperative Housing Corporations*, later.

## Qualified Home

For you to take a home mortgage interest deduction, your debt must be secured by a qualified home. This means your main home or your second home. A home includes a house, condominium, cooperative, mobile home, boat, or similar property that has sleeping, cooking, and toilet facilities.

The interest you pay on a mortgage on a home other than your main or second home may be deductible if the proceeds of the loan were used for business or investment purposes. Otherwise, it is considered personal interest and is not deductible.

**Main home.** You can have only one main home at any one time. Generally, this is the home where you spend most of your time.

If you sold this home, you could qualify to postpone or exclude any gain. For information on the sale of your main home, see Publication 523, *Selling Your Home*.

**Second home.** If you have a second home that you do not rent to others, you can treat it as a qualified home. It does not matter whether you use the home during the year.

**Second home rented out.** If you have a second home and rent it out part of the year, you also must use it during the year for it to be a qualified home. You must use this home more than 14 days or more than 10% of the number of days during the year that the home is rented at a fair rental, whichever is longer. If you do not use the home long enough, it is considered rental property and not a second home.

**More than one second home.** If you have more than one second home, you can treat only one as the qualified second home during any year. However, an exception is made to this rule in the following three situations.

- 1) If you get a new home during the year, you can choose to treat the new home as your second home as of the day you buy it.
- 2) If your main home no longer qualifies as your main home, you can choose to treat it as your second home as of the day you stop using it as your main home.
- 3) If your second home is sold during the year or becomes your main home, you can choose a new second home as of the day you sell the old one or begin using it as your main home.

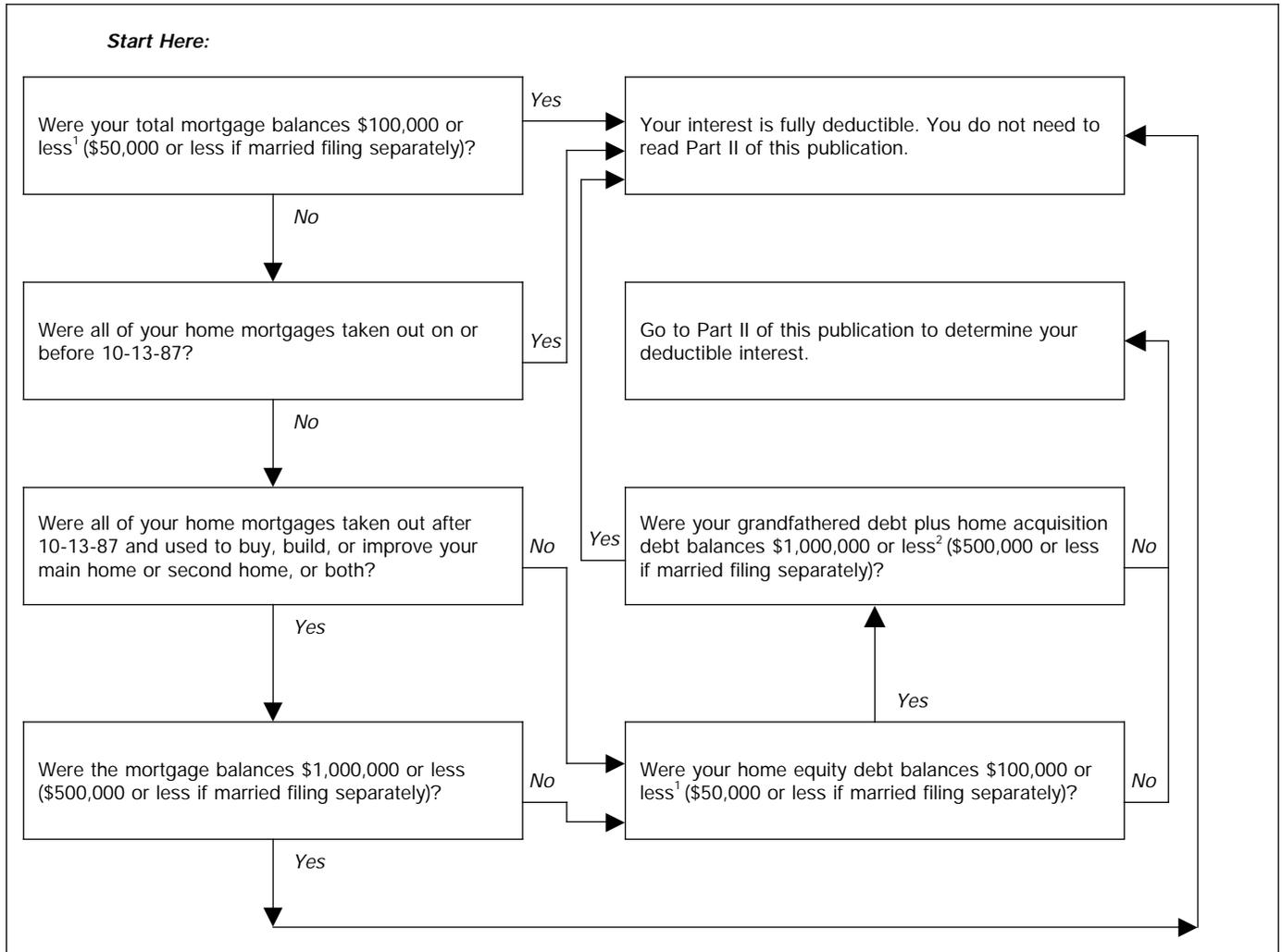
**Divided use of your home.** The only part of your home that is considered a qualified home is the part you use for residential living. You must divide both the cost and fair market value of your home between the part that is a qualified home and the part that is not. Dividing the cost may affect the amount of your home acquisition debt, which is limited to the cost of your home plus the cost of any improvements. (See *Home Acquisition Debt* in *Part II*.) Dividing the fair market value may affect your home equity debt limit, also explained in *Part II*.

**Renting out part of home.** If you rent out part of a qualified home to another person (tenant), you can treat the rented part as being used by you for residential living only if **all** three of the following conditions apply.

- 1) The rented part of your home is used by the tenant primarily for residential living.

## Figure A. Is My Interest Fully Deductible?

(Instructions: Include balances of **ALL** mortgages secured by your main home and second home. Answer **YES** only if the answer is true at **ALL** times during the year.)



<sup>1</sup> If all mortgages on your main or second home exceed the home's fair market value, a lower limit may apply. See *Home equity debt limit* under *Home Equity Debt* in Part II.

<sup>2</sup> Amounts over the \$1,000,000 limit (\$500,000 if married filing separately) qualify as home equity debt if they are not more than the total home equity debt limit. See Part II of this publication for more information about grandfathered debt, home acquisition debt, and home equity debt.

- 2) The rented part of your home is not a self-contained residential unit having separate sleeping, cooking, and toilet facilities.
- 3) You do not rent (directly or by sublease) to more than two tenants at any time during the tax year. If two persons (and dependents of either) share the same sleeping quarters, they are treated as one tenant.

**Office in home.** If you have an office in your home that you use in your business, see Publication 587, *Business Use of Your Home*. It explains how to figure your deduction for the business use of your home. It also explains whether, and how, this affects your deduction for home mortgage interest.

**Home under construction.** You can treat a home under construction as a qualified home for a period of up to 24 months, but only if it becomes your qualified home at the time it is ready for occupancy.

The 24-month period can start any time on or after the day construction actually begins.

**Home destroyed.** You may be able to continue treating your home as a qualified home even after it is destroyed in a fire, storm, tornado, earthquake, or other casualty. This means you can continue to deduct the interest you pay on your home mortgage, subject to the limits described in this publication.

To continue treating a destroyed home as a qualified home, you must do one of the following within a reasonable period of time after the home is destroyed:

- 1) Rebuild the destroyed home and move into it, or
- 2) Sell the land on which the home was located.

This rule applies whether the home is your main home or a second home that you treat as a qualified home. Also, it applies whether or not your home is in a federal disaster area.

**Time-sharing arrangements.** You can treat a home you own under a time-sharing plan as a qualified home if it meets all the requirements. A time-sharing plan is an arrangement between two or more people that limits each person's interest in the home or right to use it to a certain part of the year.

**Rental of time share.** If you rent out your time-share, it qualifies as a second home only if you also use it as a home. See *Second home*, earlier, for the use requirement. To know whether you meet that requirement, count your days of use and rental of the home only during the time you have a right to use it.

**Married taxpayers.** If you are married and file a joint return, your qualified homes can be owned either jointly or by only one spouse.

**Separate returns.** If you are married filing separately, and you and your spouse own more than one home, you can each take into account only one home as a qualified home. However, if you both consent in writing, then one spouse can take both the main home and a second home into account.

## Special Situations

This section describes certain items that can be included as home mortgage interest and others that cannot. It also describes certain special situations that may affect your deduction.

**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 performed by your mortgage holder.

**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.

**Sale of home.** If you sell your home, you can deduct your allowable home mortgage interest paid up to, but not including, the date of the sale.

**Example.** John and Peggy Harris sold their home on May 7. Through April 30, they made home mortgage interest payments of \$1,220. The settlement sheet for the sale of the home showed \$50 interest for the 6-day period in May up to, but not including, the date of sale. Their mortgage interest deduction is \$1,270 (\$1,220 + \$50).

**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. See the discussion on *Points*, later.

**Mortgage interest credit.** You may be able to claim a mortgage interest credit if you were issued a mortgage credit certificate (MCC) by a state or local government. Figure the credit on **Form 8396, Mortgage Interest Credit**. If you take this credit, you must reduce your mortgage interest deduction by the amount of the credit.

See Form 8396 and Publication 530, *Tax Information for First-Time Homeowners*, for more information on the mortgage interest credit.

**Ministers' and military housing allowance.** If you are a minister or a member of the uniformed services and receive a housing allowance that is not taxable, you can still deduct all of the deductible interest on your home mortgage.

**Shared appreciation mortgage (SAM).** Under a SAM you pay interest at a fixed rate that is lower than the prevailing interest rate. You also agree to pay "contingent interest" to the lender. The contingent interest is a percentage of any appreciation in the value of your home and is due when the SAM ends. Generally, a SAM will end when you prepay the SAM, when you sell your home, or on a specified date, whichever is earliest.

You can deduct the interest included in your monthly payments at the fixed rate, subject to any limits that apply, each year as you pay it. You can deduct the contingent interest, subject to any limits that apply, in the year you pay it.

**Example.** In 1989, you bought your main home for \$125,000. You financed the purchase with a 9% 30-year \$100,000 SAM that

provided that you pay the lender 40% of the appreciation as contingent interest. When you bought the house, the prevailing interest rate was 12%. The contingent interest was due when you paid off the loan, when you sold your home, or in 10 years, whichever was earliest. In 1997, you sold your home for \$155,000. You paid off the principal on the mortgage plus \$12,000 (40% of the \$30,000 appreciation (\$155,000 - \$125,000)). In 1997, you can deduct the \$12,000 contingent interest as home mortgage interest. The result would be the same if you had not sold your house and had paid off the SAM with funds obtained from a source other than the SAM lender.

**Refinancing a SAM.** You are not considered to have paid the contingent interest if you refinance your loan with the same lender and the face amount of the new loan includes the contingent interest due on the SAM. You can deduct the contingent interest only as you pay off the principal on the new loan. That is, part of the principal in each payment on the new loan is for the contingent interest.

**Graduated payment mortgages (GPMs).** GPMs under section 245 of the National Housing Act provide that monthly payments increase every year for a number of years and then stay the same. During the early years, payments are less than the amount of interest owed on the loan. The interest that is not paid becomes part of the principal. Future interest is figured on the increased unpaid mortgage loan balance.

Subject to any limits that apply, you can deduct the interest you actually paid during the year if you are a cash method taxpayer. For example, if the interest owed is \$2,551 but your payment for the year is \$2,517, you can deduct \$2,517. Add \$34 (\$2,551 - \$2,517) to the loan principal.

**Mortgage assistance payments.** If you qualify for mortgage assistance payments under section 235 of the National Housing Act, part or all of the interest on your mortgage may be paid for you. You cannot deduct the interest that is paid for you.

**No other effect on taxes.** Do not include these mortgage assistance payments in your income. Also, do not use these payments to reduce other deductions, such as real estate taxes.

**Divorced or separated individuals.** If a divorce or separation agreement requires you or your spouse or former spouse to pay home mortgage interest on a home owned by both of you, see the discussion of *Payments for jointly-owned home* under *Alimony* in Publication 504, *Divorced or Separated Individuals*.

**Redeemable ground rents.** In some states (Maryland, for example), you may buy your home subject to a ground rent. A ground rent is an obligation you assume to pay a fixed amount per year on the property. Under this arrangement, you are leasing (rather than buying) the land on which your home is located.

If you make annual or periodic rental payments on a redeemable ground rent, you can deduct them as mortgage interest.

A ground rent is a redeemable ground rent if:

- 1) Your lease, including renewal periods, is for more than 15 years,
- 2) You can freely assign the lease,
- 3) You have a present or future right (under state or local law) to end the lease and buy the lessor's entire interest in the land by paying a specific amount, and
- 4) The lessor's interest in the land is primarily a security interest to protect the rental payments to which he or she is entitled.

Payments made to end the lease and to buy the lessor's entire interest in the land are not ground rents. You cannot deduct them.

**Nonredeemable ground rent.** Payments on a nonredeemable ground rent are not interest. You can deduct them as rent if they are a business expense or if they are for rental property held to produce income.

**Reverse mortgage loans.** A reverse mortgage loan is a loan that is based on the value of your home and is secured by a mortgage on your home. The lending institution pays you the loan in installments over a period of months or years. The loan agreement may provide that interest will be added to the outstanding loan balance monthly as it accrues. If you are a cash method taxpayer, you deduct the interest on a reverse mortgage loan when you actually pay it, not when it is added to the outstanding loan balance.

Your deduction may be limited because a reverse mortgage loan generally is subject to the limit on *Home Equity Debt* discussed in *Part II*.

**Rental payments.** If you live in a house before final settlement on the purchase, any payments you make for that period are rent, not interest, even if the settlement papers call them interest. You cannot deduct these payments as interest.

**Mortgage proceeds invested in tax-exempt securities.** You cannot deduct the home mortgage interest on grandfathered debt or home equity debt if you used the proceeds of the mortgage to buy securities or certificates that produce tax-free income. Grandfathered debt and home equity debt are defined in *Part II* of this publication.

**Refunds of interest.** If you receive a refund of interest in the same year you paid it, you must reduce your interest expense by the amount refunded to you. If you receive a refund of interest you deducted in an earlier year, you generally must include the refund in income in the year you receive it. However, you need to include it only up to the amount of the deduction that reduced your tax in the earlier year.

If you received a refund of interest you overpaid in an earlier year, you generally will receive a Form 1098, *Mortgage Interest Statement*, showing the refund in box 3. For information about Form 1098, see *Mortgage Interest Statement*, later.

For more information on how to treat refunds of interest deducted in earlier years, see *Recoveries* in Publication 525, *Taxable and Nontaxable Income*.

**Cooperative apartment owner.** If you own a cooperative apartment, your 1997 mortgage interest deduction must be reduced by your share of any cash portion of a patronage dividend that is a refund to the co-

operative housing corporation of mortgage interest it paid before 1997.

If you receive a Form 1098 from the cooperative housing corporation, the form should show only the amount you can deduct.

## 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 must spread the points over the life (term) of the mortgage. Generally, you can deduct an equal portion in each year of the mortgage.

**Exception.** You can deduct in 1997 the entire amount paid on your loan as points if all the following are true.

- 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) You use your loan to buy or build your main home.
- 7) The points were computed as a percentage of the principal amount of the mortgage.
- 8) The amount is clearly shown on the settlement statement (for example, Form HUD-1) as points charged for the mortgage. The points may be shown as paid from either your funds or the seller's.
- 9) 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.

**Home improvement loan.** You can deduct in 1997 the entire amount of points paid on a loan to improve our main home, if statements (1) through (5) above are true.

**Figure B.** You can use *Figure B* as a quick check to see if points are fully deductible in the year paid.

**Amounts charged for services.** Amounts charged by the lender for specific services connected to the loan are not interest. Examples are appraisal fees, notary fees, and preparation costs for the mortgage note or deed of trust. You cannot deduct these amounts as points either in the year paid or over the life of the mortgage. For information about the tax treatment of these amounts and other settlement fees and closing costs, get Publication 530, *Tax Information for First-Time Homeowners*.

However, an amount shown on your settlement statement as points may be deductible in the year paid under the *Exception* to the *General rule*, even if it is for services in connection with your mortgage (whether VA, FHA, or conventional). The services must not be any of the specific services for which a charge ordinarily is stated separately on the settlement statement, as described in test (5) of the *Exception*. The other tests under the *Exception* also must be met.

**Points paid by the seller.** The term "points" includes loan placement fees that the seller pays to the lender to arrange financing for the buyer.

**Treatment by seller.** The seller **cannot** deduct these fees as interest. But they are a selling expense that reduces the seller's amount realized.

**Treatment by buyer.** The buyer reduces the basis of the home by the amount of the seller-paid points and treats the points as if he or she had paid them. If all the tests under the *Exception* are met, the buyer deducts the points in the year paid. If any of those tests is not met, the buyer deducts the points over the life of the loan.

If you need information about the basis of your home, get Publication 523, *Selling Your Home*, or Publication 530.

**Funds provided are less than points.** If you meet all the tests in the *Exception* except that the funds you provided were less than the points charged to you (test 9), you can deduct the points in the year paid, up to the amount of funds you provided. In addition, you can deduct any points paid by the seller.

**Example 1.** When you took out a \$100,000 mortgage loan to buy your home in December 1997, you were charged one point (\$1,000). You meet all the nine tests for deducting points in the year paid, except the only funds you provided were a \$750 down payment. Of the \$1,000 charged for points, you can deduct \$750 in 1997.

**Example 2.** The facts are the same as in Example 1, except that the person who sold you your home also paid one point (\$1,000) to help you get your mortgage. In 1997, you can deduct \$1,750 (\$750 of the amount you were charged plus the \$1,000 paid by the seller). You must reduce the basis of your home by the \$1,000 paid by the seller.

**Excess points.** If you meet all the tests in the *Exception* except that the points paid were more than generally paid in your area (test 3), your deduction in 1997 is limited to the points generally charged. Any additional amount of points paid is interest paid in advance, and you must spread the deduction over the life of the mortgage.

**Second home.** The *Exception* does not apply to points you pay on loans secured by your second home. You can deduct these points only over the life of the loan.

**Mortgage ending early.** If you spread your deduction for points over the life of the mortgage, you can deduct any remaining balance in the year the mortgage ends. A mortgage may end early due to a prepayment, refinancing, foreclosure, or similar event.

**Example.** Dan refinanced his mortgage in 1992 and paid \$3,000 in points that he had to spread out over the life of the mortgage. He had deducted \$1,000 of these points through 1996.

Dan prepaid his mortgage in full in 1997. He can deduct the remaining \$2,000 of points in 1997.

**Refinancing.** Generally, points you pay to refinance a mortgage are not deductible in full in the year you pay them. This is true even if the new mortgage is secured by your main home.

However, if you use part of the refinanced mortgage proceeds to **improve your main home** and you meet the first five tests listed under the *Exception*, earlier, you can fully deduct the part of the points related to the improvement in the year paid. You can deduct the rest of the points over the life of the loan.

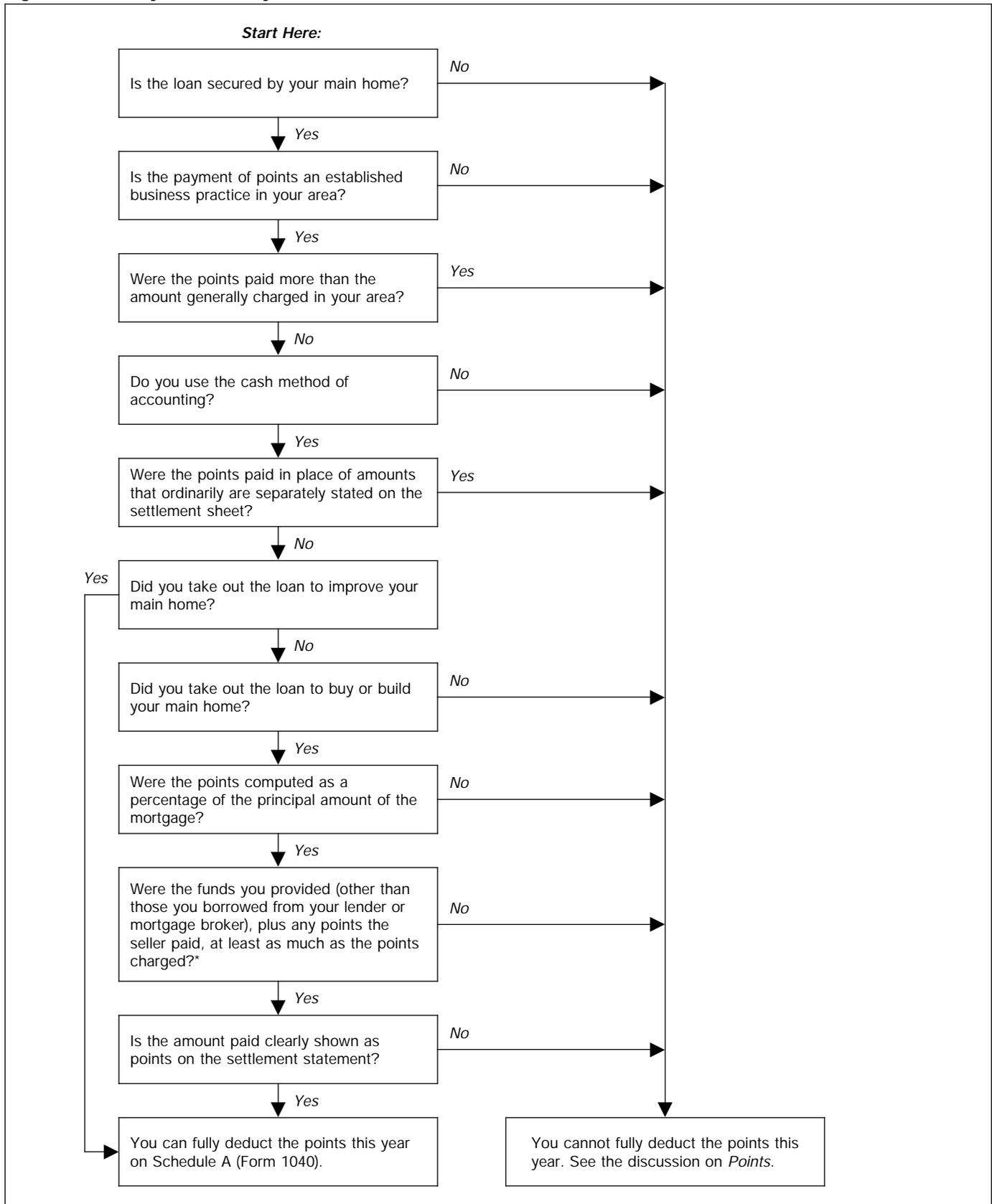
**Example 1.** In 1991, Bill Fields got a mortgage to buy a home. The interest rate on that mortgage loan was 11%. In 1997, Bill refinanced that mortgage with a 15-year \$100,000 mortgage loan that has an interest rate of 8%. The mortgage is secured by his home. To get the new loan, he had to pay three points (\$3,000). Two points (\$2,000) were for prepaid interest, and one point (\$1,000) was charged for services, in place of amounts that ordinarily are stated separately on the settlement statement. Bill paid the points out of his private funds, rather than out of the proceeds of the new loan. The payment of points is an established practice in the area, and the points charged are not more than the amount generally charged there. Bill's first payment on the new loan was due July 1. He made six payments on the loan in 1997 and is a cash basis taxpayer.

Bill used the funds from the new mortgage to repay his existing mortgage. Although the new mortgage loan was for Bill's continued ownership of his main home, it was not for the purchase or improvement of that home. For that reason, Bill does not meet all the tests in the *Exception*, and he cannot deduct all of the points in 1997. He can deduct two points (\$2,000) ratably over the life of the loan. He deducts \$67  $(\$2,000 \div 180 \text{ months}) \times 6 \text{ payments}$  of the points on his 1997 Form 1040 (on line 12, Schedule A). The other point (\$1,000) was a fee for services and not deductible.

**Example 2.** The facts are the same as in Example 1, except that Bill used \$25,000 of the loan proceeds to **improve his home** and \$75,000 to repay his existing mortgage. Bill deducts 25%  $(\$25,000 \div \$100,000)$  of the \$2,000 prepaid interest in 1997. His deduction is \$500  $(\$2,000 \times 25\%)$ .

Additionally, in 1997, Bill deducts the ratable part of the remaining \$1,500  $(\$2,000 - \$500)$  prepaid interest that must be spread over the life of the loan. This is \$50  $(\$1,500 \div 180 \text{ months}) \times 6 \text{ payments}$ . The total

Figure B. **Are My Points Fully Deductible This Year?**



\* 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.

amount deductible in 1997, on line 12, Schedule A, is \$550 (\$500 + \$50).

**Limits on deduction.** You cannot fully deduct points paid on a mortgage that exceeds the limits discussed in *Part II*. See the *Table 1 Instructions* for line 10 in *Part II*.

**Form 1098.** The mortgage interest statement you receive should show not only the total interest paid during the year, but also your deductible points. See *Mortgage Interest Statement*, next.

## Mortgage Interest Statement

If you paid \$600 or more of mortgage interest (including certain points) during the year on any one mortgage, you generally will receive a **Form 1098**, *Mortgage Interest Statement*, or a similar statement. You will receive the statement if you pay interest to a person (including a financial institution or cooperative housing corporation) in the course of that person's trade or business. A governmental unit is a person for purposes of furnishing the statement.

You should receive the statement by February 2, 1998. The mortgage interest information will also be sent to the IRS.

The statement will show the total interest you paid during the year. If you purchased a main home during the year, it also will show the deductible points paid during the year, including seller-paid points. However, it should not show any interest that was paid for you by a government agency.

As a general rule, Form 1098 will include only points that you can fully deduct in the year paid. However, certain points not included on Form 1098 also may be deductible, either in the year paid or over the life of the loan. See the earlier discussion of *Points* to determine whether you can deduct points not shown on Form 1098.

**Prepaid interest on Form 1098.** If you prepaid interest in 1997 that accrued in full by January 15, 1998, this prepaid interest may be included in box 1 of Form 1098. However, even though the prepaid amount may be included in box 1, you cannot deduct the prepaid amount in 1997. (See *Prepaid interest*, earlier.) You will have to figure the interest that accrued for 1998 and subtract it from the amount in box 1. You will include the interest for 1998 with other interest you pay for 1998.

**Refunded interest.** If you received a refund of interest you overpaid in an earlier year, you generally will receive a Form 1098 showing the refund in box 3. See *Refunds of interest*, earlier.

## How To Report

Deduct the interest and points reported to you on Form 1098 on line 10, Schedule A (Form 1040). If you paid more deductible interest to the financial institution than the amount shown on Form 1098, show the larger deductible amount on line 10. Attach a statement explaining the difference and write "See attached" next to line 10.

Deduct home mortgage interest that was **not** reported to you on Form 1098 on line 11 of Schedule A (Form 1040). If you paid home mortgage interest to the person from whom you bought your home, show that person's name, address, and social security number

(SSN) or employer identification number (EIN) on the dotted lines next to line 11. The seller must give you this number and you must give the seller your SSN. Failure to meet any of these requirements may result in a \$50 penalty for each failure.

If you can take a deduction for points that were **not** reported to you on Form 1098, deduct those points on line 12 of Schedule A (Form 1040).

**Mortgage proceeds used for business or investment.** If your home mortgage interest deduction is limited under the rules explained in *Part II*, but all or part of the mortgage proceeds were used for business or investment activities, see *Table 2* near the end of this publication. It shows where to deduct the part of your excess interest that is for those activities. The instructions in *Part II* for line 13 of *Table 1* explain how to divide the excess interest among the activities for which the mortgage proceeds were used.

**More than one borrower.** If you and at least one other person (other than your spouse if you file a joint return) were liable for, and paid, interest on a mortgage that was for your home and the other person received a Form 1098 showing the interest that was paid during the year, attach a statement to your return explaining this. Show how much of the interest each of you paid, and give the name and address of the person who received the form. Deduct your share of the interest on line 11, Schedule A, and write "See attached" next to line 11.

Similarly, if you are the payer of record on a mortgage on which there are other borrowers entitled to a deduction for the interest shown on the Form 1098 you received, deduct only your share of the interest on line 10, Schedule A. You should tell each of the other borrowers what their share is.

## Special Rule for Tenant-Stockholders in Cooperative Housing Corporations

A qualified home includes stock in a cooperative housing corporation owned by a tenant-stockholder. This applies only if the tenant-stockholder is entitled to live in the house or apartment because of owning stock in the cooperative.

**Cooperative housing corporation.** This is a corporation that meets all of the following conditions.

- 1) The corporation has only one class of stock outstanding.
- 2) Each of the stockholders, only because of owning the stock, can live in a house, apartment, or house trailer owned or leased by the corporation.
- 3) No stockholder can receive any distribution out of capital, except on a partial or complete liquidation of the corporation.
- 4) The tenant-stockholders must pay at least 80% of the corporation's gross income for the tax year. For this purpose, gross income means all income received during the entire tax year, including any received before the corporation changed to cooperative ownership.

**Stock used to secure debt.** In some cases, you cannot use your cooperative housing stock to secure a debt because of either:

- 1) Restrictions under local or state law, or
- 2) Restrictions in the cooperative agreement (other than restrictions in which the main purpose is to permit the tenant-stockholder to treat unsecured debt as secured debt).

However, you can treat a debt as secured by the stock to the extent that the proceeds are used to buy the stock under the allocation of interest rules. See chapter 8 of Publication 535 for details on these rules.

**Figuring deductible home mortgage interest.** Generally, if you are a tenant-stockholder, you can deduct payments you make for your share of the interest paid or incurred by the cooperative. The interest must be on a debt to buy, build, change, improve, or maintain the cooperative's housing, or on a debt to buy the land.

Figure your share of this interest by multiplying the total by the following fraction.

$$\frac{\text{Your shares of stock in the cooperative}}{\text{The total shares of stock in the cooperative}}$$

**Limits on deduction.** To figure how the limits discussed in *Part II* apply to you, treat your share of the cooperative's debt as debt incurred by you. The cooperative should determine your share of its grandfathered debt, its home acquisition debt, and its home equity debt. Your share of each of these types of debt is equal to the average balance of each debt multiplied by the fraction just given.

In determining the cooperative's home acquisition debt, a debt taken out to buy, build, or improve any nonresidential part of the property does not qualify. Also, in determining the fair market value of the residential property, the fair market value of any nonresidential part does not qualify.

After your share of the average balance of each type of debt is determined, include it with the average balance of that type of debt secured by your stock.

**Form 1098.** The cooperative should give you a Form 1098 showing your share of the interest. Use the rules in this publication to determine your deductible mortgage interest.

**Example.** Jeanne owns 20 shares in a cooperative, in which the total shares are 2,000. The cooperative took out a debt on January 1, 1997, with a principal balance of \$2 million. The cooperative made no principal payments in 1997, but it did pay \$200,000 interest on the debt.

By the end of 1997, the cooperative used the debt proceeds in the following manner.

- 1) \$500,000 to install a swimming pool for the use of all the residents.
- 2) \$1.4 million to make improvements to commercial space rented to tenants.
- 3) \$100,000 for maintenance costs.

The amount of the cooperative's home acquisition debt is \$500,000. Jeanne's share is \$5,000 ( $\$500,000 \times (20/2,000)$ ).

The amount of the cooperative's home equity debt is \$1.5 million (\$1.4 million +

\$100,000). Jeanne's share is \$15,000 ( $\$1.5 \text{ million} \times (20/2,000)$ ).

Jeanne is treated as having paid \$2,000 of interest during 1997 on the cooperative's debt ( $\$200,000 \times (20/2,000)$ ).

Jeanne also took out a home acquisition debt to buy her shares in the cooperative. Her average balance for 1997 was \$40,000.

Jeanne's home acquisition debt ( $\$5,000 + \$40,000 = \$45,000$ ) totaled less than \$1 million (the dollar limit that applies to these mortgages), and her home equity debt (\$15,000) is less than \$100,000 (the dollar limit that applies to these mortgages). Therefore, all of her home mortgage interest is deductible.

## Part II: Limits on Home Mortgage Interest Deduction

This part of the publication discusses the limits on deductible home mortgage interest. These limits apply to your home mortgage interest expense if you have a home mortgage that does not fit into any of the three categories listed at the beginning of *Part I* under *Fully deductible interest*.

Your home mortgage interest deduction is limited to the interest on the part of your home mortgage debt that is not more than your qualified loan limit. This is the part of your home mortgage debt that is grandfathered debt or that is not more than the limits for home acquisition debt and home equity debt. You may use *Table 1*, later, to figure your qualified loan limit and your deductible home mortgage interest.

### Home Acquisition Debt

Home acquisition debt is a mortgage you took out after October 13, 1987, to buy, build, or substantially improve a qualified home (your main or second home). It also must be secured by that home.

If the amount of your mortgage is more than the cost of the home plus the cost of any substantial improvements, only the debt that is not more than the cost of the home plus improvements qualifies as home acquisition debt. The additional debt may qualify as home equity debt (discussed later).

**Home acquisition debt limit.** The total home acquisition debt you can have at any time on your main home and second home cannot be more than \$1 million (\$500,000 if married filing separately). This limit is reduced (but not below zero) by the amount of your grandfathered debt (discussed later). Debt over this limit may qualify as home equity debt (also discussed later).

**Refinanced home acquisition debt.** Any secured debt you use to refinance home acquisition debt is treated as home acquisition debt. However, the new debt will qualify as home acquisition debt only up to the amount of the balance of the old mortgage principal

just before the refinancing. Any additional debt is not home acquisition debt, but may qualify as home equity debt (discussed later).

**Mortgage that qualifies later.** A mortgage that does not qualify as home acquisition debt because it does not meet all the requirements may qualify at a later time. For example, a debt that you use to buy your home may not qualify as home acquisition debt because it is not secured by the home. However, if the debt is later secured by the home, it may qualify as home acquisition debt after that time. Similarly, a debt that you use to buy property may not qualify because the property is not a qualified home. However, if the property later becomes a qualified home, the debt may qualify after that time.

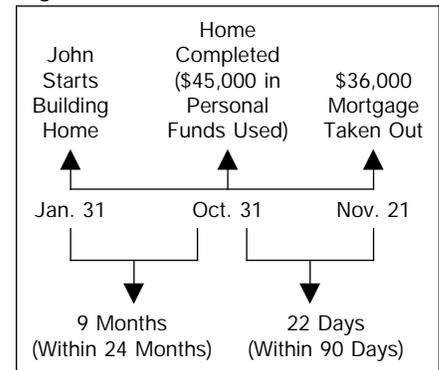
**Mortgage treated as used to buy, build, or improve home.** A mortgage secured by a qualified home may be treated as home acquisition debt, even if you do not actually use the proceeds to buy, build, or substantially improve the home, in the following situations.

- 1) You buy your home within 90 days before or after the date you take out the mortgage. The home acquisition debt is limited to the home's cost, plus the cost of any substantial improvements within the limit described below in (2) or (3).
- 2) You build or improve your home and take out the mortgage before the work is completed. The home acquisition debt is limited to the amount of the expenses incurred within 24 months before the date of the mortgage.
- 3) You build or improve your home and take out the mortgage within 90 days after the work is completed. The home acquisition debt is limited to the amount of the expenses incurred within the period beginning 24 months before the work is completed and ending on the date of the mortgage.

**Example 1.** You bought your main home on June 3 for \$175,000. You paid for the home with cash you got from the sale of your old home. On July 15, you took out a mortgage of \$150,000 secured by your main home. You used the \$150,000 to invest in stocks. You can treat the mortgage as taken out to buy your home because you bought the home within 90 days before you took out the mortgage. The entire mortgage qualifies as home acquisition debt because it was not more than the home's cost.

**Example 2.** On January 31, John began building a home on the lot that he owned. He used \$45,000 of his personal funds to build the home. The home was completed on October 31. John took out a mortgage of \$36,000, on November 21, that was secured by the home. The mortgage can be treated as used to build the home because it was taken out within 90 days after the home was completed. The entire mortgage qualifies as home acquisition debt because it was not more than the expenses incurred within the period beginning 24 months before the home was completed. *Figure C* illustrates this.

Figure C.



**Date of the mortgage.** The date you take out your mortgage is the day you receive the loan proceeds, generally the closing date. You can treat the day you apply in writing for your mortgage as the date you take it out. However, this applies only if you receive the loan proceeds within 30 days after your application is approved. If an application you make within the 90-day period is rejected, a reasonable additional time will be allowed to make a new application.

**Cost of home or improvements.** To determine your cost, include amounts paid to acquire any interest in a qualified home or to substantially improve the home.

The cost of building or substantially improving a qualified home includes the costs to acquire real property and building materials, fees for architects and design plans, and required building permits.

**Substantial improvement.** An improvement is substantial if it:

- 1) Adds to the value of your home,
- 2) Prolongs your home's useful life, or
- 3) Adapts your home to new uses.

Repairs that maintain your home in good condition, such as repainting your home, are not substantial improvements. However, if you paint your home as part of a renovation that substantially improves your qualified home, you can include the painting costs in the cost of the improvements.

**Acquiring an interest in a home because of a divorce.** Cost includes amounts spent to acquire the interest of a spouse or former spouse in a home, because of a divorce or legal separation.

**Part of home not a qualified home.** To figure your home acquisition debt, you must divide the cost of your home and improvements between the part of your home that is a qualified home and any part that is not a qualified home. See *Divided use of your home* under *Qualified Home* in *Part I*.

### Home Equity Debt

If you took out a loan for reasons other than to buy, build, or substantially improve your home, it may qualify as home equity debt. In addition, debt you incurred to buy, build, or substantially improve your home, to the extent it is more than the home acquisition debt limit, may qualify as home equity debt.

Home equity debt is a mortgage you took out after October 13, 1987. It is a debt, other than grandfathered debt, discussed later, or

home acquisition debt, that is secured by your qualified home.

**Example.** You bought your home for cash 10 years ago. You did not have a mortgage on your home until last year, when you took out a \$20,000 loan, secured by your home, to pay for your daughter's college tuition and your father's medical bills. This loan is home equity debt.

**Home equity debt limit.** There is a limit on the amount of debt that can be treated as home equity debt. The total home equity debt on your main home and second home is limited to the **smaller** of:

- 1) \$100,000 (\$50,000 if married filing separately), or
- 2) The total of each home's fair market value (FMV) reduced (but not below zero) by the amount of its home acquisition debt and grandfathered debt. Determine the FMV and the outstanding home acquisition and grandfathered debt for each home on the date that the last debt was secured by the home.

Interest on amounts over the home equity debt limit generally is treated as personal interest and is not deductible. But if the proceeds of the loan were used for investment or business purposes, the interest may be deductible. See the instructions for line 13 of *Table 1*, later, for an explanation of how to allocate the excess interest.

**Part of home not a qualified home.** To figure the limit on your home equity debt, you must divide the FMV of your home between the part that is a qualified home and any part that is not a qualified home. See *Divided use of your home* under *Qualified Home* in *Part 1*.

**Fair market value.** This is the price at which the home would change hands between you and a buyer, neither having to sell or buy, and both having reasonable knowledge of all necessary facts. Sales of similar homes in your area, on about the same date your last debt was secured by the home, may be helpful in figuring the FMV.

## Grandfathered Debt

If you took out a mortgage on your home before October 14, 1987, or you refinanced such a mortgage, it may qualify as grandfathered debt. To qualify, it must have been secured by your qualified home on October 13, 1987, and at all times after that date. How you used the proceeds does not matter.

Grandfathered debt is not limited. All of the interest you paid on grandfathered debt is fully deductible home mortgage interest. However, the amount of your grandfathered debt reduces the \$1 million limit for home acquisition debt and the limit based on your home's fair market value for home equity debt.

**Refinanced grandfathered debt.** If you refinanced grandfathered debt after October 13, 1987, for an amount that was not more than the mortgage principal left on the debt, then you still treat it as grandfathered debt. To the extent the new debt is more than that mortgage principal, it is treated as home acquisition or home equity debt, and the mortgage is a mixed-use mortgage (discussed later under *Average Mortgage Balance* in the *Table 1 Instructions*).

The debt must be secured by the qualified home.

You treat grandfathered debt that was refinanced after October 13, 1987, as grandfathered debt only for the term left on the debt that was refinanced. After that, you treat it as home acquisition debt or home equity debt, depending on how you used the proceeds.

**Exception.** If the debt before refinancing was like a balloon note (the principal on the debt was not amortized over the term of the debt), then you treat the refinanced debt as grandfathered debt for the term of the first refinancing. This term cannot be more than 30 years.

**Example.** Chester took out a \$200,000 first mortgage on his home in 1985. The mortgage was a five-year balloon note and the entire balance on the note was due in 1990. Chester refinanced the debt in 1990 with a new 20-year mortgage. The refinanced debt is treated as grandfathered debt for its entire term (20 years).

**Line-of-credit mortgage.** If you had a line-of-credit mortgage on October 13, 1987, and borrowed additional amounts against it after that date, then the additional amounts are either home acquisition debt or home equity debt depending on how you used the proceeds. The balance on the mortgage before you borrowed the additional amounts is grandfathered debt. The newly borrowed amounts are not grandfathered debt because the funds were borrowed after October 13, 1987. See *Mixed-use mortgages* under *Average Mortgage Balance* in the *Table 1 Instructions*, next.

## Table 1 Instructions

You can deduct **all** of the interest you paid during the year on mortgages secured by your main home or second home if either:

- 1) All the mortgages are grandfathered debt, or
- 2) The total of the mortgage balances is within the limits discussed earlier under *Home Acquisition Debt* and *Home Equity Debt* for the entire year.

In either of those cases, you do not need *Table 1*. Otherwise, you may use *Table 1* to determine your qualified loan limit and deductible home mortgage interest.

Fill out only one *Table 1*, for both your main and second home, regardless of how many mortgages you have.

**Home equity debt only.** If all of your mortgages are home equity debt, do not fill in lines 1 through 5. Enter zero on line 6 and complete the rest of the worksheet.

## Average Mortgage Balance

You have to figure the average balance of each mortgage to determine your qualified loan limit. You need these amounts to complete lines 1, 2, and 9 of the worksheet. You can use the highest mortgage balances during the year to complete the worksheet, but you may benefit most by using the average balances. The following are methods you can use to figure your average mortgage balances. However, if a mortgage has more than one category of debt, see *Mixed-use mortgages* later in this section.

**Average of first and last balance method.** You can use this method if all the following apply.

- 1) You did not borrow any new amounts on the mortgage during the year. (This does not include borrowing the original mortgage amount.)
- 2) You did not prepay more than one month's principal during the year. (This includes prepayment by refinancing your home or by applying proceeds from its sale.)
- 3) You had to make level payments at fixed equal intervals on at least a semi-annual basis. You treat your payments as level even if they were adjusted from time to time because of changes in the interest rate.



To figure your average balance, complete the following worksheet.

1. Enter the balance as of the first day that the mortgage was secured by your qualified home during the year (generally January 1) .....
2. Enter the balance as of the last day that the mortgage was secured by your qualified home during the year (generally December 31) .....
3. Add amounts on lines 1 and 2 .....
4. Divide the amount on line 3 by 2. Enter the result .....

**Interest paid divided by interest rate method.** You can use this method if at all times in 1997 the mortgage was secured by your qualified home and the interest was paid at least monthly.



Complete the following worksheet to figure your average balance.

1. Enter the interest paid in 1997. Do not include points or any other interest paid in 1997 that is for a year after 1997. However, do include interest that is for 1997 but was paid in an earlier year ...
2. Enter the annual interest rate on the mortgage. If the interest rate varied in 1997, use the lowest rate for the year .
3. Divide the amount on line 1 by the amount on line 2. Enter the result .....

**Example.** Mr. Blue had a line of credit secured by his main home all year. He paid interest of \$2,500 on this loan. The interest rate on the loan was 9% (.09) all year. His average balance using this method is \$27,778, figured as follows:

1. Enter the interest paid in 1997. Do not include points or any other interest paid in 1997 that is for a year after 1997. However, do include interest that is for 1997 but was paid in an earlier year ... \$2,500
2. Enter the annual interest rate on the mortgage. If the interest rate varied in 1997, use the lowest rate for the year . .09
3. Divide the amount on line 1 by the amount on line 2. Enter the result ..... \$27,778

**Statements provided by your lender.** If you receive monthly statements showing the closing balance or the average balance for the month, you can use either to figure your average balance. You can treat the balance as zero for any month the mortgage was not secured by your qualified home.

Table 1. **Worksheet To Figure Your Qualified Loan Limit and Deductible Home Mortgage Interest**

(Keep for your records.) See the **Table 1 Instructions** in this publication.



Part I Qualified Loan Limit			
1	Enter the average balance for 1997 of all your grandfathered debt. See line 1 instructions . . . . .	1	
2	Enter the average balance for 1997 of all your home acquisition debt. See line 2 instructions . . . . .	2	
3	Enter \$1,000,000 (\$500,000 if married filing separately) . . . . .	3	
4	Enter the <b>larger of</b> the amount on line 1 or the amount on line 3 . . . . .	4	
5	Add the amounts on lines 1 and 2. Enter the total here . . . . .	5	
6	Enter the <b>smaller of</b> the amount on line 4 or the amount on line 5 . . . . .	6	
7	Enter \$100,000 (\$50,000 if married filing separately). See line 7 instructions for a limit that may apply . . . . .	7	
8	Add the amounts on lines 6 and 7. Enter the total. This is your qualified loan limit . . . . .	8	

Part II Deductible Home Mortgage Interest			
9	Enter the total of the average balances for 1997 of all mortgages on <b>all</b> qualified homes. See line 9 instructions . . . . .	9	
	<ul style="list-style-type: none"> <li>• If line 8 is less than line 9, GO ON to line 10.</li> <li>• If line 8 is equal to or more than line 9, STOP HERE. All of your interest on all the mortgages included on line 9 is deductible as home mortgage interest on Schedule A (Form 1040), line 10 or 11, whichever applies.</li> </ul>		
10	Enter the total amount of interest that you paid in 1997. See line 10 instructions . . . . .	10	
11	Divide the amount on line 8 by the amount on line 9. Enter the result as a decimal amount (rounded to three places) . . . . .	11	×
12	Multiply the amount on line 10 by the decimal amount on line 11. Enter the result. This is your <b>deductible home mortgage interest</b> . Enter this amount on Schedule A (Form 1040), line 10 or 11, whichever applies . . . . .	12	
13	Subtract the amount on line 12 from the amount on line 10. Enter the result. This is <b>not home mortgage interest</b> . See line 13 instructions . . . . .	13	

For each mortgage, figure your average balance by adding your monthly closing or average balances and dividing that total by the number of months the home secured by that mortgage was a qualified home during the year.

If your lender can give you your average balance for the year, you can use that amount.

**Example.** Ms. Brown had a home equity loan secured by her main home all year. She received monthly statements showing her average balance for each month. She may figure her average balance for the year by adding her monthly average balances and dividing the total by 12.

**Mixed-use mortgages.** A mixed-use mortgage is a loan that consists of more than one of the three categories of debt (grandfathered debt, home acquisition debt, and home equity debt). For example, a mortgage you took out during the year is a mixed-use mortgage if you used its proceeds partly to refinance a mortgage that you took out in an earlier year to buy your home (home acquisition debt) and partly to pay your son's college tuition (home equity debt).

Complete lines 1 and 2 of *Table 1* by including the separate average balances of any grandfathered debt and home acquisition debt in your mixed-use mortgage. Do not use

the methods described earlier in this section to figure the average balance of either category. Instead, for each category, use the following method.

- 1) Figure the balance of that category of debt for each month. This is the amount of the loan proceeds allocated to that category, reduced by your principal payments on the mortgage previously applied to that category. Principal payments on a mixed-use mortgage are applied in full to each category of debt, until its balance is zero, in the following order:
  - a) First, any home equity debt,
  - b) Next, any grandfathered debt, and
  - c) Finally, any home acquisition debt.
- 2) Add together the monthly balances figured in (1).
- 3) Divide the result in (2) by 12.

Complete line 9 of *Table 1* by including the average balance of the entire mixed-use mortgage, figured under one of the methods described earlier in this section.

**Example 1.** In 1986, Sharon took out a \$1,400,000 mortgage to buy her main home (grandfathered debt). On March 1, 1997,

when the home had a fair market value of \$1,700,000 and she owed \$1,100,000 on the mortgage, Sharon took out a second mortgage for \$200,000. She used \$180,000 of the proceeds to make substantial improvements to her home (home acquisition debt) and the remaining \$20,000 to buy a car (home equity debt). Under the loan agreement, Sharon must make principal payments of \$1,000 at the end of each month. During 1997, her principal payments on the second mortgage totaled \$10,000.

To complete line 2 of *Table 1*, Sharon must figure a separate average balance for the part of her second mortgage that is home acquisition debt. The January and February balances were zero. The March through December balances were all \$180,000, because none of her principal payments are applied to the home acquisition debt. (They are all applied to the home equity debt, reducing it to \$10,000 (\$20,000 – \$10,000).) The monthly balances of the home acquisition debt total \$1,800,000 (\$180,000 × 10). Therefore, the average balance of the home acquisition debt for 1997 was \$150,000 (\$1,800,000 ÷ 12).

**Example 2.** The facts are the same as in *Example 1*. In 1998, Sharon's January through October principal payments on her second mortgage are applied to the home equity debt, reducing it to zero. The balance of the home acquisition debt remains

\$180,000 for each of those months. Because her November and December principal payments are applied to the home acquisition debt, the November balance is \$179,000 (\$180,000 – \$1,000) and the December balance is \$178,000 (\$180,000 – \$2,000). The monthly balances total \$2,157,000 (((\$180,000 × 10) + \$179,000 + \$178,000)). Therefore, the average balance of the home acquisition debt for 1998 is \$179,750 (\$2,157,000 ÷ 12).

### Line 1

Figure the average balance for 1997 of each mortgage you had on all qualified homes on October 13, 1987 (grandfathered debt). Add the results together and enter the total on line 1. Include the average balance for 1997 for any grandfathered debt part of a mixed-use mortgage.

### Line 2

Figure the average balance for 1997 of each mortgage you took out on all qualified homes after October 13, 1987, to buy, build, or substantially improve the home (home acquisition debt). Add the results together and enter the total on line 2. Include the average balance for 1997 for any home acquisition debt part of a mixed-use mortgage.

### Line 7

The amount on line 7 cannot be more than the **smaller** of:

- 1) \$100,000 (\$50,000 if married filing separately), or
- 2) The total of each home's fair market value (FMV) reduced (but not below zero) by the amount of its home acquisition debt and grandfathered debt. Determine the FMV and the outstanding home acquisition and grandfathered debt for each home on the date that the last debt was secured by the home.

See *Home equity debt limit* under *Home Equity Debt*, earlier, for more information about fair market value.

### Line 9

Figure the average balance for 1997 of each outstanding home mortgage. Add the average balances together and enter the total on line 9. See *Average Mortgage Balance*, earlier. **Note:** When figuring the average balance of a mixed-use mortgage, for line 9 determine the average balance of the entire mortgage.

### Line 10

If you make payments to a financial institution, or to a person whose business is making loans, you should get Form 1098, *Mortgage Interest Statement*, or a similar statement from the lender. This form will show the amount of interest to enter on line 10 of the worksheet. Also include on this line any other interest payments made on debts secured by a qualified home for which you did not receive a Form 1098. Do not include points on this line.

**Claiming your deductible points.** Figure your deductible points as follows.

- 1) Figure your deductible points for 1997 using the rules explained under *Points* in *Part I*.

- 2) Multiply the amount in item (1) by the decimal amount on line 11 of the worksheet. Enter the result on Schedule A (Form 1040), line 10 or 12, whichever applies. This amount is fully deductible.
- 3) Subtract the amount in item (2) from the amount in item (1). This amount is not deductible as home mortgage interest. However, if you used any of the loan proceeds for business or investment activities, see the instructions for line 13 of the worksheet, next.

### Line 13

You **cannot** deduct the amount of interest on line 13 of the worksheet as home mortgage interest. If you did not use any of the proceeds of any mortgage included on line 9 of the worksheet for business or investment activities, then all the interest on line 13 is personal interest. Personal interest is not deductible.

If you did use all or part of any mortgage proceeds for business or investment activities, the part of the interest on line 13 that is allocable to those activities may be deducted as business or investment expense, subject to any limits that apply. *Table 2* in this publication shows where to deduct that interest. See *Allocation of Interest* in chapter 8 of Publication 535, *Business Expenses*, for an explanation of how to determine the use of loan proceeds.

The following two rules describe how to allocate the interest on line 13 to a business or investment activity.

- 1) If you used all of the proceeds of the mortgages on line 9 for one activity, then all the interest on line 13 is allocated to that activity. In this case, deduct the interest on the form or schedule to which it applies.
- 2) If you used the proceeds of the mortgages on line 9 for more than one activity, then you can allocate the interest on line 13 among the activities in any manner you select (up to the total amount of interest otherwise allocable to each activity, explained next).

You figure the "total amount of interest otherwise allocable to each activity" by multiplying the amount on line 10 of the worksheet by the following fraction.

$$\frac{\text{Amount on line 9 of the worksheet allocated to that activity}}{\text{Total amount on line 9}}$$

**Example.** Don had two mortgages (A and B) on his main home during the entire year. Mortgage A had an average balance of \$90,000, and mortgage B had an average balance of \$110,000.

Don determines that the proceeds of mortgage A are allocable to personal expenses for the entire year. The proceeds of mortgage B are allocable to his business for the entire year. Don paid \$14,000 of interest on mortgage A and \$16,000 of interest on mortgage B. He figures the amount of home mortgage interest he can deduct by using *Table 1*. Since both mortgages are home equity debt, Don determines that \$15,000 of the interest can be deducted as home mortgage interest.

The interest Don can allocate to his business is the **smaller** of:

- 1) The amount on line 13 of the worksheet (\$15,000), or
- 2) The total amount of interest allocable to the business (\$16,500), figured by multiplying the amount on line 10 (the \$30,000 total interest paid) by the following fraction.

$$\frac{\$110,000 \text{ (the average balance of the mortgage allocated to the business)}}{\$200,000 \text{ (the total average balance of all mortgages—line 9 of the worksheet)}}$$

Because \$15,000 is the smaller of items (1) and (2), that is the amount of interest Don can allocate to his business. He deducts this amount on his Schedule C (Form 1040).

**Table 2. Where To Deduct Your Interest**

Type of interest	Where to deduct	Where to find information
Deductible home mortgage interest and points reported on Form 1098	Schedule A (Form 1040), line 10	Publication 936
Deductible home mortgage interest <i>not</i> reported on Form 1098	Schedule A (Form 1040), line 11	Publication 936
Points <i>not</i> reported on Form 1098	Schedule A (Form 1040), line 12	Publication 936
Investment interest (other than incurred to produce rents or royalties)	Schedule A (Form 1040), line 13	Publication 550
Business interest (non-farm)	Schedule C or C-EZ (Form 1040)	Publication 535
Farm business interest	Schedule F (Form 1040)	Publications 225 and 535
Interest incurred to produce rents or royalties	Schedule E (Form 1040)	Publications 527 and 535
Personal interest	Not deductible	

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## How To Get More Information



You can get help from the IRS in several ways.

**Free publications and forms.** To order free publications and forms, call 1-800-TAX-FORM (1-800-829-3676). You can also write to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. Your local library or post office also may have the items you need.

For a list of free tax publications, order Publication 910, *Guide to Free Tax Services*.

It also contains an index of tax topics and related publications and describes other free tax information services available from IRS, including tax education and assistance programs.

If you have access to a personal computer and modem, you also can get many forms and publications electronically. See *Quick and Easy Access to Tax Help and Forms* in your income tax package for details.

**Tax questions.** You can call the IRS with your tax questions. Check your income tax package or telephone book for the local number, or you can call 1-800-829-1040.

**TTY/TDD equipment.** If you have access to TTY/TDD equipment, you can call 1-800-829-4059 to ask tax questions or to order forms and publications. See your income tax package for the hours of operation.

**Evaluating the quality of our telephone services.** To ensure that IRS representatives give accurate, courteous, and professional answers, we evaluate the quality of our "800 number" telephone services in several ways.

- A second IRS representative sometimes monitors live telephone calls. That person only evaluates the IRS assistor and does not keep a record of any taxpayer's name or tax identification number.
- We sometimes record telephone calls to evaluate IRS assistors objectively. We hold these recordings no longer than one week and use them only to measure the quality of assistance.
- We value our customers' opinions. Throughout this year, we will be surveying our customers for their opinions on our service.



## Tax Publications for Individual Taxpayers

### General Guides

- 1 Your Rights as a Taxpayer
- 17 Your Federal Income Tax (For Individuals)
- 225 Farmer's Tax Guide
- 334 Tax Guide for Small Business
- 509 Tax Calendars for 1998
- 553 Highlights of 1997 Tax Changes
- 595 Tax Highlights for Commercial Fishermen
- 910 Guide to Free Tax Services

### Specialized Publications

- 3 Armed Forces' Tax Guide
- 378 Fuel Tax Credits and Refunds
- 463 Travel, Entertainment, Gift, and Car Expenses
- 501 Exemptions, Standard Deduction, and Filing Information
- 502 Medical and Dental Expenses
- 503 Child and Dependent Care Expenses
- 504 Divorced or Separated Individuals
- 505 Tax Withholding and Estimated Tax
- 508 Educational Expenses
- 514 Foreign Tax Credit for Individuals
- 516 U.S. Government Civilian Employees Stationed Abroad
- 517 Social Security and Other Information for Members of the Clergy and Religious Workers
- 519 U.S. Tax Guide for Aliens
- 520 Scholarships and Fellowships
- 521 Moving Expenses
- 523 Selling Your Home
- 524 Credit for the Elderly or the Disabled
- 525 Taxable and Nontaxable Income
- 526 Charitable Contributions
- 527 Residential Rental Property
- 529 Miscellaneous Deductions

- 530 Tax Information for First-Time Homeowners
- 531 Reporting Tip Income
- 533 Self-Employment Tax
- 534 Depreciating Property Placed in Service Before 1987
- 537 Installment Sales
- 541 Partnerships
- 544 Sales and Other Dispositions of Assets
- 547 Casualties, Disasters, and Thefts (Business and Nonbusiness)
- 550 Investment Income and Expenses
- 551 Basis of Assets
- 552 Recordkeeping for Individuals
- 554 Older Americans' Tax Guide
- 555 Federal Tax Information on Community Property
- 556 Examination of Returns, Appeal Rights, and Claims for Refund
- 559 Survivors, Executors, and Administrators
- 561 Determining the Value of Donated Property
- 564 Mutual Fund Distributions
- 570 Tax Guide for Individuals With Income From U.S. Possessions
- 575 Pension and Annuity Income
- 584 Nonbusiness Disaster, Casualty, and Theft Loss Workbook
- 587 Business Use of Your Home (Including Use by Day-Care Providers)
- 590 Individual Retirement Arrangements (IRAs) (Including SEP-IRAs and SIMPLE IRAs)
- 593 Tax Highlights for U.S. Citizens and Residents Going Abroad
- 594 Understanding the Collection Process
- 596 Earned Income Credit
- 721 Tax Guide to U.S. Civil Service Retirement Benefits

- 901 U.S. Tax Treaties
- 907 Tax Highlights for Persons with Disabilities
- 908 Bankruptcy Tax Guide
- 911 Direct Sellers
- 915 Social Security and Equivalent Railroad Retirement Benefits
- 919 Is My Withholding Correct for 1998?
- 925 Passive Activity and At-Risk Rules
- 926 Household Employer's Tax Guide
- 929 Tax Rules for Children and Dependents
- 936 Home Mortgage Interest Deduction
- 946 How To Depreciate Property
- 947 Practice Before the IRS and Power of Attorney
- 950 Introduction to Estate and Gift Taxes
- 967 IRS Will Figure Your Tax
- 968 Tax Benefits for Adoption
- 1542 Per Diem Rates
- 1544 Reporting Cash Payments of Over \$10,000
- 1546 The Problem Resolution Program of the Internal Revenue Service

### Spanish Language Publications

- 1SP Derechos del Contribuyente
- 579SP Cómo Preparar la Declaración de Impuesto Federal
- 594SP Comprendiendo el Proceso de Cobro
- 596SP Crédito por Ingreso del Trabajo
- 850 English-Spanish Glossary of Words and Phrases Used in Publications Issued by the Internal Revenue Service
- 1544SP Informe de Pagos en Efectivo en Exceso de \$10,000 (Recibidos en una Ocupación o Negocio)

## Commonly Used Tax Forms

- 1040 U.S. Individual Income Tax Return
  - Sch A Itemized Deductions
  - Sch B Interest and Dividend Income
  - Sch C Profit or Loss From Business
  - Sch C-EZ Net Profit From Business
  - Sch D Capital Gains and Losses
  - Sch E Supplemental Income and Loss
  - Sch EIC Earned Income Credit
  - Sch F Profit or Loss From Farming
  - Sch H Household Employment Taxes
  - Sch R Credit for the Elderly or the Disabled
  - Sch SE Self-Employment Tax
- 1040EZ Income Tax Return for Single and Joint Filers With No Dependents
- 1040A U.S. Individual Income Tax Return
  - Sch 1 Interest and Dividend Income for Form 1040A Filers

- Sch 2 Child and Dependent Care Expenses for Form 1040A Filers
- Sch 3 Credit for the Elderly or the Disabled for Form 1040A Filers
- 1040-ES Estimated Tax for Individuals
- 1040X Amended U.S. Individual Income Tax Return
- 2106 Employee Business Expenses
- 2106-EZ Unreimbursed Employee Business Expenses
- 2119 Sale of Your Home
- 2210 Underpayment of Estimated Tax by Individuals, Estates and Trusts
- 2441 Child and Dependent Care Expenses
- 2848 Power of Attorney and Declaration of Representative
- 3903 Moving Expenses
- 4562 Depreciation and Amortization

- 4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- 4952 Investment Interest Expense Deduction
- 5329 Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts
- 6251 Alternative Minimum Tax—Individuals
- 8283 Noncash Charitable Contributions
- 8582 Passive Activity Loss Limitations
- 8606 Nondeductible IRAs (Contributions, Distributions, and Basis)
- 8822 Change of Address
- 8829 Expenses for Business Use of Your Home

## Tax Publications for Business Taxpayers

### General Guides

- 1 Your Rights as a Taxpayer
- 17 Your Federal Income Tax (For Individuals)
- 225 Farmer's Tax Guide
- 334 Tax Guide for Small Business
- 509 Tax Calendars for 1998
- 553 Highlights of 1997 Tax Changes
- 595 Tax Highlights for Commercial Fishermen
- 910 Guide to Free Tax Services

### Employer's Guides

- 15 Employer's Tax Guide (Circular E)
- 15-A Employer's Supplemental Tax Guide
- 51 Agricultural Employer's Tax Guide (Circular A)
- 80 Federal Tax Guide For Employers in the Virgin Islands, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands (Circular SS)
- 179 Guía Contributiva Federal Para Patronos Puertorriqueños (Circular PR)
- 926 Household Employer's Tax Guide

### Specialized Publications

- 378 Fuel Tax Credits and Refunds

- 463 Travel, Entertainment, Gift, and Car Expenses
- 505 Tax Withholding and Estimated Tax
- 510 Excise Taxes for 1998
- 515 Withholding of Tax on Nonresident Aliens and Foreign Corporations
- 517 Social Security and Other Information for Members of the Clergy and Religious Workers
- 527 Residential Rental Property
- 533 Self-Employment Tax
- 534 Depreciating Property Placed in Service Before 1987
- 535 Business Expenses
- 536 Net Operating Losses
- 537 Installment Sales
- 538 Accounting Periods and Methods
- 541 Partnerships
- 542 Corporations
- 544 Sales and Other Dispositions of Assets
- 551 Basis of Assets
- 556 Examination of Returns, Appeal Rights, and Claims for Refund
- 560 Retirement Plans for Small Business (SEP, Keogh, and SIMPLE Plans)
- 561 Determining the Value of Donated Property
- 583 Starting a Business and Keeping Records
- 587 Business Use of Your Home (Including Use by Day-Care Providers)
- 594 Understanding the Collection Process

- 597 Information on the United States-Canada Income Tax Treaty
- 598 Tax on Unrelated Business Income of Exempt Organizations
- 686 Certification for Reduced Tax Rates in Tax Treaty Countries
- 901 U.S. Tax Treaties
- 908 Bankruptcy Tax Guide
- 911 Direct Sellers
- 925 Passive Activity and At-Risk Rules
- 946 How To Depreciate Property
- 947 Practice Before the IRS and Power of Attorney
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- 1544SP Informe de Pagos en Efectivo en Exceso de \$10,000 (Recibidos en una Ocupación o Negocio)

## Commonly Used Tax Forms

- W-2 Wage and Tax Statement
- W-4 Employee's Withholding Allowance Certificate
- 940 Employer's Annual Federal Unemployment (FUTA) Tax Return
- 940EZ Employer's Annual Federal Unemployment (FUTA) Tax Return
- 1040 U.S. Individual Income Tax Return
  - Sch A Itemized Deductions
  - Sch B Interest and Dividend Income
  - Sch C Profit or Loss From Business
  - Sch C-EZ Net Profit From Business
  - Sch D Capital Gains and Losses
  - Sch E Supplemental Income and Loss
  - Sch F Profit or Loss From Farming
  - Sch H Household Employment Taxes
  - Sch R Credit for the Elderly or the Disabled
  - Sch SE Self-Employment Tax
- 1040-ES Estimated Tax for Individuals
- 1040X Amended U.S. Individual Income Tax Return

- 1065 U.S. Partnership Return of Income
  - Sch D Capital Gains and Losses
  - Sch K-1 Partner's Share of Income, Credits, Deductions, etc.
- 1120 U.S. Corporation Income Tax Return
- 1120-A U.S. Corporation Short-Form Income Tax Return
- 1120S U.S. Income Tax Return for an S Corporation
  - Sch D Capital Gains and Losses and Built-In Gains
  - Sch K-1 Shareholder's Share of Income, Credits, Deductions, etc.
- 2106 Employee Business Expenses
- 2106-EZ Unreimbursed Employee Business Expenses
- 2210 Underpayment of Estimated Tax by Individuals, Estates, and Trusts
- 2441 Child and Dependent Care Expenses
- 2848 Power of Attorney and Declaration of Representative

- 3800 General Business Credit
- 3903 Moving Expenses
- 4562 Depreciation and Amortization
- 4797 Sales of Business Property
- 4868 Application for Automatic Extension of Time To File U.S. Individual Income Tax Return
- 5329 Additional Taxes Attributable to Qualified Retirement Plans (Including IRAs), Annuities, and Modified Endowment Contracts
- 6252 Installment Sale Income
- 8283 Noncash Charitable Contributions
- 8300 Report of Cash Payments Over \$10,000 Received in a Trade or Business
- 8582 Passive Activity Loss Limitations
- 8606 Nondeductible IRAs (Contributions, Distributions, and Basis)
- 8822 Change of Address
- 8829 Expenses for Business Use of Your Home