

STATE OF ALABAMA
DEPARTMENT OF REVENUE,

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STATE OF ALABAMA
DEPARTMENT OF REVENUE
ADMINISTRATIVE LAW DIVISION

§

v.

§

DOCKET NO. INC. 86-249

CHARLES F. & JENNIFER C. MINCH§
225 Mt. Vernon Drive
Montgomery, AL 36105,

§

Taxpayers.

§

ORDER

This matter involves two preliminary assessments of income tax entered against Charles F. and Jennifer C. Minch ("Taxpayers") for the years 1983 and 1984. A hearing was held on March 31, 1987. The Hon. J. Knox Argo represented the Taxpayers. Assistant counsel Mark Griffin appeared on behalf of the Department. Based on the evidence submitted by the parties, the following findings of fact and conclusions of law are hereby made and entered.

FINDINGS OF FACT

The Taxpayer, Mr. Minch, and his daughter and son-in-law ("Smiths") entered into a "shared equity financing agreement" on June 29, 1983 relative to the Smiths' personal residence in Brandon, Mississippi. The agreement was entered into with the purpose of complying with the provisions of 26 U.S.C.A. 280A. The Taxpayer had invested approximately \$100,000.00 in the house, while the Smiths had invested \$110,000.00 in cash plus a mortgage for approximately \$90,000.00. The deed to the property was in the name of the Smiths only.

The agreement provided in pertinent part that the parties

would have an undivided ownership interest in the property, one-third to the Taxpayer and the remaining two-thirds to the Smiths.

The Smiths were to use the property as their principal residence and pay the Taxpayer \$5,000.00 annually as a fair rental for the use of his one-third interest. The agreement was open-ended, but could be terminated by the mutual agreement of all parties.

On their 1983 and 1984 joint Alabama income tax returns, the Taxpayers claimed a depreciation deduction relative to the residence. The Department audited the returns and disallowed the depreciation deductions. Several other adjustments made by the Department were not contested by the Taxpayers. The Taxpayers did not report any rental income relative to the property in question on either return.

CONCLUSIONS OF LAW

Code of Ala. 1975, §40-18-15(a)(8) provides "a reasonable allowance" for depreciation of property. No statutory guidelines are set out in the Alabama Code as to how the depreciation deduction should be computed. However, Reg. 810-3-15-.05 provides that the deduction should be limited to property used in a trade or business, and that applicable federal authority, rules and regulations should be followed.

26 U.S.C.A. §280A(d)(3) governs the rental of property to family members for their use as a personal residence. Subsection (d)(3)(A) provides that a dwelling unit is not used for personal

purposes if it is rented, at a fair rental, for use as a personal residence. Subsection (d)(3)(B) governs dwelling units rented to persons with an interest in the unit and provides that Subsection (d)(3)(A) should apply only if the rental is pursuant to a shared equity financing agreement.

Subsection (d)(3)(C) defines "shared equity financing agreement" to mean an agreement under which (1) two or more persons acquire a qualified ownership interest in the unit, and (2) the person holding such interest is entitled to use the unit as a residence and is required to pay rent to one or more other persons also with a qualified ownership interest in the unit. Subsection (d)(3)(D) provides that a "qualified ownership interest" is an undivided interest "for more than fifty years" in the subject property.

The Department argues that §280A should not apply because (1) the Taxpayer is not listed on the deed and thus does not have a qualified ownership interest in the property, (2) that the Taxpayer was not paid and/or did not report the \$5,000.00 in rental as required by the agreement, and (3) the agreement did not give the Taxpayer an interest for more than fifty years in the property.

As stated, a "qualified ownership interest" is defined at Subsection (d)(3)(D) as an undivided interest of more than fifty years duration. It is not necessary under the statute that the person claiming such interest must be on the deed to the subject

property. An undivided interest created by the shared equity agreement itself, as in the present case, is sufficient. Further, the agreement in issue is not limited by its terms to a period less than fifty years, and thus grants the Taxpayer a continuing interest which, unless altered, would exist for more than fifty years, as required by Subsection (d)(3)(D).

The Department does not dispute that the \$5,000.00 yearly rental as set out in the agreement was a fair rental. The Department does argue that no depreciation should be allowed because no rental income was reported by the Taxpayers on their 1983 and 1984 returns.

There is no evidence indicating whether the \$5,000.00 yearly rental was ever paid. However, the Taxpayers concede that such rental income should have been properly reported on their returns.

Accordingly, in that the agreement set out a fair rental, as required by §280A, the Taxpayers' failure to report the rental income should not defeat the application of that section. Rather, the Taxpayers' returns should be adjusted to include the income in question.

Based on the above, the Taxpayers have substantially complied with the requirements of §280A, and thus should be allowed a depreciation deduction concerning the property in question. However, the Taxpayers' liability must also be adjusted upward to reflect the rental income set out in said agreement. Finally, such

deduction and income should be prorated for 1983 from the effective date of the shared equity agreement, June 29, 1983.

The Income Tax Division is hereby directed to adjust the assessments in issue as set out herein, and to thereafter make the assessments final, with applicable interest as required by statute.

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Done this 17th day of August, 1987.

BILL THOMPSON
Chief Administrative Law Judge