

News

ALERT: Prepayment of 2018-2019 State and Local Real Estate Taxes May Not Be Deductible

December 27, 2017

Prepayment of 2018-19 Montgomery County real estate taxes may not result in reduced 2017 federal income tax liability. Taxpayers who are considering prepaying their 2018-19 real property taxes in 2017 should take note of the following:

Internal Revenue Code (“IRC”) section 164(a)(1), which allows a taxpayer to deduct payment of state and local real estate taxes against taxable income, will be severely limited after December 31, 2017. Montgomery County has responded to this change in the income tax law by announcing that it will accept prepayments of its real estate taxes for the tax period running from July 1, 2018 through June 30, 2019. The county is doing this to facilitate real estate taxpayers taking a reporting position that prepaid real estate taxes are deductible against 2017 taxable income. These prepaid taxes may not be deductible in 2017 or will have very limited usefulness even if they are deductible for ordinary income tax purposes because this deduction is disallowed in computing the Alternative Minimum Tax.

(a) Ordinary Federal Income Tax – IRC section 164(a)(1). The U.S. Tax Court and Fourth Circuit Court of Appeals, which covers Maryland, have both ruled that a cash method taxpayer may not deduct prepaid real estate taxes in the year of payment. *Estate of Frederick R. Hoffman v. Commissioner of the Internal Revenue Service*, 87 AFTR.2d 2001-2019 (Per Curiam 4th Cir. 2001), aff’g TC Memo 1999-395. The Internal Revenue Service has issued administrative guidance that it will seek to disallow deductions for prepaid real estate taxes that have not accrued prior to January 1, 2018. IR-2017-210. Both the appellate opinion and the Tax Court opinion are unpublished and are not binding precedent in future cases. Nonetheless, they may be predictive as to how the Tax Court and the Fourth Circuit will rule if this issue comes before the respective courts again.

(b) Alternative Minimum Tax – IRC section 56(b)(1)(A)(ii). State and local real estate taxes on personal use property are not deductible for the purposes of calculating Alternative Minimum Tax for the 2017 tax year. Many taxpayers who are in a position to prepay 2018-19 Montgomery County real estate tax will be subject to the Alternative Minimum Tax which will undo most of the benefit from any deduction allowed against the ordinary federal income tax.

Any taxpayer should consult with a tax advisor as individual circumstances will differ.

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