

## Reg. Section 1.163-10T(o)(5)

Qualified residence interest (temporary).

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(o) Secured debt--(1) In general. For purposes of this section, the term "secured debt" means a debt that is on the security of any instrument (such as a mortgage, deed of trust, or land contract)--

(i) That makes the interest of the debtor in the qualified residence specific security for the payment of the debt,

(ii) Under which, in the event of default, the residence could be subjected to the satisfaction of the debt with the same priority as a mortgage or deed of trust in the jurisdiction in which the property is situated, and

(iii) That is recorded, where permitted, or is otherwise perfected in accordance with applicable State law.

A debt will not be considered to be secured by a qualified residence if it is secured solely by virtue of a lien upon the general assets of the taxpayer or by a security interest, such as a mechanic's lien or judgment lien, that attaches to the property without the consent of the debtor.

(2) Special rule for debt in certain States. Debt will not fail to be treated as secured solely because, under an applicable State or local homestead law or other debtor protection law in effect on August 16, 1986, the security interest is ineffective or the enforceability of the security interest is restricted.

(3) Times at which debt is treated as secured. For purposes of this section, a debt is treated as secured as of the date on which each of the requirements of paragraph (o)(1) of this section are satisfied, regardless of when amounts are actually borrowed with respect to the debt. For purposes of this paragraph (o)(3), if the instrument is recorded within a commercially reasonable time after the security interest is granted, the instrument will be treated as recorded on the date that the security interest was granted.

(4) Partially secured debt--(i) In general. If the security interest is limited to a prescribed maximum amount or portion of the residence, and the average balance of the debt exceeds such amount or the value of such portion, such excess shall not be treated as secured debt for purposes of this section.

(ii) Example.

T borrows \$ 80,000 on January 1, 1991. T secures the debt with a principal residence. The security in the residence for the debt, however, is limited to \$ 20,000. T pays \$ 8,000 in interest on the debt in 1991 and the average balance of the debt in that year is \$ 80,000. Because the average balance of the debt exceeds the maximum amount of the security interest, such excess is not treated as secured debt. Therefore, for purposes of applying the limitation on qualified residence interest, the average balance of the secured debt is \$ 20,000 (the maximum amount of

the security interest) and the interest paid or accrued on the secured debt is \$ 2,000 (the total interest paid on the debt multiplied by the ratio of the average balance of the secured debt (\$ 20,000) and the average balance of the total debt (\$ 80,000)).

(5) Election to treat debt as not secured by a qualified residence--(i) In general. For purposes of this section, a taxpayer may elect to treat any debt that is secured by a qualified residence as not secured by the qualified residence. An election made under this paragraph shall be effective for the taxable year for which the election is made and for all subsequent taxable years unless revoked with the consent of the Commissioner.

(ii) Example.

T owns a principal residence with a fair market value of \$ 75,000 and an adjusted purchase price of \$ 40,000. In 1988, debt A, the proceeds of which were used to purchase the residence, has an average balance of \$ 15,000. The proceeds of debt B, which is secured by a second mortgage on the property, are allocable to T's trade or business under § 1.163-8T and has an average balance of \$ 25,000. In 1988, T incurs debt C, which is also secured by T's principal residence and which has an average balance in 1988 of \$ 5,000. In the absence of an election to treat debt B as unsecured, the applicable debt limit for debt C in 1988 under paragraph (e) of this section would be zero dollars (\$ 40,000 - \$ 15,000 - \$ 25,000) and none of the interest paid on debt C would be qualified residence interest. If, however, T makes or has previously made an election pursuant to paragraph (o)(5)(i) of this section to treat debt B as not secured by the residence, the applicable debt limit for debt C would be \$ 25,000 (\$ 40,000 - \$ 15,000), and all of the interest paid on debt C during the taxable year would be qualified residence interest. Since the proceeds of debt B are allocable to T's trade or business under § 1.163-8T, interest on debt B may be deductible under other sections of the Internal Revenue Code.

(iii) Allocation of debt secured by two qualified residences. [Reserved]

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