

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Table of Contents

Introduction.....	2
Major Provisions Affecting Current and Prospective Homeowners.....	3
Major Provisions Affecting Commercial Real Estate.....	6
Major Provisions Affecting Real Estate Professionals.....	8
Appendix 1 – Examples of How the Deduction for Qualified Business Income May Affect Various Real Estate Professionals.....	12
Appendix 2 – Examples of How The New Law Will Affect the Tax Incentives of Owning a Home.....	14

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

December 20, 2017

Introduction

The National Association of REALTORS® (NAR) worked throughout the tax reform process to preserve the existing tax benefits of homeownership and real estate investment, as well to ensure as many real estate professionals as possible would benefit from proposed tax cuts. Many of the changes reflected in the final bill were the result of the engagement of NAR and its members, not only in the last three months, but over several years.

While NAR remains concerned that the overall structure of the final bill diminishes the tax benefits of homeownership and will cause adverse impacts in some markets, the advocacy of NAR members, as well as consumers, helped NAR to gain some important improvements throughout the legislative process. The final legislation will benefit many homeowners, homebuyers, real estate investors, and NAR members as a result.

The final bill includes some big successes. NAR efforts helped save the exclusion for capital gains on the sale of a home and preserved the like-kind exchange for real property. Many agents and brokers who earn income as independent contractors or from pass-through businesses will see a significant deduction on that business income.

As a result of the changes made throughout the legislative process, NAR is now projecting slower growth in home prices of 1-3% in 2019 as low inventories continue to spur price gains. However, some local markets, particularly in high cost, higher tax areas, will likely see price declines as a result of the legislation's new restrictions on mortgage interest and state and local taxes.

The following is a summary of provisions of interest to NAR and its members. NAR will be providing ongoing updates and guidance to members in the coming weeks, as well as working with Congress and the Administration to address additional concerns through future legislation and rulemaking. Lawmakers have already signaled a desire to fine tune elements of The Tax Cuts and Jobs Act as well as address additional tax provisions not included in this legislation in 2018. REALTORS® will need to continue to be engaged in the process.

The examples provided are for illustrative purposes and based on a preliminary reading of the final legislation as of December 20, 2017. Individuals should consult a tax professional about their own personal situation.

All individual provisions are generally effective after December 31, 2017 for the 2018 tax filing year and expire on December 31, 2025 unless otherwise noted. The provisions do not affect tax filings for 2017 unless noted.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Major Provisions Affecting Current and Prospective Homeowners

Tax Rate Reductions

- The new law provides generally lower tax rates for all individual tax filers. While this does not mean that every American will pay lower taxes under these changes, many will. The total size of the tax cut from the rate reductions equals more than \$1.2 trillion over ten years.
- The tax rate schedule retains seven brackets with slightly lower marginal rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37%.
- The final bill retains the current-law maximum rates on net capital gains (generally, 15% maximum rate but 20% for those in the highest tax bracket; 25% rate on "recapture" of depreciation from real property).

Tax Brackets for Ordinary Income Under Current Law and the Tax Cuts and Jobs Act (2018 Tax Year) Single Filer

Current Law		Tax Cuts and Jobs Act	
10%	\$0 - \$9,525	10%	\$0 - \$9,525
15%	\$9,525 - \$38,700	12%	\$9,525 - \$38,700
25%	\$38,700 - \$93,700	22%	\$38,700 - \$82,500
28%	\$93,700 - \$195,450	24%	\$82,500 - \$157,500
33%	\$195,450 - \$424,950	32%	\$157,500 - \$200,000
35%	\$424,950 - \$426,700	35%	\$200,000 - \$500,000
39.6%	\$426,700+	37%	\$500,000

Tax Brackets for Ordinary Income Under Current Law and the Tax Cuts and Jobs Act (2018 Tax Year) Married Filing Jointly

Current Law		Tax Cuts and Jobs Act	
10%	\$0 - \$19,050	10%	\$0 - \$19,050
15%	\$19,050 - \$77,400	12%	\$19,050 - \$77,400
25%	\$77,400 - \$156,150	22%	\$77,400 - \$165,000
28%	\$156,150 - \$237,950	24%	\$165,000 - \$315,000
33%	\$237,950 - \$424,950	32%	\$315,000 - \$400,000
35%	\$424,950 - \$480,050	35%	\$400,000 - \$600,000
39.6%	\$480,050+	37%	\$600,000+

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Exclusion of Gain on Sale of a Principal Residence

- The final bill retains current law. A significant victory in the final bill that NAR achieved.
- *The Senate-passed bill would have changed the amount of time a homeowner must live in their home to qualify for the capital gains exclusion from 2 out of the past 5 years to 5 out of the past 8 years. The House bill would have made this same change as well as phased out the exclusion for taxpayers with incomes above \$250,000 single / \$500,000 married.*

Mortgage Interest Deduction

- The final bill reduces the limit on deductible mortgage debt to \$750,000 for new loans taken out after 12/14/17. Current loans of up to \$1 million are grandfathered and are not subject to the new \$750,000 cap. Neither limit is indexed for inflation.
- Homeowners may refinance mortgage debts existing on 12/14/17 up to \$1 million and still deduct the interest, so long as the new loan does not exceed the amount of the mortgage being refinanced.
- The final bill repeals the deduction for interest paid on home equity debt through 12/31/25. Interest is still deductible on home equity loans (or second mortgages) if the proceeds are used to substantially improve the residence.
- Interest remains deductible on second homes, but subject to the \$1 million / \$750,000 limits.
- *The House-passed bill would have capped the mortgage interest limit at \$500,000 and eliminated the deduction for second homes.*

Deduction for State and Local Taxes

- The final bill allows an itemized deduction of up to \$10,000 for the total of state and local property taxes and income or sales taxes. This \$10,000 limit applies for both single and married filers and is not indexed for inflation.
- The final bill also specifically precludes the deduction of 2018 state and local income taxes prepaid in 2017.
- *When House and Senate bills were first introduced, the deduction for state and local taxes would have been completely eliminated. The House and Senate passed bills would have allowed property taxes to be deducted up to \$10,000. The final bill, while less beneficial than current law, represents a significant improvement over the original proposals.*

Standard Deduction

- The final bill provides a standard deduction of \$12,000 for single individuals and \$24,000 for joint returns. The new standard deduction is indexed for inflation.
- *By doubling the standard deduction, Congress has greatly reduced the value of the mortgage interest and property tax deductions as tax incentives for homeownership. Congressional estimates indicate that only 5-8% of filers will now be eligible to claim these deductions by itemizing, meaning there will be no tax differential between renting and owning for more than 90% of taxpayers.*

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Repeal of Personal Exemptions

- Under the prior law, tax filers could deduct \$4,150 in 2018 for the filer and his or her spouse, if any, and for each dependent. These exemptions have been repealed in the new law.
- This change alone greatly mitigates (and in some cases entirely eliminates) the positive aspects of the higher standard deduction.

To illustrate how the above-listed changes can affect the tax incentives of owning a home for a first-time buyer and a middle-income family of five, please see the two examples in the Appendix 2 on pages 19-23.

Mortgage Credit Certificates (MCCs)

- The final bill retains current law.
- *The House-passed legislation would have repealed MCCs.*

Deduction for Medical Expenses

- The final bill retains the deduction for medical expenses (including decreasing the 10% floor to 7.5% floor for 2018).
- *The House bill would have eliminated the deduction for medical expenses.*

Child Credit

- The final bill increases the child tax credit to \$2,000 from \$1,000 and keeps the age limit at 16 and younger. The income phase-out to claim the child credit was increased significantly from (\$55,000 single/\$110,000 married) under current law to \$500,000 for all filers in the final bill.

Student Loan Interest Deduction

- The final bill retains current law, allowing deductibility of student loan debt up to \$2,500, subject to income phase-outs.
- *The House bill would have eliminated the deduction for interest on student loans.*

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Deduction for Casualty Losses

- The final bill provides a deduction only if a loss is attributable to a presidentially-declared disaster.
- *The House bill would have eliminated the deduction for casualty losses with limited exceptions.*

Moving Expenses

- The final bill repeals moving expense deduction and exclusion, except for members of the Armed Forces.
- *The House-introduced bill would have eliminated the moving expense deduction for all filers, including military.*

Major Provisions Affecting Commercial Real Estate

Like-Kind Exchanges

- The final bill retains the current Section 1031 Like Kind Exchange rules for real property. It repeals the use of Section 1031 for personal property, such as art work, auto fleets, heavy equipment, etc.
- *The exclusion of real estate from the repeal of 1031 like-kind exchanges is a major victory for real estate stakeholders, who had fought hard to preserve the provision for several years, and against long odds.*

Carried Interest

- The final bill includes the House and Senate language requiring a 3-year holding period to qualify for current-law (capital gains) treatment.
- *Again, real estate stakeholders prevailed against long odds to preserve the incentive of capital gains treatment for carried interests in the final legislation.*

Cost Recovery (Depreciation)

- The final bill retains the current recovery periods for nonresidential real property (39 years), residential rental property (27.5 years) and qualified improvements (15 years). The bill also replaces separate definitions for qualified Restaurant, Leasehold, and Retail improvements with one definition of “Qualified Improvement Property.”

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Qualified Private Activity Bonds

- The final bill retains the deductibility of qualified private activity bonds used in constructing affordable housing, local transportation and infrastructure projects and for state and local mortgage bond programs.
- *The House bill would have eliminated the use of private activity bonds.*

Low Income Housing Tax Credit

- The final bill retains current law. However, a lower corporate rate will negatively impact the value of the credits in the future, and will result in less low-income housing being developed.

Rehabilitation Credit (Historic Tax Credit)

- The final bill repeals the current-law 10% credit for pre-1936 buildings, but retains the current 20% credit for certified historic structures (but modified so the credit is allowable over a 5-year period based on a ratable share (20%) each year).
- *The House bill would have entirely eliminated the Historic Rehabilitation Credit.*

Provisions Not Included in the Final Bill

Rental Income Subject to Self-Employment Tax

- The House-introduced bill would have subjected rental income to self-employment taxes. This provision was dropped from the House (and final) bill.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Major Provisions Affecting Real Estate Professionals

Deduction for Qualified Business Income

Because the new tax bill greatly decreases the tax rate for corporations (from the prior law's 35% to just 21%), many Members of Congress believed that the business income earned by sole proprietors, such as independent contractors, as well as by pass-through businesses, such as partnerships, limited liability companies (LLCs), and S corporations, should also receive tax rate reductions. In addition to lower marginal tax rates, the final bill provides a significant up-front (above the line^[1]) deduction of 20% for business income earned by many of these businesses, but with certain conditions.

Specifically, the bill limits the 20% deduction to non-personal service businesses. Essentially, a personal service business is one involving the performance of services in the following fields:

- Health, Law, Consulting, Athletics, Financial Services, Brokerage Services, and “Any business where the main asset of the business is the reputation or skill of one or more of its employees or owners.”

With the inclusion of “brokerage services” it appeared at first that most real estate agents and brokers would be considered in a personal service business and would thus not normally qualify for the 20% deduction.

However, NAR was able to help secure a major exception in the final bill that makes it possible for many real estate professionals to be able to take advantage of the deduction.

- This exception provides that if the business owner has taxable income of less than \$157,500 (for single taxpayers) or \$315,000 (for couples filing jointly), then the personal service restriction will not apply.
- Above this level of income, the benefit of the 20% deduction is phased out over an income range of \$50,000 for singles and an income range of \$100,000 for couples^[2].
- For those with non-personal service income above these thresholds, the bill provides a second exception that may still allow a full or limited 20% deduction. This second exception (the wage and capital limit exception) places a limit on the deduction of the greater of:

[1] Meaning one does not have to itemize deductions in order to claim it.

[2] This means that for single individuals, the benefit of the deduction would be fully phased out for taxable income levels above \$207,500 and for married couples filing joint returns, the benefit of the deduction would be fully phased out for taxable income levels above \$415,000.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

- 50% of the W-2 wages paid by the business, or
- The total of 25% of the W-2 wages paid by the business plus 2.5% of the cost basis of the tangible depreciable property of the business at the end of the year.

Bottom Line: Independent contractors and pass-through business owners with personal service income, **including real estate agents and brokers**, with taxable income **below** the \$157,500 or \$315,000 thresholds may generally claim the full 20% deduction under the personal service income exception. Independent contractors and pass-through business owners with **non-personal service income** and total taxable income below these thresholds may also claim the full 20% qualified business income deduction. In addition, independent contractors (or other sole proprietors) with non-personal service incomes **above** these thresholds may also be able to claim a 20% deduction, but that deduction may be limited by the wage and capital limit exception.

However, at first it appeared that real estate brokers and agents with taxable incomes above the thresholds mentioned above would not be able to claim the new deduction. **Over months of letters, meetings, and discussions with Treasury and IRS officials, NAR was able to help convince the regulators to remove real estate agents and brokers from the term “brokerage services.” Thus, the final regulations provide that real estate professionals may fully participate in the new deduction.**

The following examples (detailed in the Appendix 1 on pages 12-18) illustrate how these new changes would affect different real estate professionals based on how their income is earned, income they may claim from a spouse, and how their business is structured. NAR members should consult a tax professional about their own personal circumstances.

Example 1: Amy Agent, a single filer with sole income from real estate commissions

Example 2: Andy Agent, a married filer with children with income from his real estate business and W-2 income from his spouse

Example 3: Barry Broker, a single filer with income passed through his real estate LLC

Example 4: Bobbie Broker, a married filer with income passed through her real estate LLC and salary income from her spouse

Example 5: David Developer, a married filer with income from his development S corp, which also has wage employees and capital at risk

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Section 179 Expensing

- The final bill increases the amount of qualified property eligible for immediate expensing from \$500,000 (current law) to \$1 million. The phase-out limitations are increased from \$2 million to \$2.5 million.
- The final bill expands the definition of qualified real property eligible for section 179 expensing to include any of the following improvements to nonresidential real property placed in service after the date such property was first placed in service: roofs; heating, ventilation, and air-conditioning property; fire protection and alarm systems; and security systems.
- The bill also significantly increases the amount of first-year depreciation that may be claimed on passenger automobiles used in business to \$10,000 for the year in which the vehicle is placed in service, \$16,000 for the second year, \$9,600 for the third year, and \$5,760 for the fourth and later years in the recovery period.

Denial of Deductibility of Entertainment Expenses

- The final bill provides that no deduction is allowed with respect to:
 - An activity generally considered to be entertainment, amusement, or recreation;
 - Membership dues with respect to any club organized for business, pleasure, recreation or other social purpose, or
 - A facility or portion of a facility used in connection with the above items.
- Thus, the provision repeals the present-law exception to the deduction disallowance for entertainment, amusement, or recreation that is directly related to (or, in certain cases, associated with) the active conduct of the taxpayer's trade or business.
- Taxpayers may still generally deduct 50 percent of the food and beverage expenses associated with operating their trade or business (e.g., meals consumed by employees on work travel).

Provisions Considered But Not Included in the Final Bill

Additional Withholding Requirements for Independent Contractors

- Language in the Senate-introduced bill would have subjected Independent Contractors to an additional 5% withholding requirement. This provision was dropped from the Senate (and final) bills.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Expansion of Unrelated Business Income Tax (UBIT) for Non-Profits

- The Senate introduced bill expanded UBIT treatment to include royalties derived from association licensing of trademarks or logos. This provision was dropped in the Senate (and final) bill. Additionally, tax writers considered subjecting certain exempt income (such as trade show or education revenue) to UBIT treatment but these provisions were not included.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Appendix 1 – Examples of How the Deduction for Qualified Business Income May Affect Various Real Estate Professionals

Example 1. Amy Agent is a single REALTOR who operates as a sole proprietor and independent contractor. She received \$100,000 in net commission income in 2018. She has no capital gains or losses. After claiming deductions not related to her business, including the standard deduction, Amy's total taxable income for 2018 is \$81,000. Her qualified business income (QBI) is \$100,000, which is her gross commissions less her business deductions. **Amy's section 199A deduction for 2018 is equal to \$16,200**, which is the lesser of 20% of her QBI from her business as a real estate agent ($\$100,000 \times 20\% = \$20,000$) and 20% of Amy's total taxable income for the year ($\$81,000 \times 20\% = \$16,200$).

Example 2. Assume the same facts as in Example 1 except Amy Agent also had taxable pension income of \$20,000, making her taxable income for the year \$101,000. Her QBI is still \$100,000. **Amy's section 199A deduction for 2018 is now equal to \$20,000**, which is the lesser of 20% of her QBI from her business as a real estate agent ($\$100,000 \times 20\% = \$20,000$) and 20% of Amy's total taxable income for the year ($\$101,000 \times 20\% = \$20,200$).

Example 3. Carla and Bob Broker are married and file a joint tax return. Carla earns \$50,000 in salary as an employee of Acme Corporation in 2018. Bob owns 100% of the shares of Bob's Brokerage, which is an S corporation that provides real estate services and contracts with several agents. Bob's Brokerage generates \$100,000 in net income in 2018 after deducting Bob's salary of \$150,000. Carla and Bob have no capital gains or losses. After allowable deductions not related to the brokerage, Carla and Bob's total taxable income is \$270,000 (\$50,000 salary for Carla + \$100,000 net income from Bob's Brokerage + \$150,000 for Bob's salary less \$30,000 in deductions). Carla's and Bob's salaries are not considered Qualified Business Income (QBI). However, the net income from the S corporation is QBI. **Carla and Bob's section 199A deduction is equal to \$20,000**, the lesser of 20% of Bob's QBI from the business ($\$100,000 \times 20\% = \$20,000$) and 20% of Carla and Bob's total taxable income for the year ($\$270,000 \times 20\% = \$54,000$).

When Congress was debating the Tax Cuts and Jobs Act of 2017, it was not clear that personal services professionals like Amy and Bob would get much, if any, deduction for their business income. NAR, along with other organizations who represent small businesses, encouraged Congress to make the deduction available to as many small businesses and proprietors as possible. The result was that all sole proprietors and pass-through business owners below the taxable income thresholds of \$157,500 for single filers and \$315,000 for joint returns were made eligible for the deduction.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Example 4. Deborah is single and a high-producing real estate agent in an active market. She is an independent contractor and sole proprietor of her business. She received net commission income of \$400,000 in 2018. She has no employees, but owns business property consisting of her car and office equipment that originally cost \$70,000. After allowable deductions unrelated to her business, Deborah's total taxable income for 2018 is \$370,000. Because her income exceeds the applicable threshold amount, Deborah's section 199A deduction is subject to the W-2 wage and qualified property limitations. Her business has no W-2 wages, so the QBI component of Deborah's section 199A deduction is limited to the lesser of 20% of the business's QBI or 2.5% of its original cost of qualified property. 20% of her \$400,000 of QBI is \$80,000, and 2.5% of her original cost of her qualified business property is \$1,750 ($\$70,000 \times 2.5\%$). Therefore, **her section 199A deduction for 2018 is \$1,750.**

Example 5. Assume the same facts as in Example 4 above, except that Deborah has an employee whom she pays wages of \$50,000 in 2018. Because her taxable income is above the threshold amount, Deborah's section 199A deduction is subject to the W-2 wage and qualified property limitations. 20% of her QBI of \$400,000 is \$80,000. The W-2 wage limitation equals 50% of Deborah's employee's wages of \$50,000 or \$25,000. The original cost of qualified property limitation equals \$14,250, the sum of 25% of the employee's wages (\$50,000) or \$12,500 plus 2.5% of the original cost of qualified property (\$1,750 - as above) is \$14,250. The greater of the limitation amounts (\$25,000 and \$14,250) is \$25,000. Deborah's 199A deduction is limited to the lesser of 20% of the QBI (\$80,000) or the greater of the limitations (\$25,000). Thus, **her deduction for 2018 is \$25,000.**

Note: Had Deborah paid more wages or had a larger investment in business property (owning the business's office building, for example), the section 199A deduction could be much larger.

As enacted, the section 199A deduction provided that owners of certain businesses that provided personal services would be prohibited from claiming the deduction if their taxable income were over certain thresholds (\$157,500 for single filers and \$315,000 for joint returns). One of the prohibited types of business was "brokerage service." Thus, it appeared that real estate agents and brokers would not be allowed to claim any section 199A deduction if their taxable income happened to exceed the threshold amounts. However, NAR advocated with the U.S. Treasury Department and the Internal Revenue Service, urging them to not include real estate professionals in the "brokerage services" category. The regulations, issued in January 2019, held that real estate brokers and agents would not be included in the prohibited category and thus would be eligible to claim the deduction no matter how high their incomes.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Appendix 2 – Examples of How The New Law Will Affect the Tax Incentives of Owning a Home

Example 1 - First-Time Homebuyer. To illustrate how the changes to the standard deduction, repeal of personal exemptions, mortgage interest and state and local taxes might affect a first-time homebuyer, consider the example of Barbara Buyer. Barbara, an accountant making \$58,000 per year, is single and currently rents an apartment. She also pays state income tax of \$2,900 and makes charitable contributions of \$2,088, but the total of these is lower than the standard deduction, so she claims the standard.

Barbara's tax liability for 2018 under the **prior law** is as follows:

Salary income	\$58,000
Standard deduction	(\$ 6,500)
Personal exemption	<u>(\$ 4,150)</u>
Taxable income	\$47,350
Tax	\$ 7,491

Under the **new law**, Barbara would get a tax cut, computed as follows:

Salary income	\$58,000
Standard deduction	(\$12,000)
Personal exemption	<u>(\$ - 0 -)</u>
Taxable income	\$46,000
Tax	\$ 6,060

Tax Difference Under New Law. Even though Barbara would not get the benefit of the personal exemption under the new law, her higher standard deduction would more than make up for the loss. In addition, the lower tax rates of the new law would help deliver the total tax cut of \$1,431 (\$7,491 - \$6,060) as compared with the prior law.

However, let's take a look at what happens to Barbara if she were to purchase the condo that she likes costing \$205,000. She takes out a 30-year fixed rate mortgage at 4% interest, putting down 3.5%. Assuming she buys early in 2018, her first-year mortgage interest would total \$7,856 and she would pay real property taxes of \$2,050.

As a first-time homeowner, her tax liability under the **prior law** would be computed as follows:

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Salary income	\$58,000
Mortgage interest	\$ 7,856
Real property tax (1%)	\$ 2,050
State income tax (5%)	\$ 2,900
Charitable contributions (3.6% of income)	\$ 2,088
Total itemized deductions	(\$14,894)
Personal exemption	(\$ 4,150)
Taxable income	\$38,956
Tax	\$ 5,393

Note. Under the prior law, Barbara would lower her tax liability for 2018 by \$2,098 (\$7,491 - \$5,393) by purchasing the condo. This is the financial effect of the prior law's tax benefits of buying a home. This amount effectively lowers her monthly mortgage payment by \$175 per month.

Now, let's take a look at what her tax situation would be under the **new law** as a first-time homebuyer:

Salary income	\$58,000
Mortgage interest	\$ 7,856
Real property tax (1%)	\$ 2,050
State income tax (5%)	\$ 2,900
Charitable contributions (3.6% of income)	\$ 2,088
Total itemized deductions	(\$14,894)
Personal exemption	(\$ - 0 -)
Taxable income	\$43,106
Tax	\$ 5,423

Tax Difference Under New Law. Even though Barbara would still be able to claim all of her itemized deductions under the new law, she would lose the benefit of her personal exemption. This would mean that her taxes would actually go up under the new law by \$30 (\$5,393 - \$5,423). But far worse, look at the tax differential between renting and owning a home. This difference, which was \$2,098 under the prior law, has now shrunk to just \$637 (\$6,060 - \$5,423), or \$53 per month. In other words, under the prior law, Barbara was given a strong incentive to move into the ranks of those who own their home. The new law still offers her an incentive, but it is a shadow of what it was, and is unlikely to be very compelling.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Example 2 - Middle-Income Family of Five:

To illustrate how the changes to the standard deduction, repeal of personal exemptions, mortgage interest and state and local tax deductions, and increase in the child credit might affect middle-income family of five, consider the example of Steve and Melinda. Steve is a store manager making \$55,000 per year, while Melinda is a school principal, earning \$65,000. They have three children, ages 17, 14, and 9. Steve and Melinda recently relocated from another city, and while they are getting to know their new community, they are leasing a home. But they would like to purchase as soon as they identify which area is the best fit for their family. As renters, they pay state income tax on their salaries, totaling \$6,000, and also make some charitable contributions equaling \$3,120. Since these itemized deductions do not reach the level of the standard deduction, they do not itemize, but they expect to do so when they purchase their home.

Here is a look at Steve and Melinda's tax liability for 2018, computed under the **prior law**:

Salary income	\$120,000
Standard deduction	(\$ 13,000)
Personal exemptions (5 x \$4,150)	(\$ 20,750)
Taxable income	\$ 86,250
Tax before credits	\$ 12,870
Child tax credits (2 x \$1,000 less \$500 phase-out)	(\$ 1,500)
Net Tax	\$ 11,370

Under the **new law**, Steve and Melinda, as renters, would get a tax cut, computed as follows:

Salary income	\$120,000
Standard deduction	(\$ 24,000)
Personal exemption	(\$ - 0 -)
Taxable income	\$ 96,000
Tax before credits	\$ 12,999
Child tax credits (2 x \$2,000)	(\$ 4,000)
Net Tax	\$ 8,999

Tax Difference Under New Law As Renters. Steve and Melinda lose the big benefit of the personal and dependency exemptions for the two adults and three children. And the increase in the standard deduction is not enough to make up for this loss. However, the big increase in the child credit for the two younger children and the lower tax rate are enough to deliver them a tax cut of \$2,371 (\$11,370 - \$8,999) as compared with the prior law.

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Let's now consider how Steve and Melinda's tax situation changes if they were homeowners, rather than renters. Assume they find an ideal home in a nice neighborhood that costs \$425,000, and after offering a 10% down payment, Steve and Melinda take out a 30-year fixed mortgage at a 4% rate. Let's say that their real property tax for the year totals \$4,250, which is just 1% of the home's value.

Here is how their 2018 tax liability would be computed as homeowners, under the prior law:

Salary income	\$120,000
Mortgage interest	\$ 15,189
Real property tax (1%)	\$ 4,250
State income tax (5%)	\$ 6,000
Charitable contributions (2.6% of income)	\$ 3,120
Total itemized deductions	(\$ 28,559)
Personal exemptions (5 x \$4,150)	<u>(\$ 20,750)</u>
Taxable income	\$ 70,691
Tax before credits	\$ 9,651
Child tax credits (2 x \$1,000 less \$500 phase-out)	(\$ 1,500)
Net Tax	\$ 8,151

Note. Under the prior law, Steve and Melinda would lower their tax liability for 2018 by **\$3,219** (\$11,370 - \$8,151) by purchasing their home instead of renting. This is the financial effect of the prior law's tax benefits of buying a home. This amount effectively lowers their monthly mortgage payment by over \$268 per month.

Now, let's take a look at what her tax situation would be under the new law as a home-owning family instead of renters:

Salary income	\$120,000
Mortgage interest	\$ 15,189
Real property tax (1%)	\$ 4,250
State income tax (5%) (limited by \$10,000 cap)	\$ 5,750
Charitable contributions (2.6% of income)	\$ 3,120
Total itemized deductions	(\$ 28,309)
Personal exemptions	<u>(\$ - 0 -)</u>
Taxable income	\$ 91,691
Tax before credits	<u>\$ 12,051</u>
Child tax credits (2 x \$2,000)	(\$ 4,000)
Net Tax	\$ 8,051

The Tax Cuts and Jobs Act - What it Means for Homeowners and Real Estate Professionals

Tax Difference Under New Law As Homeowners. For Steve and Melinda, most of their itemized deductions from the prior law are preserved by the new law. They are limited slightly (\$250) by the \$10,000 limit on the deduction of state and local taxes. However, they lose big by the repeal of the personal and dependency exemptions, which equal \$20,750 for this family. Even so, Steve and Melinda receive a small tax cut of \$100 (\$8,151 - \$8,050) under the new law, thanks to the much larger child credit and lower tax rate. But as renters, they received a tax cut of almost \$2,400. Thus, buying a home becomes a net tax change of almost \$2,300.

What happened? What happened is that the new law is taking away most of the tax benefits of owning a home. Under the prior law, this benefit was \$3,219 for Steve and Melinda. But under the new law, they enjoy only a benefit of \$948 (\$8,999 - \$8,051). This gives them a benefit of just \$79 per month, which is obviously a far weaker incentive to own.