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.

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

CONSOLIDATED REPLY BRIEF OF PETITIONERS-APPELLANTS BRUCE H. VOSS & CHARLES J. SOPHY

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INTRODUCTION

On May 14, 2009, the Commissioner of Internal Revenue (the "Commissioner") issued Notices of Deficiency to unmarried taxpayers Bruce H. Voss and Charles J. Sophy (collectively the "Taxpayers") with respect to their federal income taxes for taxable years 2006 and 2007. For the years at issue, Taxpayers each claimed deductions for qualified residence interest under section

163(h)[1] on their separate individual income tax returns for interest paid on indebtedness related to residences Taxpayers co-own.

The issues on appeal are whether the Tax Court erred in: (1) finding that the section 163(h)(3) statutory limitations apply to each residence owned by the taxpayer rather than to the individual taxpayer, and (2) calculating Taxpayers' proper statutory limitation if this Court accepts the Tax Court's interpretation of section 163(h).

In our opening brief ("OB"), we demonstrated that the Tax Court erred when it applied the dollar limitations set forth in subsections (B) and (C) of section 163(h)(3) to the residence instead of the taxpayer. The Tax Court misinterpreted section 163(h)(3)(B)(i) as using the word "taxpayer" to modify the qualified residence, not the indebtedness. The statutory construction of section 163(h), particularly when considered within the attendant statutory scheme, indicates that "taxpayer" in this context modifies both the qualified residence and the indebtedness. We now respond to Commissioner's answering brief ("AB").

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[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.

ARGUMENT

A. The section 163 qualified residence interest limitation is properly applied per-taxpayer

As described in detail in our opening brief, section 163(h) limits a taxpayer 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 plain reading of section 163 does not support Commissioner's position that the repeated use of the word "residence" within a definitional provision suggests that a taxpayer must calculate taxpayer's Limitation with respect to the aggregate indebtedness on a particular residence when multiple taxpayers co-own the property. When section 163 is read as a whole and the Limitation is placed within the context of the statutory scheme in which it is embedded, it is clear the Limitation applies on a per-taxpayer basis.

A basic reading of section 163 indicates that the indebtedness upon which the Code allows a taxpayer a deduction for interest paid is the taxpayer's own indebtedness.[2] The title of section 163 is "Interest" and section 163(a) states the general rule: "There shall be allowed as a deduction all interest paid or accrued

[2] Taxpayer's own indebtedness includes debt on which is constructively liable as an owner (or partial owner) of the real estate securing the debt. *See* Treas. Reg. § 1.163-1(b) (explaining that interest paid on a mortgage upon real estate of which taxpayer is the legal or equitable owner, may be deducted as interest on taxpayer's indebtedness even when taxpayer is not directly liable for the mortgage).

within the taxable year on indebtedness." I.R.C. § 163(a). We note that the "general rule" of the statutory scheme does not explicitly state that the indebtedness to which this rule applies is the *taxpayer's* indebtedness; taxpayer is clearly implied from the context.

As Commissioner points out, a statute should be construed in a manner that prevents any clause, sentence or word from being superfluous, void or insignificant. (AB 29.) The linguistic concept of omitting a word or words that are superfluous or able to be understood from contextual clues is known as an "ellipsis".[3] The omission of "taxpayer" is a common ellipsis in the Internal Revenue Code. Consider the "general rule" of section 163 as an example. If Congress included the word "taxpayer" in every context in which it is implied or understood from the context, the general rule of section 163(a) would read as follows: "A [*taxpayer*] shall be allowed as a deduction all interest [*taxpayer*] paid or accrued within the [*taxpayer's*] taxable year on [*taxpayer's*] indebtedness." Congress' use of ellipses is obvious in this context. Furthermore, there is a logical breakdown in Commissioner's reasoning that the absence of the specific word "taxpayer" changes the context and application of the Limitation.

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[3] "Ellipsis (noun): the omission from speech or writing of a word or words that are superfluous or able to be understood from contextual clues." Oxford English Dictionary (3rd ed. 2005).

1. The operative Limitation provisions make it clear the Limitation applies per-taxpayer

The issue before the Court is the proper application of the Limitation. Commissioner's argument focuses on the repeated use of "residence" in the definitional provisions of section 163(h)(3) and glosses over the operative provisions that contain the Limitation, sections 163(h)(3)(B)(ii) and 163(h)(3)(C)(ii). The operative provision limiting acquisition indebtedness 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). Similarly, the operative provision limiting acquisition indebtedness 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 married individual filing a separate return)." I.R.C. § 163(h)(3)(C)(ii).

The operative Limitation provisions do not mention the "taxpayer" or the "residence." The Limitation provisions merely state a $1 million limit on acquisition indebtedness and $100,000 limit on home equity indebtedness. The dispute in this case is whether the Limitation should be applied "per-residence" or "per-taxpayer."

The Limitation requires the aggregation of indebtedness for a specific taxable period. The Limitation appears to require a taxpayer to aggregate all

outstanding qualified residence interest "during any period" in order to determine whether or not the Limitation is exceeded. Only a taxpayer can aggregate his or her indebtedness. A residence might be thought of as having an aggregate amount of indebtedness against it, but cannot aggregate indebtedness. Furthermore, the words "for any period" clearly indicate that this limitation was meant to apply per-taxpayer. Taxpayers have "periods" that count under the tax law known as tax years. Residences, by contrast, are not viewed as having taxable periods or tax years distinct from their owners.

Commissioner's interpretation requires this Court to reach an illogical conclusion. Commissioner contends that a plain reading of the statute requires that the residence aggregate the indebtedness for a specific taxable period. This conclusion is not only illogical, but also absurd. A residence does not have a taxable period and a residence cannot aggregate debt. The Limitation requires aggregation of the *taxpayer's* debt, which the *taxpayer* must treat as acquisition and/or home equity indebtedness during the *taxpayer's* taxable period.

2. Word repetition does not control the meaning of a statute

Commissioner goes to great lengths to italicize the word "residence" each time it appears within section 163(h), as if mere repetition were enough to alter the context in which the words appear. (AB 23-26.) Yet Commissioner also dismisses the use of the word "taxpayer" when the use of such word does not serve

Commissioner's purposes. (AB 24.) Commissioner concludes that the repeated use of the word "residence" within the definitional provisions of section 163(h)(3) requires a taxpayer to apply the Limitation provisions, which do not contain the words "residence" or "taxpayer," to the residence rather than to the taxpayer. (AB 27.) The language of the Limitation does not support this conclusion, which contradicts a plain reading of the statute from the context in which it appears. The relentless focus on a single word causes Commissioner to lose sight of the Code's primary audience, the taxpayer.

3. Commissioner erroneously suggests that joint and several liability alters a co-owner's share of the indebtedness

Commissioner suggests that because Taxpayers are jointly and severally liable for the indebtedness the strength of Commissioner's claim is bolstered in the instant case. (AB 31.) Commissioner states:

> "[the taxpayers] 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."

(AB 31.) (original emphasis included). In other words, Commissioner takes the position that because a third-party creditor could initially seek payment for the full amount of the indebtedness from one co-owner under the principles of joint and several liability, the denominator of the Limitation for single co-owners should be the aggregate amount of the indebtedness on the residence. Commissioner loses

sight of the other basic tenet of joint and several liability – while one co-owner may initially be liable for the entire debt amount, each co-owner has a valid legal claim against the other co-owners for their proportional share of the debt. *See* Cal. Civ. Code § 1432.

B. The legislative history supports Taxpayer's position

The legislative history also supports the application of the Limitation on a per-taxpayer basis. As discussed at length in our opening brief, the legislative history indicates section 163(h) is taxpayer focused. In fact, the House Report recommending the Limitation assumes the Limitation is applied per-taxpayer. The House Report states:

> "Under the bill, the total amount of acquisition debt that can give rise to qualified residence interest is $1 million. Thus, if the *taxpayer's debt* to acquire, construct or substantially improve his principal and second residence exceeds $1 million, then only the interest on a total principal amount of $1 million of such debt is deductible as acquisition interest."

H.R. Rep. No. 100-391(II), *as reprinted in* 1987 U.S.C.A.A.N. 2313-649 (emphasis added). Here Congress clearly refers expressly to the debt of the *taxpayer* and how the *taxpayer* uses the borrowed funds. There is no indication here, or in the provisions quoted by Commissioner, that Congress intended or even considered the Limitation applying on a per-residence basis.

1. The Limitation treats spouses as one taxpayer consistent with legislative intent and other Code provisions

Commissioner complains that Congress could not have intended to create the sort of marriage tax penalty that results when the Limitation is applied on a per-taxpayer basis. (AB 16, 32-33.) However, Congress generally intends to treat husband and wife as one taxpayer and at times this treatment results in a marriage tax penalty even though Congress might not have intended to create such a penalty. Section 1211(b) and corresponding legislative history provide the best example of this phenomenon.

As explained in our opening brief, section 1211 allows a taxpayer to claim a certain amount of capital losses. Under the current provision, the limitation is $3,000 per taxpayer; however, if the married couple chooses to file separately, each spouse is limited to one-half or $1,500. The limitation provisions in section 1211 are nearly identical to the Limitation provisions at issue in this case. Just like the Limitation, section 1211 does not specify that the limit is applied per-taxpayer. Nor does it explicitly provide that spouses are treated as a single taxpayer. Instead, section 1211 uses the same statutory construction and language as the Limitation. Section 1211 states the applicable limitation amount ($3,000) and then provides in a parenthetical that the limitation shall be "($1500 in the case of a married individual filing a separate return)." I.R.C. § 1211(b)(1).

This parenthetical was added as part of the Tax Reform Act of 1969 (P.L. 91-172) after Congress noted that under current law the (then) $1,000 limitation on deductibility treated the married couple as a single taxpayer, except when they filed separately, in which case each spouse would be entitled to deduct up to $1,000 in losses each. In explaining the reason for this change, the Joint Committee on Taxation provided:

> "It also appeared inappropriate to *treat married couples as one taxpayer for most purposes* but to treat them as two separate taxpayers where capital losses arise, with the result that each spouse was allowed to deduct up to $1,000 of capital losses from ordinary income."

U.S. House. Joint Committee on Taxation, *General Explanation of the Tax Reform Act of 1969* (H.R. 13270, 91st Congress, P.L. 91-172) at 169 (1970) (emphasis added). Here the Joint Committee on Taxation acknowledges that married couples were treated as one taxpayer for most purposes, but thought that they should not be able to elect to be treated as two separate taxpayers simply by filing separately. Congress added the parenthetical language of section 1211 to ensure that spouses continued to be treated as one taxpayer regardless of the filing status they choose.

Additionally, the treatment of married couples as one taxpayer is often beneficial under the Code. For example, a married couple can exclude the first $500,000 of gain on sale of a principal residence even if only one spouse owns the residence as opposed to a single taxpayer who is limited to an exclusion of

$250,000. *See* I.R.C. § 121. Section 121 treats the marital unit as the taxpayer who owns the home and thus is entitled to double the exclusion amount the same provision allows for a single person. Spouses also receive a benefit under the capital gain and loss netting provisions because if one spouse has gains and the other losses, section 1211 treats the spouses as one unit and allows them to net the gains and losses to produce a lower net taxable gain. However, with respect to deducting capital losses against ordinary income under section 1211 and the deduction of qualified residence interest under section 163(h)(3), treating the married couple as one taxpayer can produce disadvantages when compared to an unmarried couple.

Once Congress made the decision to treat spouses as a single taxpayer, the resulting benefits and burdens must be respected equally. In this case, Taxpayers should not be assigned the burden (or penalty) that results from the Tax Court's convoluted reading of section 163(h)(3) which treats Taxpayers as a married couple, when they receive none of the marriage benefits.

CONCLUSION

For the reasons set forth above and in our opening brief, the decision of the Tax Court should be reversed in its entirety.

Respectfully submitted,

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CERTIFICATE OF SERVICE

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

I hereby certify that I electronically filed the foregoing with the Clerk of the Court for the United States Court of Appeals for the Ninth Circuit by using the appellate CM/ECF system on April 4, 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.

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CERTIFICATE OF COMPLIANCE

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

I certify that pursuant to Fed. R. App. P. 32 (a)(7)(A) and Ninth Circuit Rule 32-1, the attached reply brief does not exceed 15 pages.

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