

BEFORE THE ARIZONA DEPARTMENT OF REVENUE

In the Matter of)	DECISION OF
[REDACTED])	HEARING OFFICER
UTI # [REDACTED])	Case No. 200900257-I
_____)	

Pursuant to Taxpayers' request, it was ordered that the protest of [REDACTED] (Taxpayers) to an assessment of income tax and interest by the Individual Income Tax Audit Section (Section) of the Arizona Department of Revenue (Department) for tax year 2003 be resolved through the submission of written memoranda.

Taxpayers and the Section timely filed their respective memoranda. This matter is now ready for ruling.

FINDINGS OF FACT

1. Taxpayers timely filed their Arizona income tax return for tax year 2003.
2. The Section reviewed Taxpayers' 2003 income tax return for possible audit.
3. The Section issued a proposed assessment to Taxpayers reducing their exclusions for government pension and social security retirement benefits and reducing their Schedule A medical, charitable contributions and miscellaneous itemized deductions.
4. Taxpayers timely protested the assessment.
5. The Section modified the assessment based on additional information provided by Taxpayers.
6. All issues have been resolved except for the disallowance of Taxpayers' miscellaneous itemized deduction in the amount of \$[REDACTED].
7. Taxpayers' miscellaneous itemized deduction on Schedule A was limited to amounts in excess of \$[REDACTED], which is two percent of Taxpayers' federal

adjusted gross income reported on line 35 of their 2003 federal 1040 income tax return.

8. Taxpayers calculated their \$[REDACTED] miscellaneous itemized deduction by adding \$[REDACTED] of reported home office expenses and \$[REDACTED] safe deposit box charge and subtracting the two percent limitation of \$[REDACTED].
9. Taxpayers deducted \$[REDACTED] as mortgage interest on line 10 of their Schedule A.
10. The record before the Hearing Office does not have receipts or other documents showing the composition of the \$[REDACTED] claimed as home office expenses.
11. Taxpayers' Reply Memorandum states on page 2 that the amount was the mortgage interest on their home.
12. Taxpayers presented no evidence that the amount of \$[REDACTED] identified on line 20 of Taxpayers' Schedule A was for expenses other than the mortgage interest on their home.
13. Taxpayers included their home mortgage interest on both line 10 and line 20 of their Schedule A.
14. Taxpayers' Reply Memorandum states on page 2 that [REDACTED] was an employee of a corporation and his business use of his home was as an employee of a corporation.

CONCLUSIONS OF LAW

1. The presumption is that an assessment of additional income tax is correct. *Arizona State Tax Commission v. Kieckhefer*, 67 Ariz. 102, 191 P.2d 729 (1948).
2. Arizona law requires that taxpayers keep and preserve "suitable records and other books and accounts necessary to determine the tax for which the person is liable for the period prescribed in § 42-1104." Arizona Revised Statutes (A.R.S.) § 42-1105(D).

3. The burden is on the taxpayer to show he is entitled to a deduction or exemption from tax. See *Ebasco Servs., Inc. v. Ariz. State Tax Comm'n*, 105 Ariz. 94, 99, 459 P.2d 719, 724 (1969).
4. Arizona taxpayers may deduct on their Arizona income tax return itemized deductions calculated under the Internal Revenue Code. A.R.S. § 43-1042.
5. Taxpayers were entitled to deduct their home mortgage interest whether or not there was a business use of the home.
6. Taxpayers may not deduct the same item of expense twice. A.R.S. § 43-102.
7. Taxpayers were not entitled to deduct the mortgage interest on their home on line 10 of their Schedule A and again include that amount on line 20 of their Schedule A.
8. Taxpayers were required to deduct their mortgage interest on line 10 of their Schedule A.
9. A.R.S. § 42-1123(C) provides that if the tax “or any portion of the tax is not paid” when due “the department shall collect, as a part of the tax, interest on the unpaid amount” until the tax has been paid.
10. The modified proposed assessment issued by the Section for tax year 2003 disallowing Taxpayers’ miscellaneous itemized deduction was proper.

DISCUSSION

The question presented here is whether Taxpayers may deduct the mortgage interest on their home and also include that same amount in calculating miscellaneous itemized deductions. The Section did not question Taxpayers’ mortgage interest deduction on line 10 of their Schedule A. The Section however disallowed Taxpayers’ miscellaneous itemized deduction which was calculated by including the same amount that had also been deducted as mortgage interest.

Taxpayers’ stated on page 2 of their Reply Memorandum that “... to be on the safe side, Taxpayers settled for simply claiming the mortgage interest on their home without adding other expenses allowed under Federal Form 8829.” It is therefore clear that the

amount included on line 20 of Taxpayers' Schedule A as home office expenses represented Taxpayers' mortgage interest on their home.

A.R.S. § 43-1042 allows taxpayers to take the amount of itemized deductions allowable under the Internal Revenue Code. Internal Revenue Service Publication 587 addresses reporting home office expenses by employees. The publication provides on page 19:

“Deductible mortgage interest. Although you generally deduct expenses for the business use of your home on Schedule A (Form 1040), line 21, unreimbursed employee expenses, do not include any deductible home mortgage interest on that line. Instead, deduct both the business and nonbusiness parts of this interest on line 10 or 11 of Schedule A.

If the home mortgage interest you can deduct on lines 10 or 11 is limited by the home mortgage interest rules, you cannot deduct the excess as an employee business expense on Schedule A, line 21, even though you use part of your home for business.”

Taxpayers properly deducted their home mortgage interest on line 10 of their Schedule A. Taxpayers were not entitled to also include the full amount of their mortgage interest expenses as home office expenses on line 20 of their Schedule A. ¹ A.R.S. § 43-102(B) provides:

“Nothing contained in this title shall be construed to require a taxpayer to include an item of income or permit a taxpayer to deduct an expense item more than once in computing Arizona taxable income.”

By including their home mortgage interest on both line 10 and line 20 of their Schedule A, Taxpayers were deducting an expense item more than once in computing Arizona taxable income. Therefore, the Section's assessment properly disallowed Taxpayers' miscellaneous deduction.

¹ In calculating their miscellaneous deduction, Taxpayers did not allocate their mortgage interest claimed as home office expenses between business and nonbusiness uses of their home.

The proposed assessment also included interest. A.R.S. § 42-1123(C) provides that if the tax "or any portion of the tax is not paid" when due "the department shall collect, as a part of the tax, interest on the unpaid amount" until the tax has been paid. For Arizona purposes, therefore, interest is a part of the tax and generally may not be abated unless the tax to which it relates is found not to be due for whatever reason.

Based on the foregoing, the Section's modified proposed assessment disallowing Taxpayers' miscellaneous itemized deduction is affirmed.

DATED this 16th day of March, 2010.

ARIZONA DEPARTMENT OF REVENUE
HEARING OFFICE

[REDACTED]
Hearing Officer

Original of the foregoing sent by
certified mail to:

[REDACTED]

Copy of the foregoing delivered to:

Arizona Department of Revenue
Individual Income Tax Audit Section