Mortgage Interest Deductions for Unmarried Couples

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As a general rule an unmarried individual can deduct interest on a mortgage debt so long as the debt qualifies as qualified mortgage indebtedness under Section 163 of the Internal Revenue Code. One requirement of Section 163 is this: to be qualified indebtedness, the mortgage cannot exceed $1.1 million dollars.

But here's the problem. The Code is not at all clear about what this $1.1 million limitation means. It does say that if you are married filing separately, your deduction is limited to the interest paid on $550K of mortgage debt. Many of us who teach and practice tax law had for years assumed that this situation was one of those instances under the tax code where unmarried couples (same sex or otherwise) were treated better than married couples. In other words, this rule was just another example of the sort of marriage tax penalty that occurs under the Internal Revenue Code. This $1.1 million limitation provision was enacted in 1987 and the IRS did not opine about how it applied to unmarried co-owners until 2009 (in a CCA which is not authority that binds the taxpayer).

So here is what the IRS said in 2009: if A and B co-own a residence with a total mortgage in excess of $1.1 million, then between them they are limited (just like husbands and wives) to an interest deduction only on the first $1.1 million of debt. In the view of the IRS the $1.1 M limit applied "per residence" and not "per taxpayer." The IRS then litigated this issue in Tax Court, claiming that an unmarried couple who co-owned a residence could not deduct interest on any portion of the mortgage that exceeded $1.1 million. And the IRS won. See Sophy v. Commissioner, 138 T.C. 204 (2012)

Taxpayers appealed to the Ninth Circuit. And on August 7, 2015, the Ninth Circuit Court of Appeals reversed. See Voss v. Commissioner, 796 F.3d 1051 (9th Cir. 2015). The majority opinion concluded that Section 163(h)(3) of the Internal Revenue Code should be construed to apply the $1.1 million debt limitation on a "per taxpayer" basis rather than a "per residence" basis.

Observation: Since the IRS does not recognize registered domestic partnerships or civil unions as marriages, that means that partners will be able to deduct interest on any co-owned property that is paid on the first $2.2 million of qualified debt (assuming that each partner in fact pays interest on his or her $1.1 million share of the mortgage).

The case is Voss case can be found at http://caselaw.findlaw.com/us-9th-circuit/1710007.html