

Reverse Mortgages - A Cash Flow Solution for Seniors

Article Highlights:

- Reverse Mortgages
- Reverse Mortgage Terms
- Who deducts the Interest?
- When is the Interest Deductible?

Some retirees are faced with mounting debt and inadequate income. What options do these seniors have, especially if they have a mortgage on their home and their retirement income is too low to cover the mortgage payments and have enough left over to have some enjoyment in their golden years?

One option that you see promoted on television is the "reverse mortgage" which allows a homeowner to borrow against the equity they have built up in their home over the years. The loan is not due until the homeowner passes away or moves out of the home. If the homeowner dies, the heirs can pay off the debt by selling the house and any remaining equity goes to them. If at that time the loan balance is equal to or more than the value of the home, the repayment amount is limited to the home's worth.

In order to be eligible for this loan, the borrower must be at least 62 years of age and have equity in the home. The reverse mortgage must be a first trust deed. Thus any existing loans would have to be paid off with separate funds or with the proceeds from the reverse mortgage. The amount that can be borrowed is based upon age, and the older the borrower, the greater amount that can be borrowed and the lower the interest rate. The loan amount will also depend on the value of the home, interest rates and the amount of equity built up.

The borrower has the option of taking the loan as a lump sum, a line of credit, or as fixed monthly payments. In addition, the money generally can be used for any purpose, without restrictions imposed.

One question that always comes up when discussing reverse mortgages is, when will the interest be deductible? When determining whether reverse mortgage interest is deductible, when it is deductible and by whom, these are factors to consider:

1. Interest (regardless of type) is not deductible until paid. A reverse mortgage loan is not required to be repaid as long as the borrower lives in the home. Therefore, the interest on a reverse mortgage is not deductible by anyone until the loan is paid off.
2. Generally reverse mortgages are classified as equity loans and the deductible interest would be limited to the interest accrued on the first \$100,000 of debt. There are exceptions where the reverse mortgage paid off an existing acquisition debt loan. Equity debt interest is not deductible by taxpayers subject to the alternative minimum tax (AMT).

So who deducts the interest when the loan is paid off?

Debtor - If the debtor pays off the loan while still living, the debtor is the one that deducts the sum of the interest they would have been entitled to deduct each year had it been paid, subject to the limitations discussed in 1 & 2 above.

Estate - If the estate pays off the mortgage after the debtor has passed away, the estate would deduct the interest it on its income tax return. The amount

deductible would be the sum of the interest the debtor would have been entitled to deduct each year had they paid it, subject to the limitations discussed in 1 & 2 above.

Beneficiary – If the beneficiary, or beneficiaries, who inherit the home, pays off the mortgage, the interest would be deductible as an itemized deduction on their personal 1040 income tax return(s). The amount deductible would be the sum of the interest the debtor would have been entitled to deduct each year had they paid it, subject to the limitations discussed in 1 & 2 above.

Reverse mortgages have brought financial security to many seniors so that they can live a comfortable life. If you are a senior who is struggling with your finances, carefully explore your options, including the possibility of a reverse mortgage. Keep in mind, however, that some reverse mortgages may be more expensive than traditional home loans, and the upfront costs can be high, especially if you don't plan to be in your home for a long time or only need to borrow a small amount.

If you have questions about reverse mortgages and the mortgage interest deduction, please give this office a call.