(Coopers & Lybrand analysis)

Business Use of Residence

Present Law: A deduction is permitted for expenses relating to the business use of a personal residence only in limited circumstances: the business portion of the home must be (1) used exclusively and on a regular basis as the principal place of business, (2) used to meet with patients, clients or customers, or (3) contained in a separate structure. A special rule also permits a home office deduction for that portion used regularly to store inventory (if the home is the sole fixed business location). An employee's business use of a home must be for the employer's convenience.

Observation: A 1993 Supreme Court case, Commissioner v. Soliman, further 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. In Soliman, a medical professional practiced at several hospitals and used his home for administrative and management activities several hours each day. The Court determined that the essence of his professional services was performed at the hospitals. The Court also indicated that in some situations no principal place of business would exist, and therefore no deduction would be possible.

Proposed Law: After 1995, a home office would qualify as the principal place of business if (1) the individual's essential administrative and management activities were regularly conducted there, and (2) no other location existed where these activities were conducted. As under present law, the home office would also need to be exclusively used on a regular basis as a place of business and, for employees, the use would need to be for the convenience of the employer.

The special rule permitting a home office deduction for inventory storage would be clarified to add product sample storage if the individual were in the sales business and if the home were the sole fixed location of the business.

Observation: The committee report notes that an individual could claim a home office deduction even if some administrative or management activities were conducted at sites not at fixed locations, e.g., a car or hotel room. Further, eligibility would not be affected if substantial nonadministrative or nonmanagement activities, such as meetings with clients or patients, took place at a fixed business location outside the home.

Observation: The bill would essentially nullify the Soliman decision and increase use of the home office deduction. The bill is consistent with technological advances that have made it more common for corporate employees to work from home, in addition to the consultants and small businesses that have long used home-based arrangements. It also would benefit large numbers of individuals who work out of a vehicle, such as those employed in a distribution network (e.g., trucking), the professional trades or the sales industry.

Observation: The bill also would eliminate the cost to some employers of "grossing up" employee wages to cover the nondeductibility of home office expenses.

(Budget Agreement)

SEC. 932. CLARIFICATION OF TREATMENT OF HOME OFFICE USE FOR ADMINISTRATIVE AND MANAGEMENT ACTIVITIES.

(a) IN GENERAL- Paragraph (1) of section 280A(c) is amended by adding at the end the following new sentence: `For purposes of subparagraph (A), the term `principal place of business' includes 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 or business where the taxpayer conducts substantial administrative or management activities of such trade or business.'.

(b) EFFECTIVE DATE- The amendment made by subsection (a) shall apply to taxable years beginning after December 31, 1998.