Home Equity Hassle

A key component of the TCJA is the expansion of the standard deduction. The numbers for 2018 are $24,000 (married couples filing jointly), $18,000 (heads of household), and $12,000 (all others). These amounts are almost double the respective standard deductions in 2017. However, personal exemptions were eliminated.

As a give-and-take, the new tax law trims some itemized deductions. Taxpayers can either itemize or use the standard deduction, so some shift to the standard deduction is likely.

Down with Debt Deductions

Among the trimmed itemized deductions are those for mortgage interest. The new law caps deductions to interest on $750,000 worth of debt used to buy, build, or substantially improve a main or second home. For loans incurred before December 15, 2017, the old rules remain in place, so interest on up to $1 million of such debt is still deductible.

These rule changes affect only newer home loans in the $750,000–$1 million range. Of broader impact, interest on any home equity loans or lines of credit cannot be deducted, starting in 2018. Previously, interest on home equity debt up to $100,000 generally could be deducted. (All of these home loan interest tax changes are scheduled to end after 2025, reverting to 2017 law.)

Therefore, home equity debt now looks like many other types of loans: the interest is nondeductible. Should you keep the one you have? That depends on your situation. If you wish to reduce your debt load, paying down home equity debt has become more attractive. Prepaying a nondeductible loan at, say, 5% is the equivalent of earning 5% on your money, after tax, with no market risk.

Another option is to update your existing home debt. A so-called cash out refinance might provide you with spending money, although the full interest deduction may not be available. Our office can help you crunch the numbers to see if the expense involved would make it worthwhile, and how it will impact the after-tax cost of residence related debt.

Yet another alternative is to use a personal loan to pay off the home equity debt. An unsecured personal loan might be preferable to a loan or line of credit that places your home at risk.