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How Tax Law Changes Affect Value of Home Ownership

It may be time for your clients to re-evaluate the benefits.

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The 2017 Tax Act made a host of changes that apply to homeowners, with the primary impact being the loss of formerly available deductions for most clients. This changes the basic equation for many clients as to whether to buy a home, how much home they should own, how much to borrow and even whether they're better off

renting their home to someone else. With respect to home tax benefits, much is different.

There are several general changes to the law that indirectly impact home ownership, such as the doubling of the standard deduction (and elimination of many itemized deductions), which is causing most taxpayers to not have any benefit from specific deductions for taxes, interest and other items on their personal income tax returns. The recent tax law changes may also exacerbate any significant downturn in housing prices, making things worse for homeowners.

Mortgage Interest

New, post-Act home mortgages will only be deductible for interest up to $750,000 worth of debt. Prior law permitted deduction of interest on up to $1 million of home mortgages. Mortgages that existed prior to the Act are grandfathered, but if your client takes out a new mortgage, the lower limit may impact them.

Property Tax

The property tax deduction is greatly restricted. State and local tax deductions have been capped at only $10,000 per person or married couple, and this amount won’t be inflation-indexed. This impacts clients who have more than $10,000 in combined personal state income tax, real estate and sales taxes and reduces the amount of itemized deductions that the taxpayer would have had towards exceeding the new high standard deduction, thus further restricting the number of taxpayers who can itemize deductions. Some wealthy property owners may set up special trusts and place income-producing items into the trusts with real estate to allow for deducting $10,000 per trust per year for property taxes.

Itemized Deductions

Taxpayers can only deduct certain itemizable deductions if the sum thereof exceeds the “standard deduction,” which is $12,000 for a single person and $24,000 for a

married couple filing their income tax return jointly. The itemized deductions include charitable donations, interest/expense real estate subject to the above caps, state and local income taxes also as limited above and medical expenses exceeding a specified percentage of the taxpayer's adjusted gross income. Some taxpayers will "bunch" deductions by making charitable donations and paying discretionary medical expenses and, to the extent feasible, real estate taxes every few years to exceed the standard deduction amount every other year. For example, your client might push 2018 deductions off to 2019 and in 2019, accelerate 2020 deductions by prepaying them if permissible.

Even if your client had, say, $10,000 in property tax, $10,000 in mortgage interest deductions and $2,000 in charitable deductions in a married filing joint situation, assuming no other deductions, your client is still going to have the standard deduction, which is $24,000 in 2018 for most married homeowners. Your client gets no incremental income tax benefit from all these expenses (including those for his home) as would have been the case under prior law, but your client might delay his charitable and real estate tax payments until 2019 and then pay $20,000 in real estate taxes, $10,000 in interest and $4,000 in charity to endeavor to qualify for a $34,000 deduction instead of $24,000 in that year.

Casualty Loss

Casualty loss deductions have been greatly restricted or almost eliminated, unless the property is in a disaster zone declared by the federal government. Your client may want to consider reducing any deductibles on his homeowner casualty policy and increasing the maximum coverage to take into account that there may not be any tax benefits to help him in the event of a fire, flood or other catastrophic event.

Moving Expenses

Moving expenses are no longer deductible with a limited exception for military personnel when certain requirements are met.

Economics May Offset Tax Benefit Losses

Overall, these are all significant negatives tax ramifications for home ownership. But with the low present October 2018 unemployment rates and a growing economy, increasing home values and a hot stock market, many Americans may nonetheless be bullish on home ownership. This may change fast when the next recession happens, and at that time, more people will rent instead of owning because of the tax situation. This may more often be a lifestyle decision than a tax decision, but the average taxpayer will be able to afford less home than before because of the tax savings elimination.

Vacation Homes

Vacation homes are also negatively affected by all the Tax Act changes. So, there's certainly a greater out-of-pocket cost to having a vacation home.

Home Office Deductions

More homeowners will consider making sure that they qualify for the office deduction, which requires that the requirements of Internal Revenue Code Section 280A are met. There's certainly a greater incentive for your client to have his home-based business to allow a pro-rata portion of what might be otherwise non-deductible tax, interest and other expenses become deductible. So, if 20 percent of your client's home is used for your business, then 20 percent of the property taxes and other things may also be deductible.

Time to Re-evaluate

It may be time to re-evaluate your client's situation to determine their after-tax cost of home ownership and what they might do to improve their situation. This may mean renting instead of buying because your client's landlord can afford to give him a low rent thanks to the tax deductions they're receiving, converting a personal home to a rental, moving their business or part thereof into the home and possibly

downsizing. Make sure that your client understands the economics of it before making a decision. Please remember that while the value of the median home in your client's area may have grown by 3.5 percent a year on average, these statistics don't take into account that your client's home gets older every year and therefore may lose part of its value and that your client's home will need a new roof, new air conditioning and other items that aren't counted in statistical average appreciation figures. While many Americans think that their homes have been their best investments, buy and hold diversified stock and mutual fund investments have more than doubled the rate of return over the past 60 years, and stocks and mutual funds don't need new roofs, or incur real estate taxes.

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