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6 Things to Know About Buying a Home Under New Tax Rules

How has tax reform affected homebuyers? Here are six key ways.

Portions by Christy Bieber Jan 26, 2018 retrieved on fools.com website

1. It may no longer make sense to deduct mortgage interest

For many homeowners, one big perk of ownership is the ability to deduct mortgage interest. Mortgage interest is deductible only if you're among the 30% of individual taxpayers who itemize. Of those who itemize, three in four claim a deduction for home mortgage interest, according to a 2016 report from the Tax Policy Center.

Collectively, around 21% of tax filers end up claiming this deduction and these taxpayers together saved an estimated \$77 billion in 2016. The average benefit for taxpayers claiming the deduction was estimated at around \$1,950 in 2016, according to the report, although homeowners with higher incomes benefited more.

Now, however, tax reform has almost doubled the standard deduction, reducing the incentive to itemize. The Tax Policy Center estimated that the percent of tax filers claiming the mortgage interest deduction would fall from around 21% of all taxpayers to just 4% thanks to the doubling of the standard deduction. This means far fewer homeowners will get a tax break from Uncle Sam that's geared specifically to help them pay for their homes.

2. You may not be able to deduct all your mortgage interest if you're buying a more expensive home

While wealthy homeowners with big mortgages currently get the biggest tax breaks from the home mortgage deduction, things are changing. Under the new rules ushered in by tax reform, **the mortgage interest deduction is capped at \$750,000 for newly issued mortgages**. Previously, homeowners could deduct interest on mortgages up to \$1 million.

This change is expected to make it more difficult for higher-priced homes to sell, reducing their value. It will definitely make buying a high-end home cost more.

Homebuyers in expensive markets -- especially those in the District of Columbia, Hawaii, and California -- are likely to see the biggest impact. In California alone, there are seven counties where the average home price exceeds \$750,000.

Since homebuyers typically make a down payment, those with homes valued at up to \$937,500 who put down 20% or more will still get to deduct the full amount of interest on their mortgages. Still, many homeowners stuck in places with high housing prices are likely to have at least some nondeductible interest that previously would have provided a tax break.

3. Home equity loans MAY be deductible

Home equity loans allow homeowners to tap into the value of their homes. While there are risks to borrowing against the equity in your home, this type of loan does provide a way to take cash out of one of your most illiquid assets.

The IRS has clarified that last year's big tax overhaul did not kill all interest deductions on home equity lines of credit, or HELOCs, and equity loans.

In a policy statement, the IRS said It depends on how you use the money you borrow. Taxpayers can “often still deduct interest on a home equity loan, home equity line of credit or second mortgage, regardless of how the loan is labeled,” said the IRS, provided the borrowed funds are used to “**buy, build or substantially improve the taxpayer’s home that secures the loan**” and the total debt on the house **does not exceed statutory limits**. The amount of **the first mortgage on the property, combined with the home equity or HELOC debt, cannot exceed \$750,000**, the newly revised limit for mortgage interest deductions by taxpayers filing joint returns; married owners filing separately have a new ceiling of \$375,000. Previously, the limits were \$1 million and \$500,000.

In its policy statement, the IRS offered examples of what you cannot do with your HELOC or home equity loan cash if you want to write off the interest. At the top: paying off credit card bills and other personal debts.

4. Forget about deducting mortgage interest on a second home

If the home you were planning to buy is a vacation home, tax reform means you'll pay more for your getaway. While you could previously deduct mortgage interest on a second home as well as on a primary home -- as long as your combined mortgages were under the \$1 million cap -- this is no longer permitted under the new rules.

The ban on deducting interest on a mortgage for a vacation home affects only new purchases, so if you already have a vacation home, you may want to hang onto it.

5. Your state and local taxes may no longer be fully deductible either

If you're buying a home, one of the costs to factor in is property taxes. While real estate taxes can be expensive, homeowners were previously permitted to deduct the full value of taxes paid to local governments from their federal returns. This is no longer the case.

Tax reform capped the total state and local tax (SALT) deduction that you're allowed to take at \$10,000. If your property taxes combined with other local taxes exceed \$10,000, you'll lose out. This change is also likely to hit wealthy homeowners in high-tax blue states -- like California -- very hard.

Nationwide, an estimated 4.1 million pay property taxes in excess of \$10,000, according to ATTOM Data Solutions. Many of these homeowners also have state income taxes to pay. For the first time since the federal income tax was created in 1913, they'll be taxed by the federal government on money the states have taken.

6. Capital-gains rules for home sales stayed the same

There is some good news for homeowners. While there were proposals to change the rules for avoiding capital gains taxes on the sale of a home, these changes didn't make it into the final bill. Taxpayers continue to be eligible to exclude \$250,000 in gains for single filers, and \$500,000 in gains for joint filers, if they sell their home at a profit. You can avoid paying capital gains on your home sale as long as you've lived in the house for at least two of the five years prior to selling.

Buying a home in 2018 under the new tax rules

For most homeowners, the decision to buy a home won't be affected by changes to the tax code. However, since you could lose deductions for both your mortgage and property taxes, becoming a homeowner in 2018 could be a costlier proposition than it would have been had you purchased before the ball dropped this past New Year's Eve.

Since you can't invent a time machine, the best thing to do is just run the numbers, make sure you don't end up with a house that stretches your budget too thin, and look for other ways to save on taxes where you can.