BUSINESS

New tax laws affect home mortgage interest deduction limits

Phillip Goldstein

The Tax Cuts and Jobs Act imposes new limits on home mortgage interest deductions. Here's how the changes could affect your tax situation:

The basics

For the 2018 through 2025 tax years, the new law generally allows you to deduct interest on only up to $750,000 of mortgage debt incurred to buy or improve a first or second residence. This type of debt is called "home acquisition indebtedness" in tax lingo. (For married individuals who file separately, the home acquisition indebtedness limit is $375,000 for 2018 through 2025.) Under prior law, you could deduct interest on up to $1 million of home acquisition indebtedness (or $500,000 for those who use married filing separate status).

In addition, for 2018 through 2025, the TCJA generally eliminates deductions for interest paid on home equity debt. Under prior law, individuals were allowed to deduct interest on up to $100,000 of home equity indebtedness. (Married individuals who filed separately could deduct interest on up to $50,000 of home equity indebtedness.)

Under prior law, you could also treat another $100,000 of mortgage debt as home acquisition indebtedness ($50,000 for married people who file separately) if the loan proceeds were used to buy or improve a first or second residence. The additional debt could be in the form of a bigger first mortgage or a home equity loan. So, technically, the limit on home acquisition indebtedness under prior law was $1.1 million (or $550,000 for those who use married filing separate status).

Grandfathered debts

The TCJA "grandfathers" in existing home mortgage debt under the old rules. That is, the new law doesn't affect home acquisition indebtedness of up to $1 million (or $500,000 for married-separate filers) that was taken out 1) before December 16, 2017, or 2) under a binding contract that was in effect before December 16, 2017, so long as the home purchase closes before April 1, 2018.

Under another grandfather provision, the previous home acquisition indebtedness limits of $1 million (or $500,000 for married-separate filers) continue to apply to home acquisition indebtedness that was taken out before December 16, 2017, and then refinanced during the period extending from December 16, 2017, through 2025. But the grandfather provision applies only to the extent that the initial principal balance of the new loan doesn't exceed the principal balance of the old loan at the time of the refinancing.

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What Is Home Acquisition Indebtedness?

Under the tax law, home acquisition debt is a mortgage taken out "to buy, build, or substantially improve a qualified home (your main or second home).
It also must be secured by that home."
An improvement is "substantial" if it:

- Adds to the value of your home
- Prolongs your home's useful life, or
- Adapts your home to new uses.

Repairs that maintain your home in good condition, such as repainting your home, aren't substantial improvements. However, if you paint your home as part of a renovation that substantially improves your qualified home, you can include the painting costs in the cost of the improvements.