

Tracking Down the Illusive Mortgage Interest Deduction

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- March 10, 2024 (<https://considerchapter13.org/2024/03/>)

[Link to Post: \(https://considerchapter13.org/2024/03/10/tracking-down-the-illusive-mortgage-interest-deduction/\)](https://considerchapter13.org/2024/03/10/tracking-down-the-illusive-mortgage-interest-deduction/)

Are your clients curing mortgage arrears through their Chapter 13 plan?



(https://cdn.considerchapter13.org/content/uploads/2024/03/09183534/Sleuth-Fotolia_157437636_S_opt.jpg).

If so, I'm convinced a mortgage interest tax deduction lurks, unclaimed, in the trustee's records.

Track down that tax deduction and quantify it, and your client can reduce their tax burden each year until the mortgage is brought current.

But it's difficult because, for reasons I have not been able to figure out, the lenders don't send IRS form 1098's to either the client or the trustee for mortgage interest paid through the plan. So you don't have proof that mortgage interest was paid, and neither does the IRS.

But we can fix that. I recently had occasion to walk a client through the process of figuring out the mortgage interest paid by the trustee.

I'll retrace my steps and you can see how I figured out that he'd paid some \$50,000 in mortgage interest over the years of his plan that he hadn't yet claimed on his income tax returns.

1. Find the interest element in the lender's proof of claim.

The mortgage attachment to the lender's proof of claim, B410A, has a line in Part 2 for "interest due".

That line shows us what part of the missed payments, as of the filing of the bankruptcy case, was made up of mortgage interest.

2. Calculate what percentage of the arrears is mortgage interest.

Part 3 of the mortgage attachment form breaks out the elements in the lender's claim in the bankruptcy. We need to know what fraction of the total claim the trustee will be paying is interest.

Take the "interest due" amount you located in Step 1 and divide it by the total at the foot of Part 3.

That's the percentage of the total claim of the lender that's interest.

3. Access the Chapter 13 trustee's site for payments to mortgage creditor.

The trustee's website should show a list of the date and amount of each payment made to the creditor on account of the mortgage arrears.

Total the payments for the last calendar year and multiply that total by the percentage of the claim that is interest, from Step 2 above.

Bingo! you have the number that represents what the trustee paid the creditor in mortgage interest for that calendar year.

Tax accounting rough and dirty

The figure for mortgage interest paid in a year is an approximation. By the end of the plan, the amount of interest paid will equal the amounts you've calculated this way.

The creditor may have applied the trustee's payment differently. ("May"? Almost certainly "did".) Mortgage loan servicing is so erratic these days that it's hard to tell.

If this calculation is off, it probably underestimates the amount of interest in the early payments from the trustee. Most mortgages require the lender to apply payments first to interest, then to principal, then to expenses.

If anyone objects to your calculation, make them propose a better one. Or make the recipient of the mortgage interest account for it in the usual way.

Save your work

Outside of bankruptcy, the lender would send your client and the IRS a copy of their report on Form 1098 for mortgage interest paid during the tax year.

We've done this sleuthing because they didn't tell either the IRS or you what was paid in mortgage interest.

So, you may have to show the IRS how you got to a deduction that doesn't appear in their records.

Make a record. Print or save to pdf each of the documents used to make your calculation. You want to be able to support the deduction if challenged.

Another path to tax deduction

Alternatively, you could use the Request for Information process found in RESPA to ask the servicer of the loan how much interest was paid in the calendar year.

Servicers are required to provide answers about loan servicing within 30 business days of your request. Requests must be in writing and contain identifying information.

Amend earlier returns

If your client has been in Chapter 13 for multiple years, armed with this template for calculating interest, they may wish to file amended returns. Gather your calculator and get on the trail of these illusive, but valuable, mortgage interest deductions.
