No. 12-73257 and No. 12-73261

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRUCE H. VOSS AND CHARLES J. SOPHY,

Petitioners and Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellees.

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

CONSOLIDATED BRIEF FOR PETITIONERS-APPELLANTS

Aubrey Hone
HONE MAXWELL LLP
870 Market Street, Suite 588
San Francisco, California 94102
(415) 765-1754

Attorney for Petitioners-Appellants

TABLE OF CONTENTS

STATEMENT OF JURISDICTION 1

STATEMENT OF THE ISSUES 2

STATEMENT OF THE CASE 3

STATEMENT OF THE FACTS 5

A. Background Information 5

B. IRS Deficiency Determination 6

C. Tax Court Opinion 7

SUMMARY OF THE ARGUMENT 8

ARGUMENT 10

I. STANDARD OF REVIEW. 10

II. THE STATUTORY LIMITATIONS OF SECTION 163(h)(3) APPLY ON A PER-TAXPAYER BASIS. 10

A. Statutory Construction Requires Applying the Limitation to Each Taxpayer's Aggregate Indebtedness. 11

B. Legislative History Supports Applying the Limitation Per-Taxpayer. 15

C. Taxpayers are Routinely and Historically Treated Differently Based on Filing Status. 19

III. UNDER FEDERAL TAX LAW THE TERM "RESIDENCE" MAY INCLUDE ONLY A PORTION OF A PROPERTY 21

IV. TAXPAYERS MUST AGGREGATE THEIR OWN INDEBTEDNESS TO CALCULATE THE LIMITATION UNDER SECTION 163. 23

CONCLUSION 26

STATEMENT OF RELATED CASES 27

CERTIFICATE OF SERVICE 28

CERTIFICATE OF COMPLIANCE 29

TABLE OF AUTHORITIES

Cases

Caminetti v. United States, 242 US 470 (1917) 25
Consol. Freightways Corp of Del. v. Aetna, Inc., 564 F.3d 1161 (9th Cir. 2009) ... 11
Crawford v. Commissioner, 266 F.3d 1120 (9th Cir. 2001) 10
Sophy v. Commissioner, 138 T.C. No. 8 (2012) 2, 4, 7, 20
Suzy's Zoo v. Commissioner, 273 F.3d 875 (9th Cir. 2001) 10
United States v. Am Trucking Ass'ns, Inc., 310 U.S. 534 (1940) 11

Statutes

26 U.S.C. § 163(h)(1) 12
26 U.S.C. § 163(h)(3) (1986) (amended 1987) 16
26 U.S.C. § 163(h)(3)(B)(i) 12
26 U.S.C. § 163(h)(3)(B)(ii) 11, 24
26 U.S.C. § 163(h)(3)(C)(i) 12
26 U.S.C. § 163(h)(3)(C)(ii) 11, 24
26 U.S.C. § 6214(a) 2
26 U.S.C. § 7442 2
26 U.S.C. § 7482(a)(1) 2
26 U.S.C. § 7482(b)(1)(A) 2
26 U.S.C. § 7483 2
26 U.S.C. § 7502 2
Cal. Civ. Code § 683(a) 6
Revenue Act of 1948, 62 Stat. 110 19

Other Authorities

H.R. REP. No. 100-391(II), at 234 (1987) 16
H.R. REP. No. 100-391(II), at 235 17
H.R. REP. No. 99-3838, at 263-264 (1987) 15

Regulations

Treas. Reg. § 1.121-2(a)(4), Example 1. 13
Treas. Reg. 1.121-1(b) 22

No. 12-73257 and No. 12-73261

UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRUCE H. VOSS AND CHARLES J. SOPHY,

Petitioners and Appellants,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent and Appellees.

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

CONSOLIDATED BRIEF FOR PETITIONERS-APPELLANTS

STATEMENT OF JURISDICTION

On May 14, 2009, the Commissioner of Internal Revenue (the "Commissioner") issued Notices of Deficiency to Bruce H. Voss ("Mr. Voss") and Charles J. Sophy ("Dr. Sophy" and collectively with Mr. Voss the "Taxpayers") with respect to their federal income taxes for the taxable years ended December 31, 2006 and December 31, 2007.

The Taxpayers each filed petitions in the United States Tax Court (the "Tax Court") on July 7, 2009, in which they sought a redetermination of their tax

deficiencies for tax years 2006 and 2007. On June 2, 2011, the Taxpayers filed a Joint Motion to Consolidate for Trial, Briefing and Opinion, which was granted by the Tax Court on June 3, 2011. The Tax Court had jurisdiction to re-determine the correct amount of the deficiency pursuant to sections 6214(a) and 7442.[1]

On March 5, 2012, the Clerk of the Tax Court entered a decision, which is a final, appealable judgment disposing of all claims with respect to all parties. The Tax Court's opinion addressing the issue that is the subject of this appeal is reported at 138 T.C. No. 8 (2012). The Taxpayers each filed a Notice of Appeal from the decision on October 9, 2012. The appeals were timely under sections 7483 and 7502. This Court has jurisdiction to entertain the appeals pursuant to section 7482(a)(1), and venue is proper pursuant to section 7482(b)(1)(A) because the Taxpayers' legal place of residence was California at the time they filed their petitions with the Tax Court.

STATEMENT OF THE ISSUES

The issues on appeal are whether the Tax Court erred in: (1) finding that the section 163(h)(3) statutory limitations on the amount of interest that is deductible because it is paid on qualified residence acquisition and home equity indebtedness is calculated with respect to the property as a whole rather than with respect to the

[1] Unless otherwise indicated, all "section" or § references are to the Internal Revenue Code of 1986 (26 U.S.C.) (the "Code"), as amended, or to the Treasury regulations (26 C.F.R.) (Treas. Reg.) issued thereunder, in effect during the years at issue.

taxpayer claiming the deduction, thereby requiring aggregation of all indebtedness on the property where property co-owners are not married to each other, and (2) calculating Taxpayers' proper statutory limitation if the Tax Court's interpretation is accepted.

STATEMENT OF THE CASE

This case arises from May 14, 2009, Notices of Deficiency for the Taxpayers (collectively, the "Notices of Deficiency") in which the Commissioner determined deficiencies in both of the Taxpayers' income taxes for tax years 2006 and 2007. (Excerpts of Record ("ER") 153 & 114.) Taxpayers are unmarried[2] and co-own, as joint tenants, two properties located in Beverly Hills and Rancho Mirage, California. For taxable years 2006 and 2007 Taxpayers each claimed deductions for qualified residence interest under section 163(h) on their separate individual income tax returns.[3]

The Commissioner determined federal income tax deficiencies for Mr. Voss of $16,918 for 2006 and $15,872 for 2007. (ER 153.) The Commissioner determined federal income tax deficiencies for Dr. Sophy of $19,613 for 2006 and

[2] Taxpayers are registered as domestic partners with the state of California, which is not a legally recognized relationship status under federal law.
[3] For purposes of this brief, "qualified residence interest" as defined in section 163(h)(3)(A) will be referred to as "mortgage interest".

$6,799 for 2007.[4] (ER 114.) The deficiencies were based on, amongst other issues not present before this Court,[5] the Commissioner's belief that Taxpayers' claimed mortgage interest deductions in excess of the limits allowed under the Code. (ER 168 & 133.) As a result, the Commissioner disallowed $60,421 and $56,685 of Mr. Voss's and $56,866 and $24,443 of Dr. Sophy's mortgage interest deductions for tax years 2006 and 2007, respectively. (*Id.*)

On July 7, 2009, the Taxpayers timely petitioned the Tax Court and assigned error to the Commissioner's determination of the limitation on the deduction of mortgage interest expenses under section 163(h)(3). (ER 240 & 262.) On June 3, 2011, the Tax Court consolidated the two cases for trial, briefing and opinion. (ER 227.) The cases were submitted to the Tax Court fully stipulated. (ER 73.) On March 5, 2012, the Tax Court held in *Sophy v. Commissioner*, 138 T.C. No. 8 (2012), that the limitations on the amounts that may be treated as acquisition and home equity indebtedness with respect to a qualified residence under sections 163(h)(3)(B)(ii) and (C)(ii) were properly applied on a per-residence basis rather than a per-taxpayer basis. (ER 53.) As a result, on July 13, 2012, the Tax Court entered the orders and final decisions in favor of the Commissioner. (ER 1 & 3.)

---

[4] These amounts do not reflect Commissioner's concessions in the Stipulations of Settled Issues. (ER 230-232.)

[5] Id.

STATEMENT OF THE FACTS

A. Background Information

During the years at issue, Taxpayers were unmarried and co-owned two properties located in Beverly Hills and Rancho Mirage, California as joint tenants. (ER 76, Stip. ¶ 2 & ER 79, Stip. ¶ 13.) Each property was financed with a mortgage that was secured by the property and Taxpayers were jointly and severally liable for the mortgages. (ER 79-80, Stip. ¶¶ 18, 20-21.) Taxpayers also obtained a home equity line on the Beverly Hills property, on which Taxpayers were jointly and severally liable. (ER 80, Stip. ¶¶ 22-23.) For the years at issue, Taxpayers used the Beverly Hills property as their principal residence and the Rancho Mirage property as their second residence. (ER 79, Stip. ¶ 15.)

In 2006, Mr. Voss paid mortgage interest of $85,962 and Dr. Sophy paid mortgage interest $94,698 for the two properties. (ER 82, Stip. ¶ 31.) The total average balance in 2006 for the Beverly Hills property mortgage and home equity loan and the Rancho Mirage property mortgage was $2,703,568. (ER 82, Stip. ¶ 32.) In 2007, Dr. Sophy paid mortgage interest of $99,901, and Mr. Voss paid mortgage interest of $76,635. (ER 82, Stip. ¶ 31.) The total average balance in 2007 for the two mortgages and the home equity loan was $2,669,136. (ER 82, Stip. ¶ 32.)

On their individual federal income tax returns for 2006 and 2007, Taxpayers

each claimed deductions for mortgage interest expense paid with respect to their individual one-half share of the two properties.[6] (ER 82, Stip. ¶ 30.)

B. IRS Deficiency Determination

The relevant issue raised by the Commissioner in the Notices of Deficiency was whether the mortgage interest deductions claimed by the Taxpayers exceeded the applicable limits under sections 163(h)(3)(B)(ii) and (C)(ii). (ER 168 & 133.) The Commissioner disallowed mortgage interest deductions for Mr. Voss of $60,421 for the 2006 tax year and $56,685 for the 2007 tax year. (ER 168.) The Commissioner disallowed mortgage interest deductions for Dr. Sophy of $56,866 for the 2006 tax year and $24,443 for the 2007 tax year. (ER 133.)

In these cases, the IRS computed the applicable limitation ratio as $1.1 million ($1 million for acquisition indebtedness plus $100,000 for home equity indebtedness) over the entire average balance of the qualifying loans. (ER 168 & 134.) This limitation ratio was then multiplied by the amount of mortgage interest Taxpayers each paid on their one-half interest in the two co-owned properties to arrive at the amount of deductible qualified residence interest that Taxpayers could each claim for the years at issue. (*Id.*)

---

[6] California Civil Code defines a joint tenancy (termed a "joint interest") applicable to real personal property as "one owned by two or more persons *in equal shares*" (emphasis added). *See* Cal. Civ. Code § 683(a).

C. Tax Court Opinion

On March 5, 2012, the Tax Court held in *Sophy v. Commissioner* that the limitations in section 163(h)(3)(B)(ii) and (C)(ii) on the amounts that may be treated as acquisition and home equity indebtedness with respect to a qualified residence are properly applied on a per-residence basis rather than a per-taxpayer basis; therefore, Taxpayers who are unmarried co-owners are together limited in deducting interest on $1 million of acquisition indebtedness and $100,000 of home equity indebtedness. *See* 138 T.C. No. 8 at 16.

The Tax Court focused on the definitions of "acquisition indebtedness" and "home equity indebtedness" in sections 163(h)(3)(B)(i) and (C)(i). *Id.* at 11. The Tax Court noted that the definition of acquisition indebtedness uses the phrase "any indebtedness which is incurred" in conjunction with "acquiring, constructing, or substantially improving any qualified residence of the taxpayer and is secured by such residence." *Id.* Similarly, in the definition of home equity indebtedness, the Tax Court identified the operative language as the phrase "any indebtedness" that is secured by a qualified residence (other than acquisition indebtedness). *Id.* The Tax Court took the view that in both definitions the phrase "any indebtedness" is not qualified by language relating to an individual taxpayer. *Id.* Accordingly, the Tax Court focused on the entire amount of the indebtedness with respect to the property itself stating:

> "When the statute limits the amount that may be treated as acquisition indebtedness, it appears that what is being limited is the total amount of acquisition debt that may be claimed in relation to the qualified residence, rather than the amount of acquisition debt that may be claimed in relation to an individual taxpayer."

Id. at 12. The Tax Court took an identical position for the term "home equity indebtedness." *Id.* at 12-13.

In applying its conclusion that the section 163(h)(3) limitations on the amount of acquisition and home equity indebtedness are properly applied on a per-residence basis, the Tax Court entered a decision applying the limitation by aggregating the total debt on both properties and then limited Taxpayers to their proportionate share of interest deduction on $1.1 million of debt. (ER 1- 4.)

SUMMARY OF THE ARGUMENT

The Tax Court erred in finding that the statutory limitations on the amount of indebtedness to which a taxpayer is entitled to mortgage interest deductions are properly applied with respect to the residence rather than the taxpayer where property co-owners are not married to each other. The Tax Court misinterpreted section 163(h)(3)(B)(i) as using the word 'taxpayer' merely to modify the qualified residence, not the indebtedness. The statutory construction of section 163(h), particularly when considered within the attendant statutory scheme, and the legislative history clearly indicate that 'taxpayer' in this context modifies both the qualified residence and the indebtedness.

Next, the Tax Court erred in applying its per-residence limitation on an aggregate per-property basis. A "qualified residence" as defined in section 163 (incorporating by reference sections 121 and 280A(d)(1)), indicates that when there are two or more unrelated owners of the same property, each co-owner's undivided interest is considered a separate principal residence and the use of even "a portion" of a property may meet the definition of residence thereunder. Therefore, it follows that a single property may be counted as more than one residence for different taxpayers under the Code.

The Tax Court also misconstrued the definition of "aggregate indebtedness" within the context of section 163 to mean the entire outstanding acquisition indebtedness on the property for the years in question rather than the co-owner's fractional share of the outstanding acquisition indebtedness. Since only a taxpayer may incur or aggregate his or her own indebtedness during a particular tax period, the taxpayer is required to calculate this amount with respect to the taxpayer's qualified residence. That is to say that an individual taxpayer must consider what he or she actually owns and apply the limit against the indebtedness on the portions of such properties that meet the definition of such individual taxpayer's qualified residence.

Finally, in the event the Tax Court's interpretation of the section 163 limitation is accepted, the Tax Court failed to properly calculate Mr. Voss's and

Dr. Sophy's respective mortgage interest deductions because Taxpayers owned two separate properties and therefore the per-residence limitation should have been calculated for each separate property in line with the Tax Court's holding.

For the foregoing reasons, the decision of the Tax Court should be reversed in its entirety, or in the alternative, reversed in part as to the calculation only and remanded for a proper calculation.

ARGUMENT

I. STANDARD OF REVIEW.

Decisions of the Tax Court are reviewed "in the same manner and to the same extent as decisions of the district court in civil bench trials." *Crawford v. Commissioner*, 266 F.3d 1120, 1121 (9th Cir. 2001). Accordingly, conclusions of law, including the Tax Court's interpretation of the Internal Revenue Code, are reviewed *de novo*. *Suzy's Zoo v. Commissioner*, 273 F.3d 875, 878 (9th Cir. 2001).

II. THE STATUTORY LIMITATIONS OF SECTION 163(h)(3) APPLY ON A PER-TAXPAYER BASIS.

Section 163(h) generally prohibits a taxpayer other than a corporation from deducting interest paid or accrued during the taxable year. Section 163(h)(2)(D) provides an exception for "qualified residence interest" as defined under section 163(h)(3). In general, a taxpayer is limited to a mortgage interest deduction with respect to $1 million of "acquisition indebtedness" and $100,000 of "home equity

indebtedness" (collectively, the "Limitation"). I.R.C. §§ 163(h)(3)(B)(ii) and (C)(ii).

A. Statutory Construction Requires Applying the Limitation to Each Taxpayer's Aggregate Indebtedness.

Statutory language is the most persuasive evidence of the statutory purpose. *See United States v. Am Trucking Ass'ns, Inc.,* 310 U.S. 534, 542-543 (1940). Furthermore, a statutory provision must not be construed in isolation, but as part of the statutory scheme in which it is embedded. *See Consol. Freightways Corp of Del. v. Aetna, Inc. (In re Consol. Freightways Corp. of Del.)*, 564 F.3d 1161, 1165 (9th Cir. 2009).

The operative language of section 163(h) itself is clearly focused on the taxpayer and not the residence. The first sentence of section 163(h) provides "In the case of a *taxpayer* other than a corporation...." (emphasis added). I.R.C. § 163(h)(1). Additionally, sections 163(h)(3)(A)(i) and 163(h)(3)(A)(ii) both refer to the "indebtedness with respect to any qualified residence *of the taxpayer*" (emphasis added). The fact that the indebtedness must be secured by the residence should not detract from the practical reality that it is the taxpayer who incurs such indebtedness in connection with the taxpayer's acquisition of the taxpayer's qualified residence.

Section 163(h)(3) defines "acquisition indebtedness" as "any indebtedness which is incurred" in conjunction with "acquiring, constructing, or substantially

improving any qualified residence of the taxpayer" and is secured by such residence. I.R.C. § 163(h)(3)(B)(i). The term "home equity indebtedness" is defined as "any indebtedness" that is secured by a qualified residence (other than acquisition indebtedness). I.R.C. § 163(h)(3)(C)(i).

Section 163(h)(4)(A) defines "qualified residence" as "the principal residence (within the meaning of section 121) of the taxpayer," and "1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subsection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1))." Accordingly, section 121 controls the definition of a "principal residence", and section 280A(d)(1) controls the definition of the term "other residence." Further, this wording makes it clear that the interpretation of "qualified residence" under section 163(h)(4)(A) is based on section 121 and section 280A(d)(1).

Section 121 limits the exclusion of gain on the sale of a taxpayer's "principal residence" to $250,000. The section 121 limitation is applied on a per-taxpayer basis rather than a per-residence basis. This is clear from the regulations for section 121. Example 1 of the regulations provides the scenario of unmarried taxpayers who own a fractional interest in a home as joint owners. In that example, the gain realized from the sale was $256,000 and the regulations state that each taxpayer is eligible to exclude $128,000 (one-half of $256,000) because the amount of realized

gain allocable to each of them from the sale does not exceed "each taxpayer's available limitation amount of $250,000." Treas. Reg. § 1.121-2(a)(4), Example 1. This wording confirms that the section 121 limitation of $250,000 for the exclusion of gain are applied on a per-taxpayer basis, not a per-residence basis that would require unmarried co-owners to split the $250,000 exclusion. Thus, under section 121, when there are two or more unrelated owners of the same property, each co-owner's undivided interest is considered a separate principal residence, and the exclusion permitted applies to each separate "principal residence." It follows then that "principal residence" under Section 121 may be only a portion of the property. Since joint owners are treated as each owning a separate residence under section 121, the same must be true under section 163(h)(3) because the meaning of a "qualified residence" for purposes of section 163(h)(3) incorporates by reference the definition under section 121.

Similarly, the "other residence" of the taxpayer defined in section 163(h)(4)(A)(ii) also applies to an individual taxpayer rather than the property itself by incorporating through reference section 280A(d)(1). Section 280A(d)(1) states:

> "a taxpayer uses a dwelling unit during the taxable year as a residence if he uses such unit (*or portion thereof*) for personal purposes for a number of days which exceed the greater of (A) 14 days, or (B) 10 percent of the number of days during such year for which such unit is rented at a fair rental" (emphasis added).

Under section 280A(d)(1) the residence determination is based on the taxpayer's use of the property and expressly states that use of "a portion" of a unit for personal purposes is sufficient. Thus, more than one taxpayer may claim a property as their residence, and a single property may be treated as more than one residence under the Code.

Congress intended to allow each taxpayer a deduction for mortgage interest attributable to that taxpayer’s residence and since a taxpayer’s residence may be only a portion of a property, more than one taxpayer may deduct mortgage interest attributable to the same property. Moreover, by allowing a taxpayer to deduct mortgage interest for the use of only a portion of a property, it is clear that the limitations dealing with qualified residence indebtedness do not apply to the property as a whole. Because the limitations are not properly applied to the entire property in light of the attendant statutory scheme, which imports definitions from sections 121 and 280A(d)(1), the limitations must apply on a per-taxpayer basis.

It follows that when a taxpayer calculates the amount of aggregate indebtedness for purposes of applying the Limitation, a taxpayer should take into account only his or her portion of the indebtedness that is secured by his or her “qualified residence” as defined by section 163(h)(4). Therefore, in this case, the Limitation should be applied by using $1.1 million as the numerator of the fraction where the denominator should be the respective portion of the indebtedness that

corresponds to each taxpayer's equal share of the mortgage. In other words, the Limitation should be applied on a per-taxpayer basis in light of the relevant statutory scheme in which the operative definitions are embedded.

B. Legislative History Supports Applying the Limitation Per-Taxpayer.

The legislative history of the Tax Reform Act of 1986 as it relates to section 163(h) clearly identifies the encouragement of home ownership as an important policy goal. The Joint Committee on Taxation provides that:

> "While Congress recognized that the imputed rental value of owner-occupied housing may be a significant source of untaxed income, Congress nevertheless determined that encouraging home ownership is an important policy goal, achieved in part by providing a deduction for residential mortgage interest."

H.R. REP. No. 99-3838, at 263-264 (1987).

As originally enacted in 1986, section 163(h)(3) provided a limitation on the "qualified residence interest" that a taxpayer could deduct. A taxpayer was allowed to deduct mortgage interest paid to the extent it did not exceed the lesser of (1) the fair market value of the taxpayer's residence, or (2) the *taxpayer's basis* in the residence. I.R.C. § 163(h)(3) (1986) (amended 1987) (emphasis added). Because the limitation was applied through reference to the *taxpayer's basis*, the plain language of the statute focused on the taxpayer rather than the residence when applying the limitation enacted in 1986.

When the Omnibus Reconciliation Act of 1987 ("OBRA'87") amended section 163(h)(3) the following year to reflect the current dollar limitations on indebtedness, the legislative history provides no suggestion that the dollar limitation was to be applied on a per-residence basis therefore reducing the availability of the deduction for expensive homes or expensive geographies. According to legislative history, the stated reason for the amendment was to “limit the benefits of the interest deductions in the case of high-income persons." H.R. REP. No. 100-391(II), at 234 (1987). Accordingly, the legislative history indicates that the 1987 amendment considered the application of the indebtedness limitation to the individual taxpayer. The legislative history does not indicate or suggest that the new limitation should be applied with respect to the entire property in contrast to the taxpayer as under the prior 1986 version.

Additionally, the legislative history to OBRA '87 provides an example stating "the taxpayer incurs $85,000 of acquisition indebtedness", again focusing on the indebtedness with respect to a taxpayer and not the property. H.R. REP. No. 100-391(II), at 235. The legislative history of section 163(h)(3) contemplates a taxpayer who incurs a certain amount of acquisition indebtedness, and the debt is not described with reference to the property or in relation to other indebtedness that is assumed in relation to the property. The legislative history indicates that indebtedness should be examined with respect to the taxpayer and not with respect

to the residence.

The Tax Court's interpretation of section 163 discourages home ownership by penalizing unmarried taxpayers for combining their resources to jointly own property contrary to Congress' stated policy goal for the mortgage interest deduction. Not only does the Tax Court's per-residence application contradict the stated legislative intent, it has an especially harsh effect on unmarried joint home ownership despite the legislative history's explicit discussion of joint ownership arrangements.[7]

A simple example demonstrates the punitive nature of the Tax Court's interpretation of section 163.[8] Assume A purchases a principal residence for $1 million financing the entire acquisition. B acquires a different principal residence for $1 million also financing the entire acquisition. Assuming an annual interest rate of 10%, each taxpayer pays $100,000 (interest only) per year. Under section 163(h)(3), each taxpayer calculates the Limitation by dividing the $1 million limitation by the $1 million of aggregate indebtedness and is therefore able to deduct one-hundred percent of the interest paid or $100,000 each, for a total of $200,000 deducted by A and B.

---

[7] The legislative history to section 163(h)(3) clearly contemplates the joint ownership of residences. In its report, the Joint Committee on Taxation provides that "Qualified residence interest may include interest paid by the taxpayer on debt secured by a residence of the taxpayer that he owns jointly or as a tenant in common." H.R. REP. No. 99-3838, at 267.

[8] For purposes of this example, home equity indebtedness is ignored.

Now, assume instead that A and B pool their financial resources and credit in order to jointly purchase one principal residence for $2 million, financing the entire purchase price. A and B agree to pay all expenses equally. Again assuming 10% interest, taxpayers pay $200,000 ($100,000 each) interest per year. Under the Tax Court's application of the Limitation, A and B each calculate their respective limitations by dividing the $1 million limitation by the $2 million of aggregate indebtedness and therefore may only deduct fifty percent of the interest paid or $50,000 each, for a total of $100,000 deducted by A and B.

This treatment not only has no basis in the statute or the legislative history, it also serves to penalize scores of unmarried co-owners of homes, including siblings, parents and children and unrelated third-party co-owners. Of course the problem is exacerbated if there are even more co-owners.

Legislative history supports applying the Limitation to a taxpayer's own portion of indebtedness because of the stated policy goal of the mortgage interest exception: encouragement of homeownership. Based on this policy goal, it follows that each taxpayer should calculate the amount of aggregate indebtedness for purposes of applying the limitation by taking into account only his or her portion of the indebtedness secured by his or her "qualified residence" as defined by section 163(h)(4). Therefore, the Limitation is appropriately applied with respect to the individual taxpayer in accordance with Congressional intent.

C. Taxpayers are Routinely and Historically Treated Differently Based on Filing Status.

Prior to 1948, taxpayers filed income tax returns individually regardless of marital status. In 1948 Congress authorized spouses to file joint returns to ensure equal treatment under federal tax laws regardless of the state in which they reside. Revenue Act of 1948, 62 Stat. 110 at 114. Spouses are treated differently than individual taxpayers throughout the Code. This disparate treatment arises both when married persons file their returns jointly and when they choose to file their returns separately as married individuals. For example: (i) spouses are subject to different income tax rate schedules than unmarried taxpayers under section 1; (ii) spouses who choose to file their returns jointly are also subject to different income tax rate schedules than spouses who choose to file their returns separately under section 1; (iii) spouses are aggregated to equate one taxpayer in order to meet the ownership requirements for the exclusions of gain under section 121(b); and (iv) spouses may transfer unlimited amounts of property between themselves both during their lifetime and at death without incurring any gift, estate or transfer tax liabilities under sections 1041, 2056 and 2523.

The clearest example of disparate treatment based on filing status is the limitation on the deductibility of capital losses under section 1211(b). Under section 1211(b), non-corporate taxpayers are limited on the amount of capital losses that are deductible. Section 1211(b) states:

> "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), or (2) the excess of such losses over such gains."

Section 1211 uses similar wording as that used in section 163 in that the dollar limitation is half the amount for married individuals filing a separate return than it is for all other filing statuses. A married couple that chooses to file jointly is not allowed to claim a $6,000 deduction, but is instead limited to $3,000 as are single taxpayers. Like section 163, section 1211 applies the same limitation to all filing statuses other than married filing separately. Accordingly, like section 1211, under section 163 each individual filing a single return is entitled to the same limitation on mortgage interest as a married couple filing a joint return.

These Code provisions are clear evidence that Congress does not always intend to treat spouses and individual taxpayers the same. The Tax Court concluded that the inclusion of the parenthetical statements that provide a married individual filing a separate return is limited to one-half of the Limitation implies that unmarried co-owners may "choose to allocate the limitation amounts among themselves in some other manner, such as according to percentage of ownership." *See Sophy*, 138 T.C. No. 8 at 16. This reasoning is erroneous in light of the disparate treatment of taxpayers based on filing status that exists throughout the Code.

Federal tax law commonly arrives at different tax implications based on the individual taxpayer's filing status, which is determined by marital status. This routinely results in different tax treatment for individual taxpayers of different filing statuses (i.e. married versus single) even where the individuals are similarly situated. The Tax Court's per-residence application of the Limitation has the effect of treating unmarried co-owners as if they were married. The Limitation applies with respect to each taxpayer and the indebtedness of a taxpayer's unmarried co-owners should not be considered as part of such taxpayer's aggregate indebtedness for purposes of calculating the Limitation. This treatment is consistent with various provisions of the Code where there is a different result for similarly situated taxpayers based on filing status.

III. UNDER FEDERAL TAX LAW THE TERM "RESIDENCE" MAY INCLUDE ONLY A PORTION OF A PROPERTY.

To determine the amount of mortgage interest that a taxpayer may properly deduct from income, a taxpayer must consider which of their properties, if any, meet the definition of "qualified residence" under section 163(h)(4)(A). As discussed in detail above, section 163(h)(4)(A) defines qualified residence as a principal residence of the taxpayer (within the meaning of section 121) and one other residence of the taxpayer (within the meaning of section 280A(d)(1)). The treasury regulations under section 1.121-1(b) state:

"Whether property is used by the taxpayer as the taxpayer's

> residence depends upon all the facts and circumstances. A property used by the taxpayer as the taxpayer's residence may include a houseboat, a house trailer, or the house or apartment that the taxpayer is entitled to occupy as a tenant-stockholder in a cooperative housing corporation …"

This wording clarifies that a residence is defined by the taxpayer's use and not by the property itself. As explained above, under section 121 when there are two or more unrelated owners of the same property, each co-owner's undivided interest is considered a separate principal residence provided each taxpayer uses the property in a manner that qualifies as a principal residence section 121. Similarly, section 280A(d)(1) defines residence based on the taxpayer's use of the property and goes so far as to expressly state that use of even "a portion" of a unit for personal purposes is sufficient for meeting the residence requirement.

The Limitation is calculated with respect to each taxpayer's qualified residence. Since joint owners are treated as each owning a separate residence under section 121 and use of even a portion of a property for personal purposes meets the residence requirements under section 280A(d)(1), the same must be true under section 163(h)(3) because the meaning of a "qualified residence" for purposes of section 163(h)(3) incorporates by reference the definitions under section 121 and 280A(d)(1).

In this case, as unmarried co-owners, Taxpayers' individual, one-half interest in each of the properties met the definition of "qualified residence" under

section 163(h)(4) for purposes of calculating the allowable deduction. As a result, Taxpayers each have a "qualified residence" comprised of one-half of the Rancho Mirage property and one-half of the Beverly Hills property. This is a logical result not only from a plain reading of the statute, but also because the residence must be a qualified residence for the indebtedness to qualify for a mortgage interest deduction and qualified residence is determined by the taxpayer's use of the property, or some portion thereof. It is possible to have a home that is co-owned that meets the definition of qualified residence for only one co-owner. As a result, aggregate indebtedness must be determined with respect to the taxpayer and not the residence.

Mr. Voss's and Dr. Sophy's respective aggregate acquisition and home equity indebtedness with respect to which interest is deductible, even if applied on a per-residence basis, only includes one-half of the aggregate indebtedness of each of the properties. As a result, applying the Limitation properly on a per-taxpayer basis produces the same result as applying the Limitation on a per-residence basis despite statutory construction and legislative history supporting the per-taxpayer application.

IV. TAXPAYERS MUST AGGREGATE THEIR OWN INDEBTEDNESS TO CALCULATE THE LIMITATION UNDER SECTION 163.

The amount of acquisition and home equity indebtedness that will be allowed as qualified residence indebtedness for purposes of determining deductible

mortgage interest is based on the aggregate amount of indebtedness during a particular taxable period. I.R.C. §§ 163(h)(3)(B)(ii) and (C)(ii).

Clearly, only a taxpayer can aggregate his or her own indebtedness during a specific taxable period. However, to apply the Tax Court's holding below, taxpayer's must aggregate their own debt with the debt of any and all co-owners. Thus, unrelated co-owners would be required to share mortgage details with one another at least annually in order to properly calculate their deductible mortgage interest. Not only does it seem unreasonable that a taxpayer must obtain private financial information from an unrelated co-owner in order to properly claim their mortgage interest deduction, it seems wholly impractical in certain situations. For example, how would a taxpayer aggregate the indebtedness of the property for the taxable period if their co-owner uses a different taxable year? Is each taxpayer required to report their personal mortgage information to their co-owners based on each co-owner's taxable year or based on some other period?

Additionally, aggregating the debt with respect to the property rather than with respect to the taxpayer also creates enforcement issues. For example, a taxpayer cannot compel an unwilling co-owner to disclose private mortgage information. How then, would a taxpayer calculate their Limitation if their co-owner was unwilling to provide this information? Further, how is the Limitation enforced if one co-owner claims more interest than allowed? Will a taxpayer be

required to disclose to the IRS the names and social security numbers of each co-owner of a property when deducting mortgage interest?

The statute and relevant legislative history, which contemplate joint ownership, give no indication that an unmarried taxpayer should aggregate his or her indebtedness with that of his or her co-owners when determining deductible mortgage interest. Section 163(h) requires a taxpayer to aggregate the taxpayer's indebtedness per tax period, which clearly indicates from a plain reading of the statute that Congress intended the Limitation to apply to the taxpayer and not the residence.[9]

The Tax Court erroneously concluded that the phrase "any indebtedness" as used in section 163(h)(3) is not qualified by language relating to an individual taxpayer and instead relates to the entire amount of the indebtedness with respect to the property itself. However, because it is a taxpayer who incurs debt (not the residence), it is the taxpayer, from a practical standpoint, who must aggregate his or her indebtedness for a particular tax period. The statute requires application of the term "any indebtedness" to a certain taxpayer and not the residence.

V. THE TAX COURT FAILED TO ACCURATELY CALCULATE TAXPAYERS' MORTGAGE INTEREST DEDUCTIONS IF THE

[9] *See e.g., Caminetti v. United States*, 242 US 470, 470 (1917) ("When the language of a statute is plain and does not lead to absurd or impracticable results, there is no occasion or excuse for judicial construction; the language must then be accepted by the courts as the sole evidence of the ultimate legislative intent, and the courts have no function but to apply and enforce the statute accordingly.")

PER-RESIDENCE BASIS (APPLIED PER-PROPERTY) IS ACCEPTED.

Assuming *arguendo* that the Tax Court's application of the limitation on a per-residence basis (applied per-property) was correct, the Taxpayers would still each be entitled to claim the full limitation with respect to one of the properties they jointly owned. Because Taxpayers are unmarried co-owners who each paid mortgage interest on indebtedness in excess of the Limitation, they should be allowed to claim the deductible interest any way allowable under the terms of the statute.

The Taxpayers submitted a calculation following the entry of judgment by the Tax Court detailing the allocation of interest among the Taxpayers applying the limitation on a per-residence basis, which was practically applied on a per-property basis. However, the Tax Court did not accept this calculation and instead chose to apply the Limitation as if Taxpayers were spouses filing a joint return even though the unmarried Taxpayers co-own two separate properties.

If the Limitation is properly applied on a per-residence basis as ruled by the Tax Court below (which was actually applied on a per-property basis) then Taxpayers should be entitled to claim a deduction for interest paid on indebtedness on either or some portion of the two homes.

CONCLUSION

For the reasons set forth above, the decision of the Tax Court should be reversed in its entirety, or in the alternative, reversed in part as to the calculation only and remanded for a proper calculation.

STATEMENT OF RELATED CASES

Pursuant to Rule 28-2.6, Petitioners-Appellants state that they are not aware of any related cases pending in this Court.

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 January 30, 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.

Respectfully submitted,

By: s/Aubrey Hone

Aubrey Hone
Attorney for Appellants
Hone Maxwell LLP
870 Market Street, Suite 588
San Francisco, CA 94102
Telephone: (415) 765-1754
Facsimile: (415) 765-7516

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)(A) and Ninth Circuit Rule 32-1, the attached opening brief does not exceed 30 pages.

Respectfully submitted,

By: s/Aubrey Hone

Aubrey Hone
Attorney for Appellants
Hone Maxwell LLP
870 Market Street, Suite 588
San Francisco, CA 94102
Telephone: (415) 765-1754
Facsimile: (415) 765-7516