

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 13689
[Redacted],)	
)	DECISION
Petitioners.)	
_____)	

[Redacted] (petitioners) protest the Notice of Deficiency Determination issued by the Idaho State Tax Commission (Commission) dated April 13, 1999, asserting additional income taxes, penalties, and interest totaling \$3,553, \$3,384, and \$3,169 for 1994, 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.

ADJUSTMENT 1.

An S corporation, [Redacted], was audited by the Tax Commission. This adjustment reflects the petitioners' share of the audit adjustments made to that corporation.

ADJUSTMENTS 2 & 3.

The petitioners reported rental income from [Redacted] (hereinafter, "the corporation") 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 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

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

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

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.

18. Code Sec. 280A(c)(6).

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

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

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.

Itemized deductions claimed by the petitioners were reduced by the auditor to those for which documentation was supplied. The Commission finds one error in these adjustments for which an adjustment must be made to the computations made by the auditor. For 1995, the auditor disallowed all itemized deductions except mortgage interest and real property taxes. In computing the amount of the adjustment, the auditor subtracted the deductions found to be allowable (mortgage interest and real property taxes) from the amount of itemized deductions

claimed on the petitioners' federal income tax return. On the Idaho return, the amount of the state income taxes had been subtracted from the total itemized deductions claimed on the federal income tax return. Therefore, this adjustment made by the auditor must be reduced by \$314, the amount of state income taxes included in the federal itemized deductions.

WHEREFORE, the Notice of Deficiency Determination dated April 13, 1999, is hereby MODIFIED, and as so modified, is APPROVED, AFFIRMED, AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the petitioners pay the following tax, penalty, and interest (calculated to December 31, 2001):

<u>YEAR</u>	<u>TAX</u>	<u>PENALTY</u>	<u>INTEREST</u>	<u>TOTAL</u>
1994	\$2,546	\$127	\$1,385	\$ 4,058
1995	2,559	128	1,170	3,857
1996	2,586	129	968	<u>3,683</u>
			TOTAL DUE	<u>\$11,598</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]

ADMINISTRATIVE ASSISTANT 1