Office of Chief Counsel
Internal Revenue Service
memorandum

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to: Nancy C. Carver
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(Small Business/Self-Employed)

from: Christopher F. Kane
Branch Chief, Branch 3
(Income Tax & Accounting)

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subject: Mortgage Interest Issues

This Chief Counsel Advice is in response to your request for assistance regarding cases involving the deduction for mortgage interest under section 163 of the Internal Revenue Code. This advice may not be used or cited as precedent. You ask that we consider the following fact patterns:

Situation 1. Taxpayers are a married couple and are jointly and severally liable on a mortgage, but one spouse is deceased at the end of the taxable year and the bank issues a Form 1098 under the deceased spouse's social security number. The surviving spouse files a separate return. Payment may be made from a joint account or from separate funds of either taxpayer.

Situation 2. Taxpayers are an unmarried couple and are jointly and severally liable on a mortgage, and the bank either issues a Form 1098 under only one social security number, or both. One or both taxpayers claims the mortgage interest deduction on their individual returns. Payment may be made from a joint account or from separate funds of either taxpayer.

Situation 3. Related persons co-own a house and are liable on a mortgage note. A bank may issue a Form 1098 under the name of one or both of the co-obligors. Each taxpayer claims 50% or 100% of the deduction. Payment may be made from a joint account or from separate funds of either taxpayer.

In particular, you asked that we consider the analyses in PLR 5707309730A, 1957 WL 12580, and Neracher v. Commissioner, 32 B.T.A. 236 (1935).

PLR 5707309730A took the position in an instance where a husband and wife were filing separate returns, that when funds were paid from a joint bank account owned by both spouses for medical and dental expenses, each spouse was considered to have paid one half of the amounts paid from the account. The ruling states, "Where [taxpayers] maintain a joint checking account in which each apparently has an identical interest with the other, there is a presumption that items paid from such account are paid equally by each of the two parties. "

PLR 5707309730 cites Mark B. Higgins v. Commisioner, 16 T.C. 140 (1951), where a husband was allowed to deduct only one half of the interest paid from a joint bank account on a mortgage on property held by the husband and his wife as tenants by the entirety. In Higgins, rental income relating to the property was deposited into the joint account, and the husband wrote a check on the account to pay the interest. The court determined that he was not entitled to deduct all the interest on his separate return because he had not established that the interest was paid from his separate funds.

In Finney v. Commissioner, T.C. Memo. 1976-329, husband and wife taxpayers owned property as tenants by the entirety and were jointly liable on the mortgage. Payments were made by check on a joint account by the wife, who claimed she was entitled to one-half the interest deduction. However, the court allowed the entire deduction to the husband, noting that both taxpayers stipulated that the funds used to make the payments were supplied by the husband.

The court stated:
"Under normal circumstances, a deduction in respect of payment of a joint obligation is allowable to whichever of the parties liable thereon makes the payment out of his own funds. Al Jolson, 3 T.C. 1184, 1186 (1944); F. C. Nicodemus, Jr., 26 B.T.A. 125 (1932); William R. Tracy, 25 B.T.A. 1055, 1061 (1932), revd. on another issue 70 F.2d 93 (6th Cir. 1934). See Mark B. Higgins, 16 T.C. 140, 143—144 (1951). See also Rev. Rul. 71-268, 1971-1 C.B. 58. The authorities are sparse, however, where payment is made by one such party out of funds provided by the other. In Edward C. Kohlsaat, 40 B.T.A. 528 (1939), the taxpayer deeded property to his wife as part of a divorce settlement but remained primarily liable on the mortgage debt, which the wife did not assume. Pursuant to a separation agreement, he was required to, and did, provide her with funds for the express purpose of paying the mortgage interest. Under these circumstances, the Court held that the wife was acting merely as the husband's agent in respect of the payment of the interest and that he was entitled to the deduction therefor. In Mark B. Higgins, supra, the Court held that the taxpayer husband was only entitled to deduct one-half of the interest paid in respect of a mortgage on property held by him and his wife as tenants by the entireties. In so holding, the Court emphasized that the payments were not made 'from separate funds'. See 16 T.C. at 143. Compare Deininger v. Commissioner, 313 F.2d 221,

224 (4th Cir. 1963), revg. on other issues T.C. Memo. 1961-212; Rev. Rul. 62-38, 1962-1 C.B. 15. "

In addition, Rev. Rul. 59-66, 1959-1 C.B. 60 holds that amounts paid for the medical care of a taxpayer, her husband and their son and daughter, from funds deposited in a joint checking account in which the husband and wife apparently have an equal interest are, in the absence of competent evidence to the contrary, presumed to be paid equally by the husband and wife for the purpose of computing the deduction allowable under section 213 when the husband and wife elect to file separate Federal income tax returns.

Based on these authorities, we conclude that funds paid from a joint account with two equal owners are presumed to be paid equally by each owner, in the absence of evidence showing that is not the case, as reflected in PLR 5707309730A.

In Neracher v. Commissioner, 32 B.T.A. 236 (1935), a taxpayer paid all the interest on a mortgage on which he was a joint obligor although his wife owned the mortgaged property. The court ruled the taxpayer was entitled to deduct the entire amount of interest paid on his separate return. The court did not consider the issue of whether payment of the funds was from a separate account of the taxpayer.

In Larson v. Commissioner, 44 B.T.A. 1094, (1941), the court concluded that a cosigner on a note was permitted to deduct interest. The taxpayer and her son signed notes as co-makers that were obtained entirely on the credit of the taxpayer, and the proceeds were turned over to her son. The Service argued that the obligations were incurred only by the son, not the taxpayer and that interest paid by the taxpayer was therefore not deductible. The court, however, held that the taxpayer's obligation as co-maker of the notes was both joint and several, and that "The notes were at all times her personal obligations and amounts paid by her as interest must be considered interest paid on her indebtedness," citing Neracher. In Castenada-Benitez v. Commissioner, T.C. Memo. 1981-157, a taxpayer paid interest on a mortgaged secured by the marital residence which was owned jointly by the taxpayer and his former wife. The Service disallowed half the interest, but the court allowed the deduction, stating that "A deduction in respect of the payment of interest on a joint obligation is allowable to whichever of the parties liable thereon makes the payment out of his own funds. … Inasmuch as it is clear here that petitioner made the home mortgage payments and respondent does not challenge the fact that he was an obligor on the mortgage, petitioner is clearly entitled to deduct the full amount of the stipulated mortgage interest paid …" Castenada-Benitez at 157 .

In Rev. Rul. 71-179, 1971-1 C.B. 58, a father is allowed to deduct interest on a student loan agreement that he co-signs with his son. In Rev. Rul. 71-268, 1971-1 CB 58, when a husband and wife are jointly and severally liable for payment of interest on indebtedness on property held as tenants by the entirety, and the husband makes seven payments during the year while the wife makes five payments during the year, the amount of interest actually paid by each is deductible on their separate income tax returns.

Based on these authorities, we conclude that the rule that a person who is jointly and severally liable on an indebtedness is entitled to deduct all the interest on the indebtedness provided that person actually pays the interest, remains a valid rule to the extent that the interest is otherwise deductible, as determined in Neracher v. Commissioner, supra.

Regarding the specific factual situations described in your request, we believe the following to apply.

Situation 1. Taxpayers are a married couple jointly and severally liable on a mortgage, but one spouse is deceased at the end of the taxable year and the bank issues a Form 1098 under the deceased spouse's social security number. The surviving spouse may file a separate return. Payment may be made from a joint account or from separate funds of either taxpayer.

In the year of death, if the surviving spouse files a separate return, the decedent's return should include income and deductions to the time of death. In determining the amount of interest deductible on the decedent's return, the principles discussed above regarding payment from joint or separate accounts, and joint liability should apply. For example, if the decedent paid interest from a joint account before death, the decedent's return should reflect one-half of the interest paid from the joint account before the time of death, in the absence of evidence that the interest was paid from the decedent's separate funds. In years following the year of death, the surviving spouse is entitled to the deduction for interest since the surviving spouse is liable on the note, assuming the surviving spouse makes the interest payments and all other requirements are met.

Situation 2. Taxpayers are an unmarried couple and are jointly and severally liable on a mortgage, and the bank either issues a Form 1098 under only one social security number, or both. One or both taxpayers claim the mortgage interest deduction on their individual returns. Since both taxpayers are liable on the mortgage both are entitled to claim the mortgage interest deduction to the extent of the mortgage interest paid by either taxpayer. If the mortgage interest is paid from separate funds, each taxpayer may claim the mortgage interest deduction paid from each one's separate funds. If the mortgage interest is paid from a joint bank account in which each has an equal interest, under Rev. Rul. 59-66, it would be presumed that each has paid an equal amount absent evidence to the contrary.

Situation 3. Various combinations of relatives may co-own a house and be liable on a mortgage. A bank may issue a Form 1098 under the name of one of the co-obligors, or of both co-obligors; taxpayers may claim 50% or 100% of the deduction. Payment may be made from a joint account or from separate funds of either taxpayer.

In general, to claim an interest deduction it is necessary to be liable on the note. However, section 1.163-1(b) states that "Interest 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." Under several tax court cases, Uslu v. Commissioner, T.C. Memo. 1997-551 and Amundsen v. Commissioner, T.C. Memo. 1990-337 a taxpayer was permitted to deduct interest on indebtedness even though the taxpayer's family member, such as a sibling, was liable on the indebtedness, rather than the taxpayer. In such a case the taxpayer must show that they are the equitable owner of the property based on all the facts and circumstances. In general, if co-owners of a house are both liable on a mortgage, each one may take a deduction for the amount each one pays subject to the limitations and requirements of section 163(h). Neracher v. Commissioner, supra.

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Please call (202) 317-5100 if you have any further questions.