Part I

Section 56.—Adjustments in Computing Alternative Minimum Taxable Income

(Also §§ 55, 56, 163)

Rev. Rul. 2005-11

ISSUE

Is interest paid on a home mortgage that has been refinanced more than one time deductible as qualified housing interest for purposes of the alternative minimum tax?

FACTS

In 1990, A borrowed $100x to purchase a principal residence (the 1990 mortgage). In 2000, the outstanding principal balance on the 1990 mortgage was $90x, and A refinanced the $90x balance of the 1990 mortgage (the 2000 mortgage). In 2004, the outstanding principal balance on the 2000 mortgage was $80x. A refinanced the $80x balance of the 2000 mortgage and borrowed an additional $30x. Thus, the total amount of A's mortgage in 2004 was $110x (the 2004 mortgage). A did not use

the $30x to acquire, construct, or substantially improve any property that was a principal residence or a qualified residence. At no time did A's indebtedness to acquire his principal residence or a qualified residence exceed $1,000,000. A is not a married individual filing a separate return.

LAW AND ANALYSIS

Section 55 of the Internal Revenue Code provides that the alternative minimum tax is a tax equal to the excess (if any) of the tentative minimum tax for the taxable year over the regular tax (defined in § 55(c)) for the taxable year.

Tentative minimum tax is defined in § 55(b)(1)(A) for noncorporate taxpayers as the sum of 26 percent of so much of the taxable excess as does not exceed $175,000, plus 28 percent of so much of the taxable excess as exceeds $175,000.

The term "taxable excess" is defined in § 55(b)(1)(ii) as so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount provided for in § 55(d).

Alternative minimum taxable income is defined in § 55(b)(2) as the taxable income of the taxpayer for the taxable year determined with the adjustments provided in §§56 and 58, and increased by the amount of the items of tax preference described in § 57.

Section 56(b) contains the adjustments applicable to individuals, which include the adjustment for interest in § 56(b)(1)(C). Section 56(b)(1)(C) provides that, in determining the amount allowable as a deduction for interest, § 163(d), which provides limitations on investment interest, and § 163(h), which disallows deductions for personal

interest, shall apply, except that in lieu of the exception under § 163(h)(2)(D) for qualified residence interest, the term "personal interest" shall not include any qualified housing interest.

Qualified housing interest is defined in § 56(e)(1) as interest that is qualified residence interest (as defined in § 163(h)(3)) and is paid or accrued during the taxable year on indebtedness that is incurred in acquiring, constructing, or substantially improving any property that is the principal residence (within the meaning of § 121) of the taxpayer at the time such interest accrues, or is a qualified dwelling that is a qualified residence (within the meaning of § 163(h)(4)). In addition, the last sentence of § 56(e)(1) provides that qualified housing interest includes interest on any indebtedness resulting from the refinancing of indebtedness meeting the requirements of qualified housing interest, but only to the extent that the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness immediately before the refinancing.

The legislative history to the enactment of § 56 as part of the Tax Reform Act of 1986 states "It is clarified that, for minimum tax purposes, upon a refinancing of a loan that gives rise to qualified housing interest, interest paid on the loan is treated as qualified housing interest to the extent that (1) it so qualified under the prior loan, and (2) the amount of the loan was not increased." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., vol. II, at 259 (1986).

Section 163(h) of the Code provides that, in the case of a taxpayer other than a corporation, no deduction shall be allowed for personal interest paid or accrued during

the taxable year. Under § 163(h)(2)(D), personal interest does not include qualified residence interest.

Qualified residence interest is defined in § 163(h)(3) as any interest that is paid or accrued during the taxable year on acquisition indebtedness or home equity indebtedness with respect to any qualified residence of the taxpayer. Section 163(h)(3)(B) defines acquisition indebtedness as any indebtedness that is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer and is secured by such residence. Section 163(h)(3)(B) also provides that acquisition indebtedness includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of acquisition indebtedness, or refinancing of acquisition indebtedness, but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. Under § 163(h)(3)(B)(ii), the aggregate amount of acquisition indebtedness for any period cannot exceed $1,000,000 (or $500,000 in the case of a married individual filing a separate return).

The term “qualified residence” is defined in § 163(h)(4)(A) as the principal residence (within the meaning of § 121) of the taxpayer and one other residence of the taxpayer that is selected by the taxpayer for the taxable year and that is used by the taxpayer as a residence (within the meaning of § 280A(d)(1)).

The 1990 mortgage is indebtedness incurred in acquiring A’s principal residence. The interest paid or accrued on the 1990 mortgage meets the requirements of qualified

residence interest under § 163(h)(3). Thus, the interest paid or accrued by A on the 1990 mortgage is qualified housing interest for purposes of the alternative minimum tax.

The last sentence of § 56(e)(1), as clarified by the legislative history, indicates that when § 56(b)(1)(C) was enacted as part of the alternative minimum tax provisions, Congress intended that interest with respect to a refinancing of a loan that gives rise to qualified housing interest would be deductible for alternative minimum tax purposes to the extent the amount of the loan was not increased. When A refinanced the 1990 mortgage in 2000, the refinanced amount equaled the amount of the outstanding principal. Thus, the interest paid or accrued on the 2000 mortgage is deductible as qualified housing interest for purposes of the alternative minimum tax because the interest on the 1990 mortgage is qualified housing interest and the amount of the loan is not increased.

Similarly, when A refinanced the 2000 mortgage in 2004, the interest on the 2004 mortgage is qualified housing interest to the extent of the outstanding principal balance of the 2000 mortgage at the time of the refinancing because the interest on the 2000 mortgage is qualified housing interest. However, as part of the 2004 refinancing A borrowed an additional $30x, and A did not use the $30x to acquire, construct, or substantially improve any property that was a principal residence or a qualified residence. Accordingly, for alternative minimum tax purposes A may deduct only the interest paid or incurred on $80x and not the interest attributable to the additional $30x of the $110x of the 2004 mortgage.

HOLDING

Interest paid on a home mortgage that has been refinanced more than one time is deductible as qualified housing interest for purposes of the alternative minimum tax to the extent the interest on the mortgage that was refinanced is qualified housing interest and the amount of the mortgage indebtedness is not increased.

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin Scully, Jr. of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue ruling, contact Mr. Scully at (202) 622-4960 (not a toll-free call).