

# College Tax Strategy



***Deducting Home Interest  
As A Business Expense  
(IRC 1.163-10T(o)(5))***



## **Basic Tax Strategy # 8**

### **– Deducting Home Interest As A Business Expense (IRC 1.163-10T(o)(5))**

Debt secured by a personal residence, but used for business purposes, is usually deductible only as an itemized deduction, not a business expense. When the security for the borrowed funds is a mortgage on a first or second home, the security, not the way the funds are used, controls the treatment of the interest. However, a business owner can use an IRC 1.163-10T(o)(5) election to treat the interest expense on a qualified residence loan as not "qualified-residence interest" in order to deduct the interest as a business expense.

### **How To Qualify For The IRC 1.163-10T(o)(5) Strategy**

Normally, debt secured by a personal residence, but used for business purposes, is deductible only as an itemized deduction, not a business expense. However, an election can be made to treat the interest expense on a qualified residence loan as not "qualified-residence interest" by simply attaching to an IRC 1.163-10T(o)(5) election out of the qualified-residence interest rules. This election is effective for that taxable year and for all subsequent taxable years.

To do this correctly, the business owner must use a completely separate loan on the home (such as a 2<sup>nd</sup> mortgage, or a home equity line of credit) in order to trace the use of those funds to the purchase of business equipment, etc.; thereby legally deducting the interest expense on his business tax return under IRC 1.161-8T(c)(1).

**DEDUCTING HOME INTEREST AS A  
BUSINESS EXPENSE  
IMPLEMENTATION PACKAGE**

## **Benefits Of The IRC 1.163-10T(o)(5) Strategy**

Business loans can be quite expensive, so many times business owners can get cheaper money by borrowing money from their personal residence and using it for business purposes. However, the interest on that borrowed money is usually deductible only as an itemized deduction, not a business expense. By using a separate debt instrument, such as a 2<sup>nd</sup> mortgage, or a home equity line of credit, then electing to treat the interest on that qualified residence loan as not "qualified-residence interest" (1.163-10T(o)(5) election); the business owner can deduct that interest as a business expense and avoid paying the 15.3% self employment tax. The reason you must use a separate debt instrument, such as a 2<sup>nd</sup> mortgage, or a home equity line of credit is to give you the ability to trace the use of those funds for business purposes.

## **Tax Savings Involving The IRC 1.163-10T(o)(5) Strategy**

The basic tax benefit of electing to deduct home interest as a business expense (IRC 1.163-10T(o)(5), rather than as a personal itemized deduction, is the avoidance the paying the 15.3% self employment tax on that interest expense. In addition, the taxpayer that uses the "standard deduction can take the full standard deduction, as well as deduct the interest as a business expense.

## **Example Of The IRC 1.163-10T(o)(5) Strategy**

Tom took out a \$100,000 loan from his personal residence to purchase office furniture and computer equipment for his new business. The bank required that Tom give them a second mortgage on his personal residence as additional collateral. During the year, Tom pays \$6,500 in interest expense on that home equity loan. Normally, Tom would deduct the interest expense of \$6,500 on his Schedule A as an itemized personal deduction. However, Tom decides to treat this interest as a business deduction by attaching an IRC 1.163-10T (o)(5) election to his tax return. Tom uses of the \$100,000 home equity loan to purchase business furniture and computer equipment, thereby allowing him to trace the entire use of the funds to his business and legally deduct the interest expense of \$6,500 on his business tax return. The tax savings on that \$6,500 in interest expense allows Tom to reduce his self-employment tax by \$995 per year (\$6,500 yearly interest expense x 15.3%).

**DEDUCTING HOME INTEREST AS A  
BUSINESS EXPENSE  
IMPLEMENTATION PACKAGE**

## Implementing The IRC 1.163-10T(o)(5) Strategy

- ❑ Step 1: Determine the amount you wish to borrow from your personal residence to spend on business items, such as equipment, furniture, or even marketing expenses.
- ❑ Step 2: Borrow the money from your personal residence using a separate debt instrument, such as a 2<sup>nd</sup> mortgage, or a home equity line of credit in order to give you the ability to trace the use of those funds for business purposes.
- ❑ Step 3: Attach an IRC 1.163-10T(o)(5) "Election To Treat The Debt On A Qualified Residence As Not "Qualified Residence Interest" Form to your tax return to elect out of the qualified-residence interest rules.

## Documents Used To Implement The IRC 1.163-10T(o)(5) Strategy

This is the document you will need to Implement the IRC 1.163-10T(o)(5) strategy in your business:

- Election To Treat The Debt On A Qualified Residence As Not "Qualified Residence Interest" Form

## IRS Publications & Forms References

### IRS Publications

**Title 26: Internal Revenue (IRC 1.163-10T)**

<http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr;sid=0440fec9906ccc36d118dab1e502ea9c;rgn=div8;view=ext;node=26%3A2.0.1.1.1.0.8.289;idno=26;cc=ecfr>

**DEDUCTING HOME INTEREST AS A  
BUSINESS EXPENSE  
IMPLEMENTATION PACKAGE**

**Sample Documents  
IRC 1.163-10T(o)(5) Strategy**

The following document is needed in order to implement the IRC 1.163-10T(o)(5) strategy and follow the IRS procedures and guidelines.

**DEDUCTING HOME INTEREST AS A  
BUSINESS EXPENSE  
IMPLEMENTATION PACKAGE**

**Election To Treat The Debt On A Qualified Residence  
As Not "Qualified Residence Interest"**

Pursuant to Regulation Section 1.163 — 10T(o)(5), the Taxpayer hereby elects to treat the debt on a qualified residence as not "qualified residence interest". This election is effective for this taxable year (and all subsequent taxable years unless revoked with the consent of the IRS Commissioner).

Date of Loan: \_\_\_\_\_

Loan Amount: \$\_\_\_\_\_

Lending Institution: \_\_\_\_\_

Loan proceeds were used for the following purpose(s):

\_\_\_\_\_  
\_\_\_\_\_