MEMORANDUM

TO: TOM FREEDMAN, MARY L. SMITH

FROM: DREW HANSEN

RE: HOME OFFICE TAX DEDUCTION

DATE: AUGUST 15, 1997

PROBLEM

Current law provides for a tax deduction for home office expenses only in limited circumstances. Prior to the 1997 budget agreement, the home office had to be used exclusively and on a regular basis as the principal place of business. A 1993 Supreme Court case, Commissioner v. Soliman, restricted the ability to claim the home as a principal place of business by requiring that individuals perform the "essence of the professional services" there, based on an analysis of the amount of time spent at each business location and the importance of the activities performed. The 1997 budget agreement expanded the definition of "principal place of business" to include "a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade of business where the taxpayer conducts substantial administrative or management activities of such trade of business."

However, the "exclusive use" provision remains in Section 280A of the IRS Code. This requirement causes problems for individuals who work at home but who need to work in the same room as their children or who do not make enough money to afford a separate room to be used exclusively for business. Currently, day care providers are the only home-based business not required to satisfy the "exclusive use" rule. They are required to keep detailed records of the time that a room is used for work and the time that a room is used for other purposes. IRS rules regarding the allowable allocation of time to nonwork activities limits the deduction that they can claim. In addition, many work-at-home employees do not benefit from the full value of the deduction because Section 67, enacted in 1986, disallows home-office expenses of an employee to the extent that such expenses along with certain "miscellaneous itemized deductions" do not, in the aggregate, exceed two percent of the taxpayer's adjusted gross income. The combined impact of these regulations is to make it difficult for work-at-home employees to deduct their home-office expenses.

PROPOSED SOLUTION

- Amend Section 280A to allow an exception to the "exclusive use" rule permitting mixed use of space for taxpayers who care for dependents (including elderly parents).

- Simplify or eliminate the recordkeeping requirement.

- Revise the allocation rule for mixed use to compare the amount of time that a room is used for a business purpose with the amount of time that a room is used for a personal purpose -- not the amount of time used for a "non-business" purpose, which includes both a personal use and no use at all (i.e. nighttime).

- Amend Section 67 to exclude home-office expenses of employees from the miscellaneous itemized deductions subject to the two percent floor.