

Revenue Procedure 94-27, 1994-1 CB 613

SECTION 1. PURPOSE

In order to minimize possible disputes regarding the deductibility of points paid in connection with the acquisition of a principal residence, the Internal Revenue Service will, as a matter of administrative practice, treat amounts as points that are deductible for the taxable year during which they are paid by a cash basis taxpayer if the requirements of this revenue procedure are satisfied.

SEC. 2. BACKGROUND

.01 Section 461(g)(1) of the Internal Revenue Code provides that interest that is paid by a cash basis taxpayer and that 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 the interest is paid, must be capitalized and treated as if it were paid in the period to which it is allocable.

.02 Section 461(g)(2) of the Code provides that the rules of section 461(g)(1) do not apply to points paid in connection with indebtedness that is incurred in connection with the purchase or improvement of, and that is secured by, the principal residence of the taxpayer to the extent that, under regulations prescribed by the Secretary, the payment of points is an established business practice in the area in which the indebtedness is incurred and the amount of points paid does not exceed the amount generally charged in that area.

SEC. 3. APPLICATION

The Service will, as a matter of administrative practice, treat as deductible points any amounts paid by a cash basis taxpayer during the taxable year in cases where all of the following requirements are satisfied:

.01 *Designated on Uniform Settlement Statement.* The Uniform Settlement Statement prescribed under the Real Estate Settlement Procedures Act of 1974, 12 U.S.C. sections 2601 *et seq.* (i.e., the Form HUD-1) must clearly designate the amounts as points payable in connection with the loan, for example as “loan origination fees” (including amounts so designated on Veterans Affairs (VA) and Federal Housing Administration (FHA) loans), “loan discount,” “discount points,” or “points.” The amounts designated as points on the Form HUD-1 may be shown as paid from either the borrower’s or the seller’s funds at settlement.

.02 *Computed As Percentage of Amount Borrowed.* The amounts must be computed as a percentage of the stated principal amount of the indebtedness incurred by the taxpayer.

.03 *Charged Under Established Business Practice.* The amounts paid must conform to an established business practice of charging points for loans for the acquisition of principal residences in the area in which the residence is located, and the amount of points paid must not exceed the amount generally charged in that area. Thus, if amounts designated as points are paid in lieu of amounts that are ordinarily stated separately on the settlement statement (such as appraisal fees, inspection fees, title fees, attorney fees, and property taxes), those amounts are not deductible as points under this revenue procedure.

.04 *Paid for Acquisition of Principal Residence.* The amounts must be paid in connection with the acquisition of the taxpayer’s principal residence, and the loan must be secured by that residence. See sections 4.02 through 4.04 of this revenue procedure for examples of points that do not satisfy this requirement.

.05 *Paid Directly by Taxpayer.* The amounts must be paid directly by the taxpayer. An amount is so paid if the taxpayer provides, from funds that have not been borrowed for this purpose as part of the overall transaction, an amount at least equal to the amount required to be applied as points at the closing. The amount provided may include down payments, escrow deposits, earnest money applied at the closing, and other funds actually paid over by the taxpayer at the closing. In addition, for purposes of this section 3.05, points paid by the seller (including points charged to the seller) in connection with the loan to the

taxpayer will be treated as paid directly by the taxpayer from funds that have not been borrowed for this purpose, provided the taxpayer subtracts the amount of any seller-paid points from the purchase price of the residence in computing the basis of the residence. *See* section 1.1273-2(g)(5), *Example 3*, of the Income Tax Regulations.

SEC. 4. LIMITATIONS

This revenue procedure does not apply to the following amounts:

.01 Points paid in connection with the acquisition of a principal residence, to the extent that the points are allocable to an amount of principal in excess of the aggregate amount that may be treated as acquisition indebtedness under section 163(h)(3)(B)(ii) of the Code.

.02 Points paid for loans the proceeds of which are to be used for the improvement, as opposed to the acquisition, of a principal residence.

.03 Points paid for loans to purchase or improve a residence that is not the taxpayer's principal residence, such as a second home, vacation property, investment property, or trade or business property.

.04 Points paid on a refinancing loan, home equity loan, or line of credit, even though the indebtedness is secured by a principal residence.

SEC. 5. EFFECTIVE DATE

.01 *General rule.* This revenue procedure is effective for points paid by cash basis taxpayers during taxable years beginning after December 31, 1990.

.02 *Transition rule.* For taxpayers purchasing principal residences after December 31, 1990, and before April 4, 1994 (the effective date of section 1.1273-2 of the regulations), the basis-reduction requirement in connection with seller-paid points in section 3.05 is mandatory only to the extent, if any, that the taxpayer deducts the seller-paid points.

.03 *Amended Returns.* Cash basis taxpayers may change their method of accounting for points paid during taxable years beginning after December 31, 1990, and before January 1, 1994, if the points meet the requirements of this revenue procedure and have not previously been deducted. This change of accounting method is to be effected by filing an amended federal income tax return on Form 1040X for the appropriate taxable year(s). Taxpayers who have not filed their 1993 federal income tax return may claim a deduction for points paid in 1993 by including the amount paid on line 9a of Schedule A of their 1993 Form 1040 if the points were reported to the taxpayer on Form 1098, or on line 10 if the points were not reported on Form 1098. Taxpayers filing an amended return with respect to seller-paid points should write "Seller-Paid Points" in the top right margin of the amended return, and should attach a copy of the applicable Form HUD-1 (or other settlement statement) showing the amount of points paid by the seller in connection with the transaction.

.04 *Reporting of Seller-Paid Points.* Taxpayers required to report under the information reporting requirements of section 6050H of the Code and Rev. Proc. 92-11, 1992-1 C.B. 662, need not apply those requirements to seller-paid points received prior to January 1, 1995.

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 92-12, 1992-1 C.B. 663, as modified by Rev. Proc. 92-12A, 1992-1 C.B. 664, is modified, and, as modified, is superseded. Rev. Rul. 57-541, 1957-2 C.B. 319, and Rev. Rul. 67-297, 1967-2 C.B. 87, which provide for the treatment of loan origination fees on FHA and VA loans, will not apply to cash basis borrowers who satisfy the requirements of this revenue procedure with respect to loan origination fees paid during taxable years beginning after December 31, 1990.