Frequently Asked Tax Questions

for

Homeowners, Buyers, Sellers

October 2018

1. **Homestead Exemption – What is the Homestead Exemption, and how do I apply for it?** Louisiana law provides an exemption from parish property taxes for the first $75,000 of your home's value. Generally, the two requirements for this exemption are that (1) you own the home and (2) you use it as your residence. Recent changes in the law, however, allow the exemption for other ownership arrangements (e.g., surviving or former spouse, certain trusts, etc.). In limited circumstances, an exemption may be granted to a son or daughter occupying a home that is owned by a mother or father, or vice versa. This property exemption does not apply to city property taxes (except in Orleans Parish, and to any municipal taxes levied for school purposes). There are no Louisiana state property taxes.

   You apply for the homestead exemption by taking a copy of the deed to the parish assessor's office and completing a Permanent Homestead Exemption Application. In New Orleans, you should contact the assessor for the district in which you live and request that they mail you a homestead exemption Application for you to sign and return.

   You will not need to apply for this exemption each year. If you move from that home, however, you should contact the assessor's office, notify them of the change in address, and sign a new Homestead Exemption application, if appropriate. Each parish has different annual deadlines for signing the homestead exemption, so you should do this as soon as possible after moving into your home.

   If you are age 65 or older and your adjusted gross income (from your prior year's federal income tax return) is not greater than $71,562.52, the property tax assessment on your homestead-exempt property cannot be increased. This assessment "freeze" also applies to a surviving spouse who is either age 55 or older, or who has minor children. The assessment freeze is lost if the property is transferred or improvements are made in excess of 25 percent of the property value.

2. **<u>Property Taxes</u> – Are property taxes that I pay on my home deductible on my income tax return?** If you itemize your deductions, rather than take the standard deduction, home property taxes are deductible on your federal income tax return for the year in which they are paid in an amount that, when combined with your Louisiana income taxes paid, is limited to $10,000. If your property taxes are paid through your mortgage escrow account, your year-end statement from the mortgage company will report to you the property taxes paid from your escrow during the year. If you are selling your home, your share of the property taxes for the year of sale is charged to you and included on the closing statement. This amount is your property tax paid for the year for that home for inclusion with your state income taxes paid and other such property taxes subject to the $10,000 overall deduction limit.

   If you are buying a home, your property tax deduction for the year of purchase is the amount paid by you (or through your mortgage escrow account) during the year minus the property taxes charged to the seller that are reported on the closing statement.

3. **<u>Interest Expense</u> – Is interest expense that I pay on my home mortgage loan deductible on my income tax return?** If you itemize your deductions, rather than take the standard deduction, home mortgage interest generally is deductible on your federal income tax return for the year in which it is paid. If you make loan payments to a commercial lender, your annual interest paid will be reported to you on Form 1098 shortly after year end.

   Home mortgage interest is the interest paid for a principal residence and a second residence. A second residence can be a traditional house or any other dwelling, provided that it has a sleeping space, a kitchen, and a toilet. Accordingly, a boat, mobile home, or house trailer may qualify as a second residence. There are, however, a few limitations to the interest deduction.

Home Mortgage Loan Interest Deduction Limitations – Years 2018 through 2025. For home mortgages incurred on or before December 15, 2017 (including refinancing of such debt), interest paid on debt up to $1,000,000 to purchase or substantially improve the home is deductible. For home mortgages incurred after December 15, 2017, interest paid on debt up to $750,000 ($325,000 for married filing separate returns) (including refinancing of such debt) to purchase or substantially improve the home is deductible.

The deduction for home equity loan interest (i.e., interest on debt secured by the home but not incurred to purchase or substantially improve the home) is not allowed for years 2018 through 2025. This rule applies regardless of when the debt was incurred.

Note: For the year of purchase, interest expense for an initial short period is often included on the closing statement but not included on the annual statement from the mortgage company. This interest is also deductible as home mortgage interest.

4. **Interest Expense – If I pay my January note payment in December, is the interest portion of that payment deductible in the year I make the payment, or in the following year when the payment would have been due?** The interest for the January payment is deductible in the year paid, rather than the following year when it would have been due, because the interest in the January payment is actually interest for the month of December.

Hint: If you make the January payment early, you might want to do so early enough so that the mortgage company receives it in time for them to include it on your Form 1098 and annual statement that reports interest paid for the year.

<u>Note:</u> Any additional payments that are due after the end of the year (for example, the February payment) are not deductible until the following year. In other words, prepaid interest (except for some "points" paid at closing) is not deductible in the year paid.

5. **<u>"Points" (Loan Origination Fee and Loan Discount) Paid at Closing</u> – Is the loan origination fee or loan discount (sometimes called "points"), which is a percentage of the home mortgage loan amount and paid at closing, deductible on my income tax return?** Yes, if you itemize, subject to some limitations. Also, the timing of the deduction depends on the purpose of the loan. First, points paid for the acquisition of a principal residence are deductible in the year the points are paid. Second, points paid for acquisition of a second or vacation home, or paid to refinance a home mortgage loan are deductible evenly over the entire life of the loan, rather than in the year paid. If such a loan is refinanced or repaid early, the balance of the points that have not been deducted are deductible at that time.

   Limitations to the deductibility of points apply to very large loans (more than $750,000; $325,000, if you file a married but separate tax return), and for points charged in excess of the amount generally charged in this area. You should consult with your tax adviser about any such limits that may apply to you.

   <u>Note:</u> Points are deductible by the buyer, regardless of whether the buyer or the seller pays the points. If the seller pays the points, however, the buyer must reduce his tax "basis" in the home by the amount of such points.

6. **<u>Other Costs Paid at Closing</u> – Are costs paid at closing (other than points, interest expense, and property taxes) deductible on my income tax return?** Costs such as real estate commissions, processing fees, recording fees, title search, title insurance, document preparation, etc. are not deductible.

If you are buying the home, however, these items do add to your tax "basis" in the home. If you are selling your home, such costs are considered in determining the "net sales price" (see questions #10 and #11).

7. **<u>Mortgage Insurance</u> – Are my mortgage insurance payments deductible?** For years after 2017, mortgage insurance premiums (including premiums paid to VA, FHA, or Rural Housing Administration) for acquisition debt on your personal residence are not deductible as home mortgage interest.

8. **<u>Moving Expenses</u> – Can I deduct my moving expenses?** For years 2018 through 2025, the moving expense deduction for employees and self-employed individuals is eliminated.

9. **<u>Sale of Home Reported On Form 1099-S</u> – Will I receive a tax form reporting the sale of my home, and will that information be reported to the Internal Revenue Service?** We are required to prepare Form 1099-S (a copy for you and a copy for the Internal Revenue Service) that reports the sale of your home unless (1) the sales price is $250,000 or less, ($500,000 or less for a married couple), and (2) you furnish to us by January 31 of the year following the year of sale a written statement certifying certain information concerning your period of ownership and use of the home exclusively as a residence.

10. **<u>Gain on Sale of Home</u> – How do I determine if I have a gain on the sale of my home, and will I have to pay income tax on such a gain?** A gain is the excess of the "net sales price" over your "basis" in the home. Your "net sales price" is the total sales price minus selling expenses, closing costs, and expenses incurred to make the home salable (but not reduced by any loan balance paid off at closing). Your "basis" in the home generally is your original purchase price (assuming your home was never used for business or rent purposes) plus the cost of any major improvements or alterations that you made to the home. If you have owned and lived in your residence for at least two of the five years before the sale (a special rule applies for members of uniformed services on certain extended duty), and you have not

sold a principal residence in the last two years, then up to $250,000 of gain ($500,000 for a joint income tax return) is not taxable. If you fail to meet either of these two-year tests, however, because of a hardship (e.g., change of employment, health, or unforeseen circumstances), you can exclude the gain up to a portion of the $250,000 or $500,000 amount based on the time (compared to two years) that you actually used the home as your principal residence (see questions #17 and #18).

11. <u>Loss on Sale of Home</u> **– How do I determine if I have a loss on the sale of my home, and would such a loss be deductible on my income tax return?** A loss is the excess of your "basis" in the home over the "net sales price" (see question #10 for explanation of "basis" and "net sales price") (see questions #17 and #18).

    A loss on the sale of your personal residence is not deductible.

12. <u>Sale of Residence After Inheritance</u> **– What are the income tax consequences of selling a home that was recently inherited?** Generally, there are little or no income tax consequences. Taxable gain or loss is determined by the difference between the "net sales price" received and the heirs' "basis" in the property. The heirs' basis in the property is the fair market value of the home at the time of the decedent's death. If the home was sold relatively soon after that date, the value of the home has likely not changed, and there likely is no taxable gain or loss. You should, however, report the sale on your income tax return.

    <u>Note:</u> If the value of the home was reported in a federal estate tax return, you should have received Form 8971, Schedule A from the Succession if the Succession had to file an estate tax return. This form is the new tax basis of the property to the heirs for determining any taxable gain or loss on a subsequent sale.

    <u>Note:</u> If you inherited property from a decedent who died during 2010, special rules might apply, and you should consult with your tax advisor to determine your tax basis in the property.

13. **<u>Repossession of Principal Residence</u> – If I finance the sale of my home and later take the home back in foreclosure, do I report anything on my income tax return in the year I take back the home?** If you repossess the home and again sell it within one year of the repossession, then you possibly have nothing to report on your income tax return. If you do not resell the home within one year of the repossession, then you may have some taxable gain to report on the repossession. You should consult with your tax adviser to determine the amount of taxable gain to report, if any.

14. **<u>Bad Debt Loss on Seller-Financed Mortgage Loan</u> – If I finance the sale of my home, and the buyers stop paying the note, and I do not take the home back in foreclosure, do I have a deduction on my income tax return?** If you have made all reasonable attempts to collect payment, and you conclude that the entire balance of the note will not be collected, you have a bad debt deduction. Unless you are in the loan business, however, the deduction will be a short-term capital loss subject to some limitations on your income tax return.

    <u>Note:</u> Bad debts resulting from loans to family members are closely scrutinized by the Internal Revenue Service. You should consult with your tax adviser on all bad debt deduction matters.

15. **<u>Home Repairs and Improvements</u> – Can I take a deduction for repairs and improvements that I make to my home?** The cost of repairs and improvements that you make to your personal residence is not deductible on your income tax return. The cost of improvements (but not repairs), however, is added to the tax "basis" of your home, which might give you larger depreciation deductions in the future if your home is ever converted by you to business or rent property.

16. **<u>Casualty Losses</u> – If my home suffers storm or other damage, do I get a deduction on my income**

tax return? For years 2018 through 2025, if you suffer a loss to your home from damage in excess of any reimbursement (through insurance, settlement, or award) then the net loss (the total loss minus any reimbursement) is not deductible unless the loss is attributable to a federally declared disaster area. In that case, the deduction is limited to the loss in excess of $100 that exceeds 10 percent of your adjusted gross income.

17. **<u>Office in Home</u> – Are the costs associated with a business office in my home deductible on my income tax return?** Expenses associated with a home office that is used in connection with your trade or business (other than as an employee) are deductible under certain conditions against your business income. The costs of a home office used as an employee or for your nonbusiness investments are not deductible. To be deductible against business income, a portion of your home must be used exclusively and regularly as either (1) the principle place of your business (including performance of administrative activities in your business when there is no other location for such activities), (2) a place where patients, clients, or customers come in the normal course of business, or (3) in connection with the business activity and the place is a separate structure from the home.

    <u>Note:</u> Any deductible depreciation from the home office reduces the tax "basis" of the home office for determining the gain or loss from a subsequent sale (see questions #10 and #11). If you have a deductible home office and you sell your home, any gain from a subsequent sale of the home will be a taxable gain to the extent of depreciation deducted after May 6, 1997. Any loss that is attributable to the home office portion will be deductible.

18. **<u>Renting All or Part of Home</u> – What are the income tax consequences of renting my home or some portion of it?** Rent income that you receive is taxable. Expenses, including depreciation of the rent property (or the portion of the property that is rented), are deductible against the rent income. If the deductions exceed the rent income, the net loss generally is deductible on your income tax return, but the

current deduction may be subject to limitations under the "passive activity rules." You should consult with your tax adviser on this matter.

.

If you rent your home, other than temporarily while trying to sell the property, your home will no longer be considered as your principal residence, and a gain on a subsequent sale of the home will be taxable, and a loss on the subsequent sale of the home may be deductible on your income tax return (consult your tax adviser). Any depreciation you deducted while renting reduces your tax "basis" in the home for determining your gain or loss on the sale. If you are trying to sell your home, however, and are renting it temporarily, your home will still be treated as your principal residence for determining the income tax consequences of a subsequent sale (see questions #10 and #11).

If you were entitled to take depreciation deductions, however, because you used your home as rental property, you cannot exclude the part of your gain equal to any depreciation deducted for periods after May 6, 1997.

19. **Renting Home to Family Member – If I rent my home to a family member, what are the income tax consequences to me and the renting family member?** If you rent a home to a family member at a fair market amount of rent, the income tax consequences are the same as if you rented the home to a non-family member (see question #18).

20. **Rent-Free Use of Home by Family Member – Are there any tax consequences if I do not live in the home, but I allow a family member to live there?** If you allow a family member to live rent-free in your home at your discretion, there is no income tax or gift tax consequence. Furthermore, the home can qualify as your second residence for purposes of the interest expense deduction (see questions #3 and #4).

If, however, you convey a legal right to the family member to use the home rent-free for a period of time, there may be a gift tax consequence, and you should consult with your tax adviser.

21. **Giving Home to a Family Member – Are there any tax consequences if I give my home to a family member?** There generally is no income tax consequence to you for giving a home to a family member. There is a possible exception if you also transfer to the family member a mortgage loan that has a balance in excess of your tax "basis" in the property.

    There could be, however, federal gift tax consequences. You should consult with your tax adviser on that matter.

22. **Record Keeping – What Records Should I Keep For My Home?** You should keep all of the house and loan documents that you received at closing for the entire time that you own the home. You also should keep any invoices and canceled checks for any costs to improve or alter the home for the entire time that you own the home. We further suggest that you keep these records for seven years after you sell the home.

The information contained here is presented in good faith and believed to be correct, but it is general in nature and is not intended as tax advice specifically about your situation. Furthermore, this information might not be applicable to or suitable for your particular circumstances or needs and might require consideration of other matters. Please consult your tax advisor to determine how these rules apply to you.