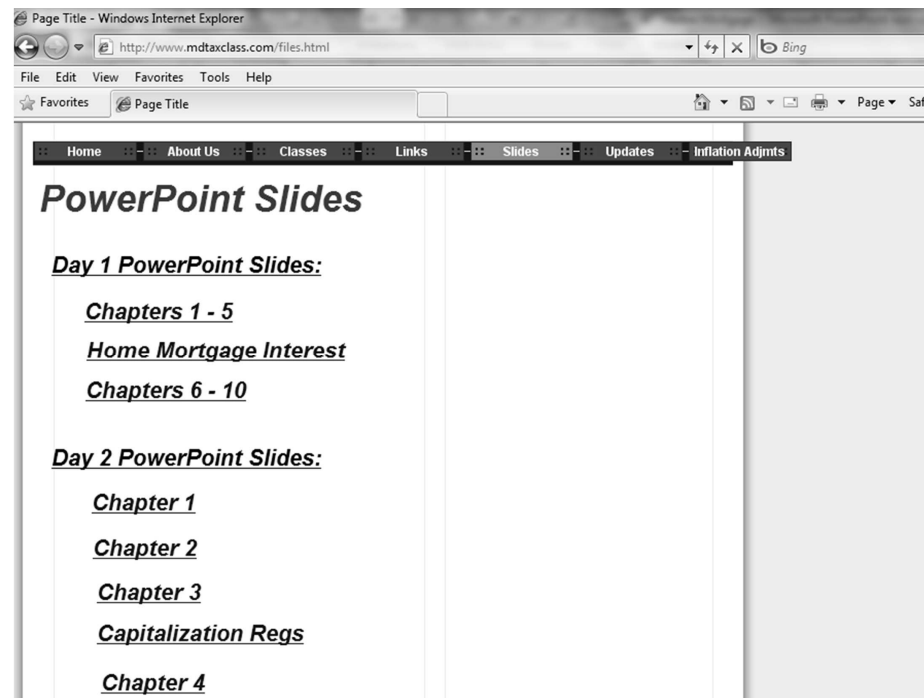


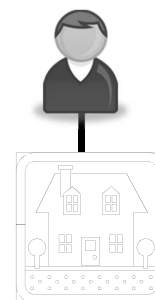
CCA 201201017

**Released
Jan 6, 2012**



CCA 201201017

**Clarification
of
Home Mortgage
Interest
Calculations**



\$1,200,000 - 1st (7%) 84,000

\$400,000 - 2nd (5%) \$20,000

Pub 936 Method: \$1.1 Million Limit Spread over All Mortgage Loans

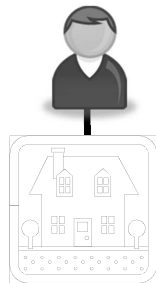
Pub 936 Method



1 st	\$1,200,000	\$84,000
2 nd	<u>\$400,000</u>	<u>\$20,000</u>
	\$1,600,000	\$104,000

1,100,000 / 1,600,000

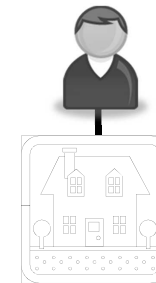
Pub 936 Method



1 st	\$1,200,000	\$84,000
2 nd	<u>\$400,000</u>	<u>\$20,000</u>
	\$1,600,000	\$104,000

1,100,000 / 1,600,000 = 68.75%

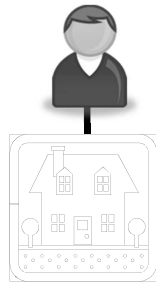
Pub 936 Method



1 st	\$1,200,000	\$84,000
2 nd	<u>\$400,000</u>	<u>\$20,000</u>
	\$1,600,000	\$104,000

1,100,000 / 1,600,000 = 68.75% x \$104,000

**Pub 936
Method**



1 st	\$1,200,000	\$84,000
2 nd	<u>\$400,000</u>	<u>\$20,000</u>
	\$1,600,000	\$104,000

$1,100,000 / 1,600,000 = 68.75\% \times \$104,000$
Home Mortgage Interest \$71,500

**However,
CCA 201201017
says . . .**

**Until
new regs
are issued. . .**

- Taxpayers may use “any reasonable method”, including:**
- the “exact method”
 - the “simplified method”
 - the Pub 936 method. . .
- or,***
- reasonable approximation of those methods.

CCA 201201017

Reg §1.163-10T
Methods
Can
Still be
Used

Reg §1.163-10T(d)
“Simplified Method”:

Similar to
Pub 936 Method
but Less
Favorable
Don't Use

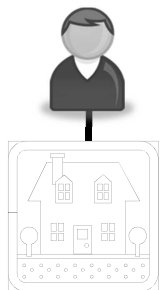
Reg §1.163-10T(e)
“Exact Method”:

Qualified Residence
Interest
Limit
Used on a
FIFO Basis

Reg §1.163-10T(e)
“Exact Method”:

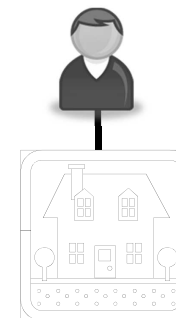
\$1.1 Million
Limit
Used on a
FIFO
Basis

“Exact Method”
Reg §1.163-10T(e)



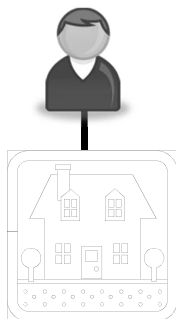
\$1,200,000 - 1st \$84,000
\$400,000 - 2nd \$20,000

“Exact Method”
FIFO



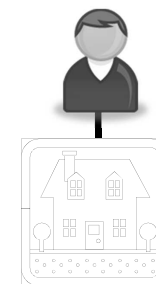
\$1,100,000 - 1st \$77,000
\$ 100,000 - 1st \$ 7,000
\$400,000 - 2nd \$20,000

“Exact Method”
FIFO



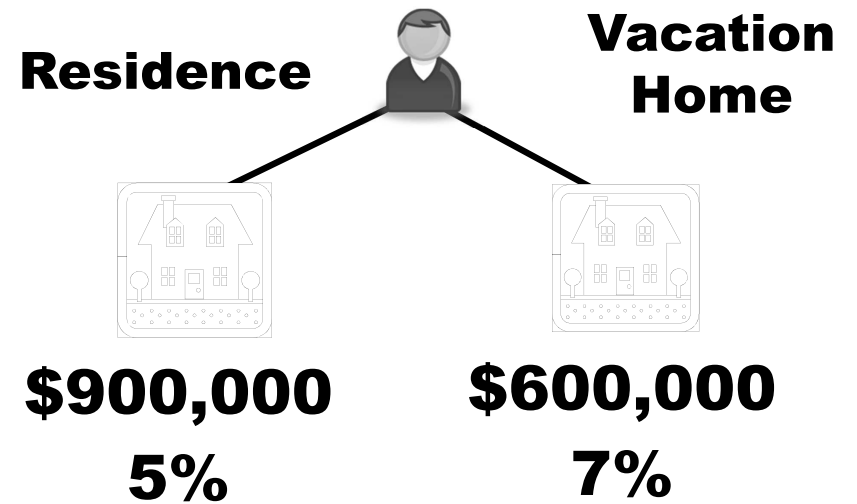
\$1,100,000 - 1st \$77,000
\$ 100,000 - 1st \$ 7,000
\$400,000 - 2nd \$20,000
Home Mortgage Int \$77,000

Pub 936
Method

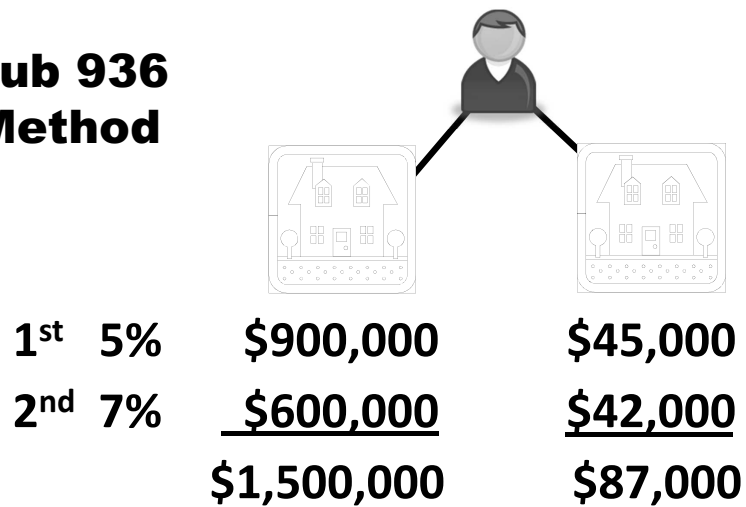


1 st	\$1,200,000	\$84,000
2 nd	\$400,000	\$20,000
	<u>\$1,600,000</u>	<u>\$104,000</u>
1,100,000 / 1,600,000 = 68.75% x \$104,000		
	Home Mortgage Interest	<u>\$71,500</u>

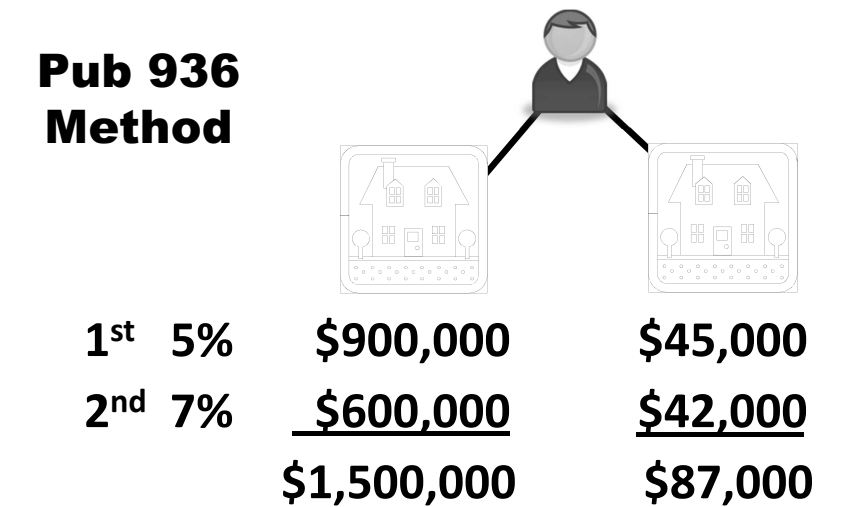
Pub 936 Method is Better if Later Debt has Higher Interest



Pub 936 Method

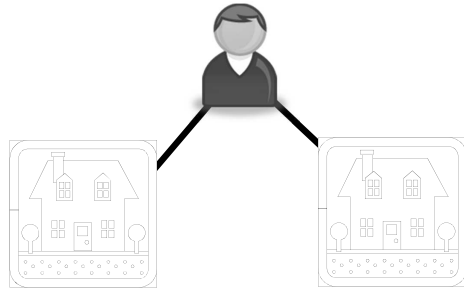


Pub 936 Method



$$1,100,000 / 1,500,000 = 73.3\% \times \$87,000$$

Pub 936 Method

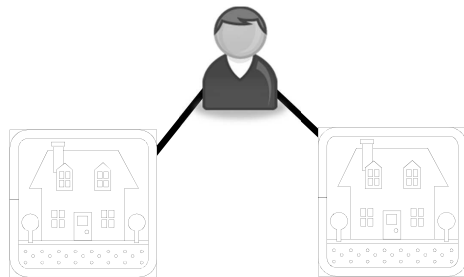


1 st 5%	\$900,000	\$45,000
2 nd 7%	<u>\$600,000</u>	<u>\$42,000</u>
	\$1,500,000	\$87,000

$1,100,000 / 1,500,000 = 73.3\% \times \$87,000$
 Home Mortgage Interest \$63,800

Compare Exact Method . . .

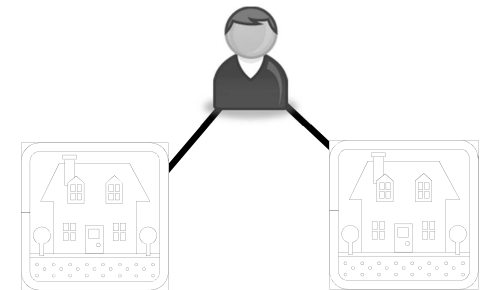
Exact Method



1 st 5%	\$900,000	\$45,000
2 nd 7%	\$600,000	\$42,000

\$200,000

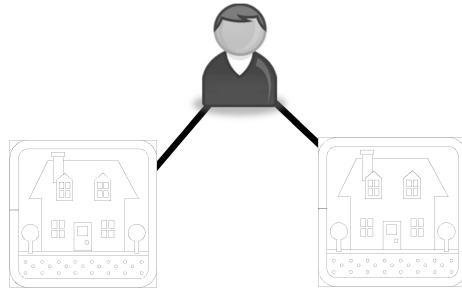
Exact Method



1 st 5%	\$900,000	\$45,000
2 nd 7%	\$600,000	\$42,000

$200,000 / 600,000 = 33.3\%$

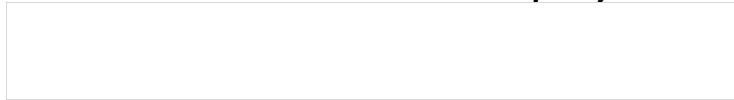
Exact Method



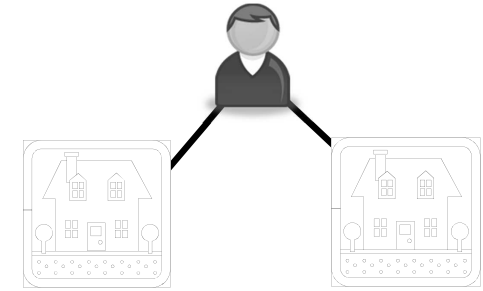
1st 5% \$900,000 \$45,000

2nd 7% \$600,000 \$42,000

$200,000 / 600,000 = 33.3\% \times \$42,000$
\$14,000



Exact Method



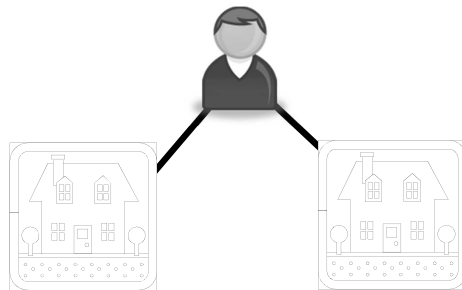
1st 5% \$900,000 \$45,000

2nd 7% \$600,000 \$42,000

$200,000 / 600,000 = 33.3\% \times \$42,000$
\$14,000

Home Mortgage Int = \$59,000

Pub 936 Method



1st 5% \$900,000 \$45,000

2nd 7% \$600,000 \$42,000

\$1,500,000 \$87,000

$1,100,000 / 1,500,000 = 73.3\% \times \$87,000$

Home Mortgage Interest \$63,800

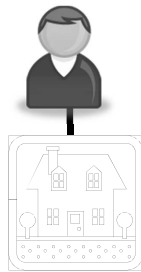
CCA 201201017

Clarification of “O Election”

“O” Election

Reg. §1.163-10T(o)(5)

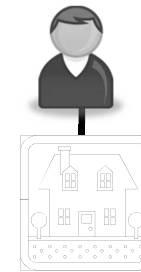
**Election to
Treat Mortgage Debt
as
Not Secured
by the Property**



\$800,000 - 1st	(5%)	\$40,000
\$600,000 - 2nd	(6%)	\$36,000

Misconception #1:

**O Election
is Needed
to Deduct
Home Equity
Business/Investment
Interest**



\$800,000 - 1st	(5%)	\$40,000
\$600,000 - 2nd	(6%)	\$36,000
<i>used:</i>		
\$150,000 - personal		\$9,000
\$450,000 - business		\$27,000

CCA 201201017

**0 Election
Not Required
to Deduct
“Excess Interest”
Otherwise
Deductible**

**Exact
Method**



\$800,000 – Acquisition \$40,000

\$600,000 - 2nd \$36,000

\$100,000 – Home Equity \$6,000
\$50,000 – Personal \$3,000
\$450,000 – Business \$27,000

\$800,000 – Acquisition \$40,000

\$600,000 - 2nd \$30,000

\$100,000 – Home Equity \$6,000
\$50,000 – Personal \$3,000
\$450,000 – Business \$27,000

“0 Election” Not Needed

**Excess Interest on Loan
Allocable to Business Use
is Automatically Deductible
Above-the-Line**

\$800,000 – Acquisition \$40,000

\$600,000 - 2nd \$30,000

\$100,000 – Home Equity \$6,000
\$50,000 – Personal \$3,000
\$450,000 – Business \$27,000

**0 Election
would be mistake
in this case in any event,
because . . .**

CCA 201201017

**0 Election
Can only be Made
for the
Entire Loan**

\$800,000 – Acquisition	\$40,000
\$600,000 - 2nd	\$30,000
\$100,000 – Home Equity	\$6,000
\$50,000 – Personal	\$3,000
\$450,000 – Business	\$27,000

**0 Election
cannot be made for the business
portion of the loan only**

Misconception #2:

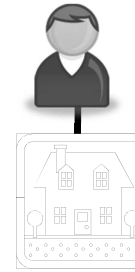
**0 Election
Can be Made
for a
Portion of a Loan**

\$800,000 – Acquisition	\$40,000
\$600,000 - 2nd	\$30,000
\$100,000 – Home Equity	\$6,000
\$50,000 – Personal	\$3,000
\$450,000 – Business	\$27,000

**0 Election
loses \$6,000
Home Equity interest,
because it applies to entire loan.**

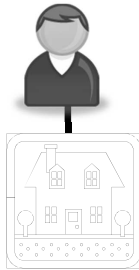
**0 Election
is Not Needed
to Avoid Loss
of
Deductible Interest
Another Example . . .**

**Exact
Method**



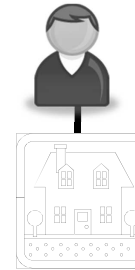
\$350,000	– 1st	
\$250,000	– 2nd	invmt
\$100,000	– 3rd	personal
700,000	5%	\$35,000

**Exact
Method:**



\$350,000	– 1st	
\$100,000	– 2nd	business
\$150,000	– 2nd	invmt
\$100,000	– 3rd	personal
700,000	5%	\$35,000

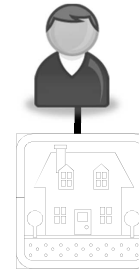
**Exact
Method:
0
Election**



\$350,000	– 1st	
\$250,000	– 2nd	invmt
\$100,000	– 3rd	personal
700,000	5%	\$35,000

**Looks like
the 0 Election
is Needed,
however
the Pub 936 Method
gets you to the
Same Result**

**Pub 936
Method**



**\$350,000 – 1st
\$250,000 – 2nd invmt
\$100,000 – 3rd personal
700,000 5% **\$35,000****

**\$350,000 – 1st
\$250,000 – 2nd invmt
\$100,000 – 3rd personal
700,000 5% \$35,000**

$\frac{450,000}{700,000} \times 35,000 = \$22,500$

**\$350,000 – 1st
\$250,000 – 2nd invmt
\$100,000 – 3rd personal
700,000 5% \$35,000**

$\frac{450,000}{700,000} \times 35,000 = \$22,500$

Excess = \$12,500

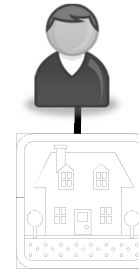
**Pub 936 Method
Allocates
Excess Interest
to
Deductible Loan Uses
First**

$$\begin{array}{r}
 \$350,000 - 1^{\text{st}} \\
 \$250,000 - 2^{\text{nd}} \text{ invmt} \\
 \underline{\$100,000} - 3^{\text{rd}} \text{ personal} \\
 \underline{\underline{700,000}} \quad 5\% \quad \underline{\underline{\$35,000}} \\
 \\
 \frac{450,000}{700,000} \times 35,000 = \$22,500 \\
 \\
 \text{Excess} = \$12,500 \\
 \\
 \frac{250,000}{700,000} \quad \boxed{}
 \end{array}$$

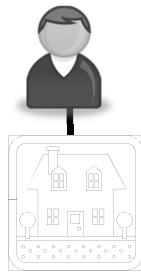
$$\begin{array}{r}
 \$350,000 - 1^{\text{st}} \\
 \$250,000 - 2^{\text{nd}} \text{ invmt} \\
 \underline{\$100,000} - 3^{\text{rd}} \text{ personal} \\
 \underline{\underline{700,000}} \quad 5\% \quad \underline{\underline{\$35,000}} \\
 \\
 \frac{450,000}{700,000} \times 35,000 = \$22,500 \\
 \\
 \text{Excess} = \$12,500 \\
 \\
 \frac{250,000}{700,000} \times 35,000 = \$12,500
 \end{array}$$

**So when
might you use
an
O election?**

**0 Election
Can Move
Interest on
\$100,000
Above the Line**

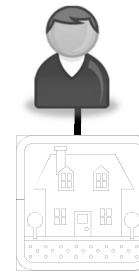


**\$350,000 – 1st
\$250,000 – 2nd business**



\$350,000 – 1st

**\$100,000 – 2nd Sch A
\$150,000 – 2nd business**



**\$350,000 – 1st
\$250,000 – 2nd business**

**0 Election
Moves Interest
on Full \$250,000
Above AGI**

**How Do You
Make
the
O Election?**

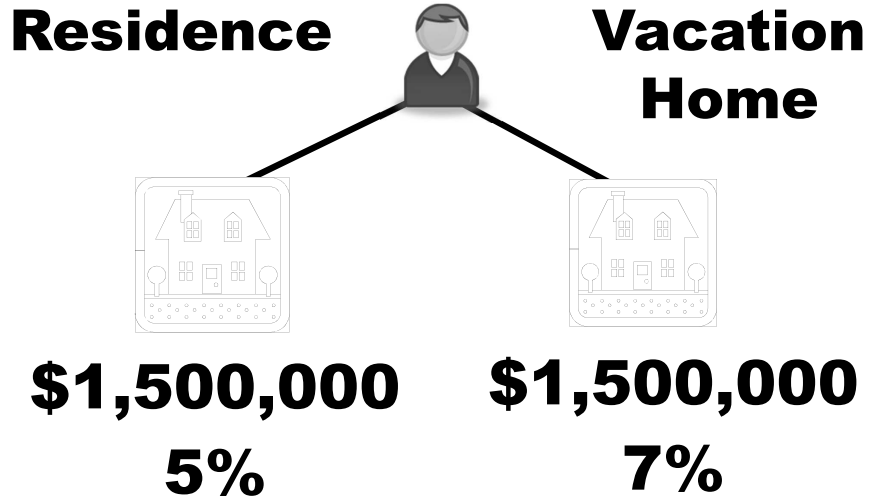
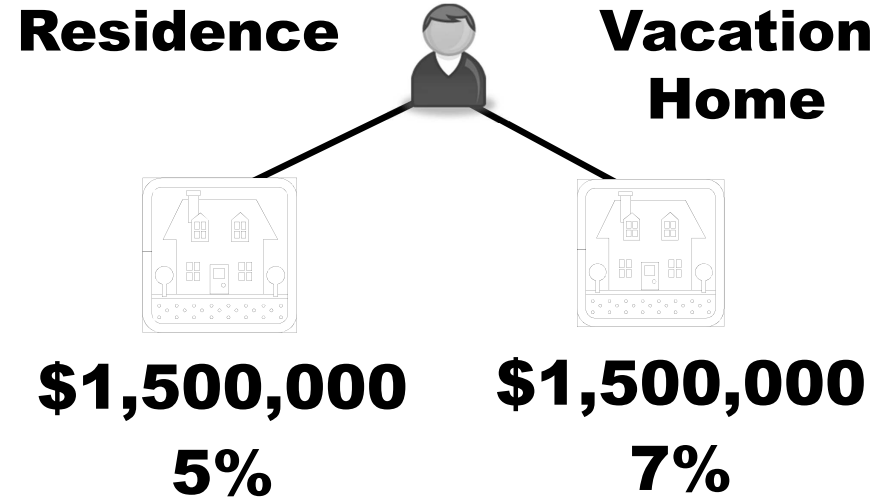
**Misconception #3:
Written Statement
Needed
to Make
the
O Election**

CCA 201201017

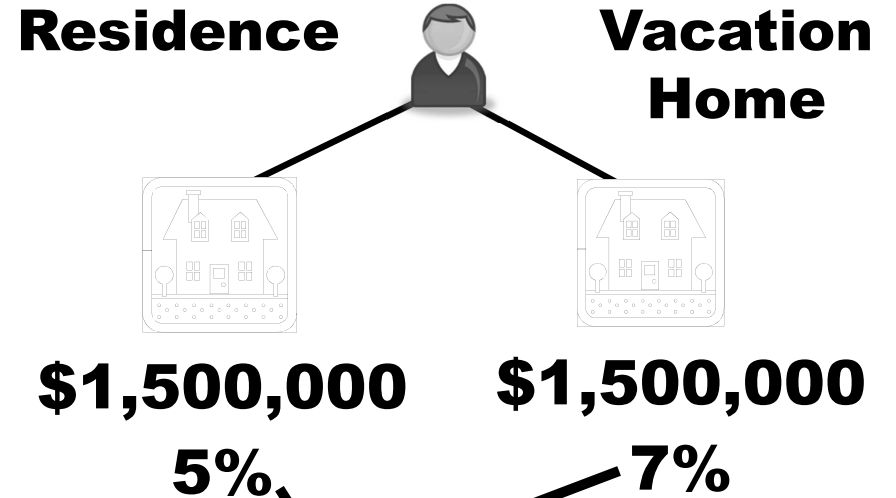
**No
Election Statement
Required
for
O Election**

*“The election is made
by reporting the interest
on the return
as business interest or
other deductible interest
rather than qualified
residence interest.”*

0 Election Trap . . .



Exact Method **5% x \$1.1MM = \$55K**



Pub 936 Method **6% x \$1.1MM = \$66K**

Residence



Vacation Home



~~\$1,500,000~~

\$1,500,000

0 Election

7%

7% x \$1.1MM = \$77K

Residence



Vacation Home



~~\$1,500,000~~

~~\$1,500,000~~

0 Election

~~7%~~

***Irrevocable
w/o Consent***

Sold

5-24

***Business
Expenses***

5-27

Bogue v Comm'r

**Contractor's
Transportation Costs
are**

**Nondeductible
Commute Cost**