Amplification and Modification of Safe Harbor Method for Participants in the HFA Hardest Hit Fund

Notice 2018-63

PURPOSE

This notice amplifies and modifies Notice 2017-40, 2017-32 I.R.B. 190, which applies to homeowners participating in the Treasury Department's Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund). Notice 2017-40 provides that a participating homeowner may use a safe harbor method for computing the amount of mortgage interest deductible under § 163 of the Internal Revenue Code (Code) and real property taxes deductible under § 164(a)(1) relating to the homeowner's principal residence. This notice extends application of a modified version of that safe harbor method to homeowners who may be affected by the new limitation in § 164(b)(6)(B) on the amount of deductible real property taxes. The modified safe harbor permits a participating homeowner to allocate mortgage payments actually made during a taxable year first to deductible mortgage interest.

BACKGROUND

Notice 2017-40 provides a safe harbor method for computing the deductions under §§ 163 and 164 on a principal residence for homeowners participating in a program designated by state housing finance agency (State HFA) using funds allocated from the HFA Hardest Hit Fund (State Program). Under Notice 2017-40, the safe harbor is available for the taxable year if the homeowner (1) meets the requirements to deduct all of the mortgage interest and real property taxes relating to the principal residence under §§ 163 and 164, respectively; and (2) participates in a State Program in which the program payments can be used to pay interest on the home mortgage. Notice 2017-40 provides that the safe harbor method is available for taxable years 2010 through 2021.

Section 164(b)(6)(B) provides that, in the case of an individual, for taxable years beginning after December 31, 2017, and before January 1, 2026, the aggregate amount of taxes taken into account under § 164(a)(1), (2), and (3) and § 164(b)(5) for any taxable year shall not exceed $10,000 ($5,000 in the case of an individual filing a separate return).

EXPLANATION OF SAFE HARBOR

This notice amplifies Notice 2017-40 to provide that the safe harbor, as modified, is available even if the limitation in § 164(b)(6)(B) precludes a homeowner from deducting all of the real property taxes imposed on the principal residence. The amplification thus preserves the availability of the safe harbor computation for most homeowners who participate in a State Program in which program payments can be used to pay interest on a home mortgage. This notice also assists homeowners by modifying the safe harbor method for taxable years 2018 through 2021 to permit a homeowner to allocate home mortgage payments that the homeowner actually makes during a taxable year first to deductible mortgage interest. This allocation will assist homeowners using the safe harbor in determining what portion, if any, of payments actually made is allocable to state and local property taxes and therefore subject to the limitation in § 164(b)(6)(B).

APPLICATION

For taxable years 2010 through 2021, a homeowner may deduct on his or her federal income tax return (subject to the limitation in § 164(b)(6)(B) for taxable years 2018 through 2021) the lesser of—

- The sum of all payments on the home mortgage that the homeowner actually makes during a taxable year to the mortgage servicer or the State HFA; and
- The sum of amounts shown on Form 1098, *Mortgage Interest Statement*, for mortgage interest received, real property taxes, and mortgage insurance premiums (if deductible for the taxable year under § 163(h)(3)(E)).

This safe harbor method of computing a homeowner's deduction applies for a taxable year if (1) the homeowner meets the requirements of § 163 to deduct all of the mortgage interest relating to the principal residence, (2) the homeowner meets the requirements of § 164(a)(1) for deducting all the real property taxes (determined without regard to § 164(b)(6)(B)), and (3) the homeowner participates in a State Program in which the program payments can be used to pay interest on the home mortgage.

If the homeowner's deduction, as provided above, is the sum of all payments made by the homeowner during a taxable year, then the homeowner may first allocate amounts paid to mortgage interest up to the amount shown on Form 1098. The homeowner may then use any reasonable method to allocate the remaining balance of the payments to real property taxes, mortgage insurance premiums, home insurance premiums, and principal.

Regardless of how a homeowner determines the deductible amount under this safe harbor, any part of such amount that is allocated to state or local property taxes is subject to the limitation in § 164(b)(6)(B).

EFFECT ON OTHER DOCUMENTS

Notice 2017-40 is amplified and modified.

DRAFTING INFORMATION

The principal author of this notice is Lisa Mojiri-Azad of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Mojiri-Azad (202) 317-4718 (not a toll-free number).