

IN THE MAGISTRATE DIVISION
OF THE OREGON TAX COURT

Income Tax

DALE D. SCHWARTZENHAUER AND)	
CINDY A. SCHWARTZENHAUER,)	
)	No. 000180F
Plaintiffs,)	
)	
v.)	
)	
DEPARTMENT OF REVENUE,)	
STATE OF OREGON,)	
)	DECISION
Defendant.)	

Plaintiffs appealed from Notices of Refund Denials issued by defendant.

This appeal involves plaintiffs' home office deductions for tax years 1995, 1996 and 1997.

A telephone trial was held on September 19, 2000. Dale Schwartzenhauer appeared for the plaintiffs. Anna Porter, Auditor, appeared for defendant.

STATEMENT OF FACTS

Plaintiffs timely filed their 1995, 1996 and 1997 tax year returns. They later amended the returns to reduce their S-Corporation income. The S-Corporation, Gemini Management Consultants Ltd. (Gemini), acts as a consultant to mining and natural resource companies in Canada. Gemini's expertise is in financial public relations. Gemini communicates with brokers and investors on behalf of its clients.

Gemini issued amended Schedule K-1's for 1995, 1996 and 1997 to reflect rent payable. Gemini's office is located in plaintiffs' home; no actual rent payments were made from Gemini to plaintiffs. Plaintiffs own 90% of Gemini. Plaintiffs' children own the remaining ten percent. Defendant denied the refund because Gemini did not make actual

payments and plaintiffs did not claim the rental income as income on their personal returns.

See IRC § 267.

The parties agree that while Gemini may not be entitled to include the rent expense on its Schedule K-1's, plaintiffs meet the criteria for a home office deduction.

During the three years in question, plaintiffs rented homes in Estacada and Milton-Freewater. From January 1995 through September 1996, plaintiffs lived in the same home in Estacada. The first nine months in 1995 they paid rent of \$750 per month. Thereafter, they paid \$800 per month. In October 1996, plaintiffs moved to a rental home in Milton-Freewater. They paid a rent of \$675 per month. Plaintiffs submitted a copy of a utility bill for the Milton-Freewater home. That bill showed electric and water usage for the month of August 1997 in the amount of \$95. Plaintiffs argue that this is representative of the utility bills for the Milton-Freewater home. Defendant had previously allowed \$92 as an average utility bill for the Estacada home.

According to plaintiffs, the Estacada home is 2,860 square feet. Mr. Schwartzenhauer testified that he used an office and large storage area exclusively for business purposes. Plaintiffs submitted a partial copy of the home's building plan which showed the office as 230 square feet and the storage area as 670 square feet. Plaintiffs argue that because 900 square feet of the home was exclusively used for business, they should be allowed to claim 31.5% of the rent and utilities as a home office expense. This information can be contrasted to a June 4, 2000, letter from Mr. Schwartzenhauer to the defendant. In that letter Mr Schwartzenhauer stated that, "[f]rom an IRS audit in a prior year, I found that the Code allows the greater of a portion of square footage or a proportion of rooms to total rooms available. In my case, **one room** out of five makes a 20% space

allocation.” (Ptf’s Ltr of June 4, 2000, at 1) (emphasis added).

According to plaintiffs, the Milton-Freewater home is 1,200 square feet. Mr. Schwartzenhauer testified that he used an office and a small storage area exclusively for business purposes. He testified that the office is 128 square feet and the storage area is 72 square feet for a total of 200 square feet. Therefore, he argued that he should be allowed to claim 16.7% of the rent and utilities as a home office expense.

Ms. Porter, in her response to the June 4th letter, accepted a rent of \$750 per month and the utilities. She argued that it was a seven room home and she would allow a 14% allocation of the rent and utilities as a home office deduction. This would be approximately \$120 per month. (Def’s Ltr of June 13, 2000, at 1.) At the time she wrote the letter plaintiffs had not presented any substantiation of rent or utilities for the Milton-Freewater home to defendant. Consequently, she stated that she would allow \$60 per month for rent and utilities for the Milton-Freewater home. (*Id.* at 2.) At trial, she argued that because of the type of business use plaintiffs made of their home, they would not need such a large storage area as they claimed for the Estacada home.

COURT'S ANALYSIS

Gemini is a consulting business. According to Mr. Schwartzenhauer, Gemini went from using a storage area of 670 square feet in Estacada to using only 72 square feet of storage in Milton-Freewater. The court fails to understand how a consulting business such as Gemini would need a 670 square foot storage area. Mr. Schwartzenhauer testified that when plaintiffs moved from Estacada to Milton-Freewater they got rid of many things that had been in the storage area. What is even more confusing to the court is why Mr. Schwartzenhauer in his letter of June 4, 2000, stated that plaintiffs

exclusively used only one room for business when he claimed at trial that two rooms were exclusively used for business.

In light of plaintiffs' failure to explain the inconsistency between the June 4, 2000, letter and Mr. Schwartzenhauer's testimony at trial, the court accepts defendant's calculation that one room out of seven or 14.3% of the Estacada home was exclusively used for business. Further, the court finds that plaintiffs' claimed rent and utility expenses for their Estacada home are reasonable and appropriate.

The court finds that plaintiffs' claimed rent and utility expenses for their Milton-Freewater home are reasonable and appropriate. Further, the court accepts plaintiffs' calculation that 200 square feet out of 1,200 square feet or 16.7% of the Milton-Freewater home was exclusively used for business.

CONCLUSION

IT IS THE DECISION OF THIS COURT that plaintiffs shall be allowed a home office deduction of \$1,466¹ for tax year 1995.

IT IS THE FURTHER DECISION OF THIS COURT that plaintiffs shall be allowed a home office deduction of \$1,534² for tax year 1996.

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IT IS THE FURTHER DECISION OF THIS COURT that plaintiffs shall be

¹ This 1995 deduction was calculated using the following formula:
 $[(750+92)*9\text{mo}] + [(800+92)*3\text{mo}] * 14.3\% = \$1,466.$

² This 1996 deduction was calculated using the following formula:
 $(800+92)*9\text{mo} * 14.3\% + (675+95)*3\text{mo} * 16.7\% = \$1,534.$

allowed a home office deduction of \$1,543³ for tax year 1997.

Dated this _____ day of November, 2000.

SALLY L. KIMSEY
MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, FOURTH FLOOR, 1241 STATE ST., SALEM, OR 97310. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE SALLY L. KIMSEY ON NOVEMBER 6, 2000. THE COURT FILED THIS DOCUMENT ON NOVEMBER 6, 2000.

³ This 1997 deduction was calculated using the following formula:
 $(675+95)*12\text{mo}*16.7\%=\$1,543.$