Induni v. Commissioner, 98 T. C. 618 (1992)

Mortgage interest and real property taxes are not deductible to the extent they are indirectly allocable to a tax-exempt living quarters allowance, unless the taxpayer falls within a statutory exception.

Summary

Induni v. Commissioner addressed whether taxpayers could deduct mortgage interest and real property taxes on their Canadian home while receiving a tax-exempt living quarters allowance (LQA) from the U. S. Immigration and Naturalization Service. The Tax Court held that these deductions were indirectly allocable to the LQA and thus not deductible under IRC section 265(a)(1), as the taxpayers did not fall within the statutory exceptions for military personnel or ministers. The court's reasoning focused on preventing a double tax benefit and the specific legislative history of section 265(a)(6). This decision has practical implications for how deductions are calculated for government employees receiving similar tax-exempt allowances.

Facts

Noel D. Induni, employed by the U. S. Immigration and Naturalization Service, worked at Dorval Airport in Montreal, Canada, from 1986 to part of 1988. During this period, he and his wife Janet purchased a home in Beaconsfield, Canada, and received a tax-exempt living quarters allowance (LQA) under 5 U. S. C. section 5923(2). The LQAs for 1986, 1987, and 1988 were $9,389. 10, $9,481. 50, and $1,881. 60 respectively. They claimed mortgage interest and real estate tax deductions on their U. S. tax returns without reducing these by the LQA amounts. The IRS disallowed portions of these deductions, arguing they were indirectly allocable to the tax-exempt income.

Procedural History

The Commissioner issued a notice of deficiency for 1986, 1987, and 1988, disallowing portions of the Indunis' mortgage interest and real estate tax deductions and imposing an addition to tax for negligence in 1988. The case was heard by the U. S. Tax Court, where it was assigned to Special Trial Judge Francis J. Cantrel. The Tax Court adopted the Special Trial Judge's opinion, affirming the Commissioner's determinations.

Issue(s)

1. Whether a portion of petitioners' mortgage interest and real property tax deductions relating to their principal residence is allocable to a tax-exempt LQA they received and therefore disallowed under IRC section 265.
2. Whether petitioners are liable for the IRC section 6653(a)(1) addition to tax for negligence.

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because petitioners' mortgage interest and real property tax deductions were indirectly allocable to their tax-exempt LQA, and they did not fall within the statutory exceptions provided by IRC section 265(a)(6) for military personnel or ministers.
2. Yes, because petitioners failed to present evidence to rebut the Commissioner's determination of negligence under IRC section 6653(a)(1).

Court's Reasoning

The Tax Court applied IRC section 265(a)(1), which disallows deductions allocable to tax-exempt income, to the Indunis' case. The court reasoned that the LQA, meant to cover housing costs, indirectly covered the mortgage interest and real property taxes, which constituted a significant portion of the Indunis' housing expenses. The court rejected the Indunis' argument that their deductions were not allocable to the LQA, emphasizing the legislative intent to prevent a double tax benefit as seen in the history of IRC section 265(a)(6), which carved out exceptions for military personnel and ministers. The court also noted that the Indunis failed to provide evidence to contradict the Commissioner's allocation method or to rebut the negligence determination for the addition to tax.

Practical Implications

This decision clarifies that civilian government employees receiving tax-exempt housing allowances must allocate a portion of their mortgage interest and property tax deductions to the tax-exempt income, unless they fall within the statutory exceptions. Legal practitioners should advise clients in similar situations to calculate their deductions carefully to avoid disallowance. The ruling may affect how government agencies structure housing allowances and how taxpayers plan their housing expenses. Subsequent cases involving similar allowances should consider this precedent, though it may be distinguished where taxpayers can prove they fall within the statutory exceptions.

© 2025 SCOTUSreports.com. All rights reserved.