

No. 12-73257 and No. 12-73261

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UNITED STATES COURT OF APPEALS  
FOR THE NINTH CIRCUIT

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**BRUCE H. VOSS AND CHARLES J. SOPHY,**

**Petitioners and Appellants,**

**vs.**

**COMMISSIONER OF INTERNAL REVENUE,**

**Respondent and Appellees.**

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Appeal from the United States Tax Court  
Docket Nos. 16443-09 and 16421-09

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Brief of *Amici Curiae* Professor Patricia Cain, et al in Support of Appellants  
Bruce H. Voss and Charles J. Sophy, Urging Reversal

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## **STATEMENT OF INTEREST**

Amici, named below, are professors of law who regularly teach income tax courses at ABA accredited law schools. These courses include coverage of the deduction for mortgage interest. Some of us have also written scholarly articles that address the issue of how Section 163(h) of the Internal Revenue Code should be construed. As professors, we have competing views on the question of whether mortgage interest deductions should ever be allowed as a matter of tax policy. But we are in agreement that so long as the mortgage interest deduction is authorized under current Code provisions (Section 163(h)(3)), that deduction should be allowed on a “per taxpayer basis.” As specialists in federal tax law, Amici believe our knowledge with respect to the issues in this case will contribute to the deliberations of the Court.

No party’s counsel authored this brief in whole or in part, and no party or a party’s counsel nor any other person other than the Amici contributed money that was intended to fund preparing or submitting the brief.

Amici offer their view only on the proper statutory construction of Section 163(h)(3) as it is currently written. Amici provide their institutional affiliations for identification purposes only.

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## **ARGUMENT**

### **I. Statutory Construction: Plain Meaning of Terms**

Prior to January 1, 1987 (the effective date of the Tax Reform Act of 1986), all interest paid was deductible under Section 163 of the Internal Revenue Code. The 1986 Act changed that rule by prohibiting a deduction for personal interest. *See* Section 163(h). Mortgage interest paid on a residence used for personal purposes is personal interest. However, Congress elected to save the mortgage interest deduction. Subsection (h)(2)(D) excluded from “personal interest” any qualified residence interest as defined under Section 163(h)(3). As a result, any interest that constitutes “qualified residence interest” would be deductible under Section 163(a).

As originally enacted, all qualified residence interest was deductible so long as it met the qualifications under Section 163(h). There were no dollar limitations in 1987. The dollar limitations (i.e, \$1.0 million for acquisition indebtedness and \$100,000 for home equity indebtedness) were passed into law a year later and became effective in 1988. Prior to 1988, “qualified home equity indebtedness” was limited to mortgage funds that were used for qualified medical and educational expenses. The amount of acquisition debt that could qualify was unlimited so long as it was used to purchase or improve the home.

“Qualified residence interest” is defined under Section 163(h)(3)(A) as “acquisition indebtedness with respect to any qualified residence **of the taxpayer**” and also as “home equity indebtedness with respect to any qualified residence **of the taxpayer.**” (emphasis added)

In turn, “qualified residence” is defined in Section 163(h)(4) as either the “principal residence (within the meaning of Section 121) of the taxpayer” or as “1 other residence of the taxpayer ... (within the meaning of section 280A(d)(1).” Under Section 121, the residence is a principal residence only if the **taxpayer** meets certain ownership and use rules (e.g., two years of ownership and use out of the past five years). Under Section 280A(d)(1), the taxpayer is similarly required to meet certain “use” rules with respect to the residence for it to be considered a “qualified residence.”

Because the determination of “qualified residence” depends on **use by a taxpayer**, the focus is on the taxpayer and not just the residence. A residence cannot stand alone apart from a taxpayer and be “qualified.” It must be used by a “taxpayer” in order to be a “qualified residence.” As a result, under plain meaning principles, the limitations (\$1.0 million and \$100,000) in Section 163(h)(3) that the IRS and Tax Court say must be applied on a per-residence basis can only be applied to residences that are owned and used by a particular taxpayer. Thus, the

effective limitation should be a “per-taxpayer” limitation, provided the taxpayer in question satisfies the ownership and use rules for “qualified residences.”

Note also that the limitation is for outstanding mortgage indebtedness “for any period.” Taxpayers have periods (taxable periods), usually a taxable year. Residences do not. This phrase “for any period” implies that the statute meant “for any period of the taxpayer.” The taxpayer should be able to deduct mortgage interest during his or her taxable period with the limitation calculated on the aggregate amount of his debt outstanding during that taxable period. It makes no sense to allocate the debt to the property rather than the taxpayer who owes the debt. What taxable period would you use to make that calculation if the two owners had different tax years?

Furthermore, the IRS formula, which was approved by the Tax Court, appears to apply to limit the overall amount deductible whenever the aggregate debt on a home exceeds \$1.1 million, even in cases where the interest claimed for deduction by the taxpayers does not exceed the limitation amount.

Example: Mother and Son co-own a residence with an average outstanding mortgage balance of \$2.2M. Son purchased the 50% interest from his mother to help her stay in the home after her husband’s death. Son is married to Wife and they own a home on which they claim interest deductions on their joint return up to the maximum amount allowed a married couple (i.e., applying the \$1.1 million



limitation). The co-owned residence is a qualified residence as to Mother, but even if it is qualified as to son, he cannot deduct any further interest because doing so would exceed the limit allocated to him as a married person. Assume Mother and Son each pay 50% of the interest on the co-owned property. But if interest is deductible only after applying the IRS limitation of 1.1/2.2, then Mother would be limited to an interest deduction of only 50% of the amount she paid. (For example, at a 4% interest rate, Mother and son would each pay \$44,000 of interest, but Mother would only be permitted to deduct \$22,000.) If the “residence,” as opposed to the “taxpayer,” is entitled to \$1.1 million of interest as the IRS and the Tax Court conclude, then something is amiss in this example. The IRS fractional share formula would have to be fine-tuned – or an exemption created – to allow Mother to claim all of the deduction that she seems entitled to.

In addition, since a qualified residence for purposes of Section 163(h)(3) means one residence as defined by Section 121 and another as defined by Section 280A, it is useful to note that both sections make it clear that in cases of co-owners, the residence qualifies as a residence for each of the co-owners. Accordingly, the home in which Mother resides can be a residence as to both Mother and Son. Son will not meet the requirements of Section 121 unless he lives in the residence for two years before sale, but, if he doesn't, it will qualify as a residence for Son under Section 280A because his mother's use is allocated to him

and counts as his personal use. See Section 280A(d)(2). Similarly, with respect to taxpayers Voss and Sophy, each co-owned home counts as a residence for each taxpayer.

Conclusion: The above example demonstrates the wisdom of applying the limitation on a per-taxpayer-basis. Mother should get her \$1.1 million limitation and Son (together with his wife, treated as one taxpayer) should get his \$1.1 million limitation. Alternatively, if Son has only used up \$900,000 of his limitation, he should be allowed to claim an additional \$200,000 of his limitation on the co-owned home, without reducing his mother's limitation of \$1.1 million.

## **II. Statutory Construction: Other Code Sections Treat Spouses as a Single Taxpayer Using Similar Language**

The parenthetical that seems to cause the current dispute is the following:

(ii) \$1,000,000 Limitation.--The aggregate amount treated as acquisition indebtedness for any period shall not exceed \$1,000,000 (\$500,000 in the case of a married individual filing a separate return)."

Of course this provision would be much clearer if it had said "the aggregate amount treated as acquisition indebtedness **of any taxpayer** for any period shall not exceed \$1,000,000 (\$500,000 in the case of a married individual filing a separate return)." The parenthetical suggests that married individuals will be treated as one taxpayer, which is not unusual in tax statutes.

Compare the statutory language in Section 163(h) to the language used in the provision limiting the deductibility of capital losses. Section 1211(b)(1) provides:

... In the case of a taxpayer other than a corporation, losses from sales or exchanges of capital assets shall be allowed only to the extent of the gains from such sales or exchanges, plus (if such losses exceed such gains) the lower of—

- (1) \$3,000 (\$1,500 in the case of a married individual filing a separate return),

Section 1211 has always been understood to restrict a married couple to the single \$3,000 amount, even when both spouses are “taxpayers” (meaning that each of them has taxable income independent of the other). It doesn’t say so explicitly. It appears to give a \$3,000 limit on a per-taxpayer basis and to treat married taxpayers filing jointly as a single taxpayer subject to the \$3,000 limit, while providing a rule that they split the limit if they file separately.

While it does not always seem appropriate to treat married taxpayers as a single taxpayer for income tax purposes, there are some justifications in the case of the capital loss limitation. And there are similar justifications in the case of the mortgage interest deduction limitation. Husbands and wives are given a benefit under the joint return rules because they can offset their capital gains and losses against each other’s. Single taxpayers cannot do that. As a result allowing husbands and wives, even after netting, to claim an additional \$6,000 loss against

ordinary income, seems too generous. Similarly, husbands and wives can claim interest deductions on a joint return on a total of \$1.1 million of debt, no matter which spouse owns the home. Thus, for example, even if the wife owns the home and has no income, the married couple can claim the interest deduction on a joint return against the husband's income. *See* IRS Publication 936: Home Mortgage Interest Deduction at page 4. Single taxpayers who live together do not have that benefit. Each of them must have an ownership interest in the home in order to claim a deduction. Thus, as with Section 1211's limit on the deduction for capital losses, the parenthetical reference to married individuals filing separate returns suggests only that a different rule applies to married taxpayers than to unmarried taxpayers. It does not suggest that there should be an overall limit of \$1.0 million acquisition indebtedness per residence.<sup>1</sup>

### **III. Statutory Construction: When Congress Intends to Limit Unmarried Taxpayers to a Single Limitation, It Does That Explicitly**

Section 36 of the Internal Revenue Code allows a taxpayer to claim a credit as a first time homebuyer. The credit is 10% of the purchase price of the residence.

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<sup>1</sup> Despite the IRS position that husbands and wives filing joint returns should be similarly limited to \$1.0 million of acquisition debt even though the statute is silent as their status, at least one academic disagrees. *See* William W. Hagen II, Debt Limit for Residences based on Filing Status, Tax Notes, August 6, 2012, page 720. For additional arguments that Section 163(h)(3) should be construed to apply the dollar limitations per taxpayer when the taxpayers are unmarried, *See* Patricia A. Cain, Unmarried Couples and the Mortgage Interest Deduction, Tax Notes, April 27, 2009, page 473.

However, there is a limitation. The credit cannot exceed \$8,000. To clarify whether the credit is applied per taxpayer or per residence, the provision states:

(b) Limitations.--

(1) Dollar limitation.--

(A) In general.--Except as otherwise provided in this paragraph, the credit allowed under subsection (a) shall not exceed \$8,000.

(B) Married individuals filing separately.--In the case of a married individual filing a separate return, subparagraph (A) shall be applied by substituting "\$4,000" for "\$8,000".

(C) Other individuals.--If two or more individuals who are not married purchase a principal residence, the amount of the credit allowed under subsection (a) shall be allocated among such individuals in such manner as the Secretary may prescribe, except that the total amount of the credits allowed to all such individuals shall not exceed \$8,000.

Thus, when Congress intends to apply a single limit to two unmarried taxpayers, it does so by including an explicit provision. No such provision is included in Section 163(h).

#### **IV. Policy Considerations**

The IRS formula for the limitation, which is designed to apply per residence, will cause problems for taxpayers who may purchase a home together but are not otherwise close or intimate friends. Given the high cost of desirable housing in some geographical areas of the country, it is not uncommon for a group of people or for two families to share resources and purchase a home together that they otherwise could not afford. Indeed, in San Francisco, real estate agents and brokers

market many properties that are sold as TICs (Tenancy in Common interests). Thus it is possible for two strangers to co-purchase a single home. Despite the financial risk of becoming jointly liable on a single mortgage with a person who is virtually a stranger or even with a person who is a friend, some purchasers of TICs do in fact share mortgage liabilities that exceed \$1.1 million. Separate agreements allocate the primary responsibility for a portion of the underlying mortgage to each purchaser. Applying the IRS formula in such cases will deprive taxpayers of full deductions for interest on their portion of the mortgage even when their portion of the mortgage is less than the \$1.1 million limitation. To limit the deduction in such cases punishes those who have found a creative solution to the problem of soaring housing prices in certain regions of the country. In addition the IRS formula will be difficult to apply in cases in which the joint owners are not all purchasing at the same time because the aggregate average amount of indebtedness during one taxpayer's ownership period may be different from the aggregate average amount of indebtedness during another taxpayer's ownership period.

Another example concerns vacation homes. The current statutory rule allows taxpayers to deduct interest paid on a second home, which often is a vacation home. Amici do not comment on the wisdom of this policy, although it clearly benefits the homebuilding industry, which is one of the justifications for the deduction. Often taxpayers arrange such purchases on a time-share basis.

Sometimes they may do so privately, via a private agreement about who can use the property when. In that case, they are likely to be jointly and severally liable on any underlying purchase money mortgage although they will have a side agreement about who is responsible for what. People buy and sell these interests at different times during the year. It would require intricate calculation to determine how much each owner is entitled to deduct under the limitation method proposed by the IRS. What if X buys from O in the middle of the year, with X assuming O's share of the underlying mortgage or using a wraparound mortgage? What is the average outstanding liability for the "tax year" for each taxpayer? That amount will necessarily be different from the average outstanding mortgage balance on the home for the entire year. While these issues can arise with respect to any co-purchase arrangement, they are often more complicated in time-share sales of vacation property.

Example: A purchases a home and borrows \$1.1 million in order to make the purchase. At that time, A may deduct 100% of the interest paid on the mortgage. Five years later, having paid only interest on the mortgage so that the outstanding balance remains at \$1.1 million, A sells a 50% interest in the home to B. B purchases that interest in the home on July 1 paying cash, assuming half of the outstanding mortgage (\$550,000) and signing a note to A in the amount of \$200,000 which is secured by B's interest in the residence.

Now the total outstanding debt on the property is \$1.3 million. But only B is liable on the \$200,000 debt. That debt benefits B. Yet, under the IRS formula, all of the debt should be aggregated and serve as the denominator of a fraction in which the numerator is the total limit of \$1.1 million. It does not seem fair to reduce A's mortgage deduction because B has borrowed an additional amount (from A) which serves to increase the overall aggregate debt on the residence.

Assume further that B was able to borrow an additional \$100,000 from his mother, who insisted on taking a secured interest in the home to ensure repayment. Now the residence has an additional \$100,000 of qualified indebtedness (home equity debt). But only B benefits from this debt. It does not make sense to reduce A's mortgage interest deduction under the IRS formula because of a home equity loan acquired by his co-owner B. The better approach is to determine how much qualified indebtedness is allocable to each taxpayer for each taxpayer's relevant tax year.

**V. The Tax Court Opinion Does Not Reflect the Correct Law Even if the Limitation is Per Residence.**

In the case before the court, taxpayers owned two homes and they paid mortgage interest on both homes. Both homes qualified as qualified residences for both taxpayers. For some reason that is not readily apparent to Amici, the stipulated facts and the Tax Court opinion aggregated the outstanding debt on both residences and aggregated the amount of interest paid by each taxpayer on both



residences. The result was to limit these two unmarried individuals to the single \$1.1 million limitation that applies to a married couple. They are not treated as married for any other purpose in the Internal Revenue Code. Thus, it seems totally incorrect to treat them that way for purposes of the mortgage interest deduction. Tax return preparers and taxpayers who read this opinion are left in confusion about how to apply even the IRS limitation correctly. At the very least, this misleading part of the opinion must be cleared up for the benefit of other taxpayers in this situation.

The opinion appears to say that any two single people who own two homes together must aggregate all debt and all interest and then apply the IRS formula. But in reality, even under the IRS position, the taxpayers should aggregate the average debt outstanding on each of the two homes separately. Only when aggregate debt on one residence exceeds the \$1.1 million limitation should the amount of deductible interest be limited. In this case, the aggregate average debt on the Rancho Mirage home did not exceed \$1.1 million. The ending balance was \$472,450 in tax year 2006 and \$466,140 in tax year 2007. See Petitioner's Computation for Entry of Decision, U.S. Tax Court. As a result, there should be no reduction in the amount of the interest deduction claimed with respect to that home. The taxpayer or taxpayers who paid the interest on the Rancho Mirage home should be able to deduct whatever amount he paid in full.

The average balance outstanding on the Beverly Hills home was \$1,930,511 in 2006 and \$1,902,770 in 2007. These are the numbers that, under the IRS formula, should have been used in the denominator of the applicable fraction. Thus for 2006, the taxpayers between then should have been allowed to deduct 57% of the interest paid on this home in 2006 and 57.8% of the interest paid on this home in 2007.

Therefore, even if this Court agrees that the limitation is to be applied per residence rather than per taxpayer, amici respectfully request the Court to clarify that the decision of the Tax Court incorrectly used an overall limitation of \$1.1 million applied to this unmarried couple. As a result, they should have been entitled to deduct 100% of the interest paid on the Rancho Mirage home and approximately 57% of the interest paid on the Beverly Hills home.

## **CONCLUSION**

Taxpayers are entitled to a mortgage interest deduction for their qualified residence interest. Under proper construction of Section 163(h), each taxpayer should be entitled on interest paid on qualified indebtedness of up to \$1.1 million per residence owned, provided no single taxpayer claims interest on more than \$1.1 million of indebtedness in the aggregate. Because the Tax Court mistakenly calculated the limitation as \$1.1 million for the two taxpayers combined, a

limitation which based on the language of the Code could only be applied to married taxpayers, we ask this Court to reverse the decision of the Tax Court.

Dated: February 6, 2013

Respectfully submitted,

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## **CERTIFICATE OF COMPLIANCE**

Certificate of Compliance Pursuant to Fed. R. App. P. 32(a)(7)(C) and Circuit Rule 32-1 for Case Numbers 12-73257 and 12-73261.

I certify that pursuant to Fed. R. App. P. 32 (a)(7)(C) and Ninth Circuit Rule 32-1, the attached *Amicus Curiae* brief is proportionately spaced, has a typeface of 14 points or more and contains 3,617 words.

Dated: February 6, 2013

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## **CERTIFICATE OF SERVICE**

Ninth Circuit Case Numbers: 12-73257 and 12-73261

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on February 6, 2013.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

Dated: February 6, 2013

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