

Interest on Home Equity Loans

Cross References

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Responding to many questions received from taxpayers and tax professionals, the IRS said in a recent news release that despite newly-enacted restrictions on home mortgages, taxpayers can often still deduct interest on a home equity loan, home equity line of credit (HELOC) or second mortgage, regardless of how the loan is labelled. The Tax Cuts and Jobs Act of 2017 suspends from 2018 until 2026 the deduction for interest paid on home equity loans and lines of credit, unless they are used to buy, build, or substantially improve the taxpayer's home that secures the loan.

Under the new law, for example, interest on a home equity loan used to build an addition to an existing home is typically deductible, while interest on the same loan used to pay personal living expenses, such as credit card debts, is not. As under prior law, the loan must be secured by the taxpayer's main home or second home (known as a qualified residence), not exceed the cost of the home and meet other requirements.

New dollar limit on total qualified residence loan balance. The new law imposes a lower dollar limit on mortgages qualifying for the home mortgage interest deduction. Beginning in 2018, taxpayers may only deduct interest on \$750,000 of qualified residence loans. The limit is \$375,000 for a married taxpayer filing a separate return. These are down from the prior limits of \$1 million, or \$500,000 for a married taxpayer filing a separate return. The limits apply to the combined amount of loans used to buy, build or substantially improve the taxpayer's main home and second home.

The following examples illustrate these points.

Example #1

In January 2018, a taxpayer takes out a \$500,000 mortgage to purchase a main home with a fair market value of \$800,000. In February 2018, the taxpayer takes out a \$250,000 home equity loan to put an addition on the main home. Both loans are secured by the main home and the total does not exceed the cost of the home. Because the total amount of both loans does not exceed \$750,000, all of the interest paid on the loans is deductible. However, if the taxpayer used the home equity loan proceeds for personal expenses, such as paying off student loans and credit cards, then the interest on the home equity loan would not be deductible.

Example #2

In January 2018, a taxpayer takes out a \$500,000 mortgage to purchase a main home. The loan is secured by the main home. In February 2018, the taxpayer takes out a \$250,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages does not exceed \$750,000, all of the interest paid on both mortgages is deductible. However, if the taxpayer took out a \$250,000 home equity loan on the main home to purchase the vacation home, then the interest on the home equity loan would not be deductible.

Example #3

In January 2018, a taxpayer takes out a \$500,000 mortgage to purchase a main home. The loan is secured by the main home. In February 2018, the taxpayer takes out a \$500,000 loan to purchase a vacation home. The loan is secured by the vacation home. Because the total amount of both mortgages exceeds \$750,000, not all of the interest paid on the mortgages is deductible. A percentage of the total interest paid is deductible.