



Highlights of [GAO-09-769](#), a report to the Joint Committee on Taxation

Why GAO Did This Study

Complex home-mortgage interest deduction rules create problems for taxpayers and increase the potential for noncompliance. For example, the rules involve mortgage debt limits and how loan proceeds are used.

GAO was asked to (1) describe how IRS detects noncompliance with the deduction's rules and what IRS knows about the extent of noncompliance; (2) identify problems taxpayers face in complying with the deduction's rules and challenges IRS faces in enforcing them; (3) assess options to give IRS more information to assist enforcement; and (4) determine if IRS's guidance to taxpayers and its examiners provides information to calculate the deduction properly. GAO analyzed IRS enforcement data and interviewed IRS and industry officials. GAO did not consider statutory changes.

What GAO Recommends

GAO recommends that IRS revise its main research program's case-selection system to better detect debt-limit noncompliance; expand information reporting on taxpayers' mortgages; revise tax forms, instructions, and examiner training; and test outreach programs.

In commenting on a draft of this report, IRS agreed with five recommendations and said it will study the recommendations on expanding information reporting and testing outreach programs to reduce noncompliance.

[View GAO-09-769](#) or [key components](#). For more information, contact James R. White at (202) 512-9110 or whitej@gao.gov.

HOME MORTGAGE INTEREST DEDUCTION

Despite Challenges Presented by Complex Tax Rules, IRS Could Enhance Enforcement and Guidance

What GAO Found


IRS enforcement and research programs do not provide an overall picture of mortgage interest deduction noncompliance. While its various compliance and research programs provide evidence of some mortgage interest deduction compliance problems, they leave gaps in what is known about the extent and specific nature of noncompliance. In particular, IRS knows little about the extent of noncompliance with various debt limits and rules regarding the use of home equity loans. The case selection system of IRS's main research program also may have excluded possible noncompliant cases. IRS examiners partly attribute noncompliance to taxpayers and paid preparers not knowing deduction rules.

Taxpayers' problems in complying with the mortgage interest deduction rules include the many steps necessary to determine whether mortgage interest and points are deductible and the recordkeeping necessary to determine how the proceeds of home equity loans are used. The deduction's complexity also poses challenges to IRS. Although mortgage interest payments above a threshold are reported to IRS, the information reported shows the dollar amount of interest a taxpayer paid in a year without regard to the limits on the amount of debt imposed by law. As a result, IRS lacks information that could help it efficiently detect noncompliance with deduction limits and must rely on costly examinations.

Several options exist for expanding information reporting on taxpayers' mortgages and using private sector data to enhance compliance. Useful information would include property addresses, debt balances, and an indicator of loan refinancing. This information would allow IRS to identify taxpayers reporting mortgage interest exceeding the acquisition debt limit. Third parties who send information reports to IRS initially may incur some additional costs to provide the data, but those costs are likely to be one-time expenses. Additional loan information from private sector sources also might help IRS detect home equity noncompliance.

The schedule for reporting mortgage interest deductions does not explicitly state that the deduction is subject to limits. Further, IRS's guidance for taxpayers and examiners provides a different interpretation for the acquisition debt limit than a prior tax court ruling, and the examiners' guidance lacks examples of problem areas cited by examiners and practitioners.

The Complexity of Determining the Deductibility of Home Mortgage Interest and Points

 Questions taxpayer needs to answer	Number of steps
Is home mortgage interest fully deductible?	Up to 7
Are points fully deductible in current year?	Up to 10
How much of my mortgage interest is deductible this year?	Up to 13

Source: GAO analysis of IRS Publication 936: Home Mortgage Interest Deduction.

Note: The steps in the table do not reflect other complicating factors, such as interest on home equity debt generally not being deductible in alternative minimum tax computations.