March 8, 2018

Taxpayers can continue to deduct interest paid on home equity loans under the recently enacted Tax Cuts and Jobs Act

SD MEDALLION SERVICES, TAX, TAX REFORM
BY CARRIE UREY

SHARE WITH A COLLEAGUE DOWNLOAD PDF

For tax years beginning after Dec. 31, 2017 and before Jan. 1, 2026, the original language of the Tax Cuts and Jobs Act (the Act) indicated that "home equity debt" is no longer deductible. The elimination of the deduction for interest on home equity debt applied regardless of when the home equity debt was incurred. However, in a recent release, the IRS stated that despite the newly enacted restrictions on home mortgages under the Act, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labelled.

In Information Release 2018-32 dated 2/22/2018, the IRS clarified that the Act "suspends the deduction for interest paid on home equity loans and lines of credit, ***unless*** the proceeds are used to buy, build or substantially improve **the taxpayer's home that secures the loan.**" This statement is important, as the illustration noted below demonstrates.

For example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal living expenses, such as credit card debts, is not. Under the Act, interest remains deductible on Schedule A as mortgage interest, if the loan is secured by the taxpayer's main home or second home (known as a qualified residence), and does not exceed the cost of the home, and meets other requirements.

As discussed in our report on the Tax Cuts and Jobs Act, the combined limit on acquisition debt generally incurred after December 15, 2017 used to acquire a principal residence and/or second home is $750,000 ($375,000 married filing separately). However, taxpayers need to exercise care in how the loan proceeds are used and documented. As noted in the second illustration provided in the release (and shown below), the incorrect form of the transaction could render interest on a loan non-deductible.

> Illustration 2:
>
> In January 2018, Mary takes out a $500,000 mortgage to purchase a main home. The loan is secured by the main home. In February 2018, she takes out a $250,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages does not exceed $750,000, all of the interest paid on both mortgages is deductible.
>
> However, if Mary 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.

The second example in the illustration is contrary with the language in the release that states that proceeds be “used to buy, build, or substantially improve the **taxpayer's home that secures the loan.**” Therefore the deduction is disallowed.

Because of the variety of limits imposed on interest deductions, the IRS provides special rules for allocating interest expense among the categories. These “tracing rules,” as they are called, are generally based on the use of the loan proceeds. Under the tracing rules, interest expense is allocated in the same way as the debt on which the interest is paid. The debt, in turn, is allocated by tracing the use of the debt proceeds to specific expenditures.

Although the release does not address these rules, there still may be an opportunity to deduct the interest if incurred on a HELOC or other mortgage loan and used for investment purposes such as for rental real estate or investment in S corporation stock via the tracing rules. Please contact Schneider Downs to discuss these rules further and determine the best option for you.

SHARE

You’ve heard our thoughts… We’d like to hear yours

The Schneider Downs Our Thoughts On blog exists to create a dialogue on issues that are important to organizations and individuals. While we enjoy sharing our ideas and insights, we’re especially interested in what you may have to say. If you have a question or a comment about this article – or any article from the Our Thoughts On blog – we hope you’ll share it with us. After all, a dialogue is an exchange of ideas, and we’d like to hear from you. Email us at contactSD@schneiderdowns.com.

Material discussed is meant for informational purposes only, and it is not to be construed as investment, tax, or legal advice. Please note that individual situations can vary. Therefore, this information should be relied upon when coordinated with individual professional advice.

© 2019 Schneider Downs. All rights-reserved. All content on this site is property of Schneider Downs unless otherwise noted and should not be used without written permission.

READ MORE >

Register to receive our weekly newsletter with our most recent columns and insights.

SUBSCRIBE FOR UPDATES

MOST RECENT

The Stages of Wealth

401(K) PLANS, WEALTH MANAGEMENT
BY ALISSA SHAWL | 8.15.2019

Although everyone's situation is different, most people will go through various stages of wealth development throughout their lifetime. Over the ...

READ MORE

MOST POPULAR

Tax Treatment of Deferred Revenue in a Taxable Stock Acquisition

MERGERS AND ACQUISITIONS, TAX
BY GARY SLIMAN | 6.1.2016

The general rule under Internal Revenue Code §451 is that an item of income shall be included in gross income for the taxable year or receipt unless ...

READ MORE

Have a question? Ask us!

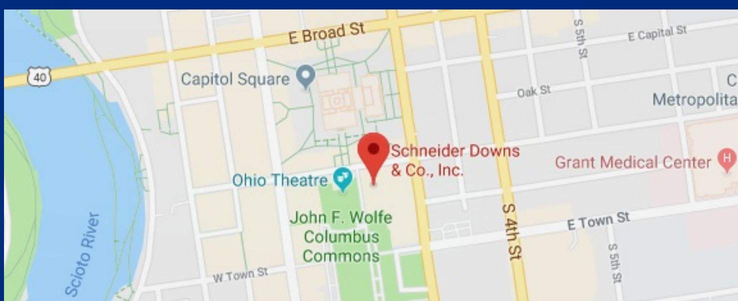
We'd love to hear from you. Drop us a note, and we'll respond to you as quickly as possible.

ASK US

CONTACT US

PITTSBURGH
One PPG Place, Suite 1700
Pittsburgh, PA 15222

contactsd@schneiderdowns.com
p:412.261.3644 f:412.261.4876



COLUMBUS
65 East State Street, Suite 2000
Columbus, OH 43215

contactsd@schneiderdowns.com
p:614.621.4060 f:614.621.4062

WASHINGTON, D.C.
1660 International Drive, Suite 600
McLean, VA 22102

contactsd@schneiderdowns.com
p:571.380.9003

PrimeGlobal
An Association of Independent Accounting Firms

FOLLOW US

CLIENT PORTAL

SUBSCRIBE FOR UPDATES

E-mail SUBMIT

INSIDE PUBLIC ACCOUNTING TOP 100 FIRMS 2018

PRIVACY POLICY

LEGAL INFORMATION

SITE MAP

Schneider Downs is a Top 60 independent Certified Public Accounting (CPA) firm providing accounting, tax, audit and business advisory services to public and private companies, not-for-profit organizations and global companies. We also offer Internal Audit; Technology Consulting; Software Solutions; Personal Financial Services; Retirement Plan Solutions and Corporate Finance Services. Schneider Downs is the 13th largest accounting firm in the Mid-Atlantic region and serves individuals and companies in Pennsylvania (PA), Ohio (OH), West Virginia (WV), New York (NY), Maryland (MD), and additional states in the United States with offices in Pittsburgh, PA and Columbus, OH.

© 2019 Schneider Downs & Co., Inc. Maryland license number 35239