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The Honorable Randy "Duke" Cunningham  
U.S. House of Representatives  
Washington, D.C. 20515

Attention: Dusty Strawn

Dear Mr. Cunningham:

I am responding to your inquiry dated March 1, 2004, on behalf of your constituent, [REDACTED]. [REDACTED] said he purchased a boat that he intends to use as his principal residence and paid local sales tax of \$ [REDACTED]. He questions whether the non-deductibility of these sales taxes for federal income tax purposes results in double taxation. I am pleased to provide the following information about the deductibility of sales taxes paid to states and localities.

Generally, a purchaser of a houseboat for use as a principal residence enjoys the same federal income tax benefits as a purchaser of any other form of residence. The purchaser can deduct the interest paid on acquisition indebtedness secured by the houseboat [Section 163(h) of the Internal Revenue Code (the Code)], and may be able to exclude gain on a sale of the houseboat from income [Section 121 of the Code and section 1.121-1(b)(1) of the Income Tax Regulations].

However, many states impose their general retail sales tax on the acquisition of the houseboat, treating it as a purchase of personal property. The purchaser cannot deduct this expense [Section 164 of the Code]. The law allows a deduction for certain taxes, such as state and local real or personal property taxes, in determining a taxpayer's federal income tax liability [Section 164 of the Code]. We can only allow those deductions the Congress has provided through legislation. [*New Colonial Ice Co. v. Helvering*, 292 U.S. 435 (1934)].

The Tax Reform Act of 1986 removed general sales taxes imposed by state and local governments from the list of deductible taxes [See also section 164(a)(1) through (5) of the Code]. Sales taxes paid in connection with the carrying on of a trade or business or an investment activity are treated as part of the cost of the property, and the purchaser can recover them through depreciation or upon disposition of the property [Section 164(a)]. However, the Code does not permit the recovery of sales taxes paid in

connection with the acquisition of a personal asset, such as a houseboat acquired for use as a principal residence.

Taxpayers are subject to the taxing jurisdiction of both the federal government, and the state where they reside or conduct business. The federal government taxes income when realized [*Eisner v. Macomber*, 252 U.S. 189 (1920)]. A state government imposes retail sales tax when the consumption of goods and services occurs. The Congress permits the deduction of certain state and local taxes, but not general sales taxes. Congress believed that the deduction for general sales taxes favored some consumption patterns over others and was inconsistent with the general principle that personal consumption is not deductible [General Explanation of the Tax Reform Act of 1986, pg. 47].

Another principle of federal income tax policy is to avoid the double taxation of income. Therefore an individual can deduct certain state and local and foreign taxes, and may receive a credit for foreign income taxes [See sections 164 and 901 of the Code]. This principle generally does not extend to state, local, or foreign consumption taxes. That an individual cannot deduct general sales taxes for federal income tax purposes does not result in the double taxation of income. Admittedly, the law may tax the same amounts when earned under an income tax, and when consumed under a sales tax, but it does not tax the income twice. Finally, the policy of avoiding double taxation is not an absolute prohibition, and rarely is the effect of double taxation completely eliminated whenever taxpayers are subject to more than one tax.

I hope this information is helpful. Please call me or [REDACTED], Identification Number [REDACTED], at [REDACTED], if you have any questions.

Sincerely,

Robert M. Brown  
Associate Chief Counsel  
(Income Tax & Accounting)