

Subject 404

Interest Expenses

Interest is an amount you pay for the use of borrowed money. To deduct interest you paid on a debt, you must have been legally liable for the debt and have actually paid the interest.

If you prepaid the interest, you must have spread the interest over the tax years to which it applies. Items you may deduct as interest include certain home mortgage interest and investment interest.

Personal interest, such as car loans and credit cards, is not deductible.

You may deduct points you paid to borrow money to buy your home if they charged only for the use of the money. However, points charged for specific services such as getting a Veteran's Administration loan, preparation costs for a mortgage note, settlement fees, or notary fees are not interest and cannot be deducted.

Other items you cannot deduct as interest include:

1. Points if you were a seller,
2. Service charges,
3. Loan fees,
4. Credit investigation fees,
5. Interest related to tax exempt income, or
6. To purchase or carry tax exempt securities.

Home equity debt is debt secured by a main or second home but not used to buy, build, or improve either home. Home equity debt can be deducted, but only if these mortgages totaled \$100,000 or less throughout the current tax year. The limit is \$50,000 if married filing separately.

A main home is the taxpayer's principal residence. It can include a residence that is used part of the year or a residence that is rented out. If the residence is rented out, it is subject to the use requirements relating to vacation homes. However, a dwelling unit may qualify even if it is neither used nor rented.