

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 13414
[Redacted],)	
)	DECISION
Petitioners.)	
_____)	

The petitioners protest the Notice of Deficiency Determination issued by the auditor for the Idaho State Tax Commission (Commission) dated January 27, 1999, asserting additional income tax, penalty, and interest totaling \$2,704 and \$2,975 for 1995 and 1996, respectively.

The auditor made the following adjustments to the petitioners' Idaho income tax returns:

1. Increased income from an interest the petitioners held in an S corporation due to audit adjustments to the returns filed by the S corporation.
2. Eliminated profit shown as rental income.
3. Adjusted the amounts allowable as itemized deductions.

ISSUE 1. [Redacted] [Redacted] (hereinafter the corporation), an S corporation in which the petitioners owned an interest, was audited by the Tax Commission. This adjustment reflects the petitioners' share of the audit adjustments made to that corporation. The income of the S corporation was adjusted pursuant to an administrative appeal. Therefore, the liability of the petitioners must be adjusted accordingly.

ISSUES 2 & 3. The petitioners reported rental income from [Redacted] for each of the years here in question. The petitioners subtracted from the rental income received from the corporation such expenses as insurance, interest, repairs, taxes, utilities, and depreciation. These expenses were deducted for the maintenance of an office in the home. The auditor denied the deduction for the office in the home and also removed the rental income which was also denied as a deduction for the corporation.

Research Institute of America addresses such situations in its Federal Tax Coordinator

2d, which states in pertinent part:

Rental of space in home to employer.

The rules of Code Sec. 280A(c)(1) (allowing the deduction of “home office” expenses where the home is exclusively used on a regular basis as a principal place of business, a place of business used by patients, clients or customers, or as separate structure used for trade or business purposes, see ¶ L-1301) do *not* apply to any expense attributable to a taxpayer's rental of all or part of his dwelling unit to his employer during any period in which the taxpayer uses the rented portion to perform services as an employee of the employer.¹⁸

^{18.} Code Sec. 280A(c)(6).

For purposes of this rule, an independent contractor is treated as an employee, and the party for whom the independent contractor is performing services is treated as an employer.¹⁹

^{19.} S Rept No. 99-313 (PL 99-514) p. 84.

Where such a lease arrangement exists, the only deductions that are allowable are those that would be allowable in the absence of any business use, e.g., mortgage interest, real estate taxes and casualty losses.²⁰

^{20.} S Rept No. 99-313 (PL 99-514) p. 84.

As a result of the above rules, taxpayers weren't allowed any deductions for the rental of part of their residence under the following circumstances. Taxpayers were the sole shareholders of a corporation which provided engineering and technical consulting services. Taxpayers leased 40% of the space of their personal residence to the corporation, which used the leased space as its exclusive place of business. IRS held that the taxpayers couldn't deduct any business expenses attributable to the rental of space in their residence to the corporation during any period in which they used the residence in performing services as employees of the corporation.²¹

^{21.} IRS Letter Ruling 8819009 .

Federal Tax Coordinator 2d, L-1347 (RIA 2000).

Internal Revenue Code § 280A stated, in part:

Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.

(a) General rule.

Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

* * *

(c) Exceptions for certain business or rental use; limitation on deductions for such use.

(1) Certain business use. Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis –

(A) [as] the principal place of business for any trade or business of the taxpayer.

(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or

(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

In the case of an employee, the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer.

* * *

(3) Rental use. Subsection (a) shall not apply to any item which is attributable to the rental of the dwelling unit or portion thereof (determined after the application subsection (e)).

* * *

(6) Treatment of rental to employer. Paragraphs (1) and (3) shall not apply to any item which is attributable to the rental of the dwelling unit (or any portion thereof) by the taxpayer to his employer during any period in which the taxpayer uses the dwelling unit (or portion) in performing services as an employee of the employer.

The petitioners cite Speers v. Commissioner, T. C. Memo 1994-157, as authority for their position. In that case, a husband and wife formed a wholly owned S corporation through which to operate their respective businesses. The corporation rented a residential structure in which they operated the businesses. Mr. and Mrs. Speers also lived in the same structure. The Tax

Court allowed the corporation to deduct a portion of the rent representing the portion of the structure which the Speers established was used exclusively for business.

The Speers case involved the tax years of 1987, 1988, and 1989. During those years, Internal Revenue Code § 280A(c)(6), the portion of the code at issue in this case, did not exist. For application of Internal Revenue Code § 280A(c)(6) to similar facts, see Roy v. Commissioner, T. C. Memo 1998-125. The Speers case is clearly distinguishable. What the petitioners ask, through their representative, is for the Commission to ignore this portion of the law and allow the deduction. The Commission finds that the petitioners are not entitled to the deductions sought with regard to an office in the home with the exception of expenses that would be allowable in the absence of any business use.

Charitable contributions and mortgage interest claimed by the petitioners were reduced by the auditor to those for which documentation was supplied. The Commission finds no error in these adjustments.

The petitioners submitted documentation for medical expenses paid both in 1995 and 1996. However, the amounts documented were less than those originally claimed on their returns. Therefore, this does not justify a modification.

WHEREFORE, the Notice of Deficiency Determination dated January 27, 1999, is hereby MODIFIED and, as so modified, is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER the petitioners to pay the following tax, penalty, and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1995	\$1,910	\$ 96	\$841	\$2,847
1996	2,293	115	820	<u>3,228</u>
			TOTAL DUE	<u>\$6,075</u>

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the petitioners' right to appeal this decision is enclosed with this decision.

DATED this ____ day of _____, 2001.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED] Receipt No. [Redacted]
[REDACTED][REDACTED]
[REDACTED][REDACTED][REDACTED]

ADMINISTRATIVE ASSISTANT 1