ELIGIBLE HOME MORTGAGE LOAN DEDUCTIONS FOR 2020

By Daniel Smith, CPA, Tax & Business Services director at Marcum LLP

Daniel Smith
Marcum LLP
Boston, MA
danielsmith@marcumllp.com

As the filing season begins for tax year 2020, taxpayers and tax professionals undergo the annual ritual of reviewing the various deductions currently available. Deductions related to loans secured by a taxpayer's principal residence should be examined closely, as this area of tax law underwent changes as a result of the Tax Cuts and Jobs Act of 2017 (TCJA).

Mortgage interest may be deducted if the amount of deductible interest plus other itemized deductions (taxes, charitable contributions, other) exceed the standard deduction, which for 2020 is $24,800 for married couples filing jointly and $12,400 for single taxpayers or married taxpayers filing separately. The deduction for interest on a mortgage secured by the taxpayer's principal residence or secondary home is limited to the interest paid on up to $750,000, down from $1 million of principal. The TCJA also eliminated the $100,000 deduction for interest on home equity lines of credit (HELOCs), with one exception.

While the TCJA established lower thresholds for the deductibility of certain mortgage interest, certain grandfathered provisions will be in effect through the end of 2025. Taxpayers may still deduct the interest on up to $1 million of principal on any mortgages incurred before December 15, 2017. A taxpayer may even refinance mortgage debt and be grandfathered under the prior $1 million cap to the extent that the amount of the refinanced mortgage is no greater than the debt being refinanced.

Time is limited to be eligible for this grandfathered treatment. The grandfathered treatment ends after the term of the original debt expires or if the loan principal is not being amortized (such as with an interest-only mortgage), depending on which of the following is earlier: the end of the term of the first refinancing or 30 years after the date of the first refinancing. As the law is currently written, there are seemingly no limits to the number of times a taxpayer may refinance and benefit from the grandfathering provision.

Prior to the TCJA, interest paid on HELOCs up to $100,000 could be deducted under the same rules as mortgage interest. HELOC proceeds could be used for any purpose so long as the debt was secured by a primary or secondary residence. The TCJA eliminated the ability to deduct interest on HELOCs under these rules. However, taxpayers may still deduct interest on HELOCs if the proceeds are used for acquisition indebtedness. In order to qualify for that deduction, the debt proceeds must be used to buy, build or substantially improve the taxpayer's primary or secondary home and be secured by that home. The $100,000 cap no longer applies. However, interest on qualifying HELOCs is deductible as long as the total acquisition indebtedness (mortgage plus HELOC) does not exceed $750,000.

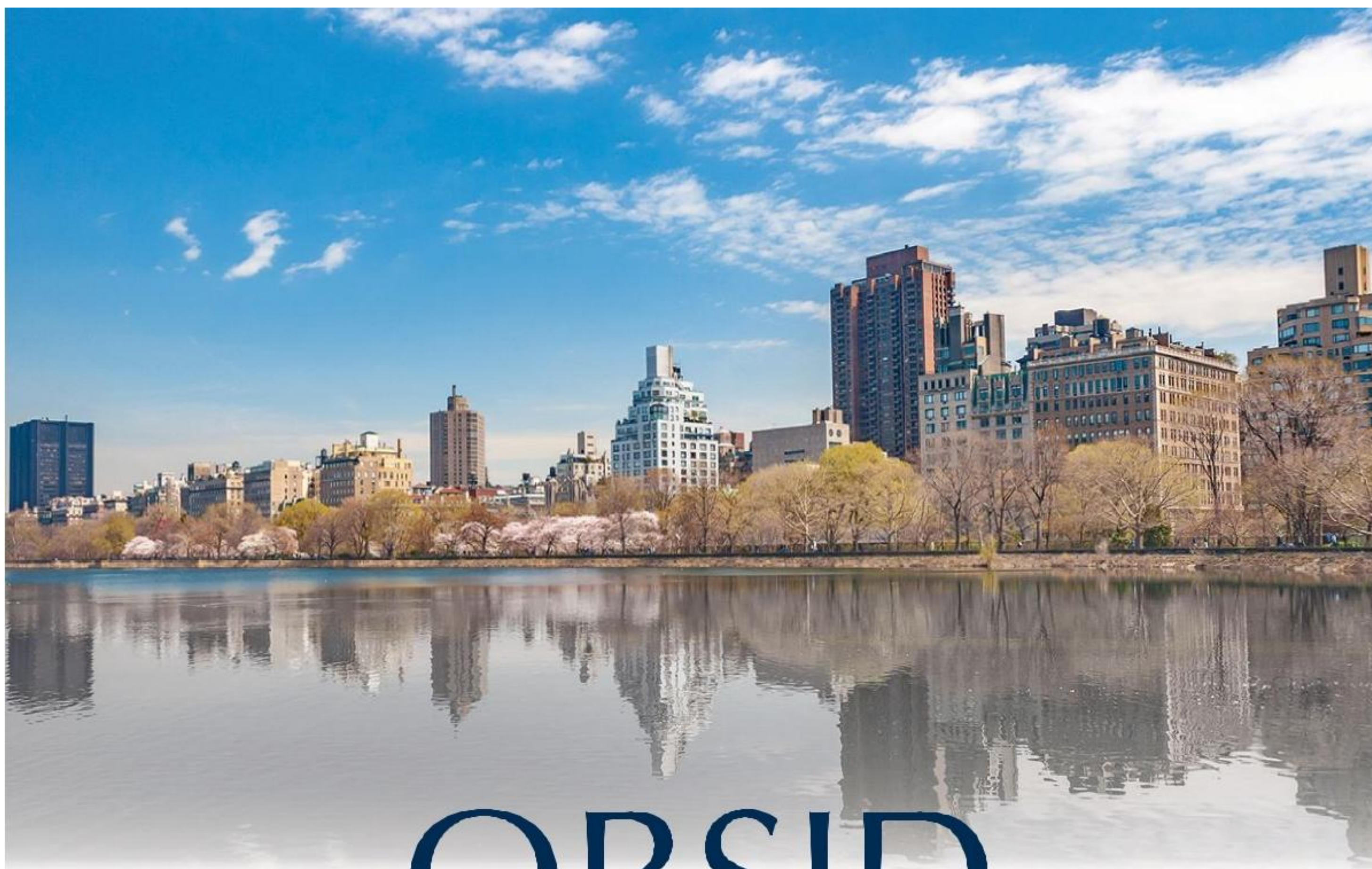
A taxpayer may still deduct interest expense if the acquisition indebtedness proceeds are used to buy taxable investments, up to the amount of a taxpayer's net investment income for the year or to invest in a pass-through trade or business entity in which the taxpayer materially participates.

These additional deductions offer incentives to borrow in order to buy taxable investments or make capital commitments to a business. They also provide the opportunity to structure debt in a tax-efficient manner.

When structuring their debts, taxpayers should take into consideration: using cash to pay down mortgages in excess of deductible amounts; borrowing against their properties at a later date, after being exposed to market and interest rate risk; investing the proceeds of these loans in either the taxpayer's trade or business or in taxable investments and electing out of the qualified residence interest rules on refinanced debt so the mortgage deductibility rules no longer apply.

The election out of the qualified residence interest rules is irrevocable. However, it allows the deductibility of interest to be determined solely under the interest tracing rules. After such an election, the interest on debt in excess of the mortgage caps would be fully deductible as either investment interest or trade or business expense.

With interest rates at historically record lows and likely to remain there for the foreseeable future, borrowing to acquire a personal residence, refinance current debt, invest in a current or new business or buy taxable investments is more affordable than ever. Taxpayers should always proceed cautiously when structuring debt to avoid running afoul of IRS rules. Seek the advice of a professional tax advisor in order to avoid traps and maximize possible interest expense deductions.



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