

# Arizona Department of Revenue

## ARIZONA INDIVIDUAL INCOME TAX RULING

### ITR 93-9

This substantive policy statement is advisory only. A substantive policy statement does not include internal procedural documents that only affect the internal procedures of the agency and does not impose additional requirements or penalties on regulated parties or include confidential information or rules made in accordance with the Arizona administrative procedure act. If you believe that this substantive policy statement does impose additional requirements or penalties on regulated parties you may petition the agency under Arizona Revised Statutes § 41-1033 for a review of the statement.

#### **ISSUE:**

Are employment related legal expenses incurred in relation to a job suspension deductible as an itemized deduction on an individual's Arizona income tax return?

#### **APPLICABLE LAW:**

Arizona Revised Statutes (A.R.S.) § 43-961 provides, in part, that no deductions shall be allowed for personal expenses.

A.R.S. § 43-1042 provides an itemized deduction for individual taxpayers in the amount allowable for the taxable year under the Internal Revenue Code (I.R.C.).

Former A.R.S. § 43-1055 provided for a deduction of all the ordinary and necessary expenses paid or incurred during the taxable year which are permitted by I.R.C. § 162.

Former A.R.S. § 43-1054 provided a deduction for ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.

I.R.C. § 162(a) provides for the deduction of all the ordinary and necessary expenses incurred during the taxable year in carrying on any trade or business.

I.R.C. § 212(1) provides for the deduction of ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income.

Caruso et al. v. United States, 236 F. Supp. 88 (1964), held that the general test for determining whether an expense is deductible as an ordinary and necessary expense paid or incurred in carrying on any trade or business is whether the acts done and expenditures made were motivated by the purpose of protecting or promoting the taxpayer's business or for the production of income.

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## **DISCUSSION:**

For federal income tax purposes, legal expenses which are ordinary and necessary and that are incurred for business purposes or for the production of income are allowable deductions under either I.R.C. § 162 or I.R.C. § 212. For the purpose of "trade or business" expenses, services performed by an employee for an employer constitute a "trade or business."

For Arizona income tax purposes, former A.R.S. § 43-1054 provided a deduction for ordinary and necessary expenses paid or incurred during the taxable year for the production or collection of income. In addition, former A.R.S. § 43-1055 provided for a deduction of all the ordinary and necessary expenses paid or incurred during the taxable year which were permitted by I.R.C. § 162. Current A.R.S. § 43-1042 provides an itemized deduction for individual taxpayers in the amount allowable for the taxable year under the Internal Revenue Code. Therefore, ordinary and necessary legal expenses which are incurred for business purposes or for the production of income are deductible as an itemized deduction on an individual's Arizona income tax return.

The question of whether legal expenses are ordinary and necessary and incurred for business purposes or for the production of income cannot be answered by a general rule, but depends largely on the circumstances of each case. Generally, no one single factor is controlling, but all relevant facts must be considered in determining the deductibility of legal expenses. The general test for determining whether an expense is deductible as an ordinary and necessary expense paid or incurred in carrying on any trade or business is whether the acts done and expenditures made were motivated by the purpose to protect or promote the taxpayer's business or for the production of income. The factors which must be considered when making this determination are:

1. The nature of and objectives of the suit in which the expenditures were made.
2. The defenses asserted.
3. The purpose for which the claimed deductions were expended.
4. The background of the litigation.
5. All facts pertaining to the entire controversy out of which the dispute arose.

## **RULING:**

Employment related legal expenses incurred in relation to a job suspension are deductible as an itemized deduction on an individual's Arizona income tax return if the

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expenditures are ordinary and necessary and are motivated by the purpose of protecting or promoting the taxpayer's trade or business or for the production of income. Expenses for legal representation may be deductible regardless of whether the employee was successful or unsuccessful in retaining employment.

Harold Scott, Director

Signed: May 24, 1993

### Explanatory Notice

The purpose of a tax ruling is to provide interpretive guidance to the general public and to department personnel. A tax ruling is intended to encompass issues of law which are not adequately covered in statute, case law or administrative rules. A tax ruling is a position statement which provides interpretation, details or supplementary information concerning the application of the law. **Relevant statute, case law, or administrative rules, as well as a subsequent ruling, may modify or negate any or all of the provisions of any tax ruling.** See GTP 92-1 for more detailed information regarding documents issued by the Department of Revenue.