Home Equity Loans and the New Tax Law

April 4, 2018 - When the President signed the new tax law late last year, the rules for interest deductions on home equity loans changed dramatically. Initially it was believed that no interest on these loans would be deductible. But the IRS has since issued guidance on the issue which means that isn't always the case. Here is what you need to know.

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Under the old law, homeowners could write off the interest on their home mortgages of up to $1 million. This included interest incurred on home equity loans of up to $100,000 regardless of how the loan was used. Those rules were grandfathered into the new law and are still in effect for loans issued before December 31, 2017.

The new law has new rules. As of 2018 homeowners can only write off interest on mortgages up to $750,000 and home equity loans aren't deductible. But the IRS guidance on the matter allows borrowers to consider some home equity loans as if they were a standard mortgage. As long as the money borrowed is used to improve or remodel your home, the interest will remain deductible on your taxes.

The guidance is also applicable to home equity lines of credit (HELOC). These are loans that allow borrowers to access the equity in their home on demand; usually through debit card issued by their bank. HELOC interest deductibility will be dependent on good record keeping on the part of borrowers. If questioned by the IRS, borrowers will need to be able to show in no uncertain terms that the money borrowed was used for home improvement.

The new rules mean that borrowers need to carefully consider how they intend to finance major purchases. For instance, anyone considering paying cash for a major home improvement and accessing a HELOC to purchase a new car in the same year should probably re-think that strategy. Interest on a car purchase using home equity isn't deductible under the new law.

Whether or not you can deduct the interest on a home loan, HELOCs and traditional home equity loans are likely to remain popular because their interest rates are significantly lower than credit card rates.
byJim Malmberg
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