

## Appendix C. External (Client-Facing) Tax Memo from Spilker et al.

### EXHIBIT 2-10 Sample Client Letter

Below is the client letter that Bill and Mercedes's CPA sent to them.

July 8, 2024

Dear Bill and Mercedes,

I enjoyed seeing you last week at the Tampa Bay Boys and Girls Clubs charity auction. What a great event for such a worthy cause!

Thank you for requesting my advice concerning the tax treatment of the points paid when refinancing your mortgage.

My research is based upon the federal income tax laws that apply as of the date of this letter and the facts that you have provided as follows: Four years ago your credit union provided you a \$450,000 interest-only note on your home that required a balloon payment at the end of four years. You chose this type of loan to minimize your mortgage payment until your previous house sold. After 18 months, you sold your previous house and refinanced the original short-term loan with a 15-year conventional mortgage. The credit union charged you \$5,000 in points upon the refinancing.

After a thorough review of the applicable tax authority, I found there is substantial authority supporting a current deduction of the \$5,000 in points paid.

§461(g)(2) allows cash-method taxpayers to deduct points in the year paid if the related debt was incurred "in connection with the purchase or improvement of," and secured by, the taxpayer's principal residence. There are two basic interpretations of "in connection with the purchase or improvement of." The IRS has ruled (Revenue Ruling 87-22) that points paid to simply refinance an existing mortgage without improving the residence must be amortized over the life of the loan. In contrast, in *J.R. Huntsman v. Comm'r*, the 8th Circuit Court held that points incurred to refinance a mortgage on the taxpayer's principal residence are currently deductible if the refinancing represents an *integrated step to secure permanent financing* for the taxpayer's residence.

The facts in *J.R. Huntsman v. Comm'r* are very similar to your facts. Like you, the taxpayers in *J.R. Huntsman v. Comm'r* purchased their principal residence using a short-term loan with a balloon payment. When the balloon payment came due, the taxpayers obtained a permanent mortgage on their home. The 8th Circuit Court held that in this case the permanent mortgage was acquired to finalize the purchase of the home and allowed the current deduction of the points.

*J.R. Huntsman v. Comm'r* provides substantial authority to support a current deduction of the \$5,000 in points paid to refinance your initial short-term mortgage. In addition, other courts have applied the 8th Circuit's interpretation of §461(g)(2), which adds "strength" to the 8th Circuit decision. However, the IRS has indicated that it will not follow the *J.R. Huntsman v. Comm'r* decision outside the 8th Circuit (in the 11th Circuit where you live). Accordingly, the IRS would likely disallow the \$5,000 deduction upon audit, and, thus, while you have substantial authority to deduct the points currently, there is risk in doing so.

I would be happy to discuss this issue with you in more depth because these types of issues are always difficult. Likewise, if you have any other questions or issues with which I may assist you, please do not hesitate to contact me. Thank you again for requesting my advice.

Sincerely,

Cassandra Miller, CPA