Should I Finance at time of Purchase even if I can pay Cash?

My clients were in the process of buying a new Florida home; they were selling their large family home and buying a smaller home consistent with their lifestyle. They had plenty of equity and cash and were wondering about just paying cash for the home, leaving open the possibility of refinancing it at some later date if they then needed to get some of their funds out. That choice turns out to have significant implications.

First, the Internal Revenue Service (the tax man) has specific rules about the deductibility of interest on home mortgage debt. Debt incurred at the time of purchase is called acquisition indebtedness. Interest on that debt up to a limit of $1.1 million can be deducted from your US tax return on Schedule A.

Mortgages taken out after acquisition (re-mortgage), however, are deemed to be equity indebtedness. They receive totally different treatment for tax purposes. Deductibility of interest on that type of debt is limited to the interest on $100,000 plus any amount of money that is used to improve the value of the property.

I recognize that each family's situation is different, and you ought to get advice from experts. I'll stand by my analysis as an expert in the mortgage market, but consult your tax advisor for advice on tax consequences.