Case Study

Bunching Both Taxable Income and Reverse Mortgage Interest Payments for Tax Efficiency

Background

- A Home Equity Conversion Mortgage for Purchase (H4P), a reverse mortgage for purchase, is classified as acquisition debt.
- Interest accumulation on $750,000 of acquisition debt is deductible under the 2017 Tax Cut and Jobs Act. Interest that accumulates on a reverse mortgage is not deductible until actually paid. Interest payments are accepted but are voluntary on an H4P loan.
- Making a substantial voluntary payment on the accrued interest can be used to offset income. Coordinating the bunching of both interest payments and taxable income may contribute to tax efficiency when total deductions exceed the standard deduction threshold[1].
- **A partial Roth Conversion offsets 100% of additional taxable income not absorbed by other income sources.**

Strategy: Focus on cash flow in the early years of retirement

- Minimize monthly outlay to defer taking RMDs (until required at 72) by not making payments and allowing interest to accumulate.
- Maximize growth on invested funds and delay Social Security until age 70.
- H4P prevents need to sink entire cash proceeds into the new home. Monthly mortgage payments are not required thus limiting monthly obligations.
- Looking ahead, combine these strategies to **limit tax consequences** once both Social Security and the RMD are part of taxable income.

How

- At age 67, provide a down payment of $367, 382 from the sale of the former home on a new home purchase of $765,600.
- H4P loan used to provide remaining purchase price and closing costs, including FHA Mortgage Insurance Premium.
- Remaining cash from the sale of their house is invested for growth.
- To help delay Social Security and taking RMDs to age 70 and 72 respectively, make no payments on the reverse mortgage loan; allow interest to accumulate on the loan for 5 years.
- After 5 years, age 72, make a voluntary payment on the loan balance adequate to zero out the FHA Mortgage Insurance fees, as well as $65,000 of accrued interest.
- To create taxable income large enough to absorb the deduction, undertake a partial **Roth Conversion.**

Result

- Offset substantial taxable income (SS, RMD, Roth Conversion) with a one time payment on bunched interest.
- Flexible Distribution: Assets converted to Roth no longer subject to RMDs.
- Liquidity: Entire payment is credited dollar for dollar to the ongoing reverse mortgage Line of Credit.
- Revolving H4P Line of Credit is available for as long as the client lives in the home, and can't be canceled, frozen or reduced.
- H4P Line of Credit grows in borrowing power at the cost of money.

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[1] www.kitces.com/blog/hecm-reverse-mortgage-interestdeduction- insurance-premiums-and-real-estate-taxes Interest accumulating on interest is home equity debt and not deductible.
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