

**Internal Revenue Service**

Department of the Treasury

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Person to Contact:

Telephone Number:

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Legend

Taxpayer	=
Association	=
Bank	=
State	=
County	=
<u>A</u>	=
<u>x</u>	=
Year 1	=

Dear \_\_\_\_\_ :

This letter is in response to a letter ruling request received by this office on November 30, 1999. Specifically, you have requested the following ruling:

Whether interest paid by the Association on a secured loan obtained by the Association to demolish and restore a portion of the common elements of the Association is deductible by Taxpayer under § 163(h), subject to (1) any other limitations on the deductibility of qualified residence interest, (2) the requirement that the loan is secured by the taxpayer's qualified residence, and (3) the requirement that the taxpayer's residence is part of the Association.

**FACTS**

Taxpayer, an individual, is a homeowner and a member of the Association. The Association is a non-stock corporation that is incorporated under the laws of State. The

Association is comprised of homeowners in a certain geographical location, and its purpose is to own and take care of the common elements of all the homeowners, including an A. In Year 1, County condemned the A. The Association planned to borrow money to demolish and rebuild the A, and planned to collect special assessments from its members to service the mortgage.

The Association obtained a commitment from the Bank to loan \$x to the Association to finance the construction project. The collateral for the loan consists of the regular and special homeowners' assessments, a deed of trust on the common elements, and the assignment of homeowners' dues. Taxpayer's home was not pledged as collateral on the loan.

## LAW AND ANALYSIS

Section 163(a) of the Internal Revenue Code provides that there shall be allowed as a deduction all interest paid or accrued within the taxable year on indebtedness.

Section 163(h)(1) of the Code provides in part that in the case of a taxpayer other than a corporation, no deduction shall be allowed for personal interest paid or accrued during the taxable year.

Section 163(h)(2) of the Code provides in part that for purposes of this subsection, the term "personal interest" means any interest allowable as a deduction other than any qualified residence interest.

Section 163(h)(3) of the Code provides in part that the term "qualified residence interest" means any interest which is paid or accrued during the taxable year on acquisition indebtedness with respect to any qualified residence of the taxpayer. "Acquisition indebtedness" is defined in the section as any indebtedness which is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and is secured by such residence.

Section 1.163-10T(o) of the Temporary Income Tax Regulations provides that "secured debt" means a debt that is on the security of any instrument (such as a mortgage, deed of trust, or land contract):

- i) that makes the interest of the debtor in the qualified residence specific security for the payment of the debt,
- ii) under which, in the event of default, the residence could be subjected to the satisfaction of the debt with the same priority as a mortgage or a deed of trust in the jurisdiction in which the property is situated, and
- iii) that is recorded, where permitted, or is otherwise perfected in accordance with applicable state law.

Section 1.163-10T(o) also provides that a debt will not be considered to be secured by a qualified residence if it is secured solely by virtue of a lien upon the general assets of the taxpayer, or by a security interest, such as a mechanic's lien or judgment lien, that attaches to the property without the consent of the debtor.

Section 1.163-10T(p) of the Regulations provides in part that the term "qualified residence" means the taxpayer's principal residence within the meaning of former Code section 1034. Section 1.163-10T(p)(ii) provides that whether property is a residence shall be determined based on all the facts and circumstances, including good faith of the taxpayer. A residence generally includes a house, condominium, mobile home, boat, or house trailer, that contains sleeping space and toilet and cooking facilities.

It is well established that the person entitled to deduct interest is the person who is legally liable to pay the interest. See Arcade Realty Company, Inc. v. Commissioner, 35 T.C. 256 (1960), acq. 1961-2 C.B. 3 (corporation that borrowed money and loaned such money to its primary stockholder was the entity entitled to the interest deduction on the loan); Norwood v. Commissioner, T.C. Memo 1983-755 (guarantors of indebtedness were entitled to an interest deduction only when they became primary obligors on the loan, and not before); Rev. Rul. 64-31, 1964-1 C.B. 300 (condominium purchaser who also assumed in his deed a proportionate share of a mortgage on entire project was entitled to § 163 interest deduction).

The Association, as a separate taxable entity, cannot be ignored for tax purposes. See Moline Properties v. Commissioner, 319 U.S. 436 (1943). The Association is the borrower on the loan and is the entity responsible for paying the interest. Although the Association intends to satisfy its contractual obligation to the Bank by using funds collected, in part, from Taxpayer, the Taxpayer has not undertaken any personal contractual obligation with the Bank as a primary obligor on the loan. Furthermore, Taxpayer's principal residence is not specific security for the loan. The Association pledged its own property (the regular and special homeowners' assessments, the common elements, and the homeowners' dues) as collateral. Therefore, Taxpayer does not satisfy the requirements for a deduction of home mortgage interest under § 163(h) with respect to the payments at issue.

### CONCLUSION

Under the facts set forth above, interest paid by the Association on a secured loan obtained by the Association is not deductible by Taxpayer, in whole or in part, under § 163(h).

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the power of attorney on file in our office, a copy of this ruling is being sent to your representative.

Sincerely,

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Douglas A. Fahey  
Acting Chief, Branch 5  
Income Tax & Accounting

cc: