

Understanding the Tax Implications of a Reverse Mortgage

A Homeowner's Guide to Interest Deductions, Line of Credit Benefits, and Smart Planning

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Introduction

Reverse mortgages allow homeowners aged 62+ to convert home equity into accessible funds. While proceeds are generally not taxable income, the interest that accrues can have tax implications when repaid particularly if paid using borrower funds, as in the case study below.

How a Reverse Mortgage Works

You borrow against home equity, but unlike traditional loans, no payments are required until a maturity event (sale, death, or move-out). Interest accrues monthly and compounds, but can become deductible once paid.

Interest, MIP, and Tax Treatment

Accrued Interest: Not deductible until actually paid.

Mortgage Insurance Premium (MIP): May be deductible depending on income limits.

Servicing Fees: Not deductible.

Loan Proceeds: Not taxable considered loan advances, not income.

Case Study: Martin & Brenda's Reverse Mortgage Interest Deduction

After five years with a reverse mortgage, **Martin and Brenda** took a retirement distribution and chose to **repay part of their HECM loan**.

- A portion of the payment was applied to **mortgage insurance premiums** (not deductible).

- The remaining funds were applied toward **accrued interest**, which **became tax-deductible** that year.

Because their repayment reduced the loan balance, that **same amount immediately became available again** through their **HECM line of credit**, ready to be withdrawn or used at any time.

Result: They effectively turned a retirement withdrawal into a **tax-deductible payment** while **replenishing access to those same funds** through their reverse mortgage, a smart, flexible financial move.

When Interest Becomes Tax-Deductible

You can generally deduct reverse mortgage interest:

- When you actually pay it (not when it accrues)
- If the funds were used for qualified home-related expenses (consult your CPA)
- On Schedule A if you itemize deductions

Line of Credit Reuse & Compounding Benefits

HECM lines of credit grow over time. When borrowers make partial repayments, their available credit expands, sometimes even faster than inflation offering both liquidity and tax planning opportunities.

Common Tax Myths

Myth: Reverse mortgage proceeds are taxable income - Fact: They are loan advances, not income.

Myth: You can deduct accrued interest every year - Fact: Only when paid.

Myth: Paying off early forfeits benefits - Fact: Partial payments can actually increase flexibility.

Working with Your CPA

Your tax preparer should review:

- Form 1098 (Interest Paid)
- Loan servicing statements
- Distribution and repayment records
- Any funds used from retirement or investment accounts

Checklist: Preparing for Tax Season

- ✓ Gather reverse mortgage statements
- ✓ Confirm 1098 interest documentation
- ✓ Review whether repayment affected your line of credit
- ✓ Discuss deductions with your CPA

Summary

Reverse mortgage tax treatment depends on timing, intent, and documentation. Strategic repayments, like Martin & Brenda's, can unlock deductions and extend credit availability, creating real financial flexibility.

About Reverse Mortgage Services Los Angeles

ReverseMortgageServicesLosAngeles.com, powered by C2 Financial Corp, helps homeowners and advisors make informed, compliant decisions about HECM and proprietary reverse mortgage programs.

Consultations are available at no cost or obligation.

Disclaimer: This guide is for informational purposes only and should not be considered tax or financial advice. Consult with a qualified tax professional or financial advisor for personalized recommendations.