BEFORE THE STATE BOARD OF TAX APPEALS STATE OF ARIZONA 100 North 15th Avenue - Suite 140 Phoenix, Arizona 85007 602.364.1102

EDMUND D. and KATHLEEN M. KAHN

Docket No. 1983-10-I

Appellants,

NOTICE OF DECISION FINDINGS OF FACT AND CONCLUSIONS OF LAW

V\$.

ARIZONA DEPARTMENT OF REVENUE,

A -- - II - -

Appellee.

The State Board of Tax Appeals, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

The Arizona Department of Revenue ("Department") audited the 2003 Arizona income tax return filed by Edmund D. and Kathleen M. Kahn ("Appellants") based on information received pursuant to an exchange of information agreement with the Internal Revenue Service ("IRS"). The information indicated larger than expected subtractions from income. The Department subsequently issued an assessment that was later modified based on additional information provided by Appellants. The only issue that remained in dispute was the Department's disallowance of Appellants' miscellaneous itemized deduction in the amount of \$3,161.

Appellants protested the disallowance of this deduction to the Department's Hearing Officer who denied the protest. Appellants then protested to the Director of the Department who affirmed the Hearing Officer's decision. Appellants now timely appeal to this Board.

DISCUSSION

The issue in this appeal is whether the Department properly disallowed the miscellaneous itemized deduction.

A.R.S. § 43-1042 provides that "it is the intent of the Arizona Legislature to adopt the provisions of the federal Internal Revenue Code relating to the measurement of adjusted gross income for

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individuals so that adjusted gross income reported to the IRS shall be the identical sum reported to Arizona, subject only to modifications set forth in Title 43 of the Arizona Revised Statutes." Under this statute, Arizona taxpayers generally may deduct itemized deductions calculated under the Internal Revenue Code on their Arizona income tax return. However, "Nothing contained in [Title 43] shall be construed to require a taxpayer to deduct an expense item more than once in computing Arizona taxable income." A.R.S. § 43-102.

Appellants first claimed \$5,778 in mortgage interest, as allowed, on line 10 of their federal Schedule A form. Appellants then claimed the same mortgage interest when calculating their home office business expense as a miscellaneous itemized deduction on line 20 of the form.

As clearly explained on page 19 of I.R.S Publication 587 addressing the "Business Use of Your Home,"

"Although you generally deduct expenses for the business use of your home on line 20 of Schedule A (Form 1040), 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."

Appellants argue that they could have claimed other items of expense, such as utilities, taxes, etc., under their home office deduction but chose to claim only the home mortgage interest. As previously established, Appellants are not entitled to claim their mortgage interest as a home office deduction, and they have failed to claim or substantiate any other items of expense within the four-year statute of limitations period allowed under A.R.S § 42-1106.

Accordingly, the Board finds that the Department properly disallowed the miscellaneous itemized deduction. Therefore, Appellants are liable for the tax assessed. Further, 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." Therefore, Appellants are liable for the interest assessed.

¹ The miscellaneous itemized deduction allowed on the federal Schedule A form is limited to two percent of Appellants' federal adjusted gross income reported on line 35 of their federal 1040 income tax return. Appellants calculated their deduction of \$3,161 by adding the \$5,778 of reported home office expenses (reported on line 20 of Schedule A), which Appellants concede is their home mortgage interest, and a \$25 safe deposit box charge and then subtracting the two percent limitation of \$2,642.

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CONCLUSIONS OF LAW

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1) The Department properly disallowed the miscellaneous itemized deduction; therefore,

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Appellants are liable for the tax assessed. A.R.S. § 43-102.

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2) Appellants are liable for the interest assessed. A.R.S. § 42-1123(C).

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ORDER

THEREFORE, IT IS HEREBY ORDERED that the appeal is denied, and the final order of the Department is affirmed.

This decision becomes final upon the expiration of thirty (30) days from receipt by the taxpayer, unless either the State or taxpayer brings an action in superior court as provided in A.R.S. § 42-1254.

DATED this

)4TH day of MAY

, 2011.

STATE BOARD OF TAX APPEALS

James M. Susa, Chairman

JMS:ALW CERTIFIED

Copies of the foregoing Mailed or delivered to:

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