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How the New Limit on SALT Deductions Affects Homeowners

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There's been a lot of controversy about the recent tax law change that limits the federal deductions for state and local taxes (SALT). This limitation will have an adverse effect on many homeowners, especially residents of jurisdictions with high property taxes and people who own expensive homes or more than one home.

How the New Limit on SALT Deductions Affects Homeowners

The ability to deduct state and local taxes (SALT) has historically been a valuable tax break for taxpayers who itemize deductions on their federal income tax returns. Unfortunately, the Tax Cuts and Jobs Act (TCJA) limits SALT deductions for 2018 through 2025. Here's important information that homeowners should know about the new limitation.

Old Law, New Law

Under prior law, in addition to being allowed to deduct 100% of state and local income (or sales) taxes, homeowners could deduct 100% of their state and local personal property taxes.

In other words, there was previously no limit on the amount of personal (nonbusiness) SALT deductions you could take, if you itemized. You also had the option of deducting personal state and local general sales taxes, instead of state and local income taxes (if you owed little or nothing for state and local income taxes).

Under the TCJA, for 2018 through 2025, itemized deductions for personal SALT amounts are limited to a combined total of only $10,000 ($5,000 if you use married filing separately status). The limitation applies to state and local 1) income (or sales) taxes, and 2) property taxes.

Moreover, personal foreign real property taxes can no longer be deducted at all. So, if you're lucky enough to own a vacation villa in Italy, a cottage in Canada or a beach condo in Cancun, you're out of luck when it comes to deducting the property taxes.

Who's Hit Hardest?

These changes unfavorably affect individuals who pay high property taxes because:

- They live in high-property-tax jurisdictions,
- They own expensive homes (resulting in a hefty property tax bill), or
- They own both a primary residence and one or more vacation homes (resulting in bigger property tax bills due to owning several properties).

People in these categories can now deduct a maximum $10,000 of personal state and local property taxes — even if they deduct nothing for personal state and local income taxes or general sales taxes.

Thinking about Selling Your Home?

There's good news if you're planning to sell a personal residence: The Tax Cuts and Jobs Act retains the home sale gain exclusion.

If you meet certain conditions, this valuable tax break allows you to exclude from federal income tax up to $250,000 of gain from a qualified home sale (or $500,000 if you're a married joint-filer). The home sale gain exclusion rules remain unchanged under the final version of the new tax law — even though both the House and Senate proposed restrictions on this tax break during tax reform negotiations.

Tax Planning Considerations

Is there any way to deduct more than $10,000 of property taxes? The only potential way around this limitation is if you own a home that's used partially for business. For example, you might have a deductible office space in your home, lease your basement to a full-time tenant or rent your house on Airbnb during the winter months.

In those situations, you could deduct property taxes allocable to those business or rental uses, on top of the $10,000 itemized deduction limit for taxes allocable to your personal use. The incremental deductions would be subject to the rules that apply to deductions for those uses.

For example, home office deductions can't exceed the income from the related business activity. And deductions for the rental use of a property that's also used as a personal residence generally can't exceed the rental income.

Important: If you pay both state and local 1) property taxes, and 2) income (or sales) taxes, trying to maximize your property tax deduction may reduce what you can deduct for state and local income (or sales) taxes.

For example, suppose you have $8,000 of state and local property taxes and $10,000 of state and local income taxes. You can deduct the full $8,000 of property taxes but only $2,000 of income taxes. If you want to deduct more state and local property taxes, your deduction for state and local income taxes goes down dollar-for-dollar.

AMT Warning

Years ago, Congress enacted the alternative minimum tax (AMT) rules to ensure that high-income individuals pay their fair share of taxes. When calculating the AMT, some regular tax breaks are disallowed to prevent taxpayers from taking advantage of multiple tax breaks.

If you're liable for the AMT, SALT deductions — including itemized deductions for personal income (or sales) and property taxes — are completely disallowed under the AMT rules. This AMT disallowance rule was in effect under prior law, and it still applies under the TCJA.

More Limits on Homeowners

The new limits on property tax deductions will affect many homeowners. But that's just the tip of the iceberg. If you have a large mortgage or home equity debt, your interest expense deductions also may be limited under the new law. For more information about how the TCJA affects homeowners, please contact us.

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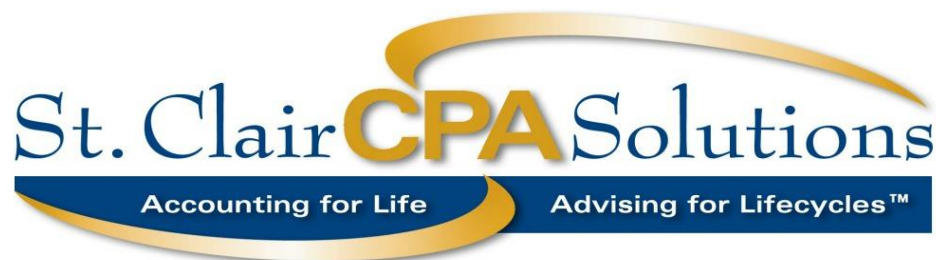

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