Your Firm LLC

Homeownership Tax Benefits

Tax experts have long touted the financial benefits of home ownership. With high rent prices, low mortgage interest rates, and rising home values, you may be considering buying a new home or selling your current residence to take advantage of these many incentives.

Before you make the leap, however, you should consider the changes brought by the recent Tax Cuts and Jobs Act (TCJA). While there are still several tax advantages associated with owning a home, they may not be as substantial as you thought.

Which homeownership expenses can you write off?

First, let's dive right into your deductible home ownership expenses. Here is a rundown with all the details.

Mortgage Interest Deduction

In the past, you could deduct interest of $1 million worth of mortgage debt if you were married filing a joint return. That number was reduced to $500,000 if you were filing separately.

After the TCJA, the new numbers are $750,000 if you're married filing jointly and $375,000 if married filing separately.

These limits will continue to apply until 2025. Please note that the mortgage debt may be used to acquire or improve your home.

The limitations for mortgage interest depend on when you purchased the home. If it was before December 15, 2017, you're subject to the old limitations of $1,000,000 (married filing jointly) or $500,000 (married filing separately). If you purchased the home after that date, you're subject to the new limitations of $750,000 (married filing jointly) or $375,000 (married filing separately).

Interest on Home Equity Debt

In addition, old laws allowed a deduction of interest on up to $100,000 of home equity debt ($50,000 if you filed separately). It didn't matter how you used the home equity proceeds, which was a great incentive for paying down debt, etc.

The new limitations only allow a home equity debt deduction if it fits within the overall $750,000 or $375,000 debt limits. Also, the home equity proceeds must be used to acquire or improve your property. Again, the current limits are in effect until 2025.

Property Taxes

Property taxes are still deductible, but the 2018-2025 limit is $10,000 for state and local property and income taxes combined. The cap is $5,000 if you're filing separately.

Which expenses can you deduct for a second home?

You may be wondering if these same rules apply for a second home. For the most part, you can deduct mortgage interest, home equity debt interest, and property taxes on a second home just like you would for a primary residence, but there are a few additional stipulations.

Second Home vs. Rental Home

If you don't rent your home during the tax year, you can deduct mortgage interest like you would for a primary residence.

If you rent the residence at any point throughout the year, it depends on how long you live there yourself. You must use the secondary residence at least 14 days or more than 10% of the number of days you rent it out (whichever is longer). If the home doesn't meet this criteria, then it's a rental home for tax purposes.

Property Taxes

Property taxes for a second home are deductible, but all of your property and income taxes together are subject to the same $10,000 (or $5,000) limitation.

Additional Homes

You can only have one qualified second home during any tax year.

How the standard deduction impacts your mortgage and property tax deductions

When you file your taxes, you can claim either the standard deduction or itemized deductions. Home ownership deductions are itemized, so you may not notice any home ownership effect on your taxes at all if you claim the standard deduction.

Standard Deduction

The TCJA greatly increased the standard deduction across the board. Because it only makes sense to itemize deductions if the total will be greater than your standard deduction, fewer people are itemizing their taxes going forward. Here are the standard deductions for 2019:

- $24,400 for married joint-filing couples.
- $18,350 for heads of households.
- $12,200 for singles and married filing separately.

These numbers are higher for 2020. In the past, because the standard deductions were much lower, many people started itemizing their deductions when they purchased a home.

Whether you should itemize or not may come down to your other itemized deductions, such as charitable contributions and state income taxes.

However, you should know that your taxable income is only reduced by the difference between your standard deduction and your itemized deduction.

For example, if your standard deduction is $24,400 and your itemized deductions are $40,000, your taxable income is only reduced by $15,600 ($40,000-24,400).

What is taxable/tax-free when you sell your home?

The chances are high that any profit you make from your home sale is tax-free as long as you meet the criteria: You must have owned and lived in the home for at least two of the past five years.

If you meet this criteria, then up to $500,000 of your profit is excluded from your taxable income ($250,000 if married filing separately). This is true every time you sell a primary residence, as long as you haven't sold a home and excluded the profit on your taxes in the past two years.

Special Circumstances

There are additional circumstances that may apply regarding a home sale:

- If you're married filing jointly, only one of you must have owned and lived in the home for two of the past five years.
- If you acquired the home during a divorce and then sold it, the time your former spouse owned and lived in the home counts towards the two year requirement.
- The two years don't have to be consecutive. The time may be split over the past five years into short, temporary stays.
- If your spouse dies and you haven't remarried before the sale date, the time your deceased spouse owned and lived in the home counts towards the two year requirement.

How to Report a Home Sale on Your Taxes

You generally don't have to report a home sale on your taxes unless you don't meet the criteria above for some reason.

If you don't meet the criteria above or your profit exceeds $250,000 ($500,000 married filing jointly), you should receive a Form 1099-S from your real estate closing agent. You can report this income as a capital gain on Schedule D.

If you don't receive a Form 1099-S, you don't need to report the sale. If you receive a Form 1099-S but the profit isn't taxable, the closing agent may have sent the form by mistake. In this case, don't report the income, but keep records as proof that the income wasn't taxable in case the IRS questions you later. To avoid these types of mistakes, simply contact the closing agent before February 15 of the year after the sale. Let them know the profit isn't taxable and they shouldn't send you a form.

Final Thoughts

While the tax advantages of home ownership aren't quite as lucrative as they were in past years, there are still many good financial benefits to owning your own home. If you have any additional questions about your specific tax situation or about home ownership in particular, please contact our office. Our experts are always happy to assist.

About Your Firm LLC

We have hand-picked a team with tax, auditing, accounting, business and management advisory expertise in a multitude of fields, including healthcare, professional-services firms, commercial contractors, home builders, real estate companies, manufacturing and distribution companies, dealerships, non-profit organizations and pension funds.

We have the expertise and the resources to provide not only the critical services you need during these evolving economic times, but also, importantly, to build for the future. Our strategic alliances with professional organizations across the country allow us to bring our clients the talent and expertise of national firms with the high-touch service of a local firm. While we remain focused on the core services of tax, accounting and audit, we expand and offer you the business consulting needed to remain competitive. We believe the success of our clients is the greatest measure of our own.

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