No. 12-73257, No. 12-73261

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

BRUCE H. VOSS and CHARLES J. SOPHY,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISIONS
OF THE UNITED STATES TAX COURT

CONSOLIDATED BRIEF FOR THE APPELLEE

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COMMISSIONER OF INTERNAL REVENUE,

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ON APPEAL FROM THE DECISIONS
OF THE UNITED STATES TAX COURT

CONSOLIDATED BRIEF FOR THE APPELLEE

STATEMENT OF JURISDICTION

On May 14, 2009, the Commissioner of Internal Revenue mailed separate notices of deficiency to taxpayers Bruce H. Voss (Voss) and Charles J. Sophy (Sophy) pursuant to § 6212 of the Internal Revenue Code of 1986 (26 U.S.C.) (the Code or I.R.C.), determining deficiencies in their respective federal income taxes for the years 2006 and 2007.

(ER 153-169, 114-139.)[1] A taxpayer has 90 days from the date a notice of deficiency is mailed within which to file a petition with the Tax Court seeking redetermination of the deficiency. *See* I.R.C. § 6213(a). On July 7, 2009, each taxpayer timely filed a petition in the Tax Court. (ER 240-242, 262-264.) The Tax Court accordingly had jurisdiction over the petitions pursuant to §§ 6213(a) and 7442 of the Code.

The cases were consolidated and submitted on stipulated facts, and the Tax Court issued an opinion sustaining the deficiencies. (ER 52-68.) On July 13, 2012, the Tax Court entered a decision in each case in accordance with its opinion. (ER 1-4.) The deadline for filing a notice of appeal is 90 days from the entry of the Tax Court's decision. I.R.C. § 7483; Fed. R. App. P. 13(a)(1). Taxpayers each filed a timely notice of appeal on October 9, 2012, the 88th day after the entry of the decisions. (ER 69, 71.) This Court has jurisdiction under § 7482(a)(1) of the Code.

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[1] "ER" references are to the pages of the excerpts of record filed by appellants with their opening brief. "App. Br." references are to the pages of appellants' opening brief. "Ami. Br." references are to the pages of the brief submitted by proposed *amici curiae* Professor Patricia Cain, *et al.*

STATEMENT OF THE ISSUE

Whether the Tax Court properly applied the limitations on deductions for interest on residential mortgages and home equity loans under I.R.C. § 163(h)(3).

STATUTES AND REGULATIONS

Pertinent provisions of applicable statutes and regulations are set forth in the addendum bound with this brief.

STATEMENT OF THE CASE

Taxpayers brought these actions in the Tax Court to challenge deficiency determinations made by the Commissioner concerning their individual federal tax liabilities for the years 2006 and 2007. (ER 240-242, 262-264.) Taxpayers, the co-owners of two residences, contended that the Commissioner had erred in applying the limitations on deductions for interest on residential mortgages and home equity loans under I.R.C. § 163(h)(3). (ER 240-242, 262-264.) The cases were consolidated and submitted to the court for decision on stipulated facts. (ER 73-75, 227-229). After the parties submitted briefs, the Tax Court (Hon. Mary Ann Cohen) issued an opinion sustaining the deficiencies, agreeing with the Commissioner that the limitations under § 163(h)(3) apply on a per-residence basis, rather than on a per-taxpayer basis. (ER 52-68.) The opinion is reported at *Sophy v. Commissioner*, 138 T.C. No. 8, 2012 WL 695486 (2012). The Tax Court entered a decision in each case in accordance with its opinion (ER 1-4), and taxpayers now appeal (ER 69, 71).

STATEMENT OF FACTS

A. Taxpayers' federal tax liabilities for 2006 and 2007

Taxpayers Bruce H. Voss and Charles J. Sophy jointly purchased two residences, one located in Rancho Mirage, California, and the other located in Beverly Hills, California. (ER 79.) Taxpayers are domestic partners, and they filed a Declaration of Domestic Partnership with the California Secretary of State in 2001. (ER 76, 88.) At issue are deductions claimed by taxpayers for 2006 and 2007 for interest paid on two refinanced mortgages and a home equity line of credit.

1. The Rancho Mirage house

In 2000, taxpayers purchased a residence in Rancho Mirage as joint tenants for a contract sales price of $607,921.29, borrowing $486,300.00 from Bank of America to finance the purchase. (ER 80-81, 205.) In 2002, taxpayers refinanced the Bank of America mortgage, obtaining a new loan from Countrywide Home Loans, Inc., also known as America's Wholesale Lender, in the amount of $500,000 ("the Rancho Mirage mortgage"). They used the proceeds of that loan to pay off the Bank of America mortgage. (ER 81, 210-211.) Taxpayers were jointly and severally liable for the Rancho Mirage mortgage, which was

secured by the Rancho Mirage house, and they held the property as joint tenants during 2006 and 2007. (ER 80-81.)

2. The Beverly Hills house

In 2002, taxpayers purchased a residence in Beverly Hills as joint tenants for a sales price of $3,200,000. (ER 79, 173.) Taxpayers financed their purchase by borrowing $2,240,000 from Hawthorne Savings, F.S.B. (ER 79, 173-174.) In 2003, taxpayers refinanced the Hawthorne Savings mortgage, obtaining a new loan from Countrywide in the amount of $2,000,000 ("the Beverly Hills mortgage"). They used the proceeds of that loan to pay off the Hawthorne Savings mortgage. (ER 80, 179.) Taxpayers were jointly and severally liable for the Beverly Hills mortgage, which was secured by the Beverly Hills house, and they held the property as joint tenants during 2006 and 2007. (ER 79-80.) Also in 2003, taxpayers obtained a $300,000 home equity line of credit for the Beverly Hills house through Greenpoint Mortgage Funding, Inc. ("the Beverly Hills HELOC"), for which taxpayers were jointly and severally liable. (ER 80, 196.) In 2006 and 2007, taxpayers used the Beverly Hills house as their primary residence and the Rancho Mirage house as their second residence. (ER 79.)

3. Taxpayers' federal income tax returns

Voss timely filed individual federal income tax returns for 2006 and 2007, listing his occupation as "Investor Relations." (ER 77, 141, 146.) Voss reported his 2006 adjusted gross income as $410,867, and, among his itemized deductions, he claimed $95,396 in home mortgage interest. (ER 140-142.) For 2007, Voss reported his adjusted gross income as $446,923, and, among his itemized deductions, he claimed $88,268 in home mortgage interest. (ER 145-147.)

Sophy timely filed his own individual federal income tax returns for 2006 and 2007, listing his occupation as "Physician." (ER 76-77,90, 101.) Sophy reported his 2006 adjusted gross income as $375,793, and, among his itemized deductions, he claimed $95,396 in home mortgage interest. (ER 89-91.) For 2007, Sophy reported his adjusted gross income as $735,036, and, among his itemized deductions, he claimed $65,614 in home mortgage interest. (ER 100-102.)

4. The Commissioner's deficiency determinations

Following examinations of taxpayers' returns, the Commissioner issued separate notices of deficiency to Voss and Sophy for 2006 and 2007, disallowing portions of their itemized deductions for home

mortgage interest and determining deficiencies in their respective federal income taxes. (ER 153-169, 114-139.) The respective notices of deficiency each stated, in part, that the claimed deductions "are not allowed because your deduction for home mortgage interest exceeds the limits per the provisions of the Internal Revenue Code" and that "[t]he excess amount is not deductible." (ER 133, 168.) Those provisions appear in § 163(h)(3) of the Code. Briefly summarized, they limit deductible mortgage interest to "acquisition indebtedness" of $1,000,000 and "home equity indebtedness" of $100,000. *See* I.R.C. §§ 163(h)(3)(B)(ii), 163(h)(3)(C)(ii).

The Commissioner calculated the disallowance amounts by determining the sum of the home mortgage and HELOC interest actually paid by taxpayers, which differed from the amounts claimed, and then applying a "limitation ratio"[2] to the total amount of such interest paid by each taxpayer for each year, pursuant to Chief Counsel Advice 200911007, 2009 WL 641772 (Mar. 13, 2009). *See also* Treas. Reg. (26 C.F.R.) § 1.163-10T(e).

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[2] The limitation ratio was calculated as a fraction (converted to decimal format) with the loan limitation as numerator and the unpaid loan balance as the denominator. The resulting percentage was then applied to the interest paid.

The Commissioner determined that Voss actually paid $85,962 in such interest in 2006, and $76,635 in 2007. (ER 168.) The Commissioner also determined that Sophy actually paid $94,698 in such interest in 2006, and $99,901 in 2007. (ER 134.)[3] The Commissioner further determined that the total average balance in 2006 of the Beverly Hills mortgage and HELOC and the Rancho Mirage mortgage was $2,703,568, and that the total average balance of these three loans in 2007 was $2,669,136. (ER 82.)

The Commissioner computed the applicable limitation ratio for each year as $1.1 million ($1 million for acquisition indebtedness, plus $100,000 for home equity indebtedness), divided by the total average balance of the qualifying loans. (ER 84, 86.) The Commissioner then multiplied this limitations ratio by the amount of interest paid by each taxpayer in order to arrive at the amount of deductible qualified

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[3] Taxpayers later stipulated that the Commissioner correctly determined the amounts of such interest they actually paid for each of the years at issue. (ER 82.) The discrepancies between the amounts of their claimed deductions and the amounts of their actual interest payments resulted, in part, from Voss's inclusion of an interest payment that he made on December 31, 2005, which taxpayers have conceded was not deductible by either of them for 2006. (ER 83.)

residence interest that each taxpayer could claim for each year at issue. (ER 84-86.)

For Voss, the Commissioner determined the amounts of deductible mortgage interest as follows (ER 86, 168):

	2006	2007
Total qualified loan limit	$1,100,000	$1,100,000
Average balance, all loans	$2,703,568	$2,669,136
Limitation ratio (limit ÷ loan balance)	0.4068697	0.41211838
Total interest paid	$85,962	$76,635
Deductible interest (ratio x interest paid)	$34,975	$31,583

For Sophy, the Commissioner determined the amounts of deductible mortgage interest as follows (ER 84, 134):

	2006	2007
Total qualified loan limit	$1,100,000	$1,100,000
Average balance, all loans	$2,703,568	$2,669,136
Limitation ratio (limit ÷ loan balance)	0.4068697	0.41211838
Total interest paid	$94,698	$99,901
Deductible interest (ratio x interest paid)	$38,530	$41,171

Because taxpayers' claimed interest deductions exceeded the allowable amounts of deductible interest, and because of other adjustments to their returns, the Commissioner determined deficiencies for each taxpayer. The Commissioner determined deficiencies for Voss of $16,918 for 2006 and $15,872 for 2007. (ER 153.) The Commissioner determined deficiencies for Sophy of $19,613 for 2006 and $6,799 for 2007. (ER 114.)

B. Proceedings in the Tax Court

Taxpayers filed separate petitions in the Tax Court challenging the respective deficiency determinations for 2006 and 2007, asserting, among other things, that "the Commissioner erred in determining the limitation on the deduction of home mortgage interest expenses under § 163(h) of the Internal Revenue Code of 1986, as amended." (ER 241, 263.)[4] The Tax Court granted the parties' joint motion to consolidate the cases. (ER 227-229.) The court also granted the parties' joint motion to submit the cases for decision without trial pursuant to Tax

[4] In their petitions, taxpayers also contended that the Commissioner erred in disallowing a portion of the amounts they deducted for real estate taxes. (ER 241, 263.) The Commissioner conceded that taxpayers were entitled to deduct the disallowed real estate taxes (ER 78, 230, 232), and these deductions are no longer in issue.

Court Rule 122, on the basis of stipulated facts and exhibits. (ER 73-75, 76-226, 291, 293.)

The Tax Court issued an opinion sustaining the deficiencies. (ER 52-68.) The court noted that taxpayers "sole contention is that the section 163(h)(3) limitations on indebtedness . . . are properly applied on a per-taxpayer basis with respect to residence co-owners who are not married to each other," and that they argued that "together they should be able to deduct interest paid on up to $2.2 million of acquisition and home equity indebtedness." (ER 60.) Analyzing the statutory definitions of "acquisition indebtedness," "home equity indebtedness," and "qualified residence interest," the court rejected taxpayers' interpretation, holding that the statute "focuses on the residence rather than the taxpayer." (ER 62-63.)

The court explained that "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." (ER 63.) The court's analysis of "home equity indebtedness"

was similar. (ER 63-64.) The court also observed that "[w]hile Congress references 'a taxpayer' and 'the taxpayer' several times in section 163(h), any reference to an individual taxpayer is conspicuously absent in the language of the indebtedness limitations." (ER 64.) The court found further support for its interpretation in statutory provisions governing married taxpayers filing separate returns, who are each limited to one-half of the otherwise allowable amount of acquisition indebtedness and home equity indebtedness. (ER 65-67.) The court found nothing in the legislative history of § 163(h)(3) to suggest that Congress "had any other intention than what we have determined from an examination of the language." (ER 67.)

After the parties submitted their respective proposed computations (ER 5-51), the court entered a decision in each case in accordance with its opinion (ER 1-4). Taxpayers each filed a notice of appeal. (ER 69, 71.) Taxpayers' unopposed motion to consolidate their appeals in this Court was granted on January 3, 2013.

SUMMARY OF ARGUMENT

Taxpayers, the co-owners of two residences, brought these actions in the Tax Court to challenge deficiency determinations made by the Commissioner for the years 2006 and 2007. Applying limitations set out in I.R.C. § 163(h)(3), the Commissioner had disallowed portions of taxpayers' deductions for interest on residential mortgages and a home equity loan. After the cases were consolidated and submitted for decision on stipulated facts, the Tax Court issued an opinion sustaining the deficiencies, agreeing with the Commissioner that the limitations imposed by § 163(h)(3) apply on a per-residence basis, rather than on a per-taxpayer basis. The Tax Court held that the $1.1 million limit on the sum of acquisition indebtedness and home equity indebtedness applied to the total indebtedness with respect to the residences at issue. The Tax Court entered a decision in each case in accordance with its opinion, and taxpayers now appeal.

The statutory text supports the Tax Court's interpretation of the limitations on the deductibility of qualified residence interest set out in § 163(h). Both acquisition indebtedness and home equity indebtedness are measured "with respect to" the residence, rather than "with respect

to" the taxpayer. Significantly, this provision of the Code does not refer to the "indebtedness of the taxpayer," but rather to the "indebtedness with respect to any qualified residence of the taxpayer," focusing on the residence, not on the taxpayer. Indeed, the only apparent reason that the word "taxpayer" is used at this point in the statute is to make it clear that it must be the taxpayer who owns the residence. A similar analysis of the definitions of acquisition indebtedness and home equity indebtedness shows that the focus of the statute is on the residence, not on the taxpayer. Read as a whole, the provisions of the Code concerning qualified residence interest, as expressed in the text of § 163(h)(3), indicate that the indebtedness limitations apply to the residence, not to the taxpayer. As a result, these provisions limit the aggregate indebtedness of the residences at issue in these cases to $1.1 million, regardless of the number of co-owners of the property.

Taxpayers' contrary analysis of the text of § 163(h) is unpersuasive. They cite portions of the statute where the word "taxpayer" relates to the residence, but, as noted above, this indicates only that the residence must be owned by the taxpayer. Moreover, taxpayers' interpretation would effectively read out of the statute the

references to the residence in question, making this language superfluous. The Tax Court's interpretation, by contrast, gives meaning to all of the statutory text, and does not render the phrase "with respect to any qualified residence" surplusage. Taxpayers' citation of other, inapposite sections of the Code does not bolster their argument. These cross-references in the statute merely define principal and secondary residences, and they do not appear in the provisions of § 163(h)(3) governing the mechanics of determining the amount of the qualified residence interest deduction. In addition, taxpayers' interpretation of the indebtedness limitations would necessarily create a special rule for married couples – a "marriage penalty" – that Congress never enacted.

Because the text of § 163(h)(3) supports the Tax Court's interpretation of the indebtedness limits, it is not necessary to examine its legislative history. But, in any event, the legislative history relied upon by taxpayers does not support their interpretation of the Code provisions at issue. The version of § 163(h) originally enacted in 1986 does not simply "focus" on the taxpayer, rather than the residence, as taxpayers contend, and even if it did, in 1987 Congress removed any

such "focus" in enacting the current limitations. Contrary to taxpayers' contentions, the legislative history of the current version of the indebtedness limitations of § 163(h) also does not support their reading of the current law. Congress enacted a "dollar cap" on the aggregate debt with respect to the residence in question, and there is no suggestion in the legislative history that these limitations apply to the debt incurred by each co-owner of the residence.

Taxpayers' policy arguments for a "per-taxpayer" reading of the statute are irrelevant, given that the statutory language supports the Tax Court's contrary interpretation. And, the asserted practical, logistical, and moral issues raised by taxpayers also are not relevant in the context of these cases. Under the Tax Court's interpretation, all co-owners are treated alike, whether married or unmarried, and such equal treatment is hardly "punitive" in nature, as taxpayers contend. Finally, having failed to present evidence in the Tax Court of the amounts of their separate payments on each loan, taxpayers cannot now challenge the resulting decisions for not taking this factor into account.

The decisions of the Tax Court are correct and should be affirmed.

ARGUMENT

The Tax Court correctly held that the limitations on deductions for qualified residence interest apply on a per-residence basis, rather than on a per-taxpayer basis

Standard of review

The Tax Court's legal conclusions are reviewed *de novo*, and its factual findings are reviewed for clear error. *Hardy v. Commissioner*, 181 F.3d 1002, 1004 (9th Cir. 1999). In particular, this Court reviews the Tax Court's interpretation of the Internal Revenue Code *de novo*. *Adkison v. Commissioner*, 592 F.3d 1050, 1052 (9th Cir. 2010).

A. Introduction: the deductibility of qualified residence interest

The Internal Revenue Code generally allows a deduction for "all interest paid or accrued within the taxable year on indebtedness." I.R.C. § 163(a). Section 163(h) of the Code, however, provides that for a taxpayer other than a corporation, "no deduction shall be allowed under this chapter for *personal interest* paid or accrued during the taxable year." I.R.C. § 163(h)(1) (emphasis added). The term "personal interest" is defined as "any interest allowable as a deduction under this chapter other than" certain specified categories of interest. And one of

the categories of interest specifically excluded from the definition of "personal interest" (and thereby generally allowable as a deduction) is "any qualified residence interest (within the meaning of paragraph (3))." I.R.C. § 163(h)(2)(D). Paragraph 3, in turn, provides as follows:

> Qualified residence interest. – For purposes of this subsection –
>
> (A) In general. – The term "qualified residence interest" means any interest which is paid or accrued during the taxable year on –
>
> (i) acquisition indebtedness with respect to any *qualified residence of the taxpayer*, or
>
> (ii) home equity indebtedness with respect to any *qualified residence of the taxpayer*.
>
> For purposes of the preceding sentence, the determination of whether any property is a qualified residence of the taxpayer shall be made as of the time the interest is accrued.

I.R.C. § 163(h)(3) (emphasis added). The term "qualified residence" generally means the principal residence of the taxpayer and one other home that is used by the taxpayer as a residence. *See* I.R.C. § 163(h)(4)(A)(i) (cross-referencing I.R.C. §§ 121, 280A(d)(1)).

The two types of deductible interest at issue in this case are interest on "acquisition indebtedness," and interest on "home equity indebtedness." The Code provides that acquisition indebtedness means "any indebtedness which – (I) is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and (II) is secured by such residence." I.R.C. § 163(h)(3)(B)(i). Acquisition indebtedness also includes "any indebtedness secured by such residence resulting from the refinancing of indebtedness . . . but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness." *Id.* The Code defines "home equity indebtedness" as "any indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed – (I) the fair market value of such qualified residence, reduced by (II) the amount of acquisition indebtedness with respect to such residence." I.R.C. § 163(h)(3)(C)(i).

The deductibility of qualified residence interest is limited, based on the amount of the indebtedness. For acquisition indebtedness, the Code provides that "[t]he 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)." I.R.C. § 163(h)(3)(B)(ii). For home equity indebtedness, the Code provides that "[t]he aggregate amount treated as home equity indebtedness for any period shall not exceed $100,000 ($50,000 in the case of a separate return by a married individual)." I.R.C. § 163(h)(3)(C)(ii). Thus, the Code limits the deductibility of qualified residence interest to the interest on a total of $1.1 million in aggregate acquisition indebtedness and home equity indebtedness. The issue in the present cases is how this limitation should be applied to the aggregate indebtedness on two residences owned by two individuals who are not married to each other.

B. The Tax Court properly sustained the Commissioner's deficiency determinations

1. The Tax Court correctly interpreted the limitations on indebtedness in I.R.C. § 163(h)(3)

The Tax Court correctly applied the limitations on the deductibility of qualified residence interest set out in § 163(h), and properly rejected taxpayers' interpretation of the statute. The Tax Court held that the $1.1 million limit on the sum of acquisition indebtedness and home equity indebtedness applies to the total

indebtedness with respect to the residences at issue. (ER 60-67.) Taxpayers, however, maintain that "[t]he Tax Court erred in finding that the statutory limitations on the amount of indebtedness to which taxpayer is entitled to mortgage interest deductions are properly applied with respect to the residence rather than to the taxpayer where property co-owners are not married to each other." (App. Br. 8.) As the Tax Court noted, under taxpayers' interpretation of the statutory limitations, they each would be able to deduct qualified residence interest on up to $1.1 million of acquisition and home equity indebtedness, effectively doubling the $1.1 million limitation established in I.R.C. § 163(h) to $2.2 million. (ER 60.)

In cases turning on statutory interpretation, the primary objective is to give effect to the intent of Congress. *United States v. Am. Trucking Ass'ns, Inc.*, 310 U.S. 534, 542 (1940). "There is, of course, no more persuasive evidence of the purpose of a statute than the words by which the legislature undertook to give expression to its wishes." *Id.* at 543. Accordingly, the place to begin is "the text of the statute, read in its context, . . . [giving] undefined terms their ordinary meanings." *Synagogue v. United States*, 482 F.3d 1058, 1061-62 (9th Cir. 2007)

(citing *United States v. Daas*, 198 F.3d 1167, 1174 (9th Cir. 1999)). The plain meaning of the statutory language is generally conclusive. *See United States v. Ron Pair Enters., Inc.*, 489 U.S. 235, 242 (1989).

The text of § 163(h)(3) supports the Tax Court's interpretation. Taxpayers are entitled to deduct "qualified residence interest" under § 163(h)(2)(D), and this term is defined in § 163(h)(3)(A) as "interest which is paid or accrued during the taxable year" on either of two types of debt: "(i) acquisition indebtedness with respect to any *qualified residence* of the taxpayer" or "(ii) home equity indebtedness with respect to any *qualified residence* of the taxpayer" (emphasis added). For either type of debt, the word "indebtedness" is used in direct relation to the "residence," and the word "taxpayer" is used only in connection with the "residence," not with the "indebtedness." In other words, the indebtedness is measured "with respect to" the residence, rather than "with respect to" the taxpayer. Significantly, this provision of the Code does not refer to the "indebtedness of the taxpayer," but rather to the "indebtedness with respect to any qualified residence of the taxpayer," a distinction that focuses the statute on the residence, not on the taxpayer. Indeed, the only apparent reason that the word

"taxpayer" is used at all in this portion of the statute is to make it clear that the taxpayer, and not someone else, must own the residence. *Cf.* Treas. Reg. § 1.163-1(b) ("[i]nterest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner, even though the taxpayer is not directly liable upon the bond or note secured by such mortgage, may be deducted as interest on his indebtedness").

A similar analysis of the definitions of "acquisition indebtedness" and "home equity indebtedness" shows that the focus of the statute is on the residence, not on the taxpayer. Section 163(h)(3)(B)(i) defines "acquisition indebtedness" as any indebtedness which "(I) is incurred in acquiring, constructing, or substantially improving *any qualified residence* of the taxpayer, and (II) is secured by such *residence*" (emphasis added). Under this provision, "acquisition indebtedness" is defined, in relevant part, as indebtedness incurred in acquiring a qualified residence of the taxpayer, not as indebtedness incurred in acquiring a taxpayer's *portion* of a qualified residence. Thus, the entire amount of indebtedness incurred in acquiring the qualified residence constitutes acquisition indebtedness. Again, the taxpayer is mentioned only to identify the owner of the residence. Moreover, the

indebtedness must be secured by the residence, further emphasizing the residence as the focal point of the statutory scheme.

A further portion of the definition of "acquisition indebtedness" underscores the statute's emphasis on the residence, rather than on the taxpayer. The next sentence of the definition provides as follows:

> Such term also includes any indebtedness secured by *such residence* resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

I.R.C. § 163(h)(3)(B) (emphasis added). This is the component of the definition that actually applies in the present cases, since taxpayers here are seeking to deduct interest on refinanced debt. (ER 80-81.) And in this component, the word "taxpayer" does not appear at all; the statute instead refers to "such residence," as that term was used in the preceding sentence. Once more, the indebtedness is defined with respect to the residence, not with respect to the taxpayer.

The definition of "home equity indebtedness" similarly focuses on the residence, and does not mention the taxpayer. Section 163(h)(3)(C)(i) provides as follows (emphasis added):

> The term "home equity indebtedness" means any indebtedness (other than acquisition indebtedness) secured by a *qualified residence* to the extent the aggregate amount of such indebtedness does not exceed –
> (I) the fair market value of *such qualified residence*, reduced by
> (II) the amount of acquisition indebtedness with respect to *such residence*.

This definition, again focusing on the residence in question, requires that the home equity indebtedness must be secured by the residence, and limits the amount of the indebtedness to the fair market value of the residence minus the amount of the acquisition indebtedness connected to that residence. This definition makes no reference at all to the taxpayer, again leaving no doubt that § 163(h) is focused on the residence, not on the taxpayer.

Accordingly, when interpreting the limitations on aggregate debt, the Tax Court properly held that these limits apply to the residence, not to each individual taxpayer. Following the definition of "acquisition indebtedness," the statute provides that "[t]he 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)." I.R.C. § 163(h)(3)(B)(ii) (emphasis added). Likewise, following the definition of "home equity indebtedness," the statute

provides that "[t]he aggregate amount *treated as* home equity indebtedness for any period shall not exceed $100,000 ($50,000 in the case of a separate return by a married individual)." I.R.C. § 163(h)(3)(C)(ii) (emphasis added). Thus, the amounts treated as indebtedness for purposes of the qualified residence interest deduction are limited to the specified maximums for total "aggregate" indebtedness, which is confirmed by the parentheticals referring to married individuals filing separate returns. These limitations do not mention the word "taxpayer," and they refer back to the provisions of the statute that focus on the residence. Read as a whole, the provisions of the Code concerning qualified residence interest, as expressed in the text of § 163(h)(3), indicate that the indebtedness limitations apply to the residence, not to the taxpayer. Accordingly, the aggregate indebtedness with respect to the residence (or residences, where, as here, taxpayers have two residences) is limited to $1.1 million, regardless of the number of co-owners of the property (or properties).

2. Taxpayers' interpretation of the governing language in the Code is unpersuasive

Taxpayers' analysis of the text of § 163(h)(3) is both cursory and unpersuasive. They first refer to the introductory sentence of § 163(h) (App. Br. 11), which provides that "[i]n the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year." I.R.C. § 163(h)(1). This general provision has no direct bearing on the issue here, and, in any event, it is subject to the exception for qualified residence interest in § 163(h)(3), which, as shown above, focuses on the residence, not the taxpayer. Taxpayers' references to the text of § 163(h)(3) (App. Br. 11-12) merely recite portions of the statute where the word "taxpayer" relates to the residence, but this indicates only that the residence must be owned by the taxpayer. Taxpayers' assertion that "it is the taxpayer who incurs such indebtedness" (App. Br. 11) does no more than state the obvious; taxpayers, whether personally liable for the debt or not, are the borrowers. And this argument cannot change the wording of the statute.

Moreover, taxpayers' interpretation would effectively read out of the statute the references to the residence in question, making this

language superfluous. For example, Congress repeatedly used the phrase "with respect to any qualified residence of the taxpayer" in the definition of qualified residence interest in § 163(h)(3)(A), even though this definition used two terms – "acquisition indebtedness" and "home equity indebtedness" – that are already defined in relation to a qualified residence. *See* I.R.C. §§ 163(h)(3)(B)(i), 163(h)(3)(C)(i). Taxpayers' interpretation would mean that the phrase "with respect to any qualified residence of the taxpayer" is superfluous, since it could be deleted without changing the meaning of the statute. Such a reading is highly disfavored, because "[i]t is 'a cardinal principle of statutory construction' that 'a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.' " *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) (quoting *Duncan v. Walker*, 533 U.S. 167, 174 (2001)). The Tax Court's interpretation, by contrast, gives meaning to all of the statutory text, and does not make the phrase "with respect to any qualified residence of the taxpayer" surplusage.

Having failed to identify any language in § 163(h) to support their strained reading of the limitations on aggregate indebtedness,

taxpayers cite inapposite sections of the Code to bolster their argument. (App. Br. 9, 12-15.) Although there is no dispute that taxpayers' residences meet the definition of "qualified residence" under § 163(h)(4)(A)(i), they nevertheless focus on the cross-references to other Code provisions contained in this definition. The definition of "qualified residence" in § 163(h)(4)(A)(i) includes both the "principal residence (within the meaning of section 121) of the taxpayers, and . . . 1 other residence of the taxpayer which is selected by the taxpayer for purposes of this subjection for the taxable year and which is used by the taxpayer as a residence (within the meaning of section 280A(d)(1))." I.R.C. § 163(h)(4)(A)(i). These cross-references (relating to the exclusion of gain from the sale of a taxpayer's principal residence in § 121, and to the disallowance of certain business expenses in connection with the taxpayer's use of a dwelling unit as a residence in § 280A(d)(1), respectively) are used solely for definitional purposes, and neither cross-referenced section is used in the provisions of § 163(h)(3) governing the mechanics of determining the amount of the qualified residence interest deduction.

The illogic of taxpayers' approach is confirmed by their conclusion that they each owned a "qualified residence" comprising one-half of their Beverly Hills home and one-half of their Rancho Mirage home. (App. 21-23.) They reach this convoluted result only by importing into their statutory analysis the cross-references to §§ 121 and 280A(d)(1) that are not contained in the operative provisions of the qualified residence interest deduction in § 163(h)(3). There is no evidence in the record that each taxpayer actually resides in only one-half of each of their two homes. Moreover, they ignore the stipulated fact that they are *not* each individually liable for only one-half of the indebtedness secured by these properties, but instead are jointly and severally liable for the entire indebtedness. (ER 80-81.) *Cf. Golder v. Commissioner,* 604 F.2d 34, 35 (9th Cir. 1979) ("[i]t has long been established that for interest to be deductible under section 163(a), the interest must be on the taxpayer's own indebtedness, not the indebtedness of another"). Their focus on fractional ownership interests is not grounded in the provisions of § 163(h)(3), which does not contemplate "fractional residences" for purposes of the qualified residence interest deduction.

In addition, taxpayers' interpretation of the indebtedness limitations necessarily would create a special rule for married couples – a "marriage penalty" – that Congress never enacted. (App. Br. 19-21.) The parenthetical language in the acquisition indebtedness limitation in § 163(h)(3)(B)(ii) provides that married taxpayers who file separate returns are limited to acquisition indebtedness of $500,000 each, which is one-half of the otherwise allowable amount of acquisition indebtedness. Similarly, the home equity indebtedness limitation in § 163(h)(3)(C)(ii) includes parenthetical language providing that married taxpayers who file separate returns are limited to home equity indebtedness of $50,000, which is one-half of the otherwise allowable amount of home equity indebtedness. As a result, these provisions make it clear that co-owners who are married to each other and file a joint return are limited to a deduction of interest on $1,000,000 of acquisition indebtedness and $100,000 of home equity indebtedness. *See Pau v. Commissioner*, T.C. Memo. 1997-43, 1997 WL 28678, at *12 (1997) (for a married couple filing a joint return, "Section 163(h) restricts home mortgage interest deductions to interest paid on $1 million of acquisition indebtedness for debt"). *Cf. Bronstein v.*

Commissioner, 138 T.C. No. 21, 2012 WL 1758633 (2012) (applying married-filing-separately limitations).

By exempting unmarried co-owners from these limitations, taxpayers here (and any other unmarried co-owners) would benefit from a "per-taxpayer" rule that Congress never intended, either for married or unmarried co-owners. In light of the residence-focused language used throughout § 163(h)(3), as well as the absence of any reference to an individual taxpayer in the indebtedness limitations themselves, there is no evidence of Congressional intent to enact a marriage penalty in these circumstances. As the Tax Court observed (ER 66-67), rather than creating a marriage penalty for married couples, § 163(h)(3)(B)(ii) and § 163(h)(3)(C)(ii) "simply appear to set out a specific allocation of the limitation amounts that must be used by married couples filing separate tax returns, thus implying that co-owners who are not married to one other may choose to allocate the limitation amounts among themselves in some other manner, such as according to percentage of ownership." (ER 67.) Notwithstanding taxpayers' citations to other inapposite Code sections, such as § 1211(b) (App. Br. 19-20), relating to the deductibility of capital losses, there are

no grounds to conclude that taxpayers are entitled to a doubling of the applicable indebtedness limitations.[5]

3. The legislative history of § 163(h)(3) is consistent with the Tax Court's interpretation

Because the text of § 163(h)(3) demonstrably supports the Tax Court's interpretation of the indebtedness limits, it is not necessary to examine its legislative history. It is well established that "when the statute's language is plain, the sole function of the courts – at least where the disposition required by the text is not absurd – is to enforce it according to its terms." *Hartford Underwriters Ins. Co. v. Union Planters Bank, N. A.*, 530 U.S. 1, 6 (2000) (internal quotation marks and citations omitted). If the plain meaning of the statute is unambiguous, that meaning is controlling and a court need not examine legislative history as an aid to interpretation unless "the

[5] The brief submitted by proposed *amici* largely echoes taxpayers' statutory construction arguments. Moreover, to the extent that the proposed *amici* seek to raise other, novel arguments under the guise of "statutory construction" (Ami. Br. 4-5, 9-10) or "policy considerations" (A. Br. 10-12), it is well established that "an amicus cannot introduce a new argument into a case." *United States v. Sturm, Ruger & Co.*, 84 F.3d 1, 6 (1st Cir. 1996); *see also Golden Gate Restaurant Ass'n v. City and County of San Francisco*, 546 F.3d 639, 653 (9th Cir. 2008); *Preservation Coalition, Inc. v. Pierce*, 667 F.2d 851, 861-62 (9th Cir. 1982); *Riverkeeper, Inc. v. Collins*, 359 F.3d 156, 163 n.8 (2d Cir. 2004).

legislative history clearly indicates that Congress meant something other than what it said." *Carson Harbor Village, Ltd. v. Unocal Corp.*, 270 F.3d 863, 877 (9th Cir. 2001) (en banc) (internal quotation marks and citation omitted). A court should not fall into the trap of "allowing ambiguous legislative history to muddy clear statutory language." *Milner v. Dep't of the Navy*, 131 S.Ct. 1259, 1266 (2011). But, even if the statutory provisions at issue in the present cases were viewed as ambiguous, the legislative history cited by taxpayers does not support their interpretation of these provisions.

Taxpayers erroneously contend that a previous version of § 163(h), as originally enacted in the Tax Reform Act of 1986, supports their interpretation of the current version of the statute. (App. Br. 15.) That older version of § 163(h) generally limited qualified residence interest to indebtedness "secured by any qualified residence" that did not exceed the lesser of (i) "the fair market value of such qualified residence" or (ii) "the taxpayer's basis in such qualified residence" plus "the aggregate amount of qualified indebtedness of the taxpayer with respect to such qualified residence," in addition to providing special rules for amounts borrowed for educational or medical expenditures.

P.L. 99-514, § 511(b) (1986). Taxpayers' contention that these provisions were "focused on the taxpayer rather than the residence" (App. Br. 15), is wide of the mark; these limitations refer to a comparison between the qualified residence and the taxpayer, not simply a "focus" on the taxpayer. Moreover, even if this version of § 163(h) was "focused" on the taxpayer, in 1987 Congress removed any such "focus" and enacted the current limitations, which are based on the aggregate indebtedness on the qualified residence. P.L. 100-203, § 10102 (1987).

Contrary to taxpayers' contentions (App. Br. 16-18), the legislative history of the current version of the indebtedness limitations of § 163(h) also does not support their reading of the current law. The House Report on the 1987 legislation that enacted the limitations stated that "[t]hus, under the bill, the total amount of acquisition debt is limited by a dollar cap, to limit the benefits of the interest deductions in the case of high-income persons," and it provided the following explanation concerning home equity indebtedness:

> The committee also believes that the provisions of present law are needlessly complex, and that the same purpose could be achieved with much simpler provisions. The special rules for educational and medical expenditures, in

> particular, create unnecessary administrative difficulty in ascertaining the amount of interest that is deductible, when a comparable result can be obtained with a simpler dollar cap. Therefore, the bill imposes a separate cap on the amount of debt in excess of debt for acquisition (or substantial improvement) of the residence, interest on which is treated as qualified residence interest. The provisions of the bill are not intended to treat as deductible qualified residence interest, interest on debt that exceeds the fair market value of the residence, or that is not secured by a security interest valid against a subsequent purchaser under local law on the taxpayer's principal or second residence (except to the extent otherwise provided in present law).

H.R. Rep. No. 100-391(II), *as reprinted in* 1987 U.S.C.A.A.N. 2313-378, 2313-648 (1987 WL 61526). This explanation indicates that the "dollar cap" applies to the aggregate debt with respect to the residence in question, just as current law expressly so provides. There is no suggestion in this passage that the qualified residence interest limitations apply instead to the aggregate debt incurred by each co-owner of the residence.

Other passages in the 1987 legislative history further support the Tax Court's interpretation of § 163(h). The House Report described the new limitations as follows:

> The bill amends the definition of qualified residence interest that is treated as deductible. Under the bill, qualified residence interest includes interest on acquisition

> indebtedness and home equity indebtedness with respect to a principal and a second residence of the taxpayer. The maximum amount of home equity indebtedness is $100,000. The maximum amount of acquisition indebtedness is $1 million.

H.R. Rep. No. 100-391(II), *as reprinted in* 1987 U.S.C.A.A.N. 2313-378, 2313-648. Just as in the text of the legislation, the House Report refers to qualified residence interest "with respect to" the residence in question, and "taxpayer" is used only to indicate the ownership of the residence. And taxpayers' reference to an example found in the House Report explaining the new law (App. Br. 16) is misplaced. The example illustrates that acquisition indebtedness cannot be increased by the taxpayer, "except by indebtedness incurred to substantially improve the residence." *See* H.R. Rep. No. 100-391(II), *as reprinted in* 1987 U.S.C.A.A.N. 2313-378, 2313-649.

4. There are no compelling policy grounds supporting taxpayers' interpretation of the statute

Apart from their contentions concerning the specific language of the governing statutory provisions, taxpayers also assert that the Tax Court's interpretation creates certain practical, logistical, or ethical problems that would be solved if this Court were to adopt their reading

of the statute. (App. Br. 24-25.) These policy concerns, however, are irrelevant where, as here, the text of the statute demonstrates Congressional intent. "Regardless of our view on the wisdom or efficacy of Congress's policy choices, we are not free to read in additional elements where the legislature has declined to include them." *Planes v. Holder* 652 F.3d 991, 996 (9th Cir. 2011) (citing *Jones v. Bock*, 549 U.S. 199, 216–17 (2007)). Accordingly, taxpayers' implicit invitation to this Court to second-guess Congress on policy grounds should be rejected.

The policy objections voiced by taxpayers are not a matter for concern here. They point to "the encouragement of home ownership as an important policy goal" (Br. App. 15, 18), which is indeed one of the purposes of the deductibility of qualified residence interest. But the incentive to home ownership via the interest deduction is not without legislative limitations because of its impact on the federal fisc. Indeed, as noted above, Congress enacted these limitations to "to limit the benefits of the interest deductions in the case of high-income persons." H.R. Rep. No. 100-391(II), *as reprinted in* 1987 U.S.C.A.A.N. 2313-378, 2313-648. Nevertheless, these limitations did not prevent taxpayers from jointly purchasing their homes in Beverly Hills and Rancho

Mirage, and they have not demonstrated that the § 163(h)(3) limitations actually prevented any other unmarried individuals from jointly owning a home. Taxpayers complain of "the punitive nature of the Tax Court's interpretation of section 163" (App. Br. 17), but they fail to show how they are being punished, other than the fact that, under the Tax Court's interpretation, all co-owners are treated alike, whether married or unmarried. Such equal treatment is hardly "punitive" in nature.

Other policy concerns raised by taxpayers are similarly meritless. Taxpayers decry as "unreasonable" the fact that "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." (App. Br. 24.) In the present cases, however, taxpayers apparently had no objection to sharing this information with one another, and, of course, because they are both parties to all of the indebtedness at issue, they can retrieve the necessary information from their own financial institutions. Joint owners of property, if they seek to deduct qualified residence interest, can easily share financial information concerning the property to substantiate their deductions.

Taxpayers' suggestions to the contrary are speculative at best, and certainly pose no legitimate challenge to the Tax Court's decisions.

5. The Tax Court properly sustained the Commissioner's computation of the taxpayers' deficiencies

Finally, assuming for the sake of argument that the Tax Court was right and that the indebtedness limitations apply on a per-residence, rather than a per-taxpayer basis, taxpayers contend that the Tax Court erred in computing the amounts of their respective deficiencies. (App. Br. 9-10, 25-26.) Taxpayers apparently argue that the Tax Court improperly aggregated their joint indebtedness on their two residences for each tax year at issue, and that their separate payments on each loan should have been separately calculated. Taxpayers' contention should be rejected for two reasons.

First, the stipulation of facts submitted by the parties does not specify the amount paid by each taxpayer on each loan; rather, for each year, the parties' stipulation sets out the total amounts that each taxpayer paid "on the Beverly Hills Mortgage, Beverly Hills HELOC, and the Rancho Mirage Mortgage." (ER 82.) Having chosen to aggregate these amounts in their stipulation, and having also failed to

present evidence of their separate payments, taxpayers cannot now challenge the Tax Court's decisions for failure to take this factor into account. Second, taxpayers do not demonstrate that the Commissioner's proposed computation was contrary to the terms of § 163(h), or that the Tax Court erred in accepting it. The Commissioner set out his proposed computation at length (ER 5-41), and taxpayers do not show how the terms of the statute prohibited the Tax Court from aggregating the payments made by each taxpayer on their joint total indebtedness. Accordingly, there are no grounds to overturn the Tax Court's decisions.

CONCLUSION

For the reasons stated above, the decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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MARCH 2013

STATEMENT OF RELATED CASES

Counsel for the Commissioner respectfully state that they are not aware of any related cases pending before this Court.

ADDENDUM

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ADDENDUM

26 U.S.C. § 163 (excerpts):

(a) General rule. – There shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

* * *

(h) Disallowance of deduction for personal interest. –

(1) In general. – In the case of a taxpayer other than a corporation, no deduction shall be allowed under this chapter for personal interest paid or accrued during the taxable year.

(2) Personal interest. – For purposes of this subsection, the term "personal interest" means any interest allowable as a deduction under this chapter other than –

* * *

(D) any qualified residence interest (within the meaning of paragraph (3))

* * *

(3) Qualified residence interest. – For purposes of this subsection –

(A) In general. – The term "qualified residence interest" means any interest which is paid or accrued during the taxable year on –

(i) acquisition indebtedness with respect to any qualified residence of the taxpayer, or

(ii) home equity indebtedness with respect to any qualified residence of the taxpayer.

For purposes of the preceding sentence, the determination of whether any property is a qualified residence of the taxpayer shall be made as of the time the interest is accrued.

26 U.S.C. § 163 (excerpts, continued):

(B) Acquisition indebtedness. –

(i) In general. – The term "acquisition indebtedness" means any indebtedness which –

(I) is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and

(II) is secured by such residence.

Such term also includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of the preceding sentence (or this sentence); but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness.

(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).

(C) Home equity indebtedness. –

(i) In general. – The term "home equity indebtedness" means any indebtedness (other than acquisition indebtedness) secured by a qualified residence to the extent the aggregate amount of such indebtedness does not exceed –

(I) the fair market value of such qualified residence, reduced by

(II) the amount of acquisition indebtedness with respect to such residence.

(ii) Limitation. – The aggregate amount treated as home equity indebtedness for any period shall not exceed $100,000 ($50,000 in the case of a separate return by a married individual).

26 U.S.C. § 163 (excerpts, continued):

* * *

(4) Other definitions and special rules. – For purposes of this subsection –

(A) Qualified residence. –

(i) In general. – The term "qualified residence" means –

(I) the principal residence (within the meaning of section 121) of the taxpayer, and

(II) 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)).

* * *

26 C.F.R. § 1.163-10T (excerpts):

(e) Determination of qualified residence interest when secured debt exceeds adjusted purchase price – Exact method – (1) In general. Under the exact method, the amount of qualified residence interest for the taxable year is determined on a debt-by-debt basis by computing the applicable debt limit for each secured debt and comparing each such applicable debt limit to the average balance of the corresponding debt. If, for the taxable year, the average balance of a secured debt does not exceed the applicable debt limit for that debt, all of the interest paid or accrued during the taxable year with respect to the debt is qualified residence interest. If the average balance of the secured debt exceeds the applicable debt limit for that debt, the amount of qualified residence interest with respect to the debt is determined by multiplying the interest paid or accrued with respect to the debt by a fraction, the numerator of which is the applicable debt limit for that debt and the denominator of which is the average balance of the debt.

* * *

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/s/ JOHN SCHUMANN
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Dated: March 21, 2013

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I hereby certify that on March 21, 2013, 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. I further certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the appellate CM/ECF system.

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