What Taxpayers Need to Know about the Proposed Federal Tax Plan - Part 3 of An ACCESS Special Report

November 9, 2017 - Home ownership is a big part of the American Dream. Consequently, US tax law has always done everything it can make the dream more affordable. But the tax reform bill currently in congress changes things. It removes many of the incentives for purchasing a home and it appears to transfer much of the nation's tax burden to current homeowners. Of course, that isn't the way that it is being promoted by members of congress and a read through the bill's provisions on home ownership make it pretty clear that these same people don't want the general public to get too educated prior to passage. Here is what we know so far.

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Home Ownership

This section of the proposed new law may have the largest impact on individual taxpayers and the overall economy.

The bill reduces the mortgage interest deduction from $1 million to $500,000 for new loans (existing loans are grandfathered). As anyone living in Los Angeles, New York, South Florida or any of a number of other areas will tell you, it isn't uncommon for homes in middle class neighborhoods to exceed $1 million in high-cost cities. To make matters even worse, the bill makes 11/2/2017, the date of this change. Anyone who has already signed a binding commitment to purchase a home and who plans to close on that home prior to January 1st, 2018 is exempted. This last provision may be open to interpretation however because it doesnâ€™t specify what constitutes a "binding commitment." Does this mean that all contingencies have to be removed? Or does it mean that loan documents have to be signed? Only time will tell.

Current law also allows homeowners to spread the $1 million interest deduction on up to two homes. That means if you purchase a home with a $250,000 loan, you can apply the remaining portion of the interest deduction to a vacation home in another location. Until the amount borrowed across both homes exceeds $1 million, all of the interest can be deducted. The new law would eliminate the mortgage interest deduction entirely for second homes regardless of value.

The elimination of the mortgage interest deduction on second homes will directly impact real estate values and inventory in vacation hot-spots across the country. Local economies that are dependent on tourism are also likely to suffer as a result of reduced vacation traffic. This provision of the law will also impact business owners who maintain homes in multiple locations for work purposes.

It also eliminates the mortgage interest deduction for home equity loans. Current law allows for home equity loan interest to be written off on loans of $100,000 or less. Since many people use home equity loans to pay for their children's' college education costs, this change could have a big impact on a lot of families. As noted in yesterday's article, congress is trying to eliminate the interest deduction for education loans. At current interest rates, home equity loans can be much less expensive than DOE education loans, so they are an attractive alternative for many families. Even with the change to the law, these loans may remain attractive, the fact that they will no longer be deductible will mean that fewer borrowers will be able to qualify for them.

The same is true for a home equity line of credit (HELOC). These loans are somewhat different. With a HELOC, your bank will give you the ability to take out money against your home as you need it. Accessing your money is as easy as writing a check or using a bank-issued credit card. As with any other home equity loan, HELOCs have been deductible up to $100,000. That will no longer be the case if the new law passes.

The worst aspect of the new tax proposal is probably the capital gains tax change. Current law shields homeowners from up to $250,000 of capital gains for an individual and up to $500,000 for married couples. The new law keeps those limits but phases them out based on income.

Once adjusted gross income hits $500,000, no portion of capital gains on your primary residence would be protected. As I understand it this means that if you have lived in your home for a long time and have a lot of equity in it, you could wind up with an adjusted gross income in the year that you sell your house which exceeds the limits. This is mitigated by the use of income averaging. When calculating the tax, the government will use your modified adjusted gross income for the year in which you sell the property as well as the prior two years to make a determination. However, depending upon the appreciation in value, you could still wind up paying taxes on all of your capital gains even if you wouldn't have hit the income limits without the sale of your home.

This provision of the law could pose significant issues for anyone who normally has a high income and runs into unanticipated financial difficulty. People in this position may consider selling their home but will have almost no way to protect any of their appreciated value from the IRS. And because the bill eliminates most other deductions, the ability to itemize and reduce your overall income will already be severely limited.

Under the new law, property taxes would still be deductible but only up to a maximum of $10,000. In California, this means that houses priced above approximately $870,000 would have a portion of their property taxes that weren't deductible. The amount will vary in other states. Consult your tax planner for information specific to you.

Mainstream media had anticipated most of the provisions of the bill concerning housing and has been reporting on them for a couple of weeks now, telling listeners that these provisions will largely impact people in high-tax states like California and New York. While people in these states will be heavily impacted if the new law is actually adopted, the housing provisions will impact people in every state.

NOTE: California, New York and New Jersey are the three states most mentioned as beneficiaries under the current tax code. That code allows residents of all states to write off their property and state income taxes. Many reports have inaccurately stated that these states are being subsidized by residents of other states as a result of these write-offs. The fact is that all three of these states are net-contributors to the federal government; paying more money in taxes to the US Treasury than they get back in services from the federal government.

The net effect of the bill, if it passes in its current form, will likely be a reduction in home values nationwide that is proportionate to the reduction in tax benefits for home ownership. In essence, this amounts to a hidden tax that will be paid by current homeowners when they attempt to sell their property. It represents a huge shift in the tax burden directly to the middle class citizens congress says they want to help.

It should also be noted that the process of qualifying for a mortgage will be impacted by changes to tax law which are not directly related to home ownership. For instance, as mentioned throughout this series of articles the bill eliminates the ability to deduct state and local income taxes, medical expenses, student loan interest and even tax preparation servicesâ€¦ and those are just a few of the examples. For borrowers, this means reduced overall income and a corresponding reduction in the amount of money they can borrow. For current homeowners, it means fewer qualified buyers when you attempt to sell and reduced overall sale prices.

NAR (the National Association of Realtors) has announced that it is reviewing the bill but that at first glance they have concerns. They are advising homeowners to take action by contacting their congressional representative and they are making it easy to do so. Just go to the following link and fill in your information:
http://homeownershipmatters.realtor/taxreform/

The Republican president of the National Conference of State Legislatures, South Dakota State Senator Deb Peters, released a press statement that makes clear her views on this tax bill. She said, "This is an attack on the sovereignty of the states." When Republican state legislators, the Wall Street Journal Editorial Board and the Club for Growth - none of which are bastions of liberal theology - all come out against a supposedly conservative tax plan, something is wrong. And when congress is attempting to move the plan forward so quickly that Americans don't have time to digest its implications, they know something is wrong.

Over the next few weeks, while this bill is moving through congress, we're going to look very closely at some the deductions we've mentioned in this series, who uses them and who will be helped or hurt as a result their elimination.

Read part 1

Read part 2
byJim Malmberg
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