Internal Revenue Service

Index Number: 163.00-00
461.08-02

Department of the Treasury

Washington, DC 20224

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CC:DOM:IT&A:Br5:PLR-104060-98
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Taxpayers =
Lender =
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Dear

This is in response to a letter from your authorized representative dated January 17, 1998, requesting a private letter ruling regarding whether Taxpayers can amortize points paid on a mortgage to purchase their principal residence over the life of the loan.

Taxpayers are husband and wife and file joint federal income tax returns on a calendar year basis using the cash receipts and disbursements method of accounting. Late in year 1 Taxpayers acquired a principal residence and obtained a mortgage to finance the purchase from Lender. Taxpayers paid 1.25 points to Lender in connection with the mortgage. Taxpayers' itemized deductions for year 1, including the points paid to Lender, are less than the standard deduction available to them for that year. Accordingly, Taxpayers propose to utilize the standard deduction for year 1 and amortize the points over the remaining life of the loan beginning in year 2.

Section 461(a) of the Internal Revenue Code (relating to the general rule for taxable year of deduction) provides that the amount of any deduction or credit allowed by this subtitle shall be taken for the taxable year which is the proper taxable year under the method of accounting used in computing taxable income.

Under § 1.461-1(a)(1) of the Income Tax Regulations, a taxpayer using the cash receipts and disbursements method of accounting generally takes into account amounts representing allowable deductions in the taxable year in which the amounts are paid.

Section 461(g) provides special rules with respect to prepaid interest. Section 461(g)(1) provides, in general, that if the taxable income of a taxpayer is computed under the cash receipts and disbursements method of accounting, interest paid by the taxpayer which, under regulations prescribed by the Secretary, is properly allocable to any period–(A) with respect to which the interest represents a charge for the use or forbearance of money, and (B) which is after the close of the taxable year in which paid, shall be charged to capital account and shall be treated as paid in the period to which so allocable. Section 461(g)(2) provides that this subsection shall not apply to points paid in respect of any indebtedness incurred in connection with the purchase or improvement of, and secured by, the principal residence of the taxpayer to the extent that, under regulations prescribed by the Secretary, such payment of points is an established business practice in the area in which such indebtedness is incurred, and the amount of such payment does not exceed the amount generally charged in such area.

The legislative history to § 461(g) indicates that the general rule of § 461(g)(1) was enacted to resolve controversies over the treatment of prepaid interest by cash method taxpayers:

> It is unsettled, however, whether a cash method taxpayer can deduct prepaid interest in full in the year paid. Recent court decisions have supported the Internal Revenue Service in requiring a cash method taxpayer to allocate his deductions for prepaid interest over the period of the loan.
>
> The House bill requires a cash method taxpayer to deduct prepaid interest over the period of the loan to the extent the interest represents the cost of using the borrowed funds during each period. The House bill also requires points paid on a loan to be deducted ratably over the term of the loan, except in the case of a mortgage incurred in connection with the purchase or improvement of, and secured by, the taxpayer's principal residence.

H. R. Conf. Rep. No. 1515, 94th Cong., 2d. Session, p. 417 (1976).

In discussing the treatment of points, the report continues:

> The Senate amendment is the same as the House bill, except that the rule *permitting* current deductibility of points on a home mortgage is amended to apply only if points are generally charged in the geographical area where the loan is made and to the extent of the number of points generally charged in that area for a home loan. (Emphasis added)

Therefore, the legislative history to section 461(g) indicates a Congressional intent to permit, but not require, taxpayers currently to deduct points on their home acquisition debt. This intent is corroborated by the structure of the statute. Section 461(g)(2) merely provides that the general rule requiring the amortization of prepaid interest does not apply to points paid on qualifying indebtedness incurred to purchase or improve a principal residence. The section does not mandate that these points be deducted currently, nor does it prohibit a taxpayer from adopting the general rule. Accordingly, we conclude that Taxpayers may amortize the points paid to Lender and take the allocable amount into account over the remaining life of the loan beginning in year 2, assuming Taxpayers elect to itemize deductions in those later years.

No opinion is expressed or implied concerning the tax treatment of the transaction under the provisions of any other sections of the Code or regulations that may be applicable thereto, or the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

A copy of this ruling should be attached to the federal income tax return to which it is relevant. This ruling is directed only to Taxpayers. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file with this office, a copy of this ruling is being sent to your authorized representative.

Sincerely,

Assistant Chief Counsel
(Income Tax and Accounting)

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