

TAX PLANNING LETTER

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Impact of TCJA on Home Mortgage Interest Deductions

The Tax Cuts and Jobs Act of 2017 (TCJA) has caused some changes in the area of home mortgage interest deductions. While a good amount of existing homeowners will not be impacted due to grandfather provisions that keep certain prior-law rules in place, other homeowners will be negatively impacted by a new provision that generally disallows interest deductions for *home equity loans* for tax years 2018-2025. This Tax Planning Letter outlines what you need to be aware of regarding TCJA's impact on home mortgage interest deductions.

HOME MORTGAGE INTEREST: Pre-TCJA

Prior to TCJA, a taxpayer was allowed to deduct the interest associated with up to \$1 million (\$500,000 if married filing separately) of "*home acquisition indebtedness*". "Home acquisition indebtedness" is debt used to buy or substantially improve a first or second residence.

Additionally, a deduction was generally allowed for regular tax purposes (i.e. not for AMT) for the interest associated with another \$100,000 (\$50,000 if married filing separately (MFS)) of "*home equity indebtedness*", without regard to the use of the proceeds. The common thread however is that each of these forms of debt must have been secured by a qualified residence. Collectively, deductible home mortgage interest is known as "*qualified residence interest*".

The IRS, in Revenue Ruling 2010-25, provided that up to \$100,000 of "*home acquisition indebtedness*" could qualify as "*home equity indebtedness*" to the extent it exceeds the \$1 million limit. This is to say that a taxpayer could:

- treat \$1 million of the loan as "*home acquisition indebtedness*", and
- \$100,000 of the same loan as "*home equity indebtedness*".

So, technically, "*qualified residence interest*" under pre-TCJA law was actually limited to \$1.1 million of mortgage debt (\$550,000 for MFS). TCJA trims these figures back quite a bit.

HOME MORTGAGE INTEREST: TCJA

Under TCJA, for the tax years 2018 - 2015:

- The "*home acquisition indebtedness*" limit is reduced, and
- The deduction for "*home equity indebtedness*" is generally eliminated.

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"Home Acquisition Indebtedness" under TCJA

TCJA generally allows taxpayers to treat interest associated with up to only \$750,000 of "*home acquisition indebtedness*" as deductible "*qualified residence interest*" (\$375,000 for married filing separately). A grandfather provision for pre-TCJA mortgages (explained in more detail later) means that this change will primarily impact new (post-TCJA) buyers.

“Home Equity Indebtedness” under TCJA

TCJA generally disallows “*home equity indebtedness*” interest altogether. Likely this will impact significantly more homeowners than the new limits on “*home acquisition indebtedness*” under the assumption that more homeowners have home equity loans than have mortgages in excess of \$750,000.

The IRS has clarified that such home equity loan and line of credit interest remains deductible if the funds are used to buy, build, or substantially improve the taxpayer’s home that secures the loan (i.e. such loans will fall under the “*home acquisition indebtedness*” rules subject to the new \$750,000/\$375,000 limits). IRS’ clarification confirms that the actual use of the loan proceeds, not the type of loan, is the determining factor as to deductibility (also explained in more detail later).

\$1 Million of “Home Acquisition Indebtedness” Grandfather Rules under TCJA

GRANDFATHER RULE #1

TCJA does not impact deductions for interest associated with “*home acquisition indebtedness*” of up to \$1 million (\$500,000 for MFS) that was consummated:

- on or before 12/15/17, or
- under a binding contract that was in effect before 12/15/17 to close on the purchase of a principal residence prior to 1/1/18,

so long as the residence is actually purchased before 4/1/18.

GRANDFATHER RULE #2

The Pre-TCJA \$1 million (\$500,000 for MFS) debt limits continue to apply to “*home acquisition indebtedness*” that was taken out on or before 12/15/17 and then subsequently refinanced . . . limited to the extent the amount of the new loan does not exceed the principal balance of the old loan at the time of the refinancing.

Taxpayers Who Can Disregard TCJA Changes

NON-ITEMIZERS

Because TCJA almost doubles the standard deductions, many taxpayers may no longer be itemizing their deductions (inclusive of the deduction for “*qualified residence interest*”).

OTHERS

- Taxpayers with a moderate amount of “*home acquisition indebtedness*” and no “*home equity indebtedness*”.
- Homeowners that, while they have relatively large amounts of “*home acquisition indebtedness*”, will be unaffected by TCJA due to the grandfather rules.



Questions?

For more details on information presented in this Tax Planning Letter or other issues, please feel free to call Roger Rossmeisl, CPA direct at (714) 325-0442 or via e-mail at roger@khopatel.com.

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