The Alternative Minimum Tax and the Home Mortgage Deduction

By Joseph M. Laub

Recently, the financial press has taken notice of a continuing trend towards an ever greater percentage of average middle class taxpayers becoming subject to tax under the increasingly complex alternative minimum tax ("AMT") system. However, a little publicized quirk of the AMT is its application to the residential mortgage interest expense deduction.

There are two major differences between the calculation of an individual's home mortgage interest expense deduction for regular income tax purposes and its calculation for AMT purposes. First, for AMT purposes (as well as for regular tax purposes), "qualified" mortgage interest is deductible if the loan is incurred for purposes of acquiring, constructing, or substantially improving a principal residence or a second home. If the loan is secured by a "principal residence", then there is no substantive difference for regular income tax or AMT purposes. However, for regular income tax purposes, a "second home" can include mobile homes, which are used on a trasient basis, or boats (as long as you are lucky enough to have sleeping, cooking and toilet facilities on your boat), but for AMT purposes neither a mobile home nor a boat qualifies as a second home. Therefore, the interest expense incurred on debt to carry this type of property will be "added back" for AMT purposes.

Second, for AMT purposes, qualified mortgage interest only includes interest on loans used to acquire, construct, or substantially improve a principal residence or a "qualified" second home. If loan proceeds are used for any other purposes, i.e., to pay off education expenses or credit card bills, the interest must be added back for AMT purposes, whereas for regular tax purposes, the proceeds of a home equity loan (not to exceed $100,000) may be used for other personal expenditures without jeopardizing the deductibility of the interest expense.

For example, assume a taxpayer purchases a principal residence and a boat, which qualifies as a second home for regular income tax purposes, financing the acquisition of each in part with mortgage debt. The taxpayer may also obtain a home equity loan (under $100,000) to pay off his personal credit card debt. For regular income tax purposes, the interest expense incurred on the loans for the principal residence, boat and home equity loan are deductible. However, for AMT purposes only the interest expense incurred on the principal residence is deductible. The interest expense incurred on the loans secured by the boat and the home equity loan are not deductible and must be added back for AMT purposes.

The addback of this disallowed interest expense is one of the reasons that there is an ever-increasing likelihood that taxpayers will be subject to AMT in future years.

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This article appeared in the Winter 2004 issue of the GReview.