



Are Profits from Cash-Out Refinances Taxable?

Millions of Americans have taken advantage of their home equity by obtaining cash-out refinance loans on their homes. This is the process of creating a new mortgage loan that will completely pay off your original mortgage and is also large enough to allow you to pull out a sum of cash based on your percentage of equity in the home. Many people use this helpful bundle of dough to finance things like debt consolidation, college tuition, or home improvements. If you are considering such a loan, you may wonder if you will have to pay taxes on that tidy sum before you can put it to good use? If you are confused about this issue, read on.

A cash-out refinance is a loan. That means that the money is being handed to you based on the promise that you will pay it back. So in truth, the money is not really yours. It is not technically a profit or gain. A loan means that you are receiving funds in order to pay off another debt. Because of this, the money you receive from a cash-out refinance is not taxable by the government.

There are, of course, exceptions to this rule. One such exception is if you try to re-invest your cash into tax-free or tax-deferred. The government wants to get a piece of that sum at some point if you are using it to make profits. If you used your cash-out money to start a business, the government would be able to tax the profits of that business. If you try to make profits from investing the money, the government will tax you before you can put it into tax-free or tax-deferred account. Even still such a strategy could be a great plan. Mortgage debt comes with the cheapest interest rates of almost any consumer debt. The key is simply to make sure that the profits you will see from investing will be enough to compensate for the taxes on the initial sum.

Another exception is if you decide to sell your home after a cash-out refinance. The money you took out from the new loan could be taxable. When you move, the government allows you to exclude roughly \$250,000 of the money from being taxed if you are single. If you are married, you and your spouse get double the benefits; a married couple can get an exclusion of approximately \$500,000. If you ended up with more than that after the sale of your home, you are subject to capital gains taxes. You can determine if your profits were over the exclusion limits by subtracting the price you paid for the home plus and expenses you had for improving or adding on to it from the price you sold your home for.

Some states do actually tax you on refinance loans, so you will have to speak with a knowledgeable tax professional in your state to learn all the details and exceptions. Basically you are only taxed on the money if you move soon afterwards or if you try to reinvest it in tax-privileged accounts. Remember though, that there are great tax benefits of refinancing. All the interest you have to repay on the loan is tax-deductible. Other non-secured loans do not provide the same advantage!