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DEDUCTIBILITY OF INTEREST ON SECOND HOMES

— by Neil E. Harl

Attention has recently been focused on the deductibility of interest on “second” homes, as a result of published assurances from a mobile home manufacturer that such vehicles might be an eligible second home.1 However, deductibility of interest on both the principal residence2 and the “second” residence3 requires careful attention to the requirements.

Phase-out of personal interest
In 1986, Congress enacted a five-year phase-out for personal interest for such acquisitions as pleasure boats, vacations or clothes.4 The deduction for personal interest was totally phased out by 1991.5 However, interest deductibility was preserved for “qualified residence interest” which includes a “principal residence” and “1 other residence.”6

Qualified residence interest
The five-year phase-out of personal interest created an exception for “any qualified residence interest.”7 That term was defined to include “acquisition indebtedness” with respect to any qualified residence8 and “home equity indebtedness” with respect to any qualified residence.9

• “Acquisition indebtedness” means indebtedness incurred in “acquiring, constructing, or substantially improving” any qualified residence of the taxpayer.10 The statute specifically requires that the indebtedness be secured by the residence.11 The regulations require that the interest of the debtor in the residence must stand as security for the debt.12 A debt is not considered secured if it is secured by a lien on the general assets of the taxpayer13 or by stocks and bonds of the taxpayer.14

The aggregate amount of acquisition indebtedness, may not exceed $1,000,000 ($500,000 for a married taxpayer filing separately).15

• “Home equity indebtedness” is indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of home equity indebtedness does not exceed the fair market value of the qualified residence reduced by the amount of acquisition indebtedness with respect to that residence.16 The aggregate amount of home equity indebtedness cannot exceed $100,000 ($50,000 on a separate return).17

Meaning of “qualified residence”
The 1986 legislation defined “qualified residence” as “the principal residence”18

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and “1 other residence” selected by the taxpayer and used as a residence.¹⁹

- The term “principal residence” is defined as it is for purposes of the sale and reinvestment provision²⁰ which was repealed in 1997.²¹ The regulations state that a principal residence can include “a houseboat, a housetrailer, or stock held by a tenant-stockholder in a cooperative housing corporation.”²²

- The term “1 other residence” is defined in terms of the I.R.C. § 280A(d)(1) requirements for use as a residence.²³ That provision specifies that “use as a residence” means use of a “dwelling unit” by the taxpayer for personal purposes for a number of days per year which exceeds the greater of—(1) 14 days or (2) 10 percent of the number of days during the year for which the unit is rented at a fair rental.²⁴

**Meaning of “dwelling unit”**

The statute defines “dwelling unit” as a “house, apartment, condominium, mobile home, boat, or similar property and all structures or other property appurtenant to such dwelling unit.”²⁵ The term does not include that part of a unit used exclusively as a hotel, motel, inn, or similar establishment.²⁶

The regulations further specify that a “dwelling unit” must provide basic living accommodations such as “sleeping space, toilet, and cooking facilities.”²⁷ Moreover, a single structure may contain more than one dwelling unit.²⁸

**In conclusion**

Provided the second residence is within the dollar limitations, secures the loan, and meets the occupancy requirements, a dwelling providing basic living accommodations should be eligible for an interest deduction even if the dwelling is in the form of a boat or mobile home.

**FOOTNOTES**

⁵ Id.
⁷ I.R.C. § 163(h)(2)(D).
¹² Temp. Treas. Reg. § 1.163-10T(0).
¹³ Id.
²⁰ I.R.C. § 1034.
²¹ TRA-97, Sec. 312(b), repealing I.R.C. § 1034.
²⁴ I.R.C. § 280A(d)(1).
²⁸ Id.

**CASES, REGULATIONS AND STATUTES**

*by Robert P. Achenbach, Jr.*

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**ADVERSE POSSESSION**

**FENCE.** The disputed strip of land was bordered by the remnants of a fence which was situated on the plaintiff’s land. The land was suitable for timber production. The defendant had acquired the property from the defendant’s grandfather and had walked the fence with the grandfather who identified the fence as the boundary line of the property. The defendant managed the strip as part of forest land, pruning existing trees, thinning undesirable trees and brush and planting new trees. The defendant also used the property for horseback riding and other recreational activities. The plaintiff argued that the defendant could not acquire title to the disputed strip because the defendant did not engage in activities on the land often enough to make continuous use of the property. The court held that the occasional use of the land for timber management and recreation was sufficient for a rural property. The plaintiff also argued that the defendant could not claim any ownership of the property where the fence was not maintained in good repair. The court held that the fence was not required to be maintained in good repair where the land was not used for activities which required a good fence, such as for cattle pasture. The court held that the remnants of the fence were sufficient to mark the existence of the claimed boundary. *Nootboom v. Bulson, 956 P.2d 1042 (Or. Ct. App. 1998).*

**ANIMALS**

**EXPERTS.** The plaintiff had boarded a horse with the defendant stables. The horse escaped and in the process of capturing the horse, the defendant’s employees caused the horse to fall. The injury was treated with no notice of any bone fracture. However, the horse later showed signs of lameness and the plaintiff sued for injury to the horse. The horse, however, had a history of chronic lameness in the leg.