The New SALT Deduction Limits Will Affect Home Sales

The Tax Cuts and Jobs Act (TCJA) of 2017 sharply raised the standard deduction and placed limits on itemized deductions. In particular, no more than $10,000 can be deducted in state and local tax (SALT) payments on a single or joint tax return.

As a result, most people will take the standard deduction now and get no tax benefit from their property tax payments. Even those who itemize may get little or no tax benefit from their property tax payments if they also have ample outlays for state and possibly local income tax. The bottom line is that property tax payments will be fully or mainly out-of-pocket expenses for most homeowners — and for many home buyers — with reduced federal tax savings as an offset.

When the TCJA was passed, some observers predicted that this effective cost increase would significantly bring down home prices.

Example: John and Mary Smithe pay $20,000 a year in property tax. They had been in a 28% tax bracket, giving them a $5,600 (28% of $20,000) federal tax saving, resulting in a net cost of $14,400. If this couple sells their home, the buyer could owe the full $20,000 a year in property tax. This might reduce the home's appeal to buyers, who would offer lower bids than would have been offered in the past.

Broadly, such price declines have not happened. The U.S. House Price Index Report from the Federal House Finance Agency shows a 6.5% growth in prices from the second quarter of 2017 to the second quarter of 2018. Nevertheless, residential housing markets are very local, and it is likely that the new tax rules are affecting numerous transactions, especially in areas where property taxes are steep.

For Sellers

If you are planning to sell a primary residence or second home, be aware that buyers probably will raise questions about the ongoing property tax they will incur. You should know the amount you're paying now and the amounts you have paid in the past. If the growth rate has been modest, or if your home is taxed less than those in your neighborhood, tell your real estate agent. Then, your agent can use this fact as a selling point.

All homeowners, particularly those who plan a sale, should investigate the possibility of reducing their property tax bill. You should find out the procedure for obtaining a lower assessment in your community and see if you might qualify. Any reduction in annual tax obligation may be worth the effort, from increased cash flow today and a potentially higher selling price tomorrow.

For Buyers

If you are planning to buy a house, know your tax situation. Will you be taking the standard deduction? Will your itemized SALT deductions be capped? You'll know whether you'll get any tax savings from deducting property tax, so you will know what to expect in after-tax costs from a home purchase. If those costs, which are likely to rise in the future, might strain your budget, you can drop your bid price or look for another place with lower property taxes.

The IRS 15% Solution

Taxpayers in high tax states may hope that state "workarounds" will effectively preserve SALT tax benefits and their housing prices. (See the CPA Client Bulletin, June 2018.) One tactic has been to create state-run charities to which taxpayers can contribute in return for a credit against state income tax. These contributions would get federal tax deductions, which generally have much higher caps, instead of deductions for state and local tax payments, with lower caps.

In response, the IRS issued proposed regulations on this subject on August 23, 2018. Here, the IRS said that a taxpayer's charitable deduction will be reduced if the anticipated state tax credit exceeds 15% of the contribution. (See the Trusted advice box.) The message from the IRS is that the new SALT deduction rules will be enforced.

Trusted Advice

Explaining the Proposed Regulations

- For example, suppose Ann Clark contributes $20,000 to a state sponsored health or education charity.
- Ann expects to receive a $14,000 state income tax credit (70% of $20,000).
- Ann's state tax credit is greater than 15% of her contribution.
- These IRS proposed regulations say that Ann's charitable deduction will be reduced by $14,000, regardless of when she claims the tax credit.