Winter 1978

Home Office Deductions under the New Section 280A of the Internal Revenue Code

Edward J. de Guardiola

Follow this and additional works at: http://ir.law.fsu.edu/lr

Part of the Taxation-Federal Commons, and the Tax Law Commons

Recommended Citation
http://ir.law.fsu.edu/lr/vol6/iss1/4

This Article is brought to you for free and open access by Scholarship Repository. It has been accepted for inclusion in Florida State University Law Review by an authorized editor of Scholarship Repository. For more information, please contact bkaplan@law.fsu.edu.
The deductions attributable to expenses incurred for partial business use or income producing use of a taxpayer's personal residence have been the subject of substantial litigation over the past decade. The causes of this controversy are several and can be traced back to the early 1960's. Since that time, taxpayers seeking to utilize these deductions have found themselves in the middle of a struggle between the Internal Revenue Service and the courts as each developed conflicting tests to determine the boundaries of the home office deduction.

As a result of the confusion and controversy, the need arose for definitive rules to resolve the conflict. Congress, although silent and inactive on this issue in the past, was clearly the best suited for final arbitration. In late 1976 it responded by promulgating the new section 280A of the Internal Revenue Code. This section carves out the general rule that no deduction will be allowed for expenses arising from business use of a dwelling in which the individual taxpayer resides. The section then sets out limited exceptions. The Code now prescribes a formula which limits the maximum deduction allowable, and establishes an additional requirement for the employee who seeks a home office deduction. The new section also permits a deduction under certain circumstances when a portion of the taxpayer's residence is used as storage for his trade inventory. Other provisions in section 280A limit deductible expenses from rental of vacation homes; they will not be discussed in this note.

This note will explore the requirements and ramifications of section 280A which directly relate to the home office deduction. It will also discuss how the new section resolves the prevalent areas of dispute between the Tax Court and the Internal Revenue Service. However, for a full understanding of the problems involved in the home office area, some historical grounding is necessary.

2. I.R.C. § 280A (a).
3. Id. § 280A (c) (1).
4. Id. § 280A (c) (5).
5. Id. § 280A (c) (1).
6. Id. § 280A (c) (2).
7. Id. § 280A (d)-(g).
BACKGROUND

The deductibility of a home office expense prior to the passage of section 280A was governed by several provisions in the Internal Revenue Code. A deduction was allowed for all the "ordinary and necessary" expenses paid or incurred in carrying on a trade or business. In addition, a depreciation deduction was allowed for property used in a trade or business. A taxpayer unable to meet the section 162 criteria could qualify for a deduction under section 212 if the expense was incurred for the production of income.

The primary restrictions on the above provisions were sections 262 and 263 which rendered all personal and capital expenses nondeductible unless specifically allowed in the Code. Accordingly, the ultimate question in each case became whether the use of a portion of one's home for work was a trade or business use, a profit-seeking use, or a nondeductible personal use.

SECTION 162 DEDUCTIONS

The key to section 162 deductions turns on the interpretation of the phrase "ordinary and necessary." In 1933 the Supreme Court in *Welch v. Helvering* construed the words "necessary" as imposing only the minimal requirement that the expenditure be "appropriate and helpful" for the development of the taxpayer's business, and

8. I.R.C. § 162. The relevant portions of section 162 provide:
   (a) In General—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—
      (1) a reasonable allowance for salaries or other compensation for personal services actually rendered;
      (2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and
      (3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.


10. Section 212 provides:
    In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—
    (1) for the production or collection of income;
    (2) for the management, conservation, or maintenance of property held for the production of income; or
    (3) in connection with the determination, collection, or refund of any tax.

11. I.R.C. §§ 262, 263. See also Treas. Reg. § 1.262-1(b)(3) (1959), which treats all expenses of maintaining a household as non-deductible unless the taxpayer "uses part of the house as his place of business."

12. 290 U.S. 111 (1933).
"ordinary" to mean that the expense be noncapital and consistent with normal business practices. "Ordinary" was later redefined by the Court in Commissioner v. Tellier, to require that the expense be merely noncapital. Thus, after Tellier, the test for a section 162 deduction was whether a noncapital expense was "appropriate and helpful" to the taxpayer's business. One who sought a deduction for home office expenses would have to demonstrate that the office at home was an ordinary and necessary business expense within the meaning of section 162.

Unfortunately, the Internal Revenue Service began to implement guidelines governing home office expenses which were inconsistent with the developing judicial attitude. The conflicting approaches of the judiciary and the Service regarding home office deductions precipitated the substantial litigation of the 1960's. One of the early confrontations was Harold H. Davis. In Davis a college professor built a study over his garage to do research. The Tax Court held that Davis was not entitled to a deduction for depreciation and the expenses of maintaining an office at his residence. The decision rested on the fact that the room was for the taxpayer's personal convenience and that he was not required by the college to maintain a home office.

The test articulated by the Tax Court in Davis was soon restated by the Service. Revenue Ruling 62-180 took a tough stand on employee home offices, stating:

The burden of proof rests upon the taxpayer to establish (1) that, as a condition of his employment, he is required to provide his own space and facilities for performance of some of his duties, (2) that he regularly uses a part of his personal residence for that purpose,

14. Id. at 689-90. In Tellier the Court allowed as a business deduction the expenses incurred by the taxpayer in the unsuccessful legal defense of a criminal action. Its rationale is expressed in the following:

The principal function of the term "ordinary" in § 162(a) is to clarify the distinction, often difficult, between those expenses that are currently deductible and those that are in the nature of capital expenditures, which, if deductible at all, must be amortized over the useful life of the asset.

Id.
15. 38 T.C. 175 (1962).
16. Id. at 179-80. The decision in Davis evoked a strong dissent from Judge Raum, in which three other judges concurred. Stressing that the statute was misconstrued by the majority, Raum alternatively proposed that the proper test was not whether the home office was required by the employer but whether it was appropriate, helpful, and proximately related to the taxpayer's business. Id. at 186-87. The Service, perhaps concerned with Raum's clairvoyant dissent, mysteriously vacated the appeal before a decision was handed down. [1964] 6 Fed. Taxes (P-H) ¶ 56, 343.
(3) the portion of his personal residence which is so used, (4) the extent of such use, and (5) the pro rata portion of the depreciation and expenses for maintaining his residence which is properly attributable to such use.

The deductible expenses of an employee, whose conditions of employment are such that he regularly uses a part of his residence in the performance of his duties as an employee, include a pro rata portion of such items as rent, light, taxes, and interest on a mortgage. No portion of purely personal expenses attributable to family household purposes are deductible.17

Revenue Ruling 62-180 was significant in two respects. First, the taxpayer was forced to demonstrate that as a condition of his employment he was required to maintain a home office. This strict requirement effectively excluded a significant number of employees who failed to show that they were required to do work outside of their business office because of their position or employment agreement. Second, the Ruling provided for the deduction of an allocable portion of the ordinary and necessary expenses. This portion was computed by multiplying two separate fractions: first, the ratio of the room(s) used to total rooms (a percentage usually determined in terms of total square feet); and second, where a portion of the residence was used for business purposes only part of the time, a further allocation was made—the ratio of the time the area was actually used for business purposes to the total time it was available for all uses.18 Whatever its motivation for issuing Revenue Ruling 62-180, the Service had in effect conceded that a taxpayer could obtain a deduction for maintaining a home office. Remaining to be resolved were the enforceability of the condition of employment requirement and the proper method of allocating the allowable deduction.

**The Newi Decision and Its Progeny**

In 1969 the Tax Court was once again faced with a taxpayer who used part of his residence as an office even though adequate working

18. Id. at 54, 56-57. The effect of the formula was substantially to decrease a taxpayer's deduction. For example, assume an employee maintained a home office and used it on the average of three hours per day. If the room used for the office equaled one-sixth of the total square footage of the home, then only $3/24 \times 1/6 = 1/48$ of the deductible expenses would be allowed. The arithmetic result for a taxpayer with rent and utility bills of $480 per month would be a deduction of $10 per month.
facilities were provided by the employer. George Newi was employed by the American Broadcasting Company to sell advertising time on television. He used a study in his home three or four hours each night to review the day's selling activities, to conduct research, to plan the next day's work, and to view television advertisements. The taxpayer's office at work was available to him at night, and TV equipment was also readily available. The Tax Court allowed a deduction and, in so doing, boldly pronounced a new standard for determining whether home office expenses were ordinary and necessary under section 162.

The Service had vigorously argued that the expenses were not ordinary and necessary within the meaning of section 162 because the employee was not required to provide office space and the American Broadcasting Company had readily available space. The Tax Court disagreed with the Commissioner's interpretation of "ordinary and necessary" and held that the word "necessary" imposed only the minimal requirement that the expenditure be "appropriate and helpful" to the taxpayer's business. Moreover, the court stated that it was unaware of any legal requirement that the expenditure be "required" before becoming an allowable business deduction.

The Commissioner appealed the Tax Court's construction of the phrase "ordinary and necessary" to the Second Circuit. He argued that the "appropriate and helpful" test "would open the doors for a business deduction to any employee who would voluntarily choose to engage in an activity at home which conceivably could be helpful to his employer's business." Unpersuaded by this argument, the court replied:

The Commissioner need have no such concern. This case opens the doors just long enough to enable this taxpayer to pass through it into his cloistered study to pursue his business. It is his business to sell television programs in a competitive market. To do this he must endeavor to secure the maximum amount of television infor-

20. Id. at 737.
21. Id. at 740.
23. Id., citing Commissioner v. Pacific Mills, 207 F.2d 177, 180 (1st Cir. 1953), aff'g 17 T.C. 705 (1951); Waring Products Corp., 27 T.C. 921, 929 (1957).
25. Id. at 1000.
mation available. It would be hard to imagine a better method than, in the isolation of his study-den, to view, ponder over and make notes relating to television programs.28

Of particular interest and importance in the court's opinion is the weight given to the convenience factor. The court said it would have been impractical for the taxpayer to travel back to his office from his residence. It reasoned that the difficulty in traveling in New York City at the theatre hour would have wasted valuable time and caused Newi to miss many of the programs which would have been of importance to him.27

Newi's liberalization of the home office deduction increased the field of employee deductions. Treating the benefit to the employer and the adequacy of available office space tests as irrelevant, the court clearly initiated a major shift in the interpretation of federal tax laws by focusing on the employee's business needs rather than those of the employer.28 Consider though, the ramifications of Newi for the Internal Revenue Service.

As mentioned previously, the Service's concern with potential taxpayer abuse in the area of home office deduction was likely an important consideration prior to the issuance of Revenue Ruling 62-180. The condition of employment requirement gave the Service solid ground to stand upon in determining the legality of the deductions. After Newi, however, the Service was faced with the difficult task of disallowing deductions for expenses incurred by an employee in the privacy of his home. Once an employee testified that the office was used for business purposes, then the heavy burden of proving that the office was not "appropriate and helpful" to the employer would shift to the Service. Thus Newi left only one of the three requirements of Revenue Ruling 62-180 to be met. A taxpayer merely had to demonstrate that he used his residence "regularly" to perform his duties as an employee.

In Stephen A. Bodzin,29 the Tax Court seemed to further expand the permissible limits of the home office deduction. The taxpayer, an Internal Revenue Service attorney employed in the Interpretative Division, used a portion of his residence to complete assigned work and "to read widely about current developments in the tax

26. Id.
27. Id.
28. This attitude was reflected in Marvin L. Dietrich, 40 T.C.M. (P-H) 715 (1971), aff'd, 503 F.2d 1379 (8th Cir. 1974), wherein the court stated that there is no reason "for imposing a stricter standard upon taxpayers whose trade or business is that of an employee." Id. at 717.
Although "not required, requested, expected, or encouraged to work after normal working hours," the attorney frequently took work home with him to "meet deadlines, self-imposed or otherwise, and to insure that work was performed to the best of his abilities." Despite the fact that the taxpayer's office at work was available to him at all times, the Tax Court held that maintenance of the home office was "appropriate and helpful" to the taxpayer's conduct of business and thus deductible under section 162. In so doing, the court rejected the Service's attempt to reinterpret Revenue Ruling 62-180. The Commissioner argued that "the examples set forth in Rev[enue] Rul[ing] 62-180 . . . made it clear that the term 'required as a condition of employment' means required in order to properly perform the employment duties." The court criticized this construction of the word "required," stating that it was too limiting and overly strict, and instead held:

The applicable test for judging the deductibility of home office expenses is whether, like any other business expense, the maintenance of an office in the home is appropriate and helpful under all the circumstances. . . . That the maintenance of the home office can be characterized as "a matter of convenience" due to the existence of duplicate employer-provided facilities does not void the conclusion that the expenditure is appropriate and helpful.

Three dissenting opinions were voiced in Bodzin which implied that home office deductions should not be allowed the liberal treatment given by the majority. Judge Scott disagreed with the majority, stating that he did not believe that the intent of section 162 was to transform the personal expenses of maintaining a home into a business expense merely because the taxpayer was sufficiently interested in his work to bring it home with him. This, he implied, would give an individual too much freedom to change a personal expense into a business expense. Judges Featherston and Quealy would deny a deduction if it was shown that the taxpayer would have rented the same apartment regardless of an intent to use a portion of it as an office.
The nominal deduction allowed in *Bodzin* did not preclude the Commissioner from seeking appellate review.\(^{37}\) On appeal, the Fourth Circuit reversed the decision of the Tax Court.\(^{38}\) The Court of Appeals held that, as a factual matter, the expense of renting the apartment was a personal expense within the meaning of section 262 and not a business expense. Because Bodzin did not use any part of his apartment as his place of business, it was unnecessary to decide whether the expense was appropriate and helpful in carrying on the taxpayer's business.\(^{39}\) However, the court suggested that an employee would be allowed a deduction if he could demonstrate that the employer's office was not available at the times the employee used the office in his residence or that the employer's office was not suitable for the purposes for which the taxpayer used his home office.\(^{40}\)

The respective positions of the Service and courts on home office deductions provided an abundance of potential pitfalls for the taxpayer seeking to claim this deduction. The interim period between the Tax Court's decision in *Bodzin* and the Fourth Circuit's reversal in 1975 was characterized by diverse judicial decisions in this area.\(^{41}\) Recall, however, that Revenue Ruling 62-180 was significant not only in that it dealt with the deductibility of expenses related to business use of the home, but also for its consideration of the proper allocation of expenses related to the home office. As the following

---

\(^{37}\) The Tax Court allowed the Bodzins in computing their taxable income, to deduct $100 of the $2,100 annual rent which they paid for the apartment. 60 T.C. at 824, 826.


\(^{39}\) 509 F.2d at 681.

\(^{40}\) Id.

\(^{41}\) See, e.g., George W. Gino, 60 T.C. 304 (1973), rev'd, 538 F.2d 833 (9th Cir.), cert. denied, 429 U.S. 979 (1976) (deductibility of home office expense was not contested by the Commissioner, just the formula used to calculate the amount of the deduction); George Durgom, 43 T.C.M. (P-H) 259 (1974) (depreciation allowed for home projection room used by agent to screen and publicize clients' films); Jay R. Gill, 44 T.C.M. (P-H) 9 (1975) (the court stated that the home office need only be "appropriate and helpful"); accord, Hall v. United States, 387 F. Supp. 612 (D.N.H. 1975). Compare John T. Steen, 61 T.C. 298 (1973), aff'd, 508 F.2d 268 (5th Cir. 1975) (the court disallowed a home office deduction for maintaining a building on a cattle ranch which was used for organizational meetings); Helen Kellner, 45 T.C.M. (P-H) 320 (1976) (the taxpayer was disallowed a deduction for failing to set aside a portion of her residence for business use); Charles Edward Shepherd, 45 T.C.M. (P-H) 215 (1976), (the court said occasional use of a table in the living room in connection with the taxpayer's business amounted to merely incidental use motivated by considerations of personal convenience).
material will demonstrate, this issue alone was a source of substantial litigation.

COMPUTING THE DEDUCTION BEFORE NEW SECTION 280A

Revenue Ruling 62-180 allowed a pro rata deduction to qualifying taxpayers for such deductible items as utilities, insurance, and depreciation allocable to the space occupied by the home office. Moreover, if the taxpayer was an apartment dweller or otherwise rented his home, a deduction was allowed for part of the rent.

Revenue Ruling 62-180 did not, however, prescribe a specific method of allocating the deductible expenses attributable to the business use of the home. Normally, it would be proper to compare the number of rooms or total square feet devoted to business use to the total number of rooms or square feet in the home and apply that ratio to the total household expenses for utilities, maintenance, etc.\(^\text{42}\) The result would be the amount properly attributable to the portion of the residence used for business purposes. A further allocation was mandated if the portion of the residence was not exclusively used for business purposes. This formula was commonly referred to as the "time-use" allocation, which meant that the allocation was derived by computing the ratio of the time the area was actually used for business purposes to the total time it was available for all uses.\(^\text{43}\)

The Service’s position in this regard was illustrated in George W. Gino,\(^\text{44}\) a case involving a husband and wife who regularly used their residence approximately two hours per night preparing for their classes the following day. They also used the same area for personal use six hours per day. The Commissioner contended that under Revenue Ruling 62-180, the proper formula for computing the allocation was the number of hours per day the office was actually used for business purposes divided by the total number of hours the room was available for such use (i.e., twenty-four hours per day).\(^\text{45}\) The Tax Court rejected this formula and held that the proper allocation ratio is the ratio of hours of business use to total hours of use. It concluded that 2/8 was a more reasonable ratio to apply than the

---

44. 60 T.C. 304 (1973), rev’d, 538 F.2d 833 (9th Cir.), cert. denied, 429 U.S. 979 (1976).
45. 60 T.C. at 312-13.
2/24 fraction employed by the Service. In so doing, the court, in effect, refused to follow Revenue Ruling 62-180.46

_Gino_ illustrated the Commissioner’s persistent attitude in prescribing all the necessary rules and regulations for enforcement of the Internal Revenue Code. His approach in _Gino_ was surprising in light of an earlier decision by the Tax Court dealing with precisely the same issue of proper allocation.47 His time and effort was well spent however, for late in 1976 the Ninth Circuit reversed the Tax Court’s decision in _Gino_.48 In a per curiam opinion the court of appeals held that the Commissioner’s method of computing the allocable office-in-home expense was the correct formula to be used. Thus, the proper computation required dividing the number of hours per day of actual business use of the room by the twenty-four hours per day during which the room is available for all uses.49

Implicit in the _Gino_ appellate decision was a sense of futility and frustration over the inconsistent approaches taken by the courts and the Service in the home office area. The court of appeals recognized the limitations imposed on the judicial branch when acting as a law-making body and chastised the Tax Court for its indifference to guidelines published for the purpose of effective tax administration.50

**The New Section 280A Of The Internal Revenue Code**

The Tax Reform Act of 1976 adds to the Code new section 280A, applicable to taxable years beginning after December 31, 1975.51

---

46. Id. at 314-15.
47. See International Artist, Ltd., 55 T.C. 94 (1970), acq. [1972] FED. TAXES (P-H) ¶ 54,717. In that case, the corporation purchased a house (3 stories and 28 rooms) to be used as a studio and home office by the entertainer Liberace. Four rooms of the house were leased by the corporation to Liberace to be used for his needs and to provide a home consistent with his lifestyle. The Service concluded that maximum business use of the house was no more than one-sixth of the total area and reduced the claimed deduction accordingly. 55 T.C. at 105. The Service arrived at the 20 percent figure by comparing the days of business use with the total number of days available for both business and personal use. Id. and 107. The Tax Court disagreed and allowed a 50 per cent allocation to business use on the grounds that the actual business use of the home was far more extensive than the Service’s determination. In so doing, the court held that the proper method for allocating between business use and personal use of a home was to determine the ratio of the time the premises were used for business purposes to the total actual use of the premises. Id. at 107-08. Thus, the application of this formula resulted in a substantially higher business deduction which was denied in earlier cases concerning the same issue. Compare Martha E. Henderson, 37 T.C.M. (P-H) 130 (1968) with Joseph J. Imhoff, 39 T.C.M. (P-H) 1056 (1970).
48. 538 F.2d 833 (9th Cir.), cert. denied, 429 U.S. 979 (1976).
49. Id. at 834-35.
50. Id. at 835.
Section 280A provides that no deductions will be allowed for the office use of a portion of a taxpayer's residence unless the taxpayer falls within specific exceptions to the general rule of disallowance. The provisions of section 280A apply to individuals, trusts, estates, partnerships, and electing small business corporations. The section does not, however, apply to corporations (other than electing small business corporations).\(^{52}\)

Section 280A will deny many taxpayers a deduction for maintaining a home office. The provisions of 280A are strict, and taxpayers will no longer be afforded the luxury of judicial discretion characteristic of the formative years between 1962 and 1976.

Beginning with the basic premise that no deductions are allowed for expenses directly attributable to the personal use of a dwelling,\(^{53}\) section 280A carves out narrow exceptions which, if met by the taxpayer, will permit him to deduct an allocable portion of the expenses incurred for business use of the home. Specifically, a taxpayer must show that the portion of the home maintained for business purposes is used exclusively and on a regular basis\(^{54}\)—

(A) as the taxpayer's principal place of business,
(B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or
(C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.\(^{55}\)

A fourth exception is included for the taxpayer who uses part of his residence for storing inventory held for use in the taxpayer's trade or business, but only if the dwelling unit is the sole fixed location of such trade or business.\(^{54}\) This latter provision applies even though the "exclusive use" test is not met. On the other hand, an additional requirement is mandated if the taxpayer happens to be an employee. To qualify he must demonstrate that the exclusive use of the home office is on a regular basis and that it is for the convenience of the employer.\(^{57}\)

A final exception was created by Congress in 1977. Realizing that the "exclusive use" test would rarely be met by taxpayers who pro-

\(^{52}\) I.R.C. § 280A(a).
\(^{53}\) Id.
\(^{54}\) Id. §280A(c)(1).
\(^{55}\) Id.
\(^{56}\) Id. § 280A(c)(2).
\(^{57}\) Id. § 280A(c)(1).
vide certain day care services in their homes.\textsuperscript{58} Congress amended section 280A to include an exception from the general disallowance rule and the exclusive use test. Section 280A now permits a deduction for expenses allocable to any portion of a residence used for the trade or business of providing day care for children, for individuals who have attained age 65, or for individuals who are physically or mentally incapable of caring for themselves.\textsuperscript{59} The amendment does retain, however, the "regular basis" test. Moreover, the deduction is allowed only if the owner or operator of the trade or business has applied for, has been granted, or is exempt from having a license, certification, registration, or approval as a day care facility under the provision of any applicable state law.\textsuperscript{60}

Graphically illustrated, the requirements of section 280A appear as follows:

<table>
<thead>
<tr>
<th>REQUIREMENT</th>
<th>USE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal Place of Business</td>
<td>X</td>
</tr>
<tr>
<td>Storage Place of Inventory</td>
<td></td>
</tr>
<tr>
<td>Meet Place of Patients, or Taxpayer's Place of Clients, or Taxpayer's Place of Customers</td>
<td>X</td>
</tr>
<tr>
<td>In Connection with Day Care Business Services</td>
<td>X</td>
</tr>
<tr>
<td>Dwelling Is Sole Location of Trade or Business</td>
<td>X</td>
</tr>
<tr>
<td>Separate Structure</td>
<td></td>
</tr>
<tr>
<td>Convenience of Employer</td>
<td>X</td>
</tr>
</tbody>
</table>

The "exclusive use" requirement appears to be the most restrictive provision of the new section. Its effect is to deny a deduction if a portion of the residence is used for both personal purposes and for the carrying on of a trade or business. The issue will undoubtedly

\textsuperscript{60} I.R.C. § 280A(c)(4)(B).
arise as to what activity constitutes "personal purposes." If the home office consists of a den used by an attorney who writes legal briefs, prepares tax returns, or engages in similar activities as well as personal purposes, he will be denied a deduction for the expenses paid or incurred in connection with the use of the residence which are allocable to these activities. Similarly, in the case of a separate structure such as a detached garage used by an artist in connection with his trade or business, if it is used for both business and personal purposes, the deduction will be denied. However, note that this latter provision (e.g., separate structure) does not mandate the requirement that the office be the taxpayer's principal place of business—just that it be used exclusively and regularly in connection with his trade or business.

We have already seen how the use of a room at different times for both business and personal purposes will effectively deny a deduction under 280A. What is not clear, however, is the status of a room part of which is regularly used for business and another portion of which is regularly used for personal purposes. To further complicate matters, suppose the room is partitioned by a divider. Under these circumstances, it appears that even the most liberal interpretation of the "exclusive use" requirement may not work to the advantage of the taxpayer. Moreover, under the "regular basis" test it is no longer possible to obtain a home office deduction if the taxpayer's use of the office is merely incidental or occasional even though he uses it exclusively for the conduct of that trade or business.

As noted above, one of the exceptions to the disallowance provision of section 280A is exclusive and regular use of a portion of the home used as the taxpayer's principal place of business. Since neither the law nor the committee reports explain the meaning of "principal place of business," a taxpayer engaged in two businesses is likely to find himself in the precarious position of having the Service decide which business is primary and which is secondary. The elements which the Service may consider include the continuity and regularity of the business activity, coupled with the presence of a profit motive. Thus, suppose a taxpayer owns property which is rented to tenants and in addition, maintains an active law practice. The deductions for home office expenses incurred in the real prop-

erty business are likely to be disallowed since the trade or business of providing legal services indicates the primary source of livelihood. Even if the taxpayer in this example can convince the Service that his home real estate office is a principal place of business, the Service is apt to disallow the deduction on the grounds that the home office was not used on a "regular basis."

The home office can also qualify under 280A if used exclusively and on a regular basis as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business. Neither the statute nor the committee reports clarify this provision. Inherent ambiguities include the meaning of terms such as "regular basis," "normal course of trade or business," and "clients." What consideration, for example, is to be given to the businessman who simply does not associate with clients, patients, or customers? Presumably, his deduction will be disallowed, although in such a situation the taxpayer may attempt to qualify under the "principal place of business" exception.

If the taxpayer happens to be an employee, not only must he qualify his home office under one of the above mentioned exceptions, but he must also hurdle the "convenience of the employer" requirement: the home office must be used and maintained for the convenience of the employer. The committee reports state that the old "appropriate and helpful" test will no longer be applied since in many situations applying this test resulted in treating personal living and family expenses, directly attributable to the home, as ordinary and necessary business deductions even though these expenses may not have resulted in additional or incremental costs. The committee reports, however, do not adequately explain the meaning of the phrase "convenience of the employer." But the identical language can be found in other sections of the Code, particularly section 119 dealing with the gross income exclusion of meals and lodging furnished to the employee for the convenience of

64. See, e.g., Joseph M. Philbin, 26 T.C. 1159 (1956), where under similar facts, the Tax Court found that the real estate purchases by the taxpayer were not infrequent and sporadic but were continuous and substantial throughout the taxable years in question. Furthermore, the net profit from the sale of the realty in those years totaled approximately $93,000.00, compared to a total of $20,000.00 derived from the practice of law. Accordingly, the court found that the above activity was sufficient to deem it a trade or business and taxed the gains as ordinary income rather than capital gains.


the employer. The Treasury Regulations for section 119 attempt to define this phrase, stating that the convenience of the employer test is met if the item provided to the employee is for substantial non-compensatory business reasons of the employer.67

The new law provides an exception to the strict “exclusive use” requirement in the case of a taxpayer whose trade or business is selling products at the retail or wholesale level and whose home is the sole fixed location of such trade or business. If the taxpayer uses part of the dwelling unit for storing inventory, then an allocable portion of the expenses attributable to the storage area are deductible.68 Care should be exercised, however, to assure that the space is used regularly and is maintained as a separate and identifiable space suitable for storage.

The 1977 amendment also provides relief to day care operators from the stringent “exclusive use” requirement. Those taxpayers in the trade or business or providing day care services in their residence do not have to use a portion of their home exclusively for that service, but must do so on a regular basis. In addition, certain licensing requirements must be complied with prior to allowance of the allocable expenses.

The Committee Report noted that the portion of a residence used for day care facilities would also be used for personal purposes, but that this fact alone should not disqualify a taxpayer from the deduction permitted under 280A.69 A day care business would ordinarily result in higher expenses for the taxpayer: additional wear and tear on the residence, additional repair and maintenance, and additional utilities costs.70 Congress believed that these incremental expenses, which are beyond those attributable to the personal use of the residence, sufficiently justified a deduction even though a portion of the home was used for both business and personal purposes.

**Computing The Allowable Deduction Under Section 280A**

If the claimed home office deductions are permissible under the provisions of section 280A, the question then becomes one of proper allocation of the attributable expenses. Section 280A further restricts the appeal of home office deductions by placing an overall limitation on the amount of deductions a taxpayer may take for maintaining an office in his dwelling. Basically, the deduction al-

---

68. I.R.C. § 280A(c)(2).
70. Id.
lowed cannot exceed the amount of gross income derived from business use of the home office reduced by the allocable deductions which are allowed without regard to their connection with the taxpayer's trade or business (i.e., interest, taxes, and casualty losses). As the examples given below illustrate, the allowable deduction is derived by first determining the total amount of gross income derived from the use of the office for the taxable year in question; from this amount subtract an allocable portion of the interest, taxes and casualty losses expended during the year for the entire dwelling unit. The remainder is then reduced by the allowable deductions that are allocable to business use.

Presumably, taxpayers will be allowed to determine the deductible amount attributable to business use of the home by any reasonable means of allocation depending, of course, on the facts and circumstances surrounding each case. Furthermore, there is no reason to believe that the previous methods of allocation employed under Revenue Ruling 62-180 are no longer available. The formula can be expressed as a ratio of the total square footage of the portion of the residence used in the trade or business divided by the total square footage of the home. The figure thus derived will be multiplied as a percentage against the total allowable deductions (e.g., utilities, insurance, depreciation and/or rent). Note that the old "time-use" test which often was juxtaposed to the "space-use" test has been eliminated here because the exclusive use requirement of section 280A.

To illustrate the foregoing, assume the following:

Employee X uses a room in his home exclusively and on a regular basis as his principal place of business. It is further shown that X maintains the room for the convenience of his employer. X derives $10,000 gross income from the business use of his room in 1977. He pays $1,500 in interest and taxes on his home, and the remaining expenses (depreciation, utility, insurance and maintenance) total $2,500. If the size of the room is approximately one-fourth (or 25%) of the total size of the house, X would compute his deduction as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross business income derived</td>
<td>$10,000.00</td>
</tr>
<tr>
<td>Allocable portion of interest and taxes</td>
<td>$ 375.00</td>
</tr>
<tr>
<td>Overall limitation on business expenses</td>
<td>$ 9,625.00</td>
</tr>
<tr>
<td>Allocable portion of depreciation, etc.</td>
<td>$ 625.00</td>
</tr>
</tbody>
</table>

71. I.R.C. § 280A(c)(5).
Since the $625 of expenses attributable to the home office does not exceed the limitation of $9,625, X can deduct $625 on his tax return.\footnote{It should be pointed out that the Joint Committee Explanation to Section 280A, omits the word "allocable" from its discussion of the permissible deductions. Although this apparently is due to draftmanship oversight, evidenced by the appearance of the word in the Senate Committee Reports and in the language of the Code itself, the omission could conceivably pose problems. For example, in the case of taxpayer X, the $1,500 expenses incurred for interest and taxes on the home would be subtracted \textit{in its entirety} from the gross business income figure. This produces a smaller overall limitation figure on business expenses—a result which further restricts the appeal of \$ 280A.}

On the other hand, consider the plight of Y. Assume the following facts exist:

Y, a self-employed retailer of Widgets, uses his garage to store his inventory. Y does not have any other location to conduct his business other than the garage set aside in his home. Y makes $3,000 gross business income in 1977. He pays $7,000 in interest and taxes on his residence and $4,000 in maintenance, utility, depreciation and insurance expenses. The square footage of the garage compared to the total dwelling unit is approximately 30%. His business deduction for his home office is as follows:

\[
\begin{align*}
\text{Gross business income derived} & \quad \text{\$3,000.00} \\
\text{Allocable portion of interest and taxes} & \quad \text{(30\% of \$7,000)} \quad \text{\$2,100.00} \\
\text{Overall limitation on business expenses} & \quad \text{\$ 900.00} \\
\text{Allocable portion of maintenance, etc.} & \quad \text{expenses (30\% of \$4,000)} \quad \text{\$1,200.00}
\end{align*}
\]

Since the $1,200 business expense attributable to the home office exceeds the overall limitation by $300, Y will only be able to deduct $900 on his tax return.

Special allocation rules apply for a taxpayer seeking a deduction for maintaining a day care facility in his residence.\footnote{I.R.C. § 280A(c)(4)(C).} Similar to existing law prior to the enactment of section 280A, an allocation of expenses is first made on the basis of space in the residence used for the day care facility. That is, the expenses attributable to the portion of the residence used for business purposes would be determined on the basis of floor space devoted to business use compared to the total floor space of the residence. Then, the expenses allocable to the space used for business purposes would be subject to the

\begin{footnotes}
\item[72] It should be pointed out that the Joint Committee Explanation to Section 280A, omits the word "allocable" from its discussion of the permissible deductions. Although this apparently is due to draftmanship oversight, evidenced by the appearance of the word in the Senate Committee Reports and in the language of the Code itself, the omission could conceivably pose problems. For example, in the case of taxpayer X, the $1,500 expenses incurred for interest and taxes on the home would be subtracted \textit{in its entirety} from the gross business income figure. This produces a smaller overall limitation figure on business expenses—a result which further restricts the appeal of \$ 280A.
\item[73] I.R.C. § 280A(c)(4)(C).
\end{footnotes}
special allocation rule based on the actual time the area was used for business purposes. Thus, the amount deductible is determined by multiplying the expenses allocable on the basis of space by a fraction—the numerator is the number of hours the area is used for business purposes and the denominator is the 24 hours per day the area is available for all uses.

For example, assume that taxpayer Z maintains a day care facility in a portion of his residence which physically represents an area equal to one-fifth (1/5) of the entire home. The area is used for day care services daily for five hours. The formula would appear as follows: 5/24 x 1/5 = 1/24. Thus, if Z's rent and utility bills are $240 per month, a deduction of $10 per month is all that is allowed. It should also be noted that the overall limitation on deductions outlined above in the case of Y is also applicable. However, for all practical purposes this limitation will seldom, if ever, be reached because the time-use formula severely restricts the amount of an allowable deduction.

THE RAMIFICATIONS OF SECTION 280A

One of the more conspicuous features of the new law is its treatment of so-called Higgins-type taxpayers. Expenses paid or incurred with respect to the use of a residence by the taxpayer both as a home and in connection with income producing activities will not be allowable deductions under section 280A unless the income producing activity constitutes a trade or business. For example, no home office deduction will be allowed to the investor who is not in the trade or business of making investments even though he uses his den exclusively and on a regular basis to read the financial reports contained in various periodicals. Although this taxpayer may realize substantial income from investment decisions made as a result of his studies in the home office, the activity is not deemed sufficient to satisfy the trade or business requirement.

This result is of particular significance if one considers past congressional action. In 1975, Congress amended the Code to extend the deductions allowable by section 162 of the Code to taxpayers engaged in profit-seeking activities. This legislative intent is re-

75. I.R.C. § 280A(c)(5).
76. See I.R.C. § 212.
flected in section 212 of the Code, the effect of which is to remove the “trade or business” feature from the “ordinary and necessary” requirement of section 162. Thus, a taxpayer engaged in a profit-seeking activity which was not a trade or business could still deduct the expenses attributable to his profit-seeking activity. The new section 280A, however, does not permit a home office deduction to this “special” class of taxpayer. In light of the 1975 action, the scope of section 280A seems unnecessarily restrictive.

Another obvious effect of the new section 280A is the resurrection of the old “convenience of the employer” requirement, reminiscent of the Service’s position in the past. The construction of this provision effectively destroys the old “appropriate and helpful” test and at the same time breathes new life into the “condition of employment” requirement previously enunciated in Revenue Ruling 62-180.

Section 280A does not apply to corporations. Arguably, this could encourage innovative taxpayers to buy their home under the guise of a corporate entity and then enter into a lease agreement whereby the “corporation” leases the home back to them. A carefully constructed lease which clearly allocated the portions of the home to be used for business and personal purposes may work to circumvent section 280A for a taxpayer unable to meet its requirements by himself. However, one should be extremely careful in this area, for it is not unusual for the Service to characterize such arrangements as receipt of constructive dividends arising from personal use of corporate property.79

Finally, it should be noted that section 280A does not affect deductions ordinarily permitted without regard to their connection with the taxpayer’s trade or business or with his income-producing activity.80 Thus, taxpayers can still deduct items such as mortgage interest, taxes and casualty losses without regard to section 280A. Furthermore, nothing in 280A prohibits depreciating tangible personal property contained in the home office, such as typewriters, business machines and office furniture.

CONCLUSION

The policy of section 262 of the Code, which denies deductions for personal expenses, was clearly a motivating force behind the new section 280A. Courts had become entangled in the controversy surrounding the mixture of personal and business use of a residence

80. I.R.C. § 280A(b).
and a clear need for congressional guidance existed. Congress' response will unquestionably alleviate the burden on the Service and the courts. The cost is high from the individual taxpayer's viewpoint. Nevertheless, a weighing of all the facts surrounding home offices reveals the need for tighter controls in this area. Even if one accepts this premise, that fact does not necessarily lead to the conclusion that section 280A will alleviate the existing conflict in the home office arena. But if equitable tax administration for all taxpayers remains the primary goal of the Service and the judiciary, stricter guidelines may be the only solution.