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Impact of the 2018 tax laws on real estate owners - Part 2 - by Pamela Michaels

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Part 1 appeared in the January 23rd edition of the New York Real Estate Journal.

This is part two of an overview of the new tax law, formally referred to as “The Tax Cuts and Jobs Act,” and the impact on both residential property owners as well as investment property owners. The scope of this overview focuses on real estate-related tax law changes and generally does not delve into tax issues not associated with real estate. Part 2 focuses on changes affecting primary residences and residential property owners. Part 1 focused on changes affecting investment property owners.

Primary Residence Homeowners

As a result of doubling the standard deduction to $12,000 for single filers and $24,000 for married filing jointly, according to Moody’s Analytics, as many as 38 million Americans who would otherwise itemize may instead choose the higher standard deduction under the new tax plan. The doubling of the standard interest deduction, in essence, removes a previous tax incentive of moving from renting a residence to home ownership. A likely unintended outcome will be fewer Americans choosing to become homeowners versus renting a residence solely for the tax advantages.

Any home mortgage interest debt incurred before December 15, 2017, will continue to be eligible for the home mortgage interest deduction up to $1 million. Any home mortgage interest debt incurred after this date will be limited to no more than $750,000 qualifying for the home mortgage interest deduction. Beginning 2018, the deduction for interest paid on a home equity line of credit (HELOC) will no longer be eligible for the home mortgage interest deduction. However, the new tax law preserves the deduction of mortgage debt used to acquire a second home. This should have a positive impact on supporting property values in resort and vacation destinations.

State and local taxes (referred to collectively as “SALT”) can be deducted, but will no longer be unlimited as under previous tax law. The 2018 tax law will allow homeowners to deduct property taxes and either income or sales taxes with a combined limit on these deductions being limited to no more than $10,000. Top earners who live in a state with higher taxes like California, Connecticut, Oregon, Massachusetts, New Jersey, New York will be negatively affected the most by no longer having the previous full federal deduction available. There is the potential for home values in high state tax areas on both the West Coast and East Coast to see a reduction in property values partially due to the new capped SALT deduction at $10,000 and partially due to the new maximum

$750,000 home mortgage deduction. A National Association of Realtors study found there could be a drop in home prices up to 10% in these and other high state tax areas as a result of limitations in the tax law that won't be as favorable as prior law for some property owners.

Both the House and Senate tax bills had originally proposed increasing the length of time a homeowner would need to live in a primary residence (from five out of eight years versus the current requirement to live in a primary residence two out of five years to qualify for the Section 121 tax exclusion). This proposed change did not become a part of the 2018 tax law. Homeowners will continue to only need to live in their primary residence 24 months in a 60 month time period to be eligible for tax exclusion up to $250,000 if filing single and up to $500,000 if married filing jointly. Property owners will still have the ability to convert a residence into a rental property or convert a rental property into a residence and qualify for tax exclusion benefits under both the primary residence Section 121 rules and also potentially qualify for tax deferral on the rental property under the Section 1031 exchange rules.

This article is only intended to provide a brief overview of some of the tax law changes, which will affect any taxpayer who owns real estate and is not intended to provide an in-depth overview of all the new tax law provisions. Every taxpayer should review their specific situation with their own tax advisor.

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