HBK CPAs & Consultants

TCJA and Home Equity Loan Interest Deduction

Tax Advisory Group

By Cassandra BAUBIE, JD
HBK Tax Advisory Group

Through Code §163(h)(3)(F), the TCJA eliminated the deduction for interest on home equity debt for tax years beginning after December 31, 2017 and before January 1, 2026. This was applicable regardless of when the home equity debt had occurred.

Prior to the TCJA, taxpayers were permitted to deduct interest on home equity debt. That was true specifically for those debts which were secured by the taxpayer's home and were not an "acquisition indebtedness" (such as those incurred acquiring, constructing or improving a home).

Through Code §163(h)(3)(F), the TCJA eliminated the deduction for interest on home equity debt for tax years beginning after December 31, 2017, and before January 1, 2026. This was applicable regardless of when the home equity debt had occurred.

Through Informational Release IR 2018-32, the IRS clarifies that, although restricted by the TCJA, taxpayers can still deduct interest on many home equity loans, home equity lines of credit or second mortgages. The IRS states that TCJA suspends the deduction for interest paid on home equity loans and lines of credit when they are used for something other than the purchase of, building of or substantial improvement of that taxpayer's home that secures the loan.

This Informational Release also clarifies the new dollar limitations on total qualified residence loans for those taxpayers considering taking out a mortgage. The TCJA imposes a lower dollar limit on mortgages qualifying for the home mortgage interest deduction. For tax years after December 31, 2017, taxpayers may only deduct interest on $750,000 of qualified residence loans. These are down from the prior limits of $1 million, or $500,000 for a married taxpayer filing a separate return. The limits apply to the combined amount of loans used to buy, build or substantially improve the taxpayer's main home, as well as a second home.

In order to qualify for this deduction, the home equity loan must be considered "acquisition indebtedness," which is essential debt secured by a home and used to acquire, construct or substantially improve the home. If the home equity line qualifies as acquisition indebtedness, the interest should be deductible, subject to the new principal balance limitations ($750,000 for debts incurred after December 15, 2017). If the principal balance of the mortgage and the equity line combined is in excess of this limitation, the interest deduction will be limited.

The following examples illustrate these updates.

EXAMPLE 1:

In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home with a fair market value of $800,000. In February 2018, the taxpayer takes out a

$250,000 home equity loan to put an addition on the main home and both loans are secured and the total does not exceed the cost of the home. Because the total amount of both loans does not exceed $750,000, all of the interest paid on the loans is deductible. However, if the taxpayer used the home equity loan proceeds for personal expenses, such as paying off student loan and/or credit card debt, then the interest on the home equity loan would not be deductible.

The IRS states that TCJA suspends the deduction for interest paid on home equity loans and lines of credit when they are used for something other than the purchase of, building of or substantial improvement of that taxpayer's home that secures the loan.

EXAMPLE 2:

In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home and the loan is secured. In February 2018, the taxpayer takes out a $250,000 loan to purchase a vacation home and the loan is secured. Because the total amount of both mortgages does not exceed $750,000, all of the interest paid on both mortgages is deductible. However, if the taxpayer took out a $250,000 home equity loan on the main home to purchase the vacation home, then the interest on the home equity loan would not be deductible.

EXAMPLE 3:

In January 2018, a taxpayer takes out a $500,000 mortgage to purchase a main home and the loan is secured. In February 2018, the taxpayer takes out a $500,000 loan to purchase a vacation home and the loan is secured. Because the total amount of both mortgages exceeds $750,000, not all of the interest paid on the mortgages is deductible.

For questions on this or any other provision of the Tax Cuts and Jobs Act please contact a member of the HBK Tax Advisory Group.

Cassandra Baubie, JD
Associate, HBK Tax Advisory Group

Cassandra Baubie is an Associate at HBK CPAs & Consultants and is a member of its Tax Advisory Group (TAG).

Ms. Baubie joined HBK in 2017. She works in the firm's Youngstown, Ohio, office after earning a dual Bachelor of Arts degree in Legal Studies and Psychology from the State University of New York, The University at Buffalo and a Juris Doctorate from the University of Pittsburgh School of Law, where she also completed a Tax Law Certification. She graduated from both schools with high honors and also spent a semester studying abroad in London, England.

Ms. Baubie has experience in tax law research. Prior to joining HBK, she worked for Jurist.org, a global legal news organization, and was a member of the University of Pittsburgh Tax Law Review Journal. Ms. Baubie also worked for the University of Pittsburgh School of Law's Low Income Tax Clinic where she performed IRS litigation and Tax Court work, and provided compliance work for low income individuals and businesses. She was an avid volunteer with the Olmsted Center for Sight in Buffalo.

Hill, Barth & King LLC has prepared this material for informational purposes only. Any tax advice contained in this communication (including any attachments) is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or under any state or local tax law or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein. Please do not hesitate to contact us if you have any questions regarding the matter.