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# Comments: "Simplification" Is Not Enough: An Analysis of the Home Office Tax Deduction and the Home Office Simplification Act of 2009

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## “SIMPLIFICATION” IS NOT ENOUGH: AN ANALYSIS OF THE HOME OFFICE TAX DEDUCTION AND THE HOME OFFICE SIMPLIFICATION ACT OF 2009.

### I. INTRODUCTION

As the workforce in the United States changes, an increasing number of taxpayers are working from home.<sup>1</sup> These taxpayers are faced with the decision of whether to take a home office tax deduction. To take the deduction, a taxpayer must navigate an intimidating thirty-five-page Internal Revenue Service (IRS) publication.<sup>2</sup> Many taxpayers who are eligible for the deduction are reluctant to take advantage of it because they think that simply taking the deduction will trigger an audit.<sup>3</sup> Taxpayers must keep careful records of expenses and comply with detailed requirements under the Tax Code.<sup>4</sup> In addition to the recordkeeping requirements, two similarly situated taxpayers may find that only one of them is eligible for the tax deduction because the deduction, as currently enacted, treats self-employed taxpayers differently from those who are employees.<sup>5</sup>

Congress has considered many amendments to the federal home office tax deduction,<sup>6</sup> including the Home Office Simplification Act

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1. *See, e.g.*, U.S. OFFICE OF PERS. MGMT., STATUS OF TELEWORK IN THE FED. GOV'T: REP. TO THE CONG., at 3-7 (2009), *available at* [http://www.telework.gov/Reports\\_and\\_Studies/Annual\\_Reports/2009teleworkreport.pdf](http://www.telework.gov/Reports_and_Studies/Annual_Reports/2009teleworkreport.pdf) (showing that as of 2008, more government employees work from home because of benefits such as a better work-life balance and energy conservation); *All Workers, and Workers Who Worked at Home for the United States: 1960 TO 2000*, U.S. CENSUS BUREAU (Oct. 20, 2004), <http://www.census.gov/population/www/cen2000/briefs/phc-t35/tables/tab01-1.pdf> (showing that in the 1980's the number of people working from home increased by more than 50% and in the 1990's by more than 20%).
  2. *See* IRS, U.S. DEP'T OF THE TREASURY, PUB. NO. 587, BUSINESS USE OF YOUR HOME (Dec. 16, 2009), *available at* <http://www.irs.gov/pub/irs-pdf/p587.pdf>.
  3. *See infra* Part III.B.
  4. *See infra* Part III.C.
  5. *See* I.R.C. § 280A(c)(1) (2006).
  6. *See, e.g.*, Help Small Businesses Start and Grow Act of 2010, H.R. 4637, 111th Cong. § 102. This bill was introduced on February 22, 2010 by Representative John Hall of New York. It proposes a \$2,500 standardized home office tax deduction for qualifying taxpayers. *See also* Home Office Tax Deduction Simplification and Improvement Act of 2009, S. 1349, 111th Cong. § 2 (This bill, which Senator Olympia Snowe introduced on June 25, 2009, proposes an option for a standardized

of 2009.<sup>7</sup> This amendment seeks to promote job creation through a standardized home office tax deduction for home-based small businesses and to address other issues with the tax deduction.<sup>8</sup> While the amendment deals with some of the problems,<sup>9</sup> it does not go far enough. For example, the amendment does not lessen inequalities between those who are self-employed and employees who work at home,<sup>10</sup> nor does it clarify the “regular use” standard put forth in Section 280A.<sup>11</sup> In amending the home office deduction, Congress should enact legislation that addresses the difference in treatment between similarly situated taxpayers and explains the regular use language.<sup>12</sup>

This comment will explain why Congress should address the inequalities in the home office tax deduction, refine the regular use standard, and enact legislation that encourages qualified taxpayers to take the deduction. In Part II, the comment begins with a discussion of the history and legislative intent behind the home office tax deduction.<sup>13</sup> Part III analyzes the four problems with the home office deduction: first, the deduction treats self-employed taxpayers differently from employees; second, qualified taxpayers are reluctant to take the deduction; third, it is difficult to substantiate home office expenses; and fourth, the regular use standard is not sufficiently defined.<sup>14</sup> The comment outlines the proposed Home Office Deduction Simplification Act of 2009 and the goals of this legislation in Part IV.<sup>15</sup> In Part V, the Simplification Act is analyzed to determine its effectiveness in addressing both the problems with the current deduction and the goals set forth for the legislation.<sup>16</sup>

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home office tax deduction based on an “applicable home office standard rate” and a modification of Section 280A to allow *de minimis* personal use of a home office).

7. S. 1754, 111th Cong. (2009).
8. Press Release, U.S. Senator Barbara Boxer, Boxer, Merkley, Lieberman, Bayh Work to Help Small Businesses Claim Tax Deduction (Oct. 6, 2009), <http://boxer.senate.gov/en/press/releases/100609.cfm>.
9. See *infra* Part V.A–B.
10. See *infra* Part V.C.
11. See *infra* Part V.D.
12. See *infra* Part V.C–D.
13. See *infra* Part II.
14. See *infra* Part III.
15. See *infra* Part IV.
16. See *infra* Part V.

## II. HISTORY OF THE HOME OFFICE TAX DEDUCTION

The home office tax deduction has changed significantly over time.<sup>17</sup> Prior to 1976, taxpayers deducted costs associated with their home offices as they would deduct any other business expense.<sup>18</sup> Before 1976, there was no specific home office tax deduction section in the Tax Code.<sup>19</sup> In 1976, Congress passed Section 280A<sup>20</sup> to specifically address the home office’s tax treatment.<sup>21</sup> Parts II.B. and II.C. discuss Congress’s reasons for enacting Section 280A and illustrate the home office deduction as it was originally enacted.<sup>22</sup> Part II.E. discusses the Supreme Court of the United States’s decision *Soliman v. Commissioner*,<sup>23</sup> a turning point for the home office tax deduction.<sup>24</sup> The *Soliman* decision was widely criticized,<sup>25</sup> and as a result, Congress modified the home office deduction in the Taxpayer Relief Act of 1997.<sup>26</sup> This most recent amendment reflects Congress’s efforts to minimize taxpayer abuse surrounding home office expenses and to mirror a changing workforce.<sup>27</sup>

The home office tax deduction has been a “source of ongoing struggle” because it affects an area where there is a tension between allowing taxpayers to deduct business expenses and preventing taxpayers from deducting solely personal expenses.<sup>28</sup> The home office needs specific treatment because it illustrates a mixed-use asset; the home office is both a personal and business expense.<sup>29</sup> The

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17. See *infra* Part II.A–D.

18. See *infra* Part II.A.

19. See *infra* Part II.A.

20. I.R.C. § 280A (1976) (current version at I.R.C. § 280A (2006)).

21. See *infra* Part II.C.

22. See *infra* Part II.B–C.

23. 506 U.S. 168 (1993), *superseded by statute*, Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932(a), 111 Stat. 788, 881, *as recognized in* *Beale v. Comm’r*, 79 T.C.M. (CCH) 2001 (2000).

24. See *infra* Part II.E.

25. See *infra* Part II.F.

26. See *infra* Part II.G.

27. See *infra* Part II.C–D.

28. Mark T. Holtschneider, Comment, *Putting the House in Order: An Analysis of and Planning Considerations for Home Office Deduction*, 14 U. BALT. L. REV. 522, 522 (1985).

29. A mixed-use asset is one that is generally a personal asset under the Tax Code, but is also used for business purposes. The important question when looking at a mixed-use asset is whether “the property [is] used essentially for consumption or for production?” David R. Burton & Dan R. Mastromarco, *The National Sales Tax: Moving Beyond the Idea*, 71 TAX NOTES 1237, 1246 (1996).

home, as a personal living expense, is generally not deductible from taxable income.<sup>30</sup> However, when taxpayers use a portion of their residences for business purposes, those business expenses are allowable deductions if they are ordinary and necessary in the course of that business.<sup>31</sup> This tension between business and personal use necessitates the home office's specialized treatment.

#### *A. The Home Office Tax Deduction Before 1976*

Prior to 1976, there was no Tax Code section specifically addressing the home office tax deduction. If taxpayers took a tax deduction for home office business expenses before 1976, they took a deduction under Section 162, which allowed a deduction from taxable income for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business."<sup>32</sup> This business deduction was limited by Section 262, which states, "[N]o deduction shall be allowed for personal, living, or family expenses."<sup>33</sup> In 1962, the IRS issued a revenue ruling, which determined that employees are eligible to take a home office deduction only if their office is required by their employer as a condition of employment, and they regularly uses the home office to perform employment duties.<sup>34</sup>

Under Sections 162 and 262, courts created a liberal standard for determining whether home office deductions were appropriate.<sup>35</sup> In 1969, the United States Tax Court heard *Newi v. Commissioner*, and held that taxpayers were allowed to deduct home office expenses if

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In addition to the home office, another example of a mixed-use asset is a vehicle used for both personal and business purposes. If a taxpayer travels for both business and personal reasons, travel costs are deductible if the trip is related primarily to the taxpayer's trade or business. Treas. Reg. § 1.162-2(b)(1) (2008).

30. I.R.C. § 262(a) (2006).
31. I.R.C. § 162(a) (2006).
32. I.R.C. § 162(a) (1976) (current version at I.R.C. § 162(a) (2006)).
33. I.R.C. § 262(a) (1976) (current version at I.R.C. § 262 (2006)).
34. See Rev. Rul. 62-180, 1962-2 C.B. 52. This revenue ruling establishes that an employee taxpayer has the burden of proof in showing (1) that he is required to have a home office space as a condition of his employment, (2) that he regularly uses the home office, (3) the portion of his home used for the office, (4) the extent of his home office use, and (5) the amount attributed to depreciation and expenses of his home office. *Id.* at 53.
35. See, e.g., *Newi v. Comm'r*, 432 F.2d 998 (2d Cir. 1970); *Hall v. United States*, 387 F. Supp. 612 (D.N.H. 1975); *Gill v. Comm'r*, 34 T.C.M. (CCH) 10 (1975). In each case, the deductibility of home office expenses depends on whether a home office is "appropriate and helpful" under all of the taxpayer's circumstances.

maintenance of an office in the home was “appropriate and helpful” to their businesses.<sup>36</sup>

In *Newi v. Commissioner*, the Commissioner of Internal Revenue appealed a Tax Court judgment, allowing George Newi to deduct expenses associated with his home office.<sup>37</sup> George Newi converted a den off of his living room into a home office for his work in selling television time to advertisers.<sup>38</sup> Newi spent an average of three hours per evening studying his sales notes, reviewing research data and television advertisements, and planning his upcoming sales work.<sup>39</sup> Newi worked in his home, even though the television company had available evening office space, because it was “impractical” for him to return to the television station after dinner.<sup>40</sup> The United States Court of Appeals for the Second Circuit determined that Newi’s home office was appropriate and helpful, and allowed a tax deduction for twenty-five percent of the rental, cleaning, and lighting costs of his three-room apartment.<sup>41</sup> The court limited its holding “as to the facts here presented,” in response to the Commissioner’s concern that the appropriate and helpful construction 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.”<sup>42</sup>

The United States Court of Appeals for the Fourth Circuit further interpreted the appropriate and helpful requirement in *Bodzin v. Commissioner*.<sup>43</sup> In this case, the Commissioner of Internal Revenue appealed a Tax Court decision<sup>44</sup> that allowed the Bodzins to deduct a percentage of their rent as a home office expense.<sup>45</sup> Stephen Bodzin worked as an attorney–advisor at the IRS and attempted to deduct a portion of his annual rent as a home office expense.<sup>46</sup> As an attorney, Bodzin had an office at the government building but sometimes did his work at home in the evenings or on weekends in order to meet deadlines.<sup>47</sup> The Tax Court interpreted the appropriate and helpful

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36. *Newi*, 432 F.2d 998.

37. 432 F.2d at 999.

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.* at 999-1000.

42. *Id.* at 1000.

43. *Bozdin v. Comm’r*, 509 F.2d 679 (4th Cir. 1975).

44. *Bodzin v. Comm’r*, 60 T.C. 820 (1973), *rev’d*, 509 F.2d 679 (4th Cir. 1975).

45. *Bodzin*, 509 F.2d at 680.

46. *Id.*

47. *Id.*

requirement and stated that a deduction is not allowed if personal convenience is the primary reason for maintaining the home office.<sup>48</sup> On appeal, the Fourth Circuit reversed the Tax Court decision.<sup>49</sup> The Fourth Circuit held that Bodzin's expenses were nondeductible personal expenses<sup>50</sup> and did not reach the issue of whether Bodzin's home office was appropriate and helpful to carrying on his business.<sup>51</sup> Because the Fourth Circuit did not reach the appropriate and helpful issue, the standard remained unclear. The court distinguished Bodzin's situation from the *Newi* case because Bodzin, a government tax attorney, "did not use any part of his apartment as his place of business . . . he sometimes, by choice, did some of his reading and writing at home."<sup>52</sup>

The appropriate and helpful standard, as interpreted by the Second and Fourth Circuits, was criticized as "fuzzy" because it allowed taxpayers to "claim the [home office] deduction on the flimsiest of grounds with no fear of a fraud penalty."<sup>53</sup> This uncertainty and criticism played a large part in influencing Congress to enact Section 280A.<sup>54</sup> After the *Bodzin* decision, Congress said, "[I]t is not clear which standard would be applied in the Fourth Circuit in a case in which the court found both personal and business use of a residence."<sup>55</sup>

### *B. The Purpose in Enacting Section 280A*

Following the *Newi* and *Bodzin* decisions, Section 280A was enacted as part of the Tax Reform Act of 1976.<sup>56</sup> Congress had two purposes: to deny deductions for personal expenses where there were few costs associated with business use, and to provide objective

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48. *Bodzin*, 60 T.C. at 825-26.

49. *Bodzin*, 509 F.2d at 681.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Cadwallader v. Comm'r*, 919 F.2d 1273, 1275 (7th Cir. 1990). In his opinion, Judge Posner looked to Congress's intent in enacting Section 280A, specifically Congress's response to the *Newi* and *Bodzin* decisions. He stated that the purpose of Section 280A was to guard against abuses and to ensure that a home office was only deductible when the related expenses were "incurred solely to produce income." *Id.*

54. S. REP. NO. 94-938, at 2-3 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3439, 3439-40. The Senate Finance Committee wanted "to simplify many tax provisions" because "[t]he public should be able to understand the tax system." *Id.*

55. *Id.* at 145, *reprinted in* 1976 U.S.C.C.A.N. at 3577.

56. Tax Reform Act of 1976, Pub. L. No. 94-455, tit. VI, § 601(a), 90 Stat. 1520.

standards for determining whether a taxpayer is eligible for such a deduction.<sup>57</sup>

Congress intended to restrict “business-related individual income tax deductions in areas where there [had] been widespread abuses,”<sup>58</sup> and specifically the home office section was “designed to eliminate tax abuses.”<sup>59</sup> Congress stated that the reform was necessary because, in many cases, the “appropriate and helpful test would appear to result in treating personal living, and family expenses . . . as ordinary and necessary business expenses, even though those expenses did not result in additional or incremental costs incurred as a result of the business use of the home.”<sup>60</sup> Section 280A aims to prevent taxpayers from converting expenses that are otherwise nondeductible personal expenses into deductible business expenses simply because “it was appropriate and helpful to perform some portion of the taxpayer’s business in his personal residence.”<sup>61</sup> Before the 1976 enactment, a taxpayer could transfer “some of his work from the place of his employment to his home,” and then “deduct from income tax a portion of his living expenses—expenses he would have incurred even if he had not been working at all.”<sup>62</sup> Section 280A places significant limitations on when a taxpayer may deduct home office expenses.

Congress also enacted Section 280A to provide definitive rules about what constituted a deduction for the business use of a home.<sup>63</sup> The legislators wanted to “resolve the conflict that existed between several . . . court decisions and the position of the Internal Revenue Service.”<sup>64</sup> The *Newi* and *Bodzin* decisions created uncertainty for taxpayers, particularly in the application of the appropriate and helpful standard.<sup>65</sup> As Senator Robert Dole stated, the statute was “enacted to replace vague standards.”<sup>66</sup> Members of Congress found the appropriate and helpful test difficult to administer because it did

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57. *Holt Schneider*, *supra* note 28, at 542.

58. S. REP. NO. 94-938, at 3, *reprinted in* 1976 U.S.C.C.A.N. at 3440.

59. *Id.* at 7, *reprinted in* 1976 U.S.C.C.A.N. at 3444.

60. *Id.* at 147, *reprinted in* 1976 U.S.C.C.A.N. at 3579–80.

61. *Id.*

62. *Cadwallader v. Comm’r*, 919 F.2d 1273, 1275, (7th Cir. 1990).

63. H.R. REP. NO. 94-658, at 160 (1976), *reprinted in* 1976 U.S.C.C.A.N. 2897, 3053.

64. *Id.*

65. *See supra* Part II.A.

66. 127 CONG. REC. S15,486 (daily ed. Dec. 16, 1981) (statement of Sen. Robert Dole).



not provide taxpayers with a “clear cut method to determine whether their offices qualified for a deduction.”<sup>67</sup>

### *C. Home Office Deductions Under Section 280A*

The general rule under Section 280A, enacted in 1976, is that no deduction is allowed with respect to a dwelling that the taxpayer uses as a residence.<sup>68</sup> There are three exceptions to this general rule.<sup>69</sup> An exception exists to the extent that the residence is used exclusively and on a regular basis as: (a) the principal place of business for the taxpayer’s trade or business; (b) a place of business where clients meet with the taxpayer in the normal course of business; or (c) there is a separate structure used for the taxpayer’s business.<sup>70</sup> An employee has an additional requirement and is only allowed a deduction if his home office is for the “convenience of his employer.”<sup>71</sup>

Section 280A restricted the home office deduction from the prior appropriate and helpful standard. Under the 1976 version of Section 280A, the home office could be deducted only if it was “vital to the taxpayer’s business or employment but also ha[d] no use but office use.”<sup>72</sup> The goal was to limit the deduction to home offices used solely for income-producing purposes.<sup>73</sup>

### *D. Principal Place of Business: The Focal Point Test*

After Congress enacted Section 280A, litigation surrounding home office tax deductions focused on whether the home office was the taxpayer’s principal place of business.<sup>74</sup> Courts originally applied the focal point test<sup>75</sup> to determine a taxpayer’s principal place of

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67. See Robert J. Gerlack, Note, *What Has the Supreme Court Done? The Home Office Deduction is Virtually Eliminated After Soliman*, 41 CLEV. ST. L. REV. 789, 792 (1993).

68. I.R.C. § 280A(a) (1977) (current version at I.R.C. § 280A(a) (2006)).

69. *Id.* § 280A(c).

70. *Id.*

71. *Id.* § 280A(c)(1).

72. *Cadwallader v. Comm’r*, 919 F.2d 1273, 1275 (7th Cir. 1990).

73. *See id.*

74. *Holtschneider*, *supra* note 28, at 528–38.

75. The Tax Court first used the focal point test in *Baie v. Comm’r*, 74 T.C. 105 (1980). *Baie* was a taxpayer who operated a hotdog stand and prepared food for sale in her kitchen. *Id.* at 106. She also used a portion of her home for bookkeeping and administrative activities. *Id.* The Tax Court looked at the legislative history behind Section 280A and did not find sufficient guidance to define a taxpayer’s “principal place of business.” *Id.* at 109. The Tax Court applied the “focal point” test and

business.<sup>76</sup> Under the focal point test, the principal place of business is determined by deciding which of the taxpayer’s business locations is the most “important.”<sup>77</sup> However, courts criticized the focal point test and found it to be unpredictable because different courts emphasized different factors in applying the test.<sup>78</sup>

#### 1. Focal Point Test: *Drucker v. Commissioner*

In *Drucker v. Commissioner*, the Second Circuit applied the focal point test when concert musicians claimed a home office tax deduction for the portion of their residences used as practice space.<sup>79</sup> The Metropolitan Opera Association employed Drucker and other concert musicians.<sup>80</sup> Each musician lived in New York City and set aside one room or a portion of a room in his or her apartment exclusively for musical practice.<sup>81</sup> The musicians deducted portions of their rent, electricity, and maintenance costs from their income in proportion to their home practice spaces.<sup>82</sup> The taxpayers each used their home practice space between thirty and thirty-two hours each week, and the Metropolitan Opera did not provide practice space for the musicians.<sup>83</sup>

The Tax Court applied the focal point test and determined that the musicians’ home studios were not their principal places of business.<sup>84</sup> This meant that the musicians were not eligible for a home office deduction under Section 280A.<sup>85</sup> The Tax Court found that individual home practice, while a necessity of the musicians’ jobs, was not “a requirement or condition of employment.”<sup>86</sup> The court also found that the musicians did not practice at home at the request of their employer, the Metropolitan Opera.<sup>87</sup> Using these factors, the

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determined that Baie was not eligible for a home office deduction because the hotdog stand, not her home, was the focal point of her business activities. *Id.* at 109–11.

76. *See, e.g.,* *Drucker v. Comm’r*, 79 T.C. 605, 614–15, *rev’d*, 715 F.2d 67 (2d Cir. 1983).

77. *Id.* at 612–14.

78. *See, e.g.,* *Pomarantz v. Comm’r*, 867 F.2d 495, 496–97 (9th Cir. 1988); *Meiers v. Comm’r*, 782 F.2d 75, 79 (7th Cir. 1986); *Weissman v. Comm’r*, 751 F.2d 512, 514 (2d Cir. 1984).

79. 715 F.2d 67 (2d Cir. 1983).

80. *Id.* at 68.

81. *Id.*

82. *Id.*

83. *Id.* at 68–69.

84. *See* *Drucker v. Comm’r*, 79 T.C. 605 (1982), *rev’d*, 715 F.2d 67 (2d Cir. 1983).

85. *See id.* at 609–10.

86. *Id.* at 608.

87. *Id.*

Tax Court determined that the musicians' principal place of business was Lincoln Center, the same as their employer, and denied the home office tax deduction.<sup>88</sup>

The Second Circuit overturned the Tax Court's application<sup>89</sup> of the focal point test and instead applied the test in a way that reflected the legislative history of Section 280A.<sup>90</sup> The Second Circuit held that the musicians' home practice studios were their principal places of business<sup>91</sup> because in both time and importance, the home practice studio was the "focal point" of the musicians' business activities.<sup>92</sup> Since the musicians' homes were their principal places of business, the Second Circuit allowed a home office deduction.<sup>93</sup> The court found this to be "the rare situation in which an employee's principal place of business is not that of his employer."<sup>94</sup>

## 2. Legislative Intent: *Meiers v. Commissioner*

Instead of applying the focal point test, The United States Court of Appeals for the Seventh Circuit looked to the legislative intent behind Section 280A in *Meiers v. Commissioner*.<sup>95</sup> The taxpayers, John and Sally Meiers, managed a laundromat.<sup>96</sup> Mrs. Meiers spent an average of one hour per day at the laundromat and two hours per day at the home office where she drafted work schedules for employees and performed bookkeeping duties.<sup>97</sup> The home office was a separate room in the Meierses' home and was used exclusively for laundromat business.<sup>98</sup> The laundry facility did not have any available office space.<sup>99</sup> In their income tax return, Mr. and Mrs. Meiers deducted expenses relating to their home office from their income pursuant to Section 280A.<sup>100</sup>

The Tax Court applied the focal point test and disallowed the home office deduction because it found that the most important part of the

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88. *Id.* at 613–15.

89. *Id.* at 612–15.

90. *See* *Drucker v. Comm'r*, 715 F.2d 67, 69 (2d Cir. 1983); *see also supra* Part II.B (discussing Congress's reasons for enacting Section 280A).

91. *Drucker*, 715 F.2d at 69.

92. *Id.*

93. *Id.*

94. *Id.*

95. *See* *Meiers v. Comm'r*, 782 F.2d 75, 79 (7th Cir. 1985).

96. *Id.* at 76.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.*

Meierses’ business took place at the laundry facility.<sup>101</sup> The Tax Court held that the number of hours a taxpayer spends in various locations, while relevant, is not determinative in applying the focal point test.<sup>102</sup> The Tax Court relied upon a narrow construction of Section 280A and reasoned that where a business relies on generating income from the sale of goods or services to consumers, the part of the business where revenues are received determines the focal point of the taxpayer’s business.<sup>103</sup> Under this standard, the Tax Court held that the Meierses’ principal place of business was the laundromat, not the home office.<sup>104</sup>

The Seventh Circuit disagreed.<sup>105</sup> The court cited the Second Circuit’s decision in *Drucker*<sup>106</sup> and “question[ed] the usefulness of the focal point test.”<sup>107</sup> The Seventh Circuit did not believe the focal point test was “fair to taxpayers or carrie[d] out in the most appropriate way the apparent intent of Congress.”<sup>108</sup> The court further criticized the test, saying it put “undue emphasis upon the location where goods or services are provided to customers.”<sup>109</sup> Finally, the court held that the amount of time a taxpayer spends at his home office in relation to other offices should be “a major consideration” in determining a taxpayer’s principal place of business, but not the only consideration.<sup>110</sup> The court also considered “the importance of the business functions performed . . . in the home office; the business necessity of maintaining a home office; and the expenditures of the taxpayer to establish a home office.”<sup>111</sup> The Seventh Circuit determined that Mr. and Mrs. Meiers were permitted a home office deduction because they spent more time and accomplished more important business functions in their home office.<sup>112</sup> The court also concluded that the taxpayers were not “attempting to convert non-deductible personal living expenses into

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101. See *Meiers v. Comm’r*, 49 T.C.M. (CCH) 136 (1984), *rev’d*, 782 F.2d 75 (7th Cir. 1985).

102. *Id.* at 136.

103. *See id.*

104. *Id.*

105. *Meiers v. Comm’r*, 782 F.2d 75, 79 (7th Cir. 1985).

106. *Id.* at 78; *see also supra* Part II.D.1.

107. *Meiers*, 782 F.2d at 79.

108. *Id.*

109. *Id.*

110. *Id.*

111. *Id.*

112. *Id.*

deductible business expenses," reflecting Congress's intent in creating Section 280A.<sup>113</sup>

*E. Principal Place of Business: Commissioner v. Soliman*<sup>114</sup>

In the *Soliman* case, the Supreme Court abandoned the focal point test and created a new test to define a taxpayer's principal place of business under Section 280A(c)(1)(A).<sup>115</sup> Soliman, an anesthesiologist, spent an average of thirty to thirty-five hours a week administering anesthesia to patients in hospitals.<sup>116</sup> He also spent two to three hours a day working from his home in a spare bedroom that he converted into a home office.<sup>117</sup> He used time at his home office for administrative tasks such as billing records, updating patient logs, researching upcoming treatments, and other tasks related to his anesthesiology practice.<sup>118</sup> Soliman used his home office exclusively for business purposes, and he did not have an office provided at any of the hospitals where he treated patients.<sup>119</sup> In 1983, Soliman claimed deductions on his income tax return for expenses related to his home office.<sup>120</sup> He deducted condominium fees, utilities, and depreciation for the portion of his home used as an office.<sup>121</sup>

The Tax Court ruled that Soliman's home was his principal place of business, and as such, he could deduct home office expenses.<sup>122</sup> The Fourth Circuit affirmed the Tax Court's ruling and allowed the deduction.<sup>123</sup> The Supreme Court reversed, disallowing Soliman's home office deduction and concluding that his home was not his principal place of business.<sup>124</sup>

In defining a taxpayer's principal place of business, the Supreme Court held that no test is determinative; however, two factors should be assessed<sup>125</sup>: (1) the relative importance of the activities performed at each business location and (2) the relative amount of time spent at

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113. *Id.*

114. 505 U.S. 168 (1993), *superseded by statute*, Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932(a), 111 Stat. 788, 881.

115. *See id.* at 168-69, 174-77.

116. *Id.* at 170.

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Soliman v. Comm'r*, 94 T.C. 20, 29 (1990), *aff'd*, 935 F.2d 52 (4th Cir. 1991), *rev'd*, 506 U.S. 168 (1993).

123. *Soliman*, 935 F.2d 52.

124. *Soliman*, 506 U.S. at 178.

125. *Id.* at 181-83.

each place.<sup>126</sup> In evaluating the first factor, the Court determined that the work Soliman performed outside his home, administering anesthesia, was more important to his business than the management functions he performed at his home office.<sup>127</sup> In assessing the second factor, the Court found that Soliman treated his patients at hospitals and spent the majority of his time there, as opposed to his home.<sup>128</sup> Both factors weighed against allowing Soliman a tax deduction for his home office.<sup>129</sup> The Court determined that the necessity of the activities performed in a location should not have “much weight in determining whether a home office deduction should be allowed” because in most businesses, “each step is essential.”<sup>130</sup> The Court noted that “the facts in each case will vary, making it difficult to develop a bright line test” or “objective formula.”<sup>131</sup>

#### F. Criticism of the Soliman Decision

The *Soliman* decision was widely criticized because it denied home office deductions to taxpayers with valid claims. Critics argued that *Soliman* resulted in different treatment for taxpayers who are similarly situated and did not provide a predictable or workable standard for determining whether a taxpayer was eligible for the home office tax deduction.<sup>132</sup>

##### 1. Unfair Result

Many critics focus on the fact that Soliman was denied a home office deduction for valid business expenses.<sup>133</sup> Even though it was necessary for Soliman to perform all of his administrative tasks from his home, because no hospital provided office space for him, the Court determined that Soliman was not entitled to a tax deduction because the activities performed from his home office were “less

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126. *Id.* at 183.

127. *See id.* at 178.

128. *See id.*

129. *Id.* at 178-79.

130. J. Patrick Sullivan, *The Continuing Saga of the Home Office Deduction*, 58 MO. L. REV. 989, 1004-05 (1993); *see also Soliman*, 506 U.S. at 176.

131. Sullivan, *supra* note 130, at 1003; *see also Soliman*, 506 U.S. at 174-75.

132. *See infra* Part II.F.1-2.

133. *See, e.g., Gerlack, supra* note 67, at 801 (stating that individuals in professions such as anesthesiology, emergency-room medicine, and construction use their home offices for business but perform important functions away from home).

important” than his work in treating patients.<sup>134</sup> Soliman was denied a tax deduction for expenses that “were bona fide business expenses.”<sup>135</sup>

A taxpayer who rents space is entitled to the deduction, while someone who performs the same tasks at his home is not.<sup>136</sup> Critics argue that the *Soliman* decision promoted inefficiency because it encourages a taxpayer to seek outside office space in order to obtain the home office deduction, while “those same activities could more conveniently be performed from the home office.”<sup>137</sup> Some argue that the “all-or-nothing” approach to the home office deduction “creates a situation where a taxpayer may have actually used the home office for business purposes, but is completely denied a home office deduction.”<sup>138</sup>

## 2. Inequalities Between Professions

In addition to denying valid business deductions, the *Soliman* decision created a “principal place of business” test that treats certain professions dissimilarly. The home office deduction was not enacted to give benefits to specific professions and should not favor one type of business over another.<sup>139</sup> Under *Soliman*, “home office deductions are completely denied for taxpayers such as house painters, carpenters, landscapers, construction workers, doctors, professors, musicians, artists, and sales professionals.”<sup>140</sup> These types of professions require that the essence of the business be conducted at other locations, not the home office. Under the all-or-nothing approach *Soliman* presents,<sup>141</sup> these taxpayers receive no benefit at all, while taxpayers in other professions, such as lawyers or accountants, are “unharmd” by the *Soliman* decision.<sup>142</sup>

This point is illustrated through a comparison between a self-employed house painter and a self-employed accountant.<sup>143</sup> Under *Soliman*, the painter cannot take a home office deduction because his

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134. Brenda A. Ray, Note, *Home Office Deduction in Need of Repair: Applying Mixed-Use Allocation Theory to Internal Revenue Code Section 280A(c)*, 60 OHIO ST. L.J. 199, 212–13 (1999).

135. *Id.* at 213.

136. *Id.*

137. *Id.* at 213–14.

138. *Id.* at 199, 213.

139. *Id.* at 214.

140. *Id.*

141. See *supra* Part II.E.

142. Ray, *supra* note 134, at 214.

143. *Id.*

home office will not qualify as his principal place of business because the more “important” part of his business, painting, must take place outside of his home.<sup>144</sup> However, an accountant can prepare tax returns, the most “important” part of his business, in his home office, and so his home can possibly qualify as his principal place of business.<sup>145</sup> The nature of the business controls whether a person qualifies for the home office tax deduction under *Soliman*.<sup>146</sup>

### 3. The Comparative Analysis Test Does Not Provide Predictability

In *Soliman*, the Court determined that a taxpayer’s principal place of business ultimately depends on the “particular facts of each case.”<sup>147</sup> Because no test is determinative, the decision creates uncertainty in tax planning, and a “taxpayer may discover at year end that he or she fails to qualify for the home office deduction.”<sup>148</sup> Justice Thomas stated in his concurring *Soliman* opinion that the Court “granted certiorari to clarify a recurring question of tax law that has been the subject of considerable disagreement.”<sup>149</sup> Unfortunately, this issue is no clearer today than it was before we granted certiorari.<sup>150</sup>

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144. *Id.*

145. *Id.* at 214–15.

146. *See id.* at 214.

147. *Comm’r v. Soliman*, 506 U.S. 168, 175 (1993), *superseded by statute*, Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932(a), 111 Stat. 788, 881.

148. Ray, *supra* note 134, at 216.

149. Some critics of the *Soliman* decision argue that the Supreme Court essentially adopted the focal point test, even as it outwardly refused to do so. *See, e.g.*, Ann Margaret Bittinger, Comment, *The Home Office Deduction: The Times Are Changing but the Tax Code is Not*, 45 U. KAN. L. REV. 921, 937 (1996). Others argue that the Supreme Court adopted a variation of the “dominant portion of the work test.” Sullivan, *supra* note 130, at 1010. This test determines the taxpayer’s principal place of business by looking at where the “dominant” portion of his work is performed. *Id.* “[T]his test essentially is the focal point test with an exception being made if the taxpayer spends the majority of his time in the home office.” *Id.* at 1002 n.128. Under this test, the relationship between delivery of goods or services and time is “disjunctive.” *Id.* at 1010. Justice Thomas also argued that when the Court adopted the “importance” and “time” test in *Soliman* that “one might think the Court was in fact adopting the focal point test.” *Soliman*, 506 U.S. at 180–81 (Thomas, J., concurring). The focal point test was the subject of heavy criticism prior to the *Soliman* decision. *See supra* Part II.D.

150. *Soliman*, 506 U.S. at 184 (Thomas, J., concurring).



### G. The Taxpayer Relief Act of 1997<sup>151</sup>

After significant criticism, Congress responded to the *Soliman* decision by enacting the Taxpayer Relief Act of 1997.<sup>152</sup> This Act expanded the definition of “principal place of business” under Section 280A so that taxpayers in positions similar to *Soliman* would be eligible for a home office deduction.<sup>153</sup>

#### 1. Reasons for the Modification

Congress thought that the *Soliman* decision unfairly denied the home office deduction to “taxpayers who manage[d] their business activities from their homes.”<sup>154</sup> Congress also sought to clarify the treatment of home office use in response to criticism that the *Soliman* decision resulted in an unworkable test.<sup>155</sup> As many argued, “Taxpayers deserve a bright-line standard for determining when home office expenses are deductible.”<sup>156</sup>

The amendment also updated the home office deduction to reflect a changing workforce. Congress saw the new approach as a response to emerging technology, which made it more practical for a taxpayer to manage his business from a home office.<sup>157</sup> The legislators believed that this amendment would “enabl[e] more taxpayers to work efficiently at home, save commuting time and expenses, and spend additional time with their families.”<sup>158</sup> The legislators enacted the modified home office deduction as a response to new technology, specifically the “computer and information revolution.”<sup>159</sup>

#### 2. Expansion of the Home Office Deduction Under the Taxpayer Relief Act of 1997

In the 1997 Act, Congress expanded the definition of a taxpayer’s principal place of business under Section 280A(c).<sup>160</sup> The legislation

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151. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932, 1997 U.S.C.C.A.N. (111 Stat. 788) 932 (codified at 26 U.S.C. § 280A).

152. *See id.*

153. *Cf. id.* (stating that the “principal place of business” includes places used by the taxpayer for administrative or management activities if there is no other fixed location for such activity).

154. H.R. REP. NO. 105-148, at 407 (1997), reprinted in 1997 U.S.C.C.A.N. 678, 801.

155. *See supra* Part II.F.

156. Sullivan, *supra* note 130, at 1012.

157. H.R. REP. NO. 105-148, at 407, reprinted in 1997 U.S.C.C.A.N. 678, 801.

158. *Id.*

159. *Id.*

160. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 932, 1997 U.S.C.C.A.N. (111 Stat. 788) 932 (codified at 26 U.S.C. § 280A).

added to the definition so that a home office could be the taxpayer’s principal place of business where: (a) the office is used for administrative or management activities of any trade or business, and (b) there is no other fixed location where the taxpayer conducts substantial administrative or management activities of such business or trade.<sup>161</sup>

The expansion directly affects taxpayers in situations similar to Soliman’s position. Soliman would be allowed a home office deduction under the Taxpayer Relief Act of 1997 because he meets both criteria under the revised Section 280A(c): Soliman conducted administrative activities in his home office, including keeping billing records and patient logs, and he had no other fixed location to conduct these administrative tasks because the hospitals did not provide him office space.<sup>162</sup>

### III. PROBLEMS WITH THE CURRENT HOME OFFICE TAX DEDUCTION UNDER SECTION 280A

The 1997 Taxpayer Relief Act modified the home office tax deduction significantly and simultaneously created new problems. There are four main areas of concern about the home office deduction as it is currently enacted.<sup>163</sup> First, the deduction treats self-employed taxpayers differently from those who are employees, even when the taxpayers are similarly situated.<sup>164</sup> Second, many taxpayers are reluctant to take the deduction because of its complexity.<sup>165</sup> Third, the home office tax deduction presents unique challenges, making it difficult for taxpayers to substantiate their deductions.<sup>166</sup> Finally, the regular use standard under the deduction presents uncertainty and unpredictability.<sup>167</sup>

#### *A. Different Treatment for the Self-Employed than for Employees*

Under Section 280A, an employee is only eligible for a home office deduction if he is using his home office “for the convenience of his employer.”<sup>168</sup> This requirement makes it very difficult for employees

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161. See I.R.C. § 280A(c) (1998) (current version at I.R.C. § 280A(c) (2006)); Taxpayer Relief Act § 932, 111 Stat. at 881.

162. See *Comm’r v. Soliman*, 506 U.S. 168, 170 (1993).

163. See *infra* Part III.A–D.

164. See *infra* Part III.A.

165. See *infra* Part III.B.

166. See *infra* Part III.C.

167. See *infra* Part III.D.

168. I.R.C. § 280A(c)(1) (2006).

who work at home or telecommute to deduct business expenses. Under the current treatment of Section 280A, if an employer provides an employee with an office and does not require her to work at home, the employee will not meet the convenience of the employer test and is not eligible for a home office deduction.<sup>169</sup> The tax treatment under Section 280A is even different between two individuals working in the same profession, for example, a self-employed doctor and a doctor who is the employee of a hospital.<sup>170</sup>

The different treatment between those who are self-employed and those who are employees working at home or telecommuting is illustrated by the difference in treatment between April, a musician in an orchestra, and John, a self-employed plumber.<sup>171</sup>

April is a cellist employed by an orchestra and performs regularly at a fine-arts center. The orchestra provides her with practice space at the center. The center is far from her home, and April plays in concerts only on the weekends, so she uses a studio in her home for individual practice on a regular basis, an average of six hours a day, thirty hours per week. Her practice is a necessary part of her job with the orchestra, and April spends the majority of her practice time learning music for upcoming performances. April will not meet the convenience of the employer test because her employer provides her with studio space. In addition, she is not required to work from home. April will not be able to claim a home office tax deduction.

John is a self-employed plumber who spends the majority of his time at his clients' homes fixing leaking pipes and repairing other plumbing issues. John has an office in his home that he uses for administrative work such as keeping billing records and ordering supplies. John does not conduct administrative or management activities at any other fixed location. John spends about three hours total per week on these administrative activities. John meets all of the qualifications, including the principal place of business requirement, so he is allowed to deduct expenses with respect to his home office.

April and John illustrate the disparity between taxpayers who are self-employed and those who are employees. The home office tax deduction is an all-or-nothing deduction; under the facts shown, John is able to deduct all of his home office expenses, despite working

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169. IRS, *supra* note 2, at 5 ex.4.

170. Ray, *supra* note 134, at 223.

171. April and John are hypothetical taxpayers and illustrate the differences in tax treatment between those who are employees and those who are self-employed. The examples are drawn loosely from examples given in IRS Publication 587. See IRS, *supra* note 2, at 3-6.

only three hours per week in his home, while April is not allowed any deduction, even though she practices at home for thirty hours every week.

*B. Qualified Taxpayers are Reluctant to Take the Deduction*

In addition to the fact that employees and self-employed taxpayers are treated differently under the home office deduction, many qualified taxpayers do not take the home office tax deduction because they are afraid of audits and because the deduction is confusing and burdensome.

[A]ccording to the Internal Revenue Services’ Office of Taxpayer Advocate, only 2.7 million of the nearly 20 million Schedule C filers in tax year 2003 took a home office deduction, despite the fact that nearly 8 million taxpayers use one or more rooms in their home for business purposes. Most home-based small businesses don’t take advantage of the deduction because it is so time-consuming and burdensome—the IRS instruction manual for the home office deduction is 32 pages long.<sup>172</sup>

These statistics indicate that only about one-third of eligible taxpayers took the home office deduction in 2003.<sup>173</sup>

Taxpayers have an understandable concern that taking the home office deduction may trigger an audit, because the IRS has stated that the deduction “is an area where compliance is a concern.”<sup>174</sup> In part because taxpayers overstate their business deductions, the IRS estimates that there are approximately \$30 billion per year in unpaid taxes.<sup>175</sup> The “tax gap”<sup>176</sup> for tax year 2001 is estimated at \$345 billion.<sup>177</sup> In order to mitigate these deficiencies, the IRS uses audits

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172. *Home Office Deduction Could Become Simplified*, NAT’L SMALL BUS. ASS’N (Sept. 29, 2009), <http://www.nsba.biz/content/2556.shtml>.

173. *See id.*

174. *Home Office Deduction Reminders*, IRS.GOV (Sept. 2006), <http://www.irs.gov/newsroom/article/0,,id=163079,00.html>.

175. *Id.*

176. The tax gap is “the difference between what taxpayers should have paid and what they actually paid on a timely basis.” Through enforcement activities, including audits, the IRS recovered “about \$55 billion of the tax gap, leaving a net tax gap of \$290 billion for Tax Year 2001.” *IRS Updates Tax Gap Estimates*, IRS.GOV (Feb. 2006), <http://www.irs.gov/newsroom/article/0,,id=154496,00.html>.

177. *Id.*

to increase compliance.<sup>178</sup> The IRS also says that the complexity of the Tax Code is “a significant factor in [increasing] the tax gap,” so Tax Code simplification is another goal.<sup>179</sup> Because the IRS has identified the home office deduction as an area where taxpayers have been found to overstate business expenses resulting in a larger deduction,<sup>180</sup> a taxpayer taking the home office tax deduction may find himself subject to an audit.

*C. The Home Office Deduction Needs More Specific Substantiation and Recordkeeping Requirements*

In addition to the fear of audits, a taxpayer may find that taking the home office deduction is burdensome because he has to comply with confusing substantiation and recordkeeping requirements. The IRS states in its publication that while a taxpayer does not have to use a specific method of recordkeeping, he must keep “checks, receipts and other evidence of expenses . . . paid.”<sup>181</sup> A taxpayer may only deduct the portion of his home used exclusively for business purposes on a regular basis; therefore, a taxpayer must have records that indicate the portion of the home used for business and that the portion is used exclusively and regularly for business—either as the principal place of his business or as a place where the taxpayer meets with clients in the normal course of business.<sup>182</sup> It is difficult to determine the percentage of one’s home used exclusively for business, particularly when the taxpayer, as both homeowner and business proprietor, is assessing the percentage for his own benefit.

The home office deduction’s recordkeeping standards allow for more flexibility than the requirements necessary to take other deductions.<sup>183</sup> For a home office deduction, the taxpayer does not have to use a specific method of recordkeeping, and he may calculate the business portion of his home through “any reasonable method.”<sup>184</sup> It is unclear what specific documentation a taxpayer should produce

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178. *Id.*

179. *Id.*

180. *Home Office Deduction Reminders*, *supra* note 174.

181. IRS, *supra* note 2, at 17.

182. *Id.* at 18.

183. *Compare id.* at 6 (stating that a taxpayer can use “any reasonable method” to substantiate his expenses for the business portion of his home), *with* IRS, U.S. DEP’T OF THE TREASURY PUB. 463, TRAVEL, ENTERTAINMENT, GIFT, AND CAR EXPENSES 26 tbl.5-1 (2010) (stating that a taxpayer must show through receipts or other documentation the cost of business travel, dates of business travel, the destination, and the purpose for that travel), *available at* <http://www.irs.gov/pub/irs-pdf/p463.pdf>.

184. *See* IRS, *supra* note 2, at 6.

to substantiate that he uses his home office exclusively for business purposes. In contrast, if a taxpayer wants to deduct business use of his personal vehicle, he must produce documentary evidence such as receipts, mileage logs, bills, or cancelled checks.<sup>185</sup> Business travel expenses must be substantiated through documentary evidence that establishes the following elements: amount, time, a place or description, and a business purpose.<sup>186</sup> The home office allows much more flexibility in these elements and therefore opens the door for exaggerated expenses and taxpayer abuse.<sup>187</sup> As the IRS reports, this is an area of concern for their agency: “According to IRS research, understated business income, including underreported receipts and overstated expenses, is an area where compliance is a concern.”<sup>188</sup>

#### *D. The Regular Use Standard is Unclear*

The ongoing criticism of the home office tax deduction section centers on its lack of clarity. A taxpayer may only deduct his home office if a portion of his home is exclusively used for business purposes on a regular basis.<sup>189</sup> Critics argue that the “regular basis” component of this rule is not clearly defined. Because of the lack of clarity, it is possible that “a taxpayer [who] uses her office for merely a few minutes each day . . . could be entitled to a full deduction for a portion of her home.”<sup>190</sup> The IRS gives only the following guidance on the regular use standard: “Incidental or occasional business use is not regular use. You must consider all facts and circumstances in determining whether your use is on a regular basis.”<sup>191</sup>

The “all facts and circumstances” analysis is particularly confusing if a taxpayer is eligible for the home office deduction because his residence is his principal place of business due to his performance of administrative activities in his home. In order to meet the administrative exception, the taxpayer must show that he does not perform “substantial” administrative or management activities at another fixed location, in addition to showing that he uses his home

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185. See IRS, *supra* note 183, at 25.

186. See *id.* at 26 tbl.5-1.

187. See *Home Office Deduction Reminders supra* note 174.

188. *Id.*

189. I.R.C. § 280A(c)(1) (2006).

190. Wendy C. Gerzog, *Expanding the Home Office Deduction: Impose at Least Two Safeguards*, 69 TAX NOTES 481, 481 (1995).

191. IRS, *supra* note 2, at 3.

office on a “regular basis.”<sup>192</sup> The term substantial is not clearly defined. The only guidance on what constitutes substantial activities is given in the Congressional committee report, stating that if a taxpayer “occasionally does minimal paperwork at another fixed location of the business,” this does not constitute substantial work.<sup>193</sup>

The issues surrounding the regular basis definition are illustrated through Matt, an electrician.<sup>194</sup> Matt is self-employed and uses a room in his home exclusively for billing and recordkeeping associated with his business. He conducts all of his administrative activities at home, meeting the “substantial” requirement under Section 280A(c)(1). As such, Matt’s principal place of business is his home under Section 280A(c)(1)(A). However, Matt’s work as an electrician does not require a substantial amount of recordkeeping or billing. Matt spends five hours every week maintaining these records. Matt can argue that spending five hours every week performing these administrative activities is neither incidental nor occasional use, and so he meets the regular basis requirement under Section 280A(c)(1). Under the facts presented, and the uncertainty surrounding the definition of regular use, Matt can still be eligible to deduct all of his home office expenses, even though he only spends five hours per week in his home office.

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192. I.R.C. § 280A(c)(1). The word substantial is not defined in the Tax Code or the regulations; however, the *Soliman* test may be useful in determining whether the administrative activities performed at a fixed location other than the taxpayer’s home are “substantial.” Ray, *supra* note 134, at 228 n.145. Ray argues that one can look at the two prongs, the work’s relative importance and the amount of time spent at each location, to determine whether the taxpayer performed substantial administrative activities outside his home. *Id.* Ray illustrates this all-or-nothing approach and the unfairness it creates through two doctors, Doctor 1 and Doctor 2. Both doctors have a hospital-provided office and a home office. Doctor 1 manages his business one hundred percent from the home office and never uses the hospital-provided office. Doctor 2 performs administrative . . . activities both from her home office and from the hospital-provided office. . . . Because Doctor 1 manages his business one hundred percent from the home office, he is entitled to a full home office deduction . . . . Doctor 2 fails, however, to qualify for the home office deduction under both section 280A(c)(1) as amended by [the Taxpayer Relief Act of 1977] and under the comparative analysis test of *Soliman*.

*Id.* at 230–31 (internal citations omitted).

193. H.R. REP. NO. 105-148, at 407–08 (1997), *reprinted in* 1997 U.S.C.C.A.N. 678, 801–02.

194. Matt, the electrician, is a hypothetical taxpayer whose situation reflects Professor Gerzog’s argument. *See* Gerzog, *supra* note 190, at 481–82.

#### IV. PROPOSED LEGISLATION: THE HOME OFFICE DEDUCTION SIMPLIFICATION ACT OF 2009<sup>195</sup>

Congress is currently considering legislation to simplify the home office deduction and to address many of its problems.<sup>196</sup> The proposed Home Office Deduction Simplification Act of 2009 creates a standardized home office deduction of \$1,500, indexed to inflation or to the business’s gross income,<sup>197</sup> whichever is less.<sup>198</sup> This standardized deduction may be taken if the taxpayer qualifies for the home office deduction under the current code.<sup>199</sup> If enacted, a qualifying taxpayer will have the option to take either the current itemized deduction or the proposed standardized deduction.<sup>200</sup> Proponents of the legislation argue that it “would make it easier for home-based small businesses to claim an existing tax deduction” through instituting a standardized home office deduction.<sup>201</sup> While similar legislation has been introduced a number of times, Congress has yet to enact any of the proposed bills.<sup>202</sup>

##### *A. Intent Behind the Home Office Simplification Act of 2009*

The main goal behind the Home Office Simplification Act is to promote job growth.<sup>203</sup> Senator Lieberman stated that the Act would give federal support for small businesses in “their role as drivers of innovation and job creation.”<sup>204</sup> The sponsoring senators saw the bill as a way to “transform the current cumbersome process into a simple and straightforward deduction that boosts small businesses.”<sup>205</sup> In introducing legislation<sup>206</sup> that closely tracks the Home Office Simplification Act of 2009, Representative Kurt Schrader said, “The current home office deduction requirements are so confusing that

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195. S. 1754, 111th Cong. (2009).

196. *See id.*

197. *Id.* This gross income limit is the same under the current Tax Code. If a business owner’s gross income from the business use of his home is less than his total business expenses, his deduction is limited. I.R.C. § 280A(c)(5) (2006).

198. S. 1754.

199. *Id.*

200. *Id.*

201. Press Release, Boxer, *supra* note 8.

202. *See, e.g.*, Home Office Deduction Simplification Act, H.R. 3615 111th Cong.; Home Office Deduction Simplification Act, H.R. 1509, 111th Cong.; H.R. 6972, 110th Cong.; Small Business Tax Modernization Act of 2008, H.R. 6601, 110th Cong.

203. *See* Press Release, Boxer, *supra* note 8.

204. *Id.*

205. *Id.*

206. H.R. 1509.



many home-based entrepreneurs opt not to take advantage of it because they fear being audited if they make a mistake.”<sup>207</sup> Representative Schrader also argued that the amendment has economic advantages because a new, simplified “home office deduction would benefit millions of home-based business owners, who are estimated to comprise 53% of all small businesses.”<sup>208</sup> The National Federation of Independent Business agreed with this view and supported the bill, saying, “This legislation will help many small business owners utilize this tax deduction and in turn these business owners will be able to use these funds to invest and grow their businesses.”<sup>209</sup>

## V. ANALYSIS OF THE HOME OFFICE SIMPLIFICATION ACT OF 2009

The Home Office Simplification Act meets some of the legislation’s goals.<sup>210</sup> The Act makes the home office deduction less intimidating through the option for a standardized deduction, and it resolves some of the complexities in substantiating a home office deduction.<sup>211</sup> The Act does not go far enough to address other issues with the home office deduction, such as the different treatment between employees and the self-employed, and the Act does not clarify the regular use standard.<sup>212</sup> The legislation is a step in the right direction, but leaves some taxpayers in a position where valid business deductions are denied without providing clear guidelines for taking the deduction.

### *A. The Simplification Through a Standardized Deduction Will Encourage Qualified Taxpayers to Take the Home Office Deduction*

The Act simplifies the thirty-five-page home office publication<sup>213</sup> through a standardized deduction, and although many taxpayers will still need to itemize their deductions to receive the full benefit, the

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207. Press Release, Kurt Schrader, Chairman, Subcomm. on Fin. & Tax, Easing Small Business Tax Burden Would Spur Jobs (May 7, 2009), <http://house.gov/smbiz/PressReleases/2009/pr-5-7-09-small-business-tax-burden.html>.

208. *Id.*

209. Press Release, Nat’l Federation of Indep. Bus., NFIB Strongly Supports Home Office Deduction Simplification Act (June 3, 2009), <http://nfib.com/press-media/newsroom-article/cmsid/49277>.

210. *See supra* Part IV.

211. *See infra* Part V.A–B.

212. *See infra* Part V.C–D.

213. IRS, *supra* note 2.

choice of a simplified deduction is available.<sup>214</sup> If a taxpayer chooses to take the standardized deduction, he will not have to go through the process of determining the percentage of his home used for business purposes, nor will he have to apply the percentage to his business expenses in order to calculate his deduction.<sup>215</sup> Under current law, qualifying taxpayers must calculate the business percentage of expenses such as real estate taxes, qualified mortgage insurance premiums, deductible mortgage interest, and casualty losses.<sup>216</sup>

By simplifying the deduction to a standardized amount, lawmakers would encourage more small businesses to take the deduction, simply because it is less complicated. Many taxpayers do not take the deduction because it is so time consuming; this Act allows those taxpayers to take advantage of the deduction without that burden.<sup>217</sup> In addition, the concern about audits may be mitigated through the standardized deduction. The IRS is concerned about overstated business expenses, but a taxpayer taking a standardized deduction does not raise that same issue.<sup>218</sup>

#### *B. Legislation Only Helps to Resolve Some Substantiation Issues*

If a taxpayer chooses the standardized deduction under the proposed legislation,<sup>219</sup> he will not have to go to the same lengths to substantiate his business expenses. If he takes the standardized deduction, he will not have to itemize his home office related business expenses, but he still must provide substantiation and records showing that he used part of his home exclusively and regularly for business.<sup>220</sup> The standardized deduction substantially simplifies the recordkeeping and substantiation requirements to receive a home office deduction; however, it does not clarify the

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214. Home Office Deduction Simplification Act of 2009, S. 1754, 111th Cong. (2009).

215. The business percentage is most often determined by dividing the area of the home (in square feet) used for business purposes by the total area of the home. A taxpayer is allowed to “use any reasonable method to determine the business percentage.” IRS, *supra* note 2, at 6. “The business use ratio is determined by the ratio of business use to total use using mileage for vehicles, floor space for real property, time for machinery and equipment, and a reasonable method for other items.” David R. Burton & Dan R. Mastromarco, *The National Sales Tax: Moving Beyond the Idea*, 71 TAX NOTES 1237, 1246 (1996).

216. IRS, *supra* note 2, at 8.

217. *Home Office Deduction Could Become Simplified*, *supra* note 172.

218. *See Home Office Deduction Reminders*, *supra* note 174.

219. S. 1754.

220. *See* IRS, *supra* note 2, at 17–18.

substantiation requirements for a taxpayer who chooses to itemize his home office deduction.

*C. The Legislation Does Not Address the Inequality Between Employees and Self-Employed Taxpayers*

The legislators focus on using the deduction for job creation but do not address employee taxpayers. The law will still treat self-employed taxpayers differently from those who are employees.<sup>221</sup> A continuous criticism of the home office deduction is that the policy “encourages people to rent office space, which decreases economic efficiency, rather than work from home, which saves money and is family friendly.”<sup>222</sup> By extending the benefit only to those who are self-employed, Congress is also limiting potential job-growth.

The U.S. Department of Transportation has found that supporting employees who work at home furthers the following policies: “transportation, energy independence and conservation, improvement of air quality, employment for people with limited mobility (disabled, retired, low income, single parent), rural economic development, global competitiveness of American business, effective health care management, the American family, and increased community involvement.”<sup>223</sup>

One of the original legislative goals for the home office tax deduction was to create tax law that reflected new technology and the resulting changes in the work force.<sup>224</sup> This was also a goal when Congress enacted the Taxpayer Relief Act of 1997.<sup>225</sup> When Section 280A was enacted and modified, legislators wanted to use the tax law to enable more taxpayers to work at home, saving commuting costs, and to reflect the realities of new technology.<sup>226</sup> Technology is a driving factor behind the shift in the U.S. workforce toward both home-based businesses and telecommuting employees.<sup>227</sup> The reality of a changing workforce is evident in the federal government itself. From 2007 to 2008, the number of government teleworkers increased from 94,643 to 102,900, an increase of 8.72%.<sup>228</sup> Congress should

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221. See *supra* Part III.A.

222. Bittinger, *supra* note 149, at 921.

223. *Transportation Implications of Telecommuting*, U.S. DEP'T. OF TRANSP., RES. & INNOVATIVE TECH. ADMIN., <http://ntl.bts.gov/DOCS/telecommute.html> (last visited Dec. 15, 2010) [hereinafter RITA].

224. See H.R. REP. NO. 105-148, at 406, *reprinted in* 1997 U.S.C.C.A.N. 678, 800.

225. *Id.* at 407, *reprinted in* 1997 U.S.C.C.A.N. 678, 801.

226. *Id.*

227. See, e.g., RITA, *supra* note 223.

228. U.S. OFFICE OF PERS. MGMT., *supra* note 1, at 3.

look to the realities of the workforce and adapt the home office deduction to treat employee taxpayers in the same way as those who are self-employed.

1. Potential Solution: Modify the For the Convenience of the Employer Requirement

Employees are prevented from taking the home office tax deduction, regardless of the amount of time they spend working at home, if their home office is not for the employer’s convenience.<sup>229</sup> The clause is meant to curb taxpayer abuse and to prevent taxpayers from converting nondeductible personal expenses to business expenses;<sup>230</sup> however, it also results in disallowing valid business deductions. Some argue that telecommuters work from home for their own convenience<sup>231</sup> and that courts previously determined that it is inappropriate for an employee to deduct expenses when they are incurred only for personal convenience.<sup>232</sup>

However, the government has many valid policy reasons to encourage telecommuters and to encourage companies to allow workers to telecommute.<sup>233</sup> If the government removes the convenience of the employer requirement and institutes a minimum or “actual use” requirement,<sup>234</sup> the Tax Code will treat employees and the self-employed in the same manner but will allow only taxpayers who use their home office for a substantial amount of time to deduct expenses.

*D. The Simplification Act Does Not Resolve Issues Surrounding the Definition of Regular Use*

In addition to not addressing the difference in treatment between employees and self-employed taxpayers, the proposed legislation does not clarify the regular use standard set forth in Section 280A. One requirement to take the home office tax deduction is that the taxpayer must use his home office on a regular basis.<sup>235</sup> Section 280A is criticized because regular use is not sufficiently defined.<sup>236</sup>

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229. I.R.C. § 280A(c)(1) (2006).

230. S. REP. NO. 94-938, at 3–4, 9–10 (1976), *reprinted in* 1976 U.S.C.C.A.N. 3439, 3440–41, 3446.

230. Gerzog, *supra* note 190, at 481.

232. *See* Bodzin v. Comm’r, 509 F.2d 679, 680–81 (4th Cir. 1975).

233. *See* RITA, *supra* note 223.

234. *See infra* Part V.D.1–2.

235. I.R.C. § 280A(c)(1) (2006).

236. *See supra* Part III.D.

This ambiguity can allow taxpayers who do not spend a lot of time in their home offices to still qualify to take the home office deduction.<sup>237</sup> Two potential solutions could alleviate this ambiguity and provide a more accurate assessment of a taxpayer's deduction.<sup>238</sup> A minimum use requirement or an actual use test would provide a solution to the uncertainty surrounding regular use.

### 1. Minimum Use Requirement

Under a minimum use requirement, a deduction is only available to the taxpayer if the taxpayer spends a minimal percentage of his total working hours in the home office or a minimum amount of time in the home office.<sup>239</sup> A minimal use requirement, defined as a percentage of the taxpayer's total number of hours worked, may still be problematic because it could result in a taxpayer receiving a deduction for only a few minutes of administrative work if those few minutes amount to a very high percentage of the business's administrative duties.<sup>240</sup> A minimum number of hours spent per week, ten, for example, in a home office will exclude taxpayers who spend very little time in their home offices but will keep the benefit available to those who spend substantial time in their home offices.

The minimum use test can be applied to Matt the electrician<sup>241</sup> in its two forms. First, the test is applied as a minimum percentage; for example, a taxpayer must conduct ten percent of his total business in his home office to be eligible for a home office deduction. If Matt works forty hours per week as an electrician, five of which are spent working in his home office, he spends just over twelve percent of his work time in his home office. Assuming Matt meets all other requirements under Section 280A, under this ten percent test, he would be eligible for a home office deduction.

Second, the test is applied as a minimum hour requirement. A taxpayer must work ten hours per week in his office to be eligible for a home office deduction. Since Matt only spends five hours per week in his home office, he is not eligible for a deduction under this rule.

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237. See *supra* Part III.D.

238. See *infra* Part V.D.1-2.

239. Gerzog, *supra* note 190, at 481-82.

240. *Id.* at 481.

241. See *supra* Part III.D. Matt is a hypothetical taxpayer used to illustrate how, under the current regular use standard, a taxpayer can spend very little time in his home office and still be eligible for a home office deduction.

## 2. The Actual Use Test

The actual use test allows a deduction for the expenses attributable to the actual use of the home in connection with the taxpayer’s business.<sup>242</sup> This test is used in other areas of tax law that involve mixed-use property,<sup>243</sup> such as home rental and the business use of a car.<sup>244</sup> This could potentially allow Congress to do away with the “exclusive use” requirement, allowing more flexibility for taxpayers who work at home. The test provides a more accurate assessment of a taxpayer’s actual home office expenses.

The actual use test takes both the amount of expenses as a portion of the whole household’s expenses and the time spent in the home office into consideration.<sup>245</sup> First, the portion of the home used exclusively as the home office is multiplied by the total yearly home expenses.<sup>246</sup> This number is the amount of expenses allocable to the business use for the entire year.<sup>247</sup> That number is divided by the total hours in a year to determine the business expenses per hour.<sup>248</sup> The business expenses per hour are multiplied by the number of hours actually spent working in the home office.<sup>249</sup>

For example,<sup>250</sup> Jim has a home office that is one-fourth the size of his residence, and his total home expenses for the year are \$100,000. His expenses allocable to the business use for the year are \$25,000. There are 8760 hours in a year. Jim’s business expenses per hour are approximately \$2.85 (\$25,000 divided by 8760). Jim spends only three hours per week in his home office, a total of 156 hours per year. This means that, under the actual use calculation, Jim is eligible for a \$444.60 tax deduction (\$2.85 multiplied by 156 hours).

The drawback of the actual use test is that it will not simplify the existing Tax Code but will more likely complicate it. The test may be difficult to administer and could present issues in substantiating

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242. Ray, *supra* note 134, at 232-33.

243. See *supra* note 29.

244. In apportioning between the business and personal use of a vehicle, a taxpayer has a choice between two methods. He can use (1) the standard mileage rate, or (2) the actual costs attributed to his business use in figuring the amount he can deduct for business use of his vehicle. IRS, *supra* note 183, at 15-16.

245. See Ray, *supra* note 134, at 233-34 fig.1.

246. *Id.* at 233.

247. *Id.*

248. *Id.*

249. *Id.*

250. Jim is a hypothetical taxpayer used to illustrate how the actual use test would be calculated.

deductions. Proponents of the actual use test counter this criticism by saying that the taxpayer only needs to determine three criteria: “(1) the portion of the home actually used in connection with the business, (2) the total costs of the home, and (3) actual hours used in connection with the business.”<sup>251</sup> The actual use test “creates a home office deduction that is fair, equitable, and certain.”<sup>252</sup> Adopting the actual use test in conjunction with eliminating the convenience of the employer standard<sup>253</sup> results in a predictable home office deduction that treats self-employed and employee taxpayers fairly.

## VI. CONCLUSION

There are many criticisms of the home office tax deduction,<sup>254</sup> including that it is too complicated and difficult for taxpayers to take the home office deduction<sup>255</sup> and it unfairly favors self-employed over employee taxpayers.<sup>256</sup> In addition, the regular basis requirement is a source of uncertainty and unfairness.<sup>257</sup>

The proposed legislation would effectively simplify the complexities under the current deduction, encouraging qualified taxpayers to take the home office deduction.<sup>258</sup> The option for a standardized deduction allows taxpayers to take advantage of the deduction without the fear of an audit or intricate substantiation requirements.<sup>259</sup>

However, the Home Office Simplification Act of 2009<sup>260</sup> is intended as an economic stimulus to create job growth,<sup>261</sup> but misses opportunities for meaningful reform of the home office tax deduction.<sup>262</sup> Congress should adopt measures to clarify the regular basis test through either a minimum use requirement<sup>263</sup> or actual use test.<sup>264</sup> The home office deduction should be modified to include one of these tests to more accurately reflect a worker’s home office

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251. Ray, *supra* note 134, at 237.

252. *Id.* at 239.

253. *See supra* Part V.C.1.

254. *See supra* Part III.

255. *See supra* Part III.B.

256. *See supra* Part III.A.

257. *See supra* Part III.D.

258. *See supra* Part V.A–B.

259. *See supra* Part V.A.

260. S. 1754, 111th Cong. (2009).

261. *See supra* Part V.

262. *See supra* Part V.C–D.

263. *See supra* Part V.D.1.

264. *See supra* Part V.D.2.

expenses.<sup>265</sup> Either test would help to curb abuse and ensure that only business related expenses, and not nondeductible personal expenses, are the subject of the home office tax deduction.<sup>266</sup> In conjunction with a minimum use requirement or actual use test, Congress should eliminate the convenience of the employer requirement and allow employee and self-employed taxpayers equal treatment under the home office deduction while assuring a fair and accurate assessment of the deduction.<sup>267</sup> While Congress is reforming the home office deduction to promote job growth, it should also take the opportunity to bring clarity and equality to the home office tax deduction.

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265. *See supra* Part V.D.

266. *See supra* Part V.D.

267. *See supra* Part V.C.1.

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