

John Bought A House!

John is realizing the American dream! He's finally a property owner. His first purchase is a small home in a Massachusetts suburb. He bought the house for \$290,000. John has a 30 year conventional mortgage for \$250,000 at 7%.



Mortgages follow an amortization schedule. They calculate how much of your payment goes towards interest vs. principal by factoring in the principal amount due.

We've attached an amortization schedule to show the effects.

Note that John's payment is always the same, \$1663.26. John bought the house in January, so his first payment isn't until February. Note that in the beginning of the mortgage, virtually all of the payment is being allocated towards interest. As the loan progresses and the principal amount decreases, the interest portion decreases as well. A mortgage near completion will behave in the opposite manner. Most of your payment will be allocated towards principal.

Planners advocate making additional payments at the beginning of your mortgage. Reason being, additional payments are allocated directly to principal. Effectively you reduce the amount of interest paid as it is calculated by the principal amount due. A good website is www.bankrate.com. Their calculators let you add in additional payments and change other variables and show their effects.

Amortization Table for \$250000.00 borrowed on Jan 1, 2006												
Month Year	2 2006	3 2006	4 2006	5 2006	6 2006	7 2006	8 2006	9 2006	10 2006	11 2006	12 2006	1 2007
Payment (\$)	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26
Principal Paid (\$)	204.92	206.12	207.32	208.53	209.75	210.97	212.20	213.44	214.68	215.94	217.20	218.46
Interest Paid (\$)	1458.33	1457.14	1455.94	1454.73	1453.51	1452.29	1451.06	1449.82	1448.57	1447.32	1446.06	1444.79
Total Interest (\$)	1458.33	2915.47	4371.41	5826.13	7279.64	8731.93	10182.98	11632.80	13081.38	14528.70	15974.76	17419.55
Balance (\$)	249795.08	249588.96	249381.64	249173.11	248963.36	248752.39	248540.19	248326.75	248112.07	247896.13	247678.94	247460.48

Month Year	2 2007	3 2007	4 2007	5 2007	6 2007	7 2007	8 2007	9 2007	10 2007	11 2007	12 2007	1 2008
Payment (\$)	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26
Principal Paid (\$)	219.74	221.02	222.31	223.60	224.91	226.22	227.54	228.87	230.20	231.55	232.90	234.26
Interest Paid (\$)	1443.52	1442.24	1440.95	1439.65	1438.35	1437.04	1435.72	1434.39	1433.05	1431.71	1430.36	1429.00
Total Interest (\$)	18863.07	20305.31	21746.26	23185.91	24624.25	26061.29	27497.01	28931.39	30364.45	31796.16	33226.52	34655.52
Balance (\$)	247240.74	247019.72	246797.41	246573.81	246348.90	246122.68	245895.14	245666.27	245436.07	245204.52	244971.62	244737.37
Month Year	2 2008	3 2008	4 2008	5 2008	6 2008	7 2008	8 2008	9 2008	10 2008	11 2008	12 2008	1 2009
Payment (\$)	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26	1663.26
Principal Paid (\$)	235.62	237.00	238.38	239.77	241.17	242.57	243.99	245.41	246.84	248.28	249.73	251.19
Interest Paid (\$)	1427.63	1426.26	1424.88	1423.49	1422.09	1420.68	1419.27	1417.84	1416.41	1414.97	1413.52	1412.07
Total Interest (\$)	36083.15	37509.41	38934.29	40357.78	41779.87	43200.55	44619.81	46037.66	47454.07	48869.04	50282.57	51694.63
Balance (\$)	244501.75	244264.75	244026.37	243786.60	243545.44	243302.86	243058.87	242813.46	242566.61	242318.33	242068.60	241817.41

SCHEDULE A (Form 1040) Itemized Deductions OMB No. 1545-0074
2006 Attachment Sequence No. 07
 Department of the Treasury Internal Revenue Service (99) Attach to Form 1040. See Instructions for Schedule A (Form 1040).
 Names shown on Form 1040: JOHN SAILOR Your social security number: 123-45-6665

Medical and Dental Expenses
 1 Caution. Do not include expenses reimbursed or paid by others.
 2 Enter amount from Form 1040, line 38 2
 3 Multiply line 2 by 7.5% (.075) 3
 4 Subtract line 3 from line 1. If line 3 is more than line 1, enter -0- 4

Taxes You Paid
 5 State and local income taxes 3,750.
 6 Real estate taxes (see instructions) 2,500.
 7 Personal property taxes 7
 8 Other taxes. List type and amount 311.
 9 Add lines 5 through 8 6,561.

Interest You Paid
 10 Home mtg interest and points reported to you on Form 1098 15,975.
 11 Home mortgage interest not reported to you on Form 1098. If paid to the person from whom you bought the home, see instructions and show that person's name, identifying number, and address
 12 Points not reported to you on Form 1098. See instructions for special rules
 13 Investment interest. Attach Form 4952 if required.
 14 Add lines 10 through 13 15,975.

Gifts to Charity
 15 Gifts by cash or check. If you made any gift of \$250 or more, see instrs 360.
 16 Other than by cash or check. If any gift of \$250 or more, see instructions. You must attach Form 8283 if over \$500
 17 Carryover from prior year
 18 Add lines 15 through 17 360.

Casualty and Theft Losses
 19 Casualty or theft loss(es). Attach Form 4684. (See instructions.)
 20 Unreimbursed employee expenses — job travel, union dues, job education, etc. Attach Form 2106 or 2106-EZ if required. (See instructions.)
 21 Tax preparation fees
 22 Other expenses — investment, safe deposit box, etc. List type and amount
 23 Add lines 20 through 22
 24 Enter amount from Form 1040, line 38 24
 25 Multiply line 24 by 2% (.02)
 26 Subtract line 25 from line 23. If line 25 is more than line 23, enter -0-
 27 Other — from list in the instructions. List type and amount

Total Itemized Deductions
 28 Is Form 1040, line 38, over \$150,500 (over \$75,250 if married filing separately)?
 No. Your deduction is not limited. Add the amounts in the far right column for lines 4 through 27. Also, enter this amount on Form 1040, line 40.
 Yes. Your deduction may be limited. See instructions for the amount to enter.
 29 If you elect to itemize deductions even though they are less than your standard deduction, check here

With a home purchase, certain tax advantages become available. The main deductions realized by most taxpayers are property taxes paid and interest paid on their mortgage. Mortgage interest (not principal) paid is deductible.

In John's case, he paid \$15,975 in mortgage interest in 2006. He also paid \$2,500 in property taxes.

John's itemized deductions for 2006 are \$22,896! This exceeds the standard deduction by \$17,746! This will substantially reduce his tax due. In fact, John is due a \$3,200+ refund without business expenses.

Another important factor to consider is that ALL of John's allocatable business expenses will be realized. Meaning once he exceeds the 2% floor discussed in

our last article, he won't lose deductions trying to exceed the standard deduction.

Summary

These (MTax-101 series) are the basic fundamentals incorporated in taxation and tax planning. It isn't one single deduction that makes the difference, it's the plan. As we continue, things will get more complicated. John will buy rental properties, get married, have kids and make more money. John's going to reach a point that he'll begin to lose some of the benefits we've already discussed. Don't worry, John's on top of it. His plan will help reduce the negative effects.

Individual Summary

Gross Income – \$75,620
Taxable Gross Income - \$75,620
Adjusted Gross Income – \$75,620
Standard/Itemized Deduction – \$22,896
Tax – \$8,914

Original Tax - \$13,351
Percent Difference – 33%

Overall Summary (including 401(k) and business deductions)

Gross Income – \$75,620
Taxable Gross Income - \$70,620
Adjusted Gross Income – \$70,620
Standard/Itemized Deduction – \$28,397
Tax – \$7,539

Original Tax - \$13,351
Percent Difference (tax savings) – 44%