

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 13574
[Redacted])	
)	DECISION
Petitioners.)	
_____)	

On February 23, 1999, the staff of the Income Tax Audit Bureau (Bureau) issued a Notice of Deficiency Determination to [Redacted] (petitioners) proposing additional income taxes, penalty, and interest for the taxable years 1994, 1995, and 1996 in the total amount of \$4,019.

On April 24, 1999, the petitioners made a timely protest and request for redetermination. The petitioners did not request a hearing, but the petitioners and their representative corresponded with the Tax Commission and submitted additional information for consideration. The Tax Commission, having reviewed the file, hereby issues its decision.

The audit consisted of a general compliance examination that looked at the petitioners' basis in a corporation, expense accounts, and related-party transactions. The Bureau made expense account adjustments for unverified expenses, as well as miscellaneous expense adjustments, and issued the petitioners a Notice of Deficiency Determination (NODD).

The petitioners appealed the Bureau's decision, but did not raise issue with any of the audit adjustments. Rather, the petitioners sought an interest deduction pursuant to Internal Revenue Code § 163, for interest paid on investments during the years in question. The petitioners did not claim the investment interest deduction on either their original or amended returns.

The Commission sent the petitioners a hearing rights letter explaining the process of appeal and request for determination. The petitioners did not request a hearing, but the petitioners and their representative corresponded with the Commission regarding the investment interest deduction issue. The representative stated that the interest was incurred on investments in businesses and real estate and submitted a description of the itemized amounts that the petitioners invested in various businesses and for a real estate/home purchase.

IRC § 163 generally allows an investment interest deduction for interest paid or accrued within the taxable year. “Investment interest” means any interest paid or accrued on indebtedness properly allocable to property held for investment. See IRC § 163(d)(3). “Property held for investment” is any property that produces income designated as portfolio income under the passive activity loss rules, as well as any interest in an activity involving a trade or business in which the taxpayer does not materially participate, provided that activity is not passive under the passive activity loss rules. See IRC § 163(d)(5)(A); see also IRC § 469(e)(1). A home may be “property held for investment” and the interest on the mortgage deductible as investment interest if the purpose of the purchase was to acquire investment property.

Noncorporate petitioners, like the petitioners in this case, may deduct investment interest only to the extent of net investment income. “Net investment income” is the amount by which investment income exceeds investment expenses. See IRC § 163(d)(4)(A).

Although the petitioners’ representative provided a basic description of the investments on which the petitioners accrued interest, neither the representative nor the petitioners provided adequate documentation to establish that the investments and the interest accrued on them qualifies for a deduction under IRC § 163. Examples of information/documentation that may establish the interest qualifies for deduction under IRC § 163 include information about the

businesses in which the taxpayers invested (i.e. incorporation papers or partnership agreement, the taxpayers' involvement in the business, a description of any work or services the taxpayers performed for the business and the amount of time spent working or providing the services) and information about the home/real estate acquired as an investment. Despite requests for information/documentation relating to the investment interest and extensions of time, no documentation to substantiate the investment interest deduction was submitted to the Commission for consideration.

Since the petitioners did not raise issue with any of the audit adjustments and have not substantiated their claim for an investment interest deduction, the Commission upholds the NODD.

The NODD included an addition for a penalty pursuant to Idaho Code § 63-3046 for the 1994 taxable year. Section 63-3046 provides for penalties when the taxpayer is negligent, disregards the rules, or intends to evade tax. These circumstances do not exist in the present situation; therefore, the penalty is inapplicable.

The NODD also included additions for interest in accordance with Idaho Code § 63-3045. The Commission hereby upholds the additions and finds them appropriate.

WHEREFORE, the Notice of Deficiency Determination dated February 23, 1999, is hereby MODIFIED in accordance with the provisions of this decision, and as so modified, is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1994	\$1,822	\$ 0	\$ 848	\$2,670
1995	\$1,244	\$ 0	\$ 485	<u>\$1,729</u>
			TOTAL DUE:	<u>\$4,399</u>

An explanation of the petitioners' right to appeal this decision is included 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]
[REDACTED]

Receipt No.: [Redacted]

[REDACTED]
