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"THE MORE YOU BUY, THE BIGGER YOUR TAX BREAK": WHY THE NINTH CIRCUIT IN *VOSS V. COMMISSIONER* ERRED IN INTERPRETING THE DEBT LIMITATIONS OF THE HOME MORTGAGE INTEREST DEDUCTION

Michelle Monroy∗

I. INTRODUCTION

When the United States imposed its first income tax in 1913, all interest was deductible.[1] After Congress passed the Tax Reform Act of 1986, however, only the qualified residence interest deduction ("mortgage interest deduction") was retained.[2] President Ronald Reagan declared the mortgage interest deduction beyond the reach of tax reformers by instructing the Department of the Treasury ("Treasury") to "preserve that part of the American dream which the home mortgage interest deduction symbolizes."[3]

The deduction costs the federal government about $70 billion a year, making it one of the government's largest federal tax expenditures.[4] In fact, the deduction "has never ranked lower than third on the government's list of costliest tax expenditure items."[5]

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1. Rebecca N. Morrow, *Billions of Tax Dollars Spent Inflating the Housing Bubble: How and Why the Mortgage Interest Deduction Failed*, 17 FORDHAM J. CORP. & FIN. L. 751, 755 (2012); *see* Revenue Act of 1913, sec II. para. b, Pub. L. No. 63-16, 38 Stat. 114, 167 ("That in computing net income for the purpose of the normal tax there shall be allowed as deductions: . . . second, all interest paid within the year by a taxable person on indebtedness.").

2. Morrow, *supra* note 1, at 755; *see* Tax Reform Act of 1986, Pub. L. No. 99-514, § 511, 100 Stat. 2085, 2247.

3. Dennis J. Ventry, Jr., *The Accidental Deduction: A History and Critique of the Tax Subsidy for Mortgage Interest*, 73 L. & CONTEMP. PROBS. 233, 235 (2010) (citing Lou Cannon, *Reagan to Keep Mortgage Tax Deduction*, WASH. POST, May 11, 1984, at F1).

4. OFFICE OF MGMT. & BUDGET, EXEC. OFFICE OF THE PRESIDENT, *Tax Expenditures*, *in* ANALYTICAL PERSPECTIVES: BUDGET OF THE U.S. GOVERNMENT 203 (2015), http://www.treasury.gov/resource-center/tax-policy/Documents/Tax-Expenditures-FY2015.pdf; *see* David M. Schizer, *Limiting Tax Expenditures*, 68 TAX L. REV. 275, 284 (2015).

5. Ventry, *supra* note 3, at 235.

Congress uses tax expenditures to incentivize particular behavior.[6] Although the mortgage interest deduction is widely believed to incentivize homeownership, numerous studies have concluded that the deduction actually has little impact.[7] Instead, the deduction encourages excessive borrowing and inflates housing prices.[8]

Despite the significant revenue loss associated with the mortgage interest deduction, the deduction benefits only a small percentage of taxpayers.[9] The mortgage interest deduction is available only to taxpayers who itemize their deductions.[10] Taxpayers who claim the standard deduction do not receive any benefit.[11] In 2013, only one-third of all taxpayers itemized their deductions.[12] The amount of the benefit favored those itemizing taxpayers in higher income brackets and with larger mortgages.[13] In 2012, seventy-seven percent of the benefits from the deduction went to homeowners with incomes above $100,000.[14] Homeowners with less expensive homes or those who have built up equity in their homes do not receive any benefit because their potential deduction is less than the standard deduction.[15] The recent Ninth Circuit opinion in *Voss v. Commissioner*[16] may have widened the gap between taxpayers who derive benefit from the mortgage interest deduction and those who do not.[17]

This Comment argues that the Ninth Circuit in *Voss* incorrectly interpreted section 163(h)(3) of the Internal Revenue Code (the

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6. *See* Morrow, *supra* note 1, at 817.

7. David Frederick, *Reconciling Intentions with Outcomes: A Critical Examination of the Mortgage Interest Deduction*, 28 AKRON TAX J. 41, 43 (2013).

8. *See* Morrow, *supra* note 1, at 771, 775.

9. *Id.* at 759.

10. Schizer, *supra* note 4, at 315 ("[O]nly those who itemize (instead of claiming the standard deduction) are eligible for tax expenditures.").

11. *Id.*

12. INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 1304 (REV. 08-2015), INDIVIDUAL INCOME TAX RETURNS 2013 (2015), https://www.irs.gov/pub/irs-soi/13inalcr.pdf (Table 1.2 reports 44,330,496 total tax returns with itemized deductions, and 100,898,698 total tax returns with the standard deduction).

13. Morrow, *supra* note 1, at 760.

14. Will Fischer and Chye-Ching Huang, *Mortgage Interest Deduction is Ripe for Reform*, CTR. ON BUDGET POL'Y & PRIORITIES (Nov. 3, 2013), http://www.cbpp.org/research/mortgage-interest-deduction-is-ripe-for-reform; Anthony Randazzo & Dean Stansel, *Mortgage Interest Deduction Saves Middle Class Taxpayers of $51/Month*, FORBES (Dec. 18, 2013, 8:00 AM), http://www.forbes.com/sites/realspin/2013/12/18/mortgage-interest-deduction-saves-middle-class-taxpayers-all-of-51month.

15. Morrow, *supra* note 1, at 760.

16. 796 F.3d 1051 (9th Cir. 2015).

17. *Id.* at 1053.

"Code") by interpreting the mortgage interest deduction debt limitations as applying per-taxpayer. Part II details the statutory framework of Code section 163(h)(3) ("Code Section (h)(3)"). Part III explores the facts of the *Voss* case, while Part IV highlights the Tax Court and Ninth Circuit courts' reasoning. Part V addresses why the Ninth Circuit erred in applying the provision per-taxpayer by misinterpreting the statutory language and in failing to consider the policy implications of a per-taxpayer approach. In addition, Part V further details the application of the court's reasoning in *National Cable & Telecommunications Ass'n v. Brand X Internet Services*.[18] Part VI explains why the *Voss* decision merits Treasury regulation treatment, and Part VII concludes that the Internal Revenue Service ("IRS") should issue a Treasury regulation adopting the Tax Court's interpretation of the Code.

II. STATUTORY FRAMEWORK

When calculating taxable income, deductions allowed by the Code—the United States' statutory tax law—reduce the amount of a taxpayer's gross income.[19] Individual taxpayers may choose between itemized deductions and the standard deduction.[20] When a taxpayer itemizes his or her deductions, he or she reduces taxable income by a series of deductions that are specifically outlined in the Code, such as deductions for medical expenses, charitable contributions, or state income taxes paid.[21] When a taxpayer claims the standard deduction, he or she reduces taxable income by a single amount determined by his or her filing status.[22] Usually, taxpayers will itemize deductions if the total amount of their itemized deductions will exceed the standard deduction.[23] To claim the mortgage interest deduction, a taxpayer must itemize his or her deductions.[24]

In general, the Code disallows deductions for personal interest.[25] Personal interest includes, but is not limited to, interest

18. 545 U.S. 967 (2005).
19. I.R.C. § 63(a) (2015).
20. *See* I.R.C. § 63(b) (2012).
21. *See* Jason Summers, *Should You Itemize Your Deductions? Tax Tips for Claiming Itemizing Deductions vs. the Standard Deduction*, U.S. TAX CENTER (Jan. 22, 2015), http://www.irs.com/articles/should-you-itemize-your-deductions.
22. *Id.* (A taxpayer's filing status can be single, head of household, married filing jointly, or married filing separately).
23. *Id.*
24. *Id.*
25. I.R.C. § 163(h)(1) (2015).

paid on a loan to purchase a car for personal use or interest on credit card charges.[26] Qualified residence interest is a type of personal interest, but is not subject to the disallowance.[27] Qualified residence interest refers to any interest paid or accrued on debt secured by a taxpayer's qualified residence.[28]

There are two types of qualified residence indebtedness: (1) acquisition indebtedness and (2) home equity indebtedness.[29] The mortgage interest deduction allows taxpayers to deduct the amount of interest paid on both acquisition indebtedness and home equity indebtedness secured by a qualified residence.[30]

Acquisition indebtedness refers to any debt that the taxpayer incurs in acquiring, constructing, or substantially improving his or her qualified residence.[31] A qualified residence includes both the taxpayer's principal residence and a second residence.[32] Home equity indebtedness denotes to any debt in excess of acquisition indebtedness that does not exceed the fair market value of the residence.[33]

When a taxpayer secures a residence with a mortgage, the taxpayer can deduct the amount of interest paid on the mortgage. However, taxpayers may not be entitled to a deduction for interest paid on the entire principal amount of the mortgage. Taxpayers are limited to interest paid on $1 million of acquisition indebtedness ($500,000 in the case of married individuals filing separately) and interest paid on $100,000 of home equity indebtedness ($50,000 in the case of married individuals filing separately).[34] Therefore, taxpayers are limited to interest paid on $1.1 million of debt in total. The issue in *Voss v. Commissioner* was whether to apply the debt limitation using a per-taxpayer or per-residence approach.[35]

III. STATEMENT OF THE CASE

Bruce Voss and Charles Sophy ("Taxpayers") were, at all

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26. INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 17 (10311G), TAX GUIDE 2015 FOR INDIVIDUALS 157 (2014).
27. I.R.C. § 163(h)(2)(D) (2015).
28. *Id.* § 163(h)(3)(A).
29. *Id.* § 163(h)(3)(B)–(C).
30. *See id.* § 163(h)(3).
31. *Id.* § 163(h)(3)(B).
32. *Id.* § 163(h)(4)(A).
33. *Id.* § 163(h)(3)(C).
34. *Id.* § 163(h)(3)(B)(ii)–(C)(ii).
35. *Voss v. Comm'r*, 796 F.3d 1051, 1053 (9th Cir. 2015).

relevant times, domestic partners registered with the State of California.[36] They co-owned two residences located in Rancho Mirage, California, and Beverly Hills, California, as joint tenants.[37] The Taxpayers financed the purchase of each residence with a mortgage secured by the residence.[38] The balance of the two mortgages in 2006 and 2007, the years at issue, was about $2.7 million.[39] The issue in *Voss* was whether (a) the debt limitation applies per-residence, such that the Taxpayers could deduct only interest on a combined total of $1.1 million of debt, or (b) the debt limitation applies per-taxpayer, such that the Taxpayers could each deduct interest on $1.1 million, for a combined total of $2.2 million of debt.[40]

In 2006 and 2007, the Taxpayers each claimed the mortgage interest deduction for $1.1 million of debt, or a total of $2.2 million.[41] The IRS audited the Taxpayers and issued proposed notices of deficiency, limiting their interest deduction to $1.1 million in total.[42] In response, each Taxpayer filed a petition with the Tax Court.[43] The Tax Court issued an opinion in favor of the IRS, holding that the debt limitation applied on a per-residence basis when co-owners are not married to each other.[44] The Ninth Circuit took the case on appeal and reviewed it de novo.[45] In holding that the debt limitation applied per-taxpayer, it reversed the Tax Court's decision and remanded for further proceedings to determine the amount of qualified residence interest that the Taxpayers were entitled to deduct, and the proper amount of any remaining deficiency.[46]

IV. REASONING OF THE COURT

A. The Tax Court

The Ninth Circuit's decision in *Voss* reversed the Tax Court's

36. *Id.* at 1055.
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.* at 1053.
41. *Id*.
42. *Id.*
43. *Id.* at 1056.
44. *Sophy v. Comm'r*, 138 T.C. 204, 204 (2012).
45. *Voss*, 796 F.3d at 1057.
46. *Id.* at 1068.

decision in *Sophy v. Commissioner*.[47] In *Sophy*, the Tax Court held that the limitation applied per-residence.[48] In its analysis, the Tax Court highlighted several reasons as to why the debt limitation applied per-residence. First, the court looked at the statutory language defining "acquisition indebtedness" and "home equity indebtedness."[49] Next, it found that the definitions contain the phrase "any indebtedness," which is not qualified by language related to an individual taxpayer.[50] In addition, the definition of "qualified residence interest" contains the phrase "with respect to any qualified residence," which focuses entirely on the residence, rather than the taxpayer.[51]

The court noted that while "taxpayer" appears several times in the section, any reference to an individual taxpayer is absent from the language of the debt limitations.[52] Furthermore, any reference to the "taxpayer" relates to the qualified residence, rather than to the indebtedness.[53] In analyzing the language as a whole, the court found that the repeated emphasis on "qualified residence" supports the contention that the debt limitations are limited in relation to the qualified residence, and not in relation to an individual taxpayer.[54]

Second, the court looked at the language contained in the parenthetical addressing married taxpayers filing separate tax returns.[55] The parenthetical language limits each married taxpayer filing separately to one-half of the debt limitation, such that he or she cannot deduct interest on more than $1.1 million of his or her mortgage.[56] The Taxpayers in *Sophy* argued that the parenthetical language created a "marriage penalty" that did not apply to unmarried co-owners.[57] However, the court found it more likely that

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47. *Id.* at 1053.
48. *Sophy*, 138 T.C. at 213.
49. *Id.* at 210.
50. *Id.*
51. *Id.*; *Voss*, 796 F.3d at 1056.
52. *Sophy*; 138 T.C. at 210; *Voss*, 796 F.3d at 1056; *see* I.R.C. § 163(h)(3)(B)(ii) (2015) ("The aggregate amount treated as acquisition indebtedness for any period shall not exceed $1,000,000."); *id.* § 163(h)(3)(C)(ii) ("The aggregate amount treated as home equity indebtedness for any period shall not exceed $100,000.").
53. *Sophy*, 138 T.C. at 211.
54. *Id.* at 212.
55. *Id.*; *see* I.R.C. § 163(h)(3)(B)(ii) ("$500,000 in the case of a married individual filing a separate return"); *id.* § 163(h)(3)(C)(ii) ("$50,000 in the case of a separate return by a married individual").
56. *Sophy*, 138 T.C. at 212.
57. *Id.*

the language provided a specific allocation of the debt limitation that must be used by married taxpayers filing separately, implying that unmarried co-owners could choose how to allocate the debt limitations.[58] Noting that nothing in the legislative history of Code Section (h)(3) suggested the contrary, the Tax Court concluded that the debt limitations applied on a per-residence basis.[59]

B. The Ninth Circuit

On appeal, the Ninth Circuit's opinion in *Voss* rejected the Tax Court's interpretation of Code Section (h)(3).[60] The Ninth Circuit explained that finding an answer from the language in Code Section (h)(3) "requires considerable effort" because the statute is mostly silent as to how the debt limitations apply to unmarried co-owners.[61] The court noted that relevant Treasury Regulation section 1.163-10T is also silent on the issue.[62] However, the court found some textual guidance in the parenthetical language addressing married individuals filing separately.[63] In particular, the court held that the use of the phrase "in the case of" suggests that the language in the parentheticals contains an exception to the general debt limitations, not an illustration of how the limitation should be allocated.[64]

In its interpretation of the parenthetical language, the Ninth Circuit offered three insights.[65] First, the parentheticals speak in per-taxpayer terms because the language states that the limit is for "$500,000 in the case of *a married individual* filing a separate return" and "$50,000 in the case of a separate return by *a married individual*."[66] The court reasoned that if Congress had wanted to draft the parenthetical language in per-residence terms, it could have done so by stating, "in the case of a qualified residence of a married individual filing a separate return," the debt limitations apply.[67]

Second, the parentheticals operate in per-taxpayer terms.[68] The parentheticals give each spouse a separate debt limitation of

58. *Id.* at 213.
59. *Id.*
60. *See Voss v. Comm'r*, 796 F.3d 1051, 1057 (9th Cir. 2015).
61. *Id.* at 1058.
62. *Id.* at 1058 n. 5.
63. *Id.* at 1058.
64. *Id.*
65. *Id.*
66. *Id.* (emphasis in original).
67. *Id.* at 1058–59.
68. *Id.* at 1059.

$550,000, so that the two spouses are entitled to a combined $1.1 million debt limitation.[69] In other words, the $550,000 debt limit is to be applied per spouse.[70] Because the debt limitation applies per-taxpayer for married individuals, the court suggested that the general debt limitations also apply per-taxpayer.[71]

Lastly, the inclusion of the parentheticals suggests that the debt limits apply per-taxpayer.[72] The court argued that if the $1.1 million debt limit applied per-residence, the parenthetical language would be superfluous because there would be no need to provide that each spouse gets a $550,000 debt limit.[73] However, if the debt limit is applied per-taxpayer, the parentheticals play a role in giving each spouse half of the debt limit so that the couple is subject to the same debt limit as that of a jointly filing couple.[74] In fact, Congress has done so in other provisions of the Code.[75]

The Ninth Circuit found the Tax Court's argument, that the parentheticals acted as a specific allocation, unpersuasive because Congress would not prevent spouses from allocating debt limitations as they choose, especially since most spouses own their home as equal partners.[76] The Ninth Circuit determined that the language ensures that all married couples are treated as a single taxpayer.[77] In addition, the statute's apparent focus on "qualified residence" was unpersuasive on the Ninth Circuit's reasoning.[78] The Court stated that any reasonable reader would understand that the statute refers to a taxpayer, despite the omission of the word "taxpayer."[79]

The Ninth Circuit highlighted certain difficulties in applying a per-residence reading.[80] First, the court found that the repeated reference to a "taxable year" indicates that the statute should be read as applying a per-taxpayer approach because residences do not have

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69. *Id.*
70. *Id.* (per spouse can also be referred to as per taxpayer).
71. *Id.*
72. *Id.*
73. *Id.* at 1059–60.
74. *Id.* at 1060.
75. *Id.* at 1061; *see, e.g.*, I.R.C. § 22(c)(2)(A) (providing an initial credit of $7,500 to a qualifying married couple filing jointly and a credit of $3,750 in the case of a married individual filing a separate return).
76. *Voss*, 796 F.3d at 1060.
77. *Id.*
78. *Id.* at 1062.
79. *Id.* at 1062.
80. *Id.* at 1063.

taxable years, only taxpayers do.[81] The court reasoned that if Congress intended to apply the debt limits per-taxpayer, it would be unlikely that Congress would define qualified residence interest with respect to a single taxable year.[82] Second, it is unclear how co-owners with different taxable years could determine the amount of indebtedness for any period.[83] Third, two co-owners might each have a separate principal residence or separate secondary residence so that co-owners will have to coordinate tax returns to ensure that each qualified residence does not exceed $1 million.[84] The court concluded that the impracticability of applying the provisions under a per-residence approach suggests that Congress never intended to apply that approach; therefore, the statute should be read as applying per-taxpayer.[85]

V. ANALYSIS: THE IRS SHOULD PROMULGATE A REGULATION FOLLOWING THE APPROACH OF THE TAX COURT

The Ninth Circuit erred in interpreting Code section (h)(3) as applying the debt limitations per-taxpayer. First, the court incorrectly relied on the statute's treatment of married individuals filing separate tax returns. Second, it failed to take into consideration the policy implications of a per-taxpayer approach. Third, the section's legislative history suggests that Congress intended to apply the debt limitations per-residence. Lastly, existing interpretative guidance supports the implementation of a per-residence approach. However, the Ninth Circuit was not required to defer to existing interpretative guidance on the issue. Therefore, the IRS should update Treasury Regulation section 1.163-10T and implement the Tax Court's approach. Applying the Ninth Circuit's reasoning in *Brand X* would require courts to defer to this regulation when interpreting Code Section (h)(3).

A. The Ninth Circuit Erred in Interpreting Code Section 163(h)(3)

The Ninth Circuit in *Voss* found that Code section (h)(3) was silent as to whether the debt limitation of $1.1 million applied per-

81. *Id.*
82. *Id.*
83. *Id.*
84. *Id.* at 1064.
85. *Id.*

residence or per-taxpayer.[86] As a result, it issued its own interpretation of the statutory language.[87] However, the court erred in interpreting Code section (h)(3) as applying per-taxpayer.

The Ninth Circuit placed too much emphasis on the language found in the parentheticals regarding married taxpayers filing separately.[88] The court argued that the parentheticals clearly spoke and operated in per-taxpayer terms.[89] The parentheticals give each separately filing spouse a separate debt limit of $500,000 for acquisition indebtedness and $50,000 for home equity indebtedness,[90] so that the two spouses combined are entitled to a $1.1 million debt limitation.[91] The Ninth Circuit argued that reading the parentheticals in per-residence terms would result in a debt limitation of $550,000 combined for married couples.[92]

The parenthetical language of Code section (h)(3) clearly speaks in per-taxpayer terms.[93] The court correctly concluded that the purpose of this language is "to ensure that the separately filing spouse don't get double the benefit that jointly filing couples get."[94] It reasoned that since the debt limit for married couples filing separately applies per taxpayer, the general debt limitations should as well.[95] However, the general debt limitations have an entirely different purpose altogether: they limit the amount of interest that can be deducted. The parenthetical language is drafted in per-taxpayer terms because its purpose is to avoid double benefits for separately filing spouses. Drafting the parenthetical language in per-residence terms, if at all possible, would blur this purpose.

The Ninth Circuit stated that "it is a well-established rule of statutory construction that courts should not interpret statutes in a way that renders a provision superfluous."[96] It argued that the parenthetical language would be superfluous if the general debt

86. *Id.* at 1053.
87. *Id.*
88. *See* I.R.C. § 163(h)(3)(B)(ii) ("$500,000 in the case of a married individual filing a separate return"); *id.* § 163(h)(3)(C)(ii) ("$50,000 in the case of a separate return by a married individual").
89. *Voss*, 796 F.3d at 1058–59.
90. *See* I.R.C. § 163(h)(3)(B)(ii); *id.* § 163(h)(3)(C)(ii).
91. *Voss*, 796 F.3d at 1059.
92. *Id.*
93. *See* I.R.C. § 163(h)(3)(B)(ii)–(C)(ii).
94. *Voss*, 796 F.3d at 1060.
95. *Id.* at 1059.
96. *Id.* (citing Chubb Customs Ins. Co. v. Space Sys., 710 F.3d 946, 966 (9th Cir. 2013)).

limitations are applied in per-residence terms. However, the Supreme Court has held that it "is appropriate to tolerate a degree of surplusage language rather than adopt a textually dubious construction that threatens to render the entire provision a nullity."[97] The parenthetical language performs a significant function in clarifying how the IRS treats married couples filing separately. As the Ninth Circuit noted, such language, although unnecessary, aids the reader in understanding complex tax statutes.[98]

With regard to the difficulties that may arise in applying the per-residence approach, individual taxpayers must generally adopt the calendar year as their tax year.[99] Therefore, situations in which two co-owners have different taxable years will not occur on a frequent basis. Moreover, situations where co-owners own a principal residence together, and each own separate secondary residences, are also not determinative of what approach to use.[100] Deductions with respect to payments of joint obligation are to be allocated to whichever party is liable and makes the payment out of his or her own funds.[101] Therefore, a taxpayer can calculate the amount of his or her deduction based on what was actually paid, with such payments affecting other co-owners own deduction calculations.

B. *Policy Implications of a Per-Taxpayer Approach*

The Ninth Circuit's reasoning ignores the policy implications of a per-taxpayer approach. The amount of the benefit arising from the mortgage interest deduction is skewed in favor of taxpayers in higher income brackets and with larger mortgages.[102] In other words, the deduction benefits taxpayers who would purchase homes with or without the deduction, failing to promote homeownership amongst those who need the deduction the most.[103] Implementing a per-

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97. United States v. Atl. Research Corp., 551 U.S. 128, 137 (2007) (concluding that the phrase "any other person" although made superfluous by the phrase "any other necessary costs," serves to clarify the statutory language).

98. *Voss*, 796 F.3d at 1062 ("In all likelihood, these phrases, though technically unnecessary, were included simply to ease the reader's understanding of a complex tax statute full of technical definitions.").

99. INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, PUB. 538 (15068G), ACCOUNTING PERIODS AND METHODS 4 (2012), https://www.irs.gov/pub/irs-pdf/p538.pdf.

100. *See Voss*, 796 F.3d at 1064.

101. Jolson v. Comm'r, 3 T.C. 1184, 1186 (1944) (quoting MERTENS, LAW OF FEDERAL INCOME TAXATION, vol. 5, § 27.02 9 (1942)).

102. *See* Morrow, *supra* note 1, at 760.

103. *See* Ventry, *supra* note 3, at 264.

taxpayer approach would further skew the benefit in favor of purchasing larger mortgages because co-owners would no longer be limited to $1.1 million of indebtedness.

Furthermore, the Tax Reform Act of 1986 lowered the value of the mortgage interest deduction due to changes it made in reducing marginal tax rates, which reduces the amount of the benefit.[104] Increasing the standard deduction further diminished the value of the deduction because it resulted in fewer taxpayers itemizing their deductions.[105] The Omnibus Budget Reconciliation Act of 1987 ("OBRA") further impacted the deduction's benefit. OBRA introduced the debt limitations at issue in *Voss*.[106] The changes made to the mortgage interest deduction "encouraged taxpayers to move from house to house as the primary mortgage on the house was paid off or the house increased in value."[107]

Throughout the next two decades, politicians sought to increase homeownership rates.[108] In 2005, President George W. Bush commissioned a tax reform panel to develop strategies for recognizing the importance of home ownership.[109] The panel recommended that the benefits for home mortgage interest be retained as a tax credit, rather than as a deduction, as a way to "encourage home ownership, not big homes."[110] Despite these recommendations, the deduction remained "untouchable."[111]

The mortgage interest deduction is ineffective in promoting homeownership, "in large part, due to price capitalization."[112] Price capitalization occurs when the value of the subsidy created by the mortgage interest deduction increases the price of homes.[113] The deduction increases the value of housing, therefore increasing the demand for housing.[114] Although price capitalization supports the mortgage interest deduction's elimination because it makes housing

104. *Id.* at 275.
105. *See id.*
106. *Id.*
107. *Id.* at 276 (quoting C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 143 (Urban Inst. Press, 2d ed. 2004)).
108. *Id.*
109. *Id.*
110. *Id.* at 276–77 (quoting PRESIDENT'S ADVISORY PANEL ON FEDERAL TAX REFORM, SIMPLE, FAIR, AND PRO-GROWTH: PROPOSALS TO FIX AMERICA'S TAX SYSTEM 73 (2005)).
111. *Id.* (quoting Heidi Glenn, *Tax Reform Panel's Ideas Cause Stir in Washington*, 109 TAX NOTES 415, 418 (2005) (quoting Rep. Katherine Harris)).
112. Morrow, *supra* note 1, at 771.
113. *Id.*
114. *Id.* at 772.

less affordable, it also creates a risk that home value will drop if the deduction is phased out.[115] However, the possible negative effects of phasing out the deduction should not deter experts from determining the extent to which the mortgage interest deduction can be reformed to better meet taxpayer and government needs.

The mortgage interest deduction also played a detrimental role in housing market crisis by promoting overinvestment in housing.[116] Real estate agents emphasized, "the more you buy, the bigger your tax break."[117] The Ninth Circuit, by interpreting the debt limitations as applying per-taxpayer, has also promoted overinvestment. Under the court's reasoning, owning a home with multiple taxpayers could result in a virtually limitless deduction. Three co-owners could deduct interest on up to $3.3 million of debt. Five co-owners could deduct interest on up to $5.5 million of debt. Where should the deduction stop?

The policy implications are the same as they were decades ago. The *Voss* decision encourages more debt because it means lower taxes, in turn resulting in a widening the gap between taxpayers who can benefit from this deduction and those who cannot.[118] Following a per-taxpayer approach further obscures the mortgage interest deduction's goal of encouraging homeownership.

C. Congressional Intent Supports a Per-Residence Approach

In 1987, the OBRA amended the definition of qualified residence interest that is treated as deductible.[119] In a congressional report, the Committee on the Budget of the House of Representatives explained that if a taxpayer's acquisition indebtedness exceeds $1 million, then "only the interest on a total principal amount of $1 million of such debt is deductible as acquisition interest."[120] In other words, only the first $1 million of the principal is deductible as acquisition indebtedness. The same treatment is afforded to home equity indebtedness.[121]

115. *Id.*

116. Ventry, *supra* note 3, at 278 (During this time, politicians sought to increase rates of homeownership with various tax subsidies, including tax-free rollover of gains on home sales, which has since been repealed).

117. *Id.*

118. *Cf. id.*

119. *See* H.R. REP. NO. 100-391, pt. 2, at 1033 (1987).

120. *Id.*

121. *See id.*

In *Sophy*, the court noted that when a statute is silent or ambiguous, as is the case here, the court may look at the statute's legislative history in an attempt to determine congressional intent.[122] For purposes of legislative history, congressional committee reports are the most important source for determining legislative intent.[123] If a court ascertains that Congress had a particular intention on the issue, "that intention is the law and must be given effect."[124]

Despite the importance of deferring to legislative history, the court in *Voss* failed to do so, and instead issued its own interpretation.[125] The congressional report is clear, only $1 million of the total principal amount can be treated as acquisition indebtedness.[126] For Bruce Voss and Charles Sophy, anything above the first $1 million of the total principal mortgage balance cannot be used to determine their interest deduction.

D. Deference Afforded to IRS Guidance on the Interpretation of Section 163(h)(3)

Other IRS guidance also supports Congressional intent. The dissent in *Voss* urged the majority to defer to prior IRS guidance on the issue.[127] In 2009, the IRS issued a Chief Counsel Advice memorandum ("CCA") applying the debt limit per-residence.[128] A CCA memorandum is legal advice issued by a national office within the IRS Office of Chief Counsel.[129] The memorandum interprets a specific provision or a specific set of facts, but is not intended for taxpayers to rely upon.[130] In the memorandum in question, two co-owners lived in the residence as joint tenants.[131] The aggregate amount of acquisition indebtedness on the property exceeded the $1

122. Sophy v. Comm'r, 138 T.C. 204, 209 (2012).
123. *Legislative History Research Guide*, GEO L. LIBR. (Dec. 8, 2015, 1:37 AM), http://guides.ll.georgetown.edu/legislative_history.
124. Chevron, U.S.A., Inc. v. Nat'l Res. Def. Council Inc., 467 U.S. 837, 843 n.9 (1984).
125. See Voss v. Comm'r, 796 F.3d 1051, 1073 (9th Cir. 2015) (Ikuta, J., dissenting).
126. H.R. REP. NO. 100-391, pt. 2, at 1033.
127. *Voss*, 796 F.3d at 1071 (Ikuta, J., dissenting).
128. See I.R.S. Chief Couns. Adv. Mem. 2009-11-007 (Mar. 13, 2009).
129. Daniel L. Korb, *The Four R's Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21 Century: A View from Within*, 46 DUQ. L. REV. 323, 357 (2004) (quoting I.R.C. § 6110(i)(1) (2000)).
130. *Id.* at 358.
131. Office of Chief Counsel, Internal Revenue Serv., Memorandum on the Mortgage Interest Deduction (Limitation on Acquisition Indebtedness), at 2 (Mar. 13, 2009), https://www.irs.gov/pub/irs-wd/0911007.pdf.

million limitation.[132] The taxpayers argued that they should be able to deduct interest paid on $1 million of debt each.[133] The IRS emphasized that acquisition indebtedness is defined 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."[134] Because the amount of indebtedness in its entirety constitutes acquisition indebtedness, the $1 million limitation applies to such amount in its entirety.[135]

To further support this position, the IRS issued a publication stating that the dollar limits apply to the combined mortgages on the taxpayer's main home and second home.[136] In other words, the limitation applies to the combined balances of the mortgages. Any amount that exceeds the debt limit may not be used to calculate an interest deduction.

Despite the dissent's insistence, the Ninth Circuit gave the Chief Counsel Advice limited weight.[137] In analyzing the proper level of deference to afford IRS guidance, the reasoning of *Chevron U.S.A., Inc. v. National Resources Defense Council Inc.*[138] is pertinent to the discussion. The *Chevron* opinion held that courts have a duty to defer to reasonable agency interpretations when Congress is silent or leaves ambiguity in a statute that the agency is charged with administering.[139] The *Chevron* doctrine's first step asks courts to decide "whether Congress has directly spoken to the precise question at issue."[140] If the court finds the statute is silent or ambiguous with respect to the specific issue, the second step requires courts to determine whether the agency's answer is based on a reasonable interpretation of the statute.[141] The issue in post-*Chevron* cases was to what statutes and agency interpretations does the *Chevron* deference apply.[142]

The Court in *United States v. Mead Corp.*[143] held that the

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132. *Id.*
133. *Id.* at 4.
134. *Id.* (emphasis omitted).
135. *Id.*
136. INTERNAL REVENUE SERV., *supra* note 26, at 153.
137. Voss v. Comm'r, 796 F.3d 1051, 1066 (9th Cir. 2015).
138. 467 U.S. 837 (1984).
139. Thomas W. Merrill & Kristin Hickman, *Chevron's Domain*, 834 GEO. L.J. 833 (2001).
140. *Chevron*, 467 U.S. at 842.
141. *Id.* at 843.
142. Merrill & Hickman, *supra* note 139, at 835.
143. 533 U.S. 218 (2001).

amount of deference afforded to agency pronouncements should be decided on an agency-by-agency basis, and that the weight given in a particular case will depend on "the degree of the agency's care, its consistency, formality, and relative expertness, and to the persuasiveness of the agency's position."[144] Under *Mead*, deciding whether an agency pronouncement is afforded *Chevron* deference requires an analysis of both Congressional intent to delegate authority to make rules carrying the force of law and the agency's intent to adopt rules in the exercise of that authority.[145]

The IRC authorizes the Treasury to promulgate regulations.[146] The power to promulgate regulations may be conveyed through several specific statutory authorizations, or through general authorization granted by section 7805(a) of the Code.[147] The tax community characterizes specific authority regulations as legislative and general authority regulations as interpretative.[148] However, both specific and general authority Treasury regulations legally bind taxpayers and the government.[149] Since the Treasury's promulgated regulations are legally binding, an analysis of the *Mead* opinion would indicate that Treasury regulations should be afforded *Chevron* deference.[150] However, there is a lack of consensus in authority regarding the appropriate degree of deference to give in general authority regulations.[151] It was not until the decision of *Mayo Foundation for Medical Education & Research v. United States*[152] that courts established *Chevron* deference controlled over general authority regulations.[153] The same cannot be said about other interpretative guidance, such as Chief Counsel Advice memorandum or other IRS publications.

The distinguishing feature between Treasury regulations and other IRS interpretations is the level of formality by which they are

144. *Id.* at 228 (footnotes omitted).
145. *Id.* at 226–27.
146. Kristin E. Hickman, *Coloring Outside the Lines: Examining Treasury's (Lack Of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 NOTRE DAME L. REV. 1727, 1732 (2007).
147. *Id.* at 1735–36; *see* I.R.C. § 7805(a)(2015).
148. Hickman, *supra* note 146, at 1761.
149. *Id.* at 1736.
150. Kristin E. Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1538-39 (2006).
151. *See id.* at 1545–46 (explaining that interpretative general authority regulations were entitled to less deference than specific authority regulations).
152. 562 U.S. 44 (2011).
153. *Id.* at 55–56.

promulgated.[154] The Administrative Procedure Act of 1946 ("APA") mandates a notice-and-comment process for Treasury regulations.[155] However, most of the interpretive guidance the Treasury and IRS issue is not formally promulgated through a notice-and-comment process.[156] Interpretive guidance, such as Chief Counsel Advice memoranda, does not carry the same weight as regulations.[157] That is, the Ninth Circuit was correct in refusing to give the Chief Counsel Advice memorandum importance in reaching a decision in *Voss*.

Since the Chief Counsel Advice memorandum does very little to support a per-residence approach, the IRS should update and finalize temporary Treasury Regulation section 1.163-10T and implement the Tax Court's reasoning.[158] The Treasury and the IRS have followed an "interim-final rulemaking" approach when issuing temporary regulations, which fails to meet the notice-and-comment procedures mandated by the APA.[159] As a result, the IRS should solicit post-promulgation public comments when finalizing temporary Treasury Regulation section 1.163-10T, in order to ensure the validity of the regulation.[160]

E. The Treasury Regulation Applying the Per-Residence Approach Would Control over the Ninth Circuit's Opinion

The *Brand X* opinion established that an agency is entitled to choose a different interpretation than a court's prior interpretation since the agency remains the authoritative interpreter of statutory language.[161] The agency retains the ability to construe the statute in any way it determines meets congressional intent, even if a court's prior interpretation would foreclose the new interpretation.[162] Here,

154. Matthew H. Friedman, *Reviving National Muffler: Analyzing the Effect of Mayo Foundation on Judicial Deference as Applied to General Authority Tax Guidance*, 107 NW. U. L. REV. 115, 122 (2012).

155. Ellen P. Aprill, *The Impact of Agency Procedures and Judicial Review on Tax Reform*, 65 NAT'L TAX J. 917, 918 (2012).

156. Friedman, *supra* note 154, at 122.

157. *See* Korb, *supra* note 129, at 358; *see* Friedman, *supra* note 154, at 122 (explaining that the IRS treated revenue rulings and revenue procedures as binding to taxpayers with the same set of facts).

158. *Voss v. Comm'r*, 796 F.3d 1051, 1058 n.5 (9th Cir. 2015) (explaining that Treas. Reg. § 1.163-10T is also silent on the issue of whether to follow the per-taxpayer approach or per-residence approach).

159. Aprill, *supra* note 155, at 925.

160. *See id.*

161. *Nat'l Cable & Telecomms. Ass'n*, 545 U.S. 967, 983 (2005).

162. Christopher J. Walker, *Avoiding Normative Canons in the Review of Administrative Interpretations of Law: A* Brand X *Doctrine of Constitutional Avoidance*, 64 ADMIN. L. REV.

congressional intent indicates that Code Section (h)(3) should be interpreted under a per-residence approach.

A court's prior interpretation of a statute can override an agency's interpretation only if the relevant court decision finds the statute to be unambiguous.[163] In *United States v. Home Concrete & Supply*,[164] the court found that the *Brand X* opinion requires *Chevron*-style deference when "a particular statute in effect delegates to an agency the power to fill a gap, thereby implicitly taking from a court the power to void a reasonable gap-filling interpretation."[165] The Ninth Circuit in *Voss* found the statute to be silent,[166] and silence is the loudest indication that an agency is entitled to issue its own interpretation. In essence, *Home Concrete* established that the government may use regulations to reverse lower court decisions that do not satisfy *Chevron*'s first step analysis.[167]

In light of the IRS' position in the *Sophy* and *Voss* cases, its prior guidance on the issue, and congressional intent, the IRS should issue its own regulation adopting the Tax Court's per-residence approach. The court's reasoning in *Brand X* indicates that such regulation would supersede the Ninth Circuit's opinion.

F. Why the Per-Residence Approach Merits Treasury Regulation Treatment

The Code grants the Treasury authority to promulgate regulations.[168] The Code explicitly grants the Treasury interpretive authority through several specific statutory authorizations.[169] In addition, Code section 7805(a) grants general rulemaking authority to develop "all needful rules and regulations for the enforcement of" the Code.[170] Every year, the Treasury uses both specific and general rulemaking authority to adopt, modify, and remove Treasury

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139, 144 (2012).

163. *Nat'l Cable & Telecomms. Ass'n*, 545 U.S. at 984.

164. 132 S. Ct. 1836 (2012).

165. *Id.* at 1843.

166. *Voss v. Comm'r*, 796 F.3d 1051, 1053 (9th Cir. 2015)

167. Amanda M. Traphagan, *Agency Deference After* Home Concrete, 14 TEX. TECH. ADMIN. L.J. 153, 169 (2012).

168. Hickman, *supra* note 146, at 1735.

169. *Id.* (An example of a specific statutory authorization can be found in Code section 1502, which grants authority to promulgate regulations that are deemed necessary to clearly reflect the income tax liability of affiliated corporations filing a single tax return).

170. *Id.* at 1735–36.

regulations interpreting the Code.[171]

Because the IRS has limited resources to litigate tax cases, it may choose not to challenge a particular case. When a case's holding adversely affects the Government's legal position, the IRS may issue an Action on Decision ("AOD") to announce whether it will follow the adverse decision.[172] There are three possible positions that the IRS may take in an announcement: acquiescence, acquiescence in result only, or nonacquiesence.[173] Acquiescence indicates that the IRS accepts the court's holding and will follow the holding when deciding cases with the same controlling facts.[174] An announcement of acquiescence does not indicate approval or disapproval of the court's reasoning.[175] Acquiescence in result only indicates the acceptance of the court's holding, but demonstrates disagreement or concern with the court's reasoning.[176] Nonacquiesence indicates that the IRS does not agree with the court's holding, and will only follow the decision in cases arising within the deciding circuit court's jurisdiction.[177] In general, the IRS tends to adhere to a given circuit court's controlling precedent.[178]

The IRS and the Treasury expend substantial time and resources in adopting regulations.[179] For this reason, the IRS must decide whether to allocate resources to challenge a decision, or issue an announcement of nonacquiesence. If the IRS chooses the latter, the Ninth Circuit's holding would bind only Tax Court cases that are appealed to the Ninth Circuit. The issue presented in *Voss* merits treasury regulation treatment for various reasons.

First, Treasury regulations aim to interpret and administer the Code. The relevant Treasury regulation to Code section (h)(3) is silent on the tax treatment of unmarried co-owners, despite it being a common form of homeownership.[180] In 2010, there were about 7.7

171. *Id.* at 1729, 1736.
172. Korb, *supra* note 129, at 363.
173. *Id.* at 366.
174. *Id.*
175. *Id.*
176. *Id.*
177. *Id.*
178. *Id.*
179. Kristin E. Hickman, *Administering the Tax System We Have*, 63 DUKE L.J. 1717, 1752–53 (2014).
180. Voss v. Comm'r, 796 F.3d 1051, 1058 n. 5 (9th Cir. 2015); U.S. CENSUS BUREAU, C2010BR-14, HOUSEHOLDS AND FAMILIES: 2010 1, 3 (2012).

million unmarried couple households in the United States.[181] Between 2000 and 2010, the rate of unmarried partner households grew 41 percent, four times as fast as the overall household population.[182] In addition, the *Voss* decision also affects residences owned by siblings or multiple family members. The current Treasury regulation provides the method for determining the amount of qualified residence interest with regard to single taxpayers and married taxpayers filing separate returns.[183] The regulation fails to address the issue addressed by the *Voss* decision.[184] In order to successfully interpret and administer the Code, the regulation must be updated to clarify the method for determining qualified residence interest for unmarried co-owners.

Second, the mortgage interest deduction is one of the federal government's costliest tax expenditures. As addressed in Part I, the mortgage interest deductions cost the Federal government $70 billion a year.[185] Third, over several decades, experts have shown that the mortgage interest deduction is ineffective in furthering its policy goal of incentivizing homeownership. The deduction's little to no effect on rate of homeownership does not justify its costs.

In addition, policy implications indicate that a per-taxpayer approach would encourage excessive borrowing. If the mortgage interest deduction's debt limitations are interpreted to apply per-taxpayer, then taxpayers will be more encouraged to purchase and co-own more expensive homes with larger mortgages.

Lastly, nonacquiesence would create an unfair advantage for homeowners within the Ninth Circuit's jurisdiction. As explained in Part V, the *Voss* decision allows the deduction to be skewed in favor of co-owners with large mortgages. When the IRS issues an announcement of acquiescence, the IRS indicates to taxpayers that the issue will no longer be litigated.[186] Co-owners within the Ninth Circuit's jurisdiction would be entitled to deduct interest on $2.2 million of debt or more, while their counterparts in other jurisdictions would be limited to interest on $1.1 million of debt.

Over several decades, experts have agreed that the mortgage

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181. *Id.* at 5.
182. *Id.* at 3.
183. *Voss*, 796 F.3d at 1054.
184. *Voss*, 796 F.3d at 1058 n. 5.
185. OFFICE OF MGMT. & BUDGET, *supra* note 4; *see* Schizer, *supra* note 4, at 284.
186. Korb, *supra* note 129, at 364–65.

interest deduction should be phased out, and re-introduced as a credit to encourage homeownership among taxpayers who cannot itemize their deductions.[187] Not only was the Tax Court's per-residence approach correct, its impact on the federal government and U.S.taxpayers merits Treasury Regulation treatment. The deduction is ripe for reform due to the reasons outlined above.

VI. CONCLUSION

The Ninth Circuit erred in interpreting Code section (h)(3) as applying the debt limitations per-taxpayer. The court incorrectly relied on the statute's treatment of married individuals filing separate tax returns, therefore placing too much emphasis on the parenthetical language's purpose. In addition, the court failed to place any importance on legislative history and IRS guidance on the issue. In so doing, the court's interpretation deviated from the proper per-residence approach.

The Ninth Circuit court should have adopted the Tax Court's interpretation of Code Section (h)(3). This interpretation is correct and merits regulation treatment because it avoids a tax avoidance shelter's negative implications, scaling back the difference between those who benefit from the deduction and those who cannot. For these reasons, the IRS should finalize and issue a regulation adopting the Tax Court's approach in interpreting Code Section (h)(3)'s debt limitations.

187. Morrow, *supra* note 1, at 800.