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IMPACTS TO HOMEOWNERS (Tax Topic #2)

New Tax Law and What it Means for Homeowners.

The Tax Cuts and Jobs Act will impact homeowners through changes to the standard deduction and limits on state and local taxes as well as lowering limits on home mortgage deductions. Please note that unless otherwise indicated, the provisions discussed are in effect Jan. 1, 2018 and sunset Dec. 31, 2025 at which time tax law reverts back to 2017 rules.

Property taxes. The deduction for all state and local taxes, including property taxes, is capped at $10,000. This limit applies to homeowners and their Schedule A property taxes. It does not apply to taxes paid on business or rental property.

> • **What does this change mean?** It can mean that you get no tax benefit for the property taxes that you pay. For example, if your state income taxes exceed the $10,000 deduction limit, your federal income taxes are not reduced by the payment of property taxes. If your state income taxes are $7,000 and your property taxes are $6,000, only $3,000 of your property taxes end up deductible on your federal tax return. You get no tax benefit for the remaining property tax payment.

Mortgage interest. Mortgage interest continues to be deductible but the limit on debt used to purchase, construct or substantially improve your personal residence has been reduced for new mortgages. The limit on mortgage debt for purposes of the mortgage interest deduction is reduced from $1,000,000 to $750,000 for loans made after Dec. 15, 2017. Loans made before Dec. 15, 2017, are grandfathered at the $1,000,000 debt limit.

Interest on equity debt is no longer deductible if used for personal expenses. This means that the interest paid on the borrowing from the equity of your home to pay off personal debts (such as credit card debt, auto loans, or student loans) is not deductible beginning in 2018.

Second home interest continues to be deductible. But, the combined total of the acquisition debt on your first and second home cannot exceed $750,000 ($1,000,000 if the debt is incurred prior to Dec. 15, 2017.)

> • **What does this change mean?** If your acquisition mortgage(s) is less than $750,000, the change does not affect you. If you purchased your home a few years ago and your acquisition mortgage(s) is less than $1,000,000, the change does not affect you because of the grandfathering provision. But if you are buying a new home this year, the interest you pay on a mortgage above $750,000 will not be deductible. If you borrowed from the equity of your home, this year or in a prior year, to pay off personal debt, the interest on the equity borrowing is not deductible. It was deductible in 2017.

• **Can I refinance my grandfathered debt?** The $1,000,000 acquisition debt limit continues to apply to refinanced debt as long as the refinanced debt **does not exceed** the amount of the old debt balance. Use caution when refinancing as you must pay all closing costs out-of-pocket to protect the grandfathered $1,000,000 amount.

Standard deduction. The new tax law doubles the standard deduction. The higher standard deduction ($12,000 for singles, $18,000 for heads of household, and $24,000 for married filing joint) means that fewer taxpayers will benefit from itemizing deductions. The additional standard deduction amount for those 65 or older (or are blind) is $1,300 per person if married and $1,600 if single.

• **What does this change mean?** It may mean that the standard deduction is more than your itemized deductions (medical expense, state tax and property tax, mortgage interest, and charity). For example, you are married and file a joint tax return. Your standard deduction is $24,000. Your 2018 itemized deductions are $10,000 of taxes (capped), $10,000 of mortgage interest and $2,000 of charity. Since your itemized deductions are less than $24,000, you get no tax benefit from paying any of your itemized deductions, including the property taxes and mortgage interest on your home.

Home sale. Changes were proposed to the home sale rules. No changes were included in the final tax reform law. You may still exclude up to $250,000 ($500,000 married filing joint) of the gain on the sale of your principle residence if you have owned and occupied the home for two of the prior five years.

State impact. California and several other states do not automatically conform to the Federal tax changes.

• **Property taxes**. There is no deduction for state income taxes paid on the California return, but the $10,000 limit would be applied against property and personal taxes that is allowed under California law. For example, if you paid $13,000 in property taxes, you would be limited to a deduction of $10,000 and would get no benefit for the remaining $3,000 of property taxes paid.

Questions we can help to answer.

- Is there anything I can do now that will make my taxes less under the new tax reform law?
- If I buy a house, will I get any tax benefits?
- If I buy a bigger house, will I get any tax benefits?
- If I refinance my first mortgage to include my prior home equity borrowing will I be able to deduct the interest on the combined debt?

Please do reach out if you have questions regarding your specific situation.