Home invasion: ownership under attack

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Homeowners are likely to lose key tax breaks under the Republican tax plan. Particularly under attack are those individuals who own valuable real estate purchased with a mortgage, a summary of which follows:

- Under current US federal income tax law, a homeowner can deduct interest paid on the mortgage generally up to US$1 million; however, the proposal caps the deduction at US$500,000 for newly purchased homes.
- Unlike the UK, US state and local governments typically assess an ad valorem tax (i.e. a tax according to the value of the home) on real property located within the state or locality on an annual basis. The US federal government has subsidised this by allowing an unlimited deduction for real property tax paid to reduce taxpayers US federal income tax; however, the current proposal would cap this deduction at US$10,000.
- Relief from capital gains on the sale of your principal residence is under attack as well, which will be of particular importance to those US citizen/UK resident homeowners who otherwise are granted unlimited relief from capital gains in the UK. Where US and UK tax policy diverge in such a substantial manner on a transaction which affects so many (i.e. the sale of one's home), additional US tax is likely to be paid. Therefore, this is likely to be the proposal to watch for the majority of our clients going forward. Under current rules, a US taxpayer can exclude up to US$250,000 of capital gains (US$500,000 for married taxpayers) on the sale of their primary residence if they have lived in the home for two of the past five years, and this exclusion can only be claimed to one sale every two years.
- The new rules require the taxpayer to have lived in the home for five of the past eight years, the exclusion is limited to a sale every five years… and the exemption phased out for taxpayers who have an adjusted gross income of more than US$250,000 (US$500,000 for married US taxpayers filing jointly). The exemption from US tax on the capital gains phases out all the way to zero, meaning no relief at all for the sale of your home if you happen to be earning a decent income when you sell your home. To put some numbers to the loss of this exemption – this means an additional US tax bill of up to US$119,000 on the sale of your home (the example assumes a loss of the entire exemption for married US taxpayers with more than US$500,000 of gain taxed at 23.8%).