

Respondent determined a deficiency in and a penalty on petitioners' 1990 Federal income tax as follows:

Year	Deficiency	Penalty Sec. 6662(a)
1990	\$438,692	\$61,040

On November 7, 1994, the Paus filed a petition with this Court. An answer was filed on December 20, 1994, in which respondent asserted further adjustments to petitioners' 1990 joint return, including: (1) An increase of \$195,101 in the deficiency in income tax set forth in the original notice; and (2) an addition to tax of \$373,731 under the civil fraud penalty of section 6663 or, alternatively, an increased penalty pursuant to section 6662(a) of \$99,662.

After concessions, two issues remain regarding petitioners' income tax liability for 1990: (1) Whether petitioners are liable for the penalty pursuant to section 6663 for failure to report \$990,000 of income with the intent of evading the payment of Federal income tax. We hold they are. (2) Whether section 163(h)(3) limits petitioners' Schedule A deduction for home mortgage interest to interest paid on acquisition debt of \$1 million. We hold it does.

FINDINGS OF FACT

The parties have stipulated to some of the facts and the Court has so found. The stipulation of facts and accompanying exhibits are incorporated herein. Peter S. Pau (petitioner) and Susanna H. Pau (Susanna) were married and resided in Hillsborough, California, at the time they filed their petition in this case.

II. The Mortgage Interest Deduction

Until 1989, petitioners owned a condominium in San Mateo, California, that they used as their primary residence. In 1989, after their move, petitioners reclassified the condominium as rental property. In that year, petitioners also purchased a home in Hillsborough, California, for use as their primary residence and they have since lived there at all times. The purchase price of the residence was \$1,780,000. Petitioners have a mortgage on the Hillsborough residence, the original principal amount of which was \$1,330,000.

In 1990, petitioners claimed a home mortgage interest deduction on Schedule A of \$107,226. Despite having actually paid a greater amount of mortgage interest, petitioners limited their deduction to interest on \$1.1 million indebtedness based on advice from an accountant. In her notice of deficiency, respondent completely disallowed petitioners' Schedule A deduction for home mortgage interest.

As a result of the October 31, 1995, meeting with petitioner, Clement allowed the Paus a home mortgage interest deduction, but he limited the allowable deduction to the interest on \$1 million indebtedness. Consequently, he calculated that the allowable deduction is \$99,040 rather than the \$107,226 claimed by petitioners, a difference of \$8,186. Clement also increased the Schedule A deduction for personal interest by \$819, from \$4,210 to \$5,029.

OPINION

As a general rule, the Commissioner's determinations are presumed correct, and taxpayers bear the burden of proving that those determinations are erroneous. Accordingly, with respect to deficiencies flowing from the home mortgage interest deduction and the \$840,000 omission, petitioners have the burden of proof. Rule 142(a); *Welch v. Helvering*, 290 U.S. 111 (1933).

Since the \$150,000 omission was asserted by respondent after the notice of deficiency was mailed, it is new matter on which respondent bears the burden. Rule 142(a). Respondent also bears the burden of proving, by clear and convincing evidence, that petitioners are liable for the civil fraud penalty. Sec. 7454(a); Rule 142(b).

Issue 2. Section 163(h)(3) Restriction on Home Mortgage Interest Deduction

Section 163(a) states the general rule for deductions for interest paid or incurred on indebtedness within the taxable year. Other provisions of section 163 limit such deductions. Section 163(h) disallows personal interest deductions unless they fit within certain narrowly prescribed categories. Among these narrow exceptions is the deduction for interest on a qualified residence. Sec. 163(h)(2)(D). The parties agree that the interest paid on the mortgage for petitioners' home was qualified residence interest, because the Paus paid it on acquisition indebtedness pursuant to section 163(h)(3)(A)(i) and (B)(i). The parties dispute only the amount of acquisition indebtedness petitioners may use in computing their deduction.

Section 163(h) restricts home mortgage interest deductions to interest paid on \$1 million of acquisition indebtedness for debt incurred after October 13, 1987. Acquisition indebtedness is defined as that which is “incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer, and *** is secured by such residence.” Sec. 163(h)(3)(B). A taxpayer may be entitled to a greater deduction if he has incurred home equity indebtedness up to \$100,000, as allowed by section 163(h)(3)(C)(ii). There can be no additional deduction where taxpayers fail to show that they had home equity indebtedness. See Notice 88-74, 1988- 2 C.B. 385. Home equity indebtedness is defined as “any indebtedness (*other than acquisition indebtedness*) secured by a qualified residence”. Sec. 163(h)(3)(C) (emphasis added).

Petitioners, who purchased their home in 1989, did not demonstrate that any of their debt was not incurred in acquiring, constructing or substantially improving their residence and thus have failed to carry their burden of proof. We therefore sustain respondent's determination as to the amount petitioners may properly deduct for home mortgage interest.

To reflect the foregoing and issues previously resolved,

Decision will be entered under Rule 155.