Is Home Equity Interest in 2018 Deductible or Not? It Depends.

Kathryn A. Mellon kmellon@dopkins.com August 2018

Many have heard that the Tax Cuts and Jobs Act of 2017 have suspended the deduction of interest paid on home equity loans and lines of credit. In order to respond to the multitude of questions received from taxpayers the IRS has issued guidance that clarifies that interest on home equity loans and lines of credit are still deductible in many cases.

The Tax Cuts and Jobs Act of 2017 has eliminated the deduction of interest paid on home equity loans and lines of credit through 2025, unless the proceeds from the loan are used to buy, build, or substantially improve the qualified residence that secures the loan (also known as acquisition indebtedness) and the loan does not exceed the cost of the home. Under these circumstances the interest arising from home equity debt can be included with the home mortgage interest deduction. It is important to note that the proceeds from the loan must be used on the same residence that secures the loan.

For example, a taxpayer that took a home equity loan on their primary residence to purchase a second home would not be able to deduct the interest of the home equity loan. Even though the second home would be a qualified residence, the home equity loan is not secured by the second home which the funds were used to purchase.

Another item that needs to be taken into consideration when determining deductions for both mortgage interest and home equity loan interest is the new dollar limitations put in place beginning in 2018. Starting this year, taxpayers may only deduct interest on $750,000 of qualified residence loans. Qualified residence loans include all of the acquisition indebtedness, mortgages and home equity loans used to buy, build, or substantially improve the qualified residence, for both a main home and second home combined. This upper limit of $750,000 is a decrease from the previous limit of $1,000,000.

Loans taken out before December 15th, 2017 are grandfathered at the former limit of $1,000,000. However, any new loans that are entered into after this date need to be under the $750,000 limit when combined with any older loans in order for the interest to be deductible. For example, if a taxpayer has a mortgage that was secured before December 15th 2017 for $800,000 all of the interest on that mortgage would be deductible, going forward, as it falls under the old limit of $1,000,000. If that taxpayer takes out additional acquisition indebtedness of $50,000 in 2018 any interest on the new loan would not be deductible as the original $800,000 loan already exceeds the new upper threshold of $750,000.

Taxpayers who in the past have deducted home equity interest when the borrowed funds were used for other personal reasons not related to home acquisition will no longer be able to deduct these amounts.

The new law does not grandfather in any amounts for home equity debt used for other personal reasons. This means that the interest paid on home equity loans or lines of credit, regardless of when they were obtained that were used to pay off credit card debt, pay for college tuition, or pay for a new car will no longer be deductible beginning in 2018.

If the proceeds from a home equity loan or line of credit were used for multiple purposes the taxpayer may need to follow interest tracing rules to determine the amount of interest that is deductible as an itemized deduction under the new rules. Regulations have outlined specific rules on how to properly trace disbursements of debt proceeds; the related interest expense then takes on the same character as the corresponding expenditure for which the proceeds were used. This may require going back and digging through old records for some taxpayers that have home equity debt from years prior to 2018.

Although these changes will inevitably cost some taxpayers a deduction that had been taken in the past, the impact may not be as large as expected when you take into account the number of taxpayers who will no longer utilize itemized deductions in favor of the much larger standard deductions allowed in 2018. Nevertheless, any taxpayer that is beginning the process of securing a home equity loan or line of credit will want to keep records of how the proceeds are used so that if they find themselves in the position to itemize deductions on their tax return they can easily determine an accurate home mortgage interest deduction.

For more information, please contact:

#
Ndwku|q#D1#P hoorq/#FSD#
P dqdjhu#
kmellon@dopkins.com ▪ 716.634.8800

Katie specializes in corporate and personal tax returns, financial statements, and accounting services.