Maximize Home Mortgage Interest Deductions

Before the TCJA, taxpayers could deduct interest paid on up to $1 million ($500,000 if married filing separately) of home acquisition debt (debt used to buy or substantially improve a first or second home). Also, taxpayers could deduct interest paid on up to $100,000 ($50,000 if married filing separately) of home equity debt, regardless of how the proceeds were used. The TCJA cuts those numbers back significantly.

For 2018–2025, the TCJA reduces the limit on home acquisition debt to $750,000. For married taxpayers filing separately, the debt limit is halved to $375,000. Also, the TCJA generally disallows home equity debt interest. However, the IRS recently advised homeowners that interest paid on home equity loans and lines of credit may be deductible if the funds are used to buy, build, or substantially improve the taxpayer’s home that secures the loan. In other words, such loans will be treated as home acquisition debt subject to the new $750,000/$375,000 limits.

Thanks to a set of grandfather rules, the new limits don’t apply to home acquisition debt that was taken out on or before 12/15/17 (or taken out on or before that date and refinanced later). This is good news for existing homeowners. However, if you have a home equity loan or line of credit, we will need to trace how the proceeds were used to determine if the interest is still deductible under the new law.

In addition, it may be beneficial to refinance your home using an interest-only mortgage. For example, if you refinance $1 million of pre-TCJA home acquisition debt with a new $1 million interest-only loan, you can continue to deduct all the interest under the grandfather rules. In contrast, if you gradually make principal payments on your $1 million of pre-TCJA home acquisition debt, you won’t be able to treat any portion of an additional home loan taken in 2018–2025 as home acquisition debt because your existing loan will absorb the entire $750,000 TCJA limit.
Consider Investing in Qualified Opportunity Zones

Tucked away in the TCJA is the creation of Qualified Opportunity Zones (QO Zones). These are low-income communities that meet certain requirements. Investing in QO Zones can result in two major tax breaks: (1) temporary deferral of gain from the sale of property and (2) permanent exclusion of post-acquisition capital gains on the disposition of investments in QO Zones held for ten years.

The IRS has already announced the designation of QO Zones in over 20 states and U.S. possessions. It will make future designations as permanent exclusion of post-acquisition capital gains on the disposition of investments in QO Zones held for ten years.

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Monitor State Response to Tax Reform

States react differently to changes to federal tax law. For example, some states automatically conform to federal tax law as soon as legislation is passed. Other states require their legislatures to adopt federal tax law as of a fixed date. This generally occurs on an annual basis. There are some states, however, that pick and choose which federal provisions to adopt. Because of this, your state income tax rules may be drastically different than the federal income tax rules. For example, you may be better off claiming the standard deduction for federal tax purposes but itemizing for state income tax purposes. We have monitored your state’s response to the TCJA and will help you minimize your state income tax bill.

Beware of the Alternative Minimum Tax

As tax reform efforts progressed late last year, there were high hopes that the individual Alternative Minimum Tax (AMT) would be repealed. Unfortunately, it still exists under the TCJA. The good news is that you are allowed a relatively generous AMT exemption, which is deducted in calculating your AMT income. The TCJA significantly increases the AMT exemptions for 2018–2025. The exemption is phased out when your AMT income surpasses the applicable threshold, but the TCJA greatly increases those thresholds for 2018–2025. This means that less people will be subject to the AMT rules.

Maximize Your Qualified Business Income Deduction

You may have heard a lot of talk in the news about a new deduction for “pass-through” income, but it’s actually available for qualified business income from a sole proprietorship (including a farm), as well as from pass-through entities such as partnerships, LLCs, and S corporations. Under the TCJA, individuals may deduct up to 20% of their qualified business income; however, the deduction is subject to various rules and limitations. Although there is some uncertainty surrounding this new deduction, there are some planning strategies we can consider. For example, there are ways to adjust your business’s W-2 wages to maximize your qualified business income deduction. Also, it may be helpful to convert your independent contractors to employees, assuming the benefit of the deduction outweighs the increased payroll tax burden. We will work with you to determine which strategies produce the best outcome.

Conclusion

As we said at the beginning, this letter is to get you thinking about tax planning moves for the rest of the year. This year is definitely unique given the numerous tax law changes brought by the TCJA. Even with uncertainty about some of the TCJA’s provisions, there are things you can do to improve your situation. Please don’t hesitate to contact us if you want more details or would like to schedule a tax planning session.

Best regards,