With home mortgage rates near the lowest level in years, you may be considering refinancing your fixed-rate or adjustable rate mortgage. Although you may be able to deduct the full amount of mortgage interest you pay, you may be surprised to learn that a portion of the mortgage interest may not be deductible.

Here are the rules. The interest you pay on the new loan will be completely deductible if 1) the new loan amount does not exceed the balance remaining on your old mortgage, 2) the loan proceeds from the old mortgage were used to buy or substantially improve your home; and 3) the new loan balance does not exceed $1 million.

When you borrow more than the balance remaining on the old loan and do not use the proceeds to improve your home, the amount of the proceeds in excess of the old balance will be deductible as "home equity debt" as long as this portion of the new loan does not exceed $100,000. With the exception of the purchase of tax-exempt bonds, generally "home equity debt" is deductible as home mortgage interest regardless of how the proceeds are used as long as the "home equity debt" is $100,000 or less.

If you decide to refinance, these are the rules. The interest you pay on the new loan usually will be deductible if 1) you are refinancing an old mortgage dollar-for-dollar, 2) your new loan exceeds the old mortgage balance and you use all the new money to improve your home, or 3) the new loan proceeds that are not used to improve your home does not exceed the $100,000 limit for "home equity debt."

If you need further clarification, please don’t hesitate to give me a call. I would be happy to discuss this with you.

Sincerely,

Peggy Hall