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### Home Office Deductions: *Curphey v. Commissioner*, 73 T.C. 766 (1980)

Gay Wolesensky Crosier  
*University of Nebraska College of Law*

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# Home Office Deductions

*Curphey v. Commissioner*, 73 T.C. 766 (1980).

## I. INTRODUCTION

Income tax deductions for expenses associated with an office in the taxpayer's personal residence have been the subject of substantial controversy since the early 1960s. Prior to 1976, home office expenses were deducted under the same sections of the Internal Revenue Code (Code) as other business expenses.<sup>1</sup> The courts and the Internal Revenue Service (Service) often disagreed over the proper interpretation to be given these Code sections with respect to deductions for home office expenses.<sup>2</sup> Currently, section 280A of the Code governs deductions associated with offices in the home.<sup>3</sup>

The Tax Court recently interpreted section 280A in a series of cases.<sup>4</sup> In *Curphey v. Commissioner*<sup>5</sup> the court took a liberal stance in interpreting section 280A,<sup>6</sup> and held that a taxpayer employed outside the home could have more than one principal place

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1. See I.R.C. §§ 162, 167; notes 12-13 & accompanying text *infra*.

2. See Section II of the text *infra*.

3. Section 280A of the Internal Revenue Code was added to the Code by the Tax Reform Act of 1976 to deal specifically with the office-in-the-home deduction. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified in scattered sections of 26 U.S.C.).

4. The Tax Court had its first opportunity to interpret section 280A of the Code in *Curphey v. Commissioner*, 73 T.C. 766 (1980). Since that time, four other cases have been decided: *Chauls v. Commissioner*, T.C.M. (P-H) ¶ 80,471 (1980); *Borom v. Commissioner*, T.C.M. (P-H) ¶ 80,459 (1980); *Hynes v. Commissioner*, 74 T.C. 93 (Sept. 1980); *Baie v. Commissioner*, 74 T.C. 105 (Apr. 1980).

5. 73 T.C. 766 (1980).

6. Section 208A of the Internal Revenue Code, in pertinent part, provides:  
Sec. 280A. DISALLOWANCE OF CERTAIN EXPENSES IN CONNECTION WITH BUSINESS USE OF HOME . . . .

(a) GENERAL RULE.— Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an electing small business corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence.

. . . .

of business, thereby allowing a deduction for home office expenses associated with the management of rental property.<sup>7</sup> However, the Service had conceded that the taxpayer's activities concerning the business of renting property were conducted from the office in the taxpayer's home. The Tax Court, therefore, was not called upon to decide whether the home office or the rental properties themselves constituted the taxpayer's principal place of business.<sup>8</sup> In many cases this will be the central issue.<sup>9</sup>

On August 10, 1980 the Service issued proposed regulations for section 280A.<sup>10</sup> These proposed regulations conflict with the

(c) EXCEPTION FOR CERTAIN BUSINESS OR RENTAL USE; LIMITATIONS ON DEDUCTION FOR SUCH USE.—

(1) Certain business use.—Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis—

(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.

In the case of an employee the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer.

I.R.C. § 280A.

7. 73 T.C. at 776.

8. *Id.* at n. 11.

9. See Section IV of the text *infra*.

10. The proposed regulations for section 280A in pertinent part, provide:

*Use as the taxpayer's principal place of business—(1) In general.* Section 280A(c)(1)(A) provides an exception to the general rule of section 280A(a) for any item to the extent the item is allocable to a portion of the dwelling unit which is used exclusively and on a regular basis as the taxpayer's principal place of business. (2) *Determination of principal place of business.* For purposes of section 280A(c)(1)(A) and this section, a taxpayer may have only one principal place of business regardless of the number of business activities in which the taxpayer may be engaged. When a taxpayer engages in business activities at more than one location, it is necessary to determine the principal place of the taxpayer's overall business activity in light of all the facts and circumstances. Among the facts and circumstances to be taken into account in determining an individual's principal place of business are the following:

(i) The portion of the total income from business activities which is attributable to activities at each location;

(ii) The amount of time spent in business activities in each location; and

(iii) The facilities available to the taxpayer at each location. For example, a home office in which a taxpayer engages in business as a self-employed person would rarely qualify as the taxpayer's principal place of business if the taxpayer's primary source of income is wages for services performed in another business on the employer's premises. On the other hand, if an outside salesperson has

*Curphey* holding by allowing a home office deduction only for the principal place of business for the taxpayer's primary business.<sup>11</sup> The proposed regulation, along with the Tax Court's constrictive view as to the actual location of the business activity, could narrow the range of allowable deductions so that it would be virtually impossible for most taxpayers to qualify for the deduction even if they had offices in their homes used regularly and exclusively in the conduct of their businesses.

## II. THE OFFICE IN THE HOME DEDUCTION

The standards used to determine the allowability of home office deductions have not remained constant for any significant length of time. Prior to the enactment of section 280A in 1976, deductions for home office expenses were taken under sections 162<sup>12</sup> and 167<sup>13</sup> of the Code. The primary restriction on the deductions was the Code's denial of any deductions for personal living expenses under section 262.<sup>14</sup> Because the courts and the Service offered various interpretations of these sections, it became very difficult to predict exactly where the fine line would be drawn between allowable and nonallowable deductions.

### A. Early distinctions

Some very early cases under the 1939 Code<sup>15</sup> focused on the distinctions the Code made between deductions taken for trade or business expenses and deductions taken for expenses incurred in connection with investment activities.<sup>16</sup> The 1939 Code also distinguished deductions available to a self-employed person from those allowed to an employee.<sup>17</sup> The cases generally focused on whether income was ordinary income or capital gain, and only incidentally on whether a deduction was allowable for home office expense.<sup>18</sup>

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no office space except at home and spends a substantial amount of time on paperwork at home, the office in the home may qualify as the salesperson's principal place of business.

Proposed Treas. Reg. § 1.280A-2(b)(1), (2), 45 Fed. Reg. 52399, 52403 (1980).

11. *Id.*

12. Section 162 of the Code allows a deduction for ordinary and necessary business expenditures. I.R.C. § 162.

13. Section 167 of the Code allows a deduction for depreciation of equipment used in a trade or business or used to produce income. I.R.C. § 167.

14. I.R.C. § 262. See Treas. Reg. § 1.262-1(b)(3) (1958).

15. Int. Rev. Code of 1939, ch. 2, § 23, 53 Stat. 12.

16. See note 18 & accompanying text *infra*.

17. Int. Rev. Code of 1939, ch. 2, § 23, 53 Stat. 12. See note 19 & accompanying text *infra*.

18. The earliest cases that tangentially addressed the home office deduction were *Higgins v. Commissioner*, 39 B.T.A. 1005 (1939), *aff'd*, 111 F.2d 795 (2d Cir. 1940), *aff'd*, 312 U.S. 212 (1941), and *Rider v. Commissioner*, 16 T.C. 1456

However, the cases which squarely addressed the home office deduction issue often involved the same controversies which have been the subject of continued litigation: 1) whether an activity constitutes a trade or business; and 2) what standards should be applied to an employee.<sup>19</sup>

### B. The Fluctuating Controversy: 1960 to 1976

During the Sixties, the controversy over home office deductions increased, as both the courts and the Service adopted varying interpretations of what deductions were allowable under sections 162 and 167 of the 1954 Code. The courts generally allowed a deduction under section 162<sup>20</sup> if the taxpayer made substantial use of an office in the home for trade or business purposes<sup>21</sup> even without proof of exact expenses.<sup>22</sup>

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(1951). In *Higgins*, which involved a deduction under the Revenue Act of 1932, the primary issue was the existence of a trade or business. The taxpayer was allowed to deduct expenses for his second office in Paris, France, located adjacent to his residence, up to the percentage of his activities that constituted a trade or business. 39 B.T.A. at 1015. In *Rider*, the court held that a professor who had written several texts had more than one trade or business and that the sale of his manuscripts did not constitute a sale of capital assets. Accordingly, it produced ordinary income. One factor influencing the court's decision was the commissioner's allowance of a deduction for an office in the home even though the professor chose to work at home for his personal convenience. 16 T.C. at 1457, 1461.

19. Two cases which focused on these issues early in the litigation history of office-in-the-home deductions were *Hand v. Commissioner*, 16 T.C. 1410 (1951), and *Bien v. Commissioner*, 20 T.C. 49 (1953). In *Hand*, a teacher who taught at two schools was not allowed a home office deduction because the court deemed him to be an employee of the schools because under sections 22 and 23 of the 1939 Code, an employee was entitled to deduct only expenses for travel, meals and lodging while away from home, and not home office expenses. See Int. Rev. Code of 1939, ch. 2, §§ 22, 23, 53 Stat. 12. The taxpayer also did occasional accounting work out of his home but because no income was received in the taxable year in question, no deduction was allowed. *Hand v. Commissioner*, 16 T.C. at 1415.

In *Bien*, an architect who ran his business out of his home was allowed to deduct the expenses of an office in the home. *Bien v. Commissioner*, 20 T.C. at 56.

20. Section 162 of the Code provides a deduction for "all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business . . ." I.R.C. § 162(a).
21. See, e.g., *Stuart v. Commissioner*, 20 T.C.M. (CCH) 938 (1961), where the court allowed a deduction for a home office because the taxpayers, husband and wife, made substantial use of the office. The wife used it in her business of selling real estate, and the husband, who was a C.P.A., an attorney and a professor, frequently used the home office. *Id.* at 939.
22. The court would allow deductions based on proof that the expenses were incurred even where there was inadequate proof as to the exact amount. However, the amount of the deduction was determined in a manner weighted against the taxpayer because of his lack of evidence. See, e.g., *Hayes v. Com-*

In 1962, the Tax Court, in *Davis v. Commissioner*,<sup>23</sup> held that a professor could not deduct his home office expenses for a study built over his garage which was used for conducting research, concluding that the study was built for the personal convenience of the taxpayer.<sup>24</sup> However, a strong dissent by four justices forecasted the standard which was to have future importance. Writing for the dissent, Justice Raum suggested that whether a home office was an ordinary and necessary business expenditure deductible under section 162 of the Code should be determined under a standard defined as whether the expenditure was "‘appropriate’ or ‘helpful’ and proximately related to the taxpayer’s trade or business."<sup>25</sup> His approach made no distinction on the basis of whether the taxpayer was in the business of being an "employee." In an attempt to buttress the majority opinion in *Davis*, the Service issued Revenue Ruling 62-180<sup>26</sup> which restated the *Davis* test. The ruling provided that a home office deduction would be permissible under the following circumstances:

An employee who, as a *condition of his employment*, is required to provide his own space and facilities for performance of his duties and *regularly uses a portion* of his personal residence for that purpose may deduct a pro rata portion of the expenses of maintenance and depreciation on his residence. However, the voluntary, occasional, or incidental use by an employee of a part of his residence in connection with his employment does not entitle him to a business expense deduction . . . .<sup>27</sup>

However, this ruling received a liberal construction from the Tax Court in 1963. In *Peiss v. Commissioner*,<sup>28</sup> a professor was allowed an ordinary and necessary business expense deduction for use of his home office for research and other professional activities because his work space at the college was inadequate. The Service had objected to the deduction because the taxpayer did not show that a specific portion of the home was allotted exclusively to office use.<sup>29</sup>

Later that same year, the Service released Revenue Ruling 63-275<sup>30</sup> in an attempt to limit the use of the *Peiss* case by other taxpayers. Under the Revenue Ruling, a professor claiming research

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missioner, 26 T.C.M. (CCH) 393 (1967); *Winfield v. Commissioner*, 25 T.C.M. (CCH) 305 (1966); *Stuart v. Commissioner*, 20 T.C.M. (CCH) 938 (1961); *Bien v. Commissioner*, 20 T.C. 49 (1953).

23. 38 T.C. 175 (1962).

24. *Id.* at 180.

25. *Id.* at 186 (Raum, J. dissenting; joined by Bruce, J.; Forrester, J.; and Train, J.).

26. Rev. Rul. 62-180, 1962-2 C.B. 52.

27. *Id.* at 52 (emphasis added).

28. 40 T.C. 78 (1963).

29. *Id.* at 83-84.

30. Rev. Rul. 63-275, 1963-2 C.B. 85.

expense deductions generally would be required to show the reasonableness of the research and that such research was conducted in his area of competence.<sup>31</sup> The Service then issued another Ruling which stated that a home office may be a reasonable expense for a professor if it is shown that employer-furnished space is inadequate.<sup>32</sup> These two rulings helped to maintain the "condition of employment" requirement as established in Revenue Ruling 62-180, as a standard for the deductibility of home office expenses.<sup>33</sup>

However, the Tax Court gradually began to shift away from its strict adherence to the "condition of employment" requirement. In *Bischoff v. Commissioner*,<sup>34</sup> the court announced in dictum that the employer-imposed requirement that the taxpayer maintain an office in his home was not necessarily a prerequisite to a deduction.<sup>35</sup> Returning to the standard suggested by the dissent in *Davis*,<sup>36</sup> the court stated that the employee's home office expenses were deductible even if not required by the employer so long as the expenses were "appropriate to the conduct of his trade or business."<sup>37</sup> This standard, as utilized by the court in *Newi v. Commissioner*,<sup>38</sup> allowed a deduction for "appropriate and helpful" home office expenses.<sup>39</sup> In *Newi* the taxpayer was a television advertising salesman who had adequate office space at the network offices, but he used his home office for about three hours daily to review and plan his activities, study materials, and view competitors' television advertisements.<sup>40</sup> The court, citing *Welch v. Helvering*<sup>41</sup> and *Commissioner v. Tellier*<sup>42</sup> to define ordinary and necessary busi-

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31. *Id.* at 86.

32. *See* Rev. Rul. 64-272, 1964-2 C.B. 55.

33. *See, e.g.,* Anzalone v. Commissioner, 23 T.C.M.(CCH) 497, 498 (1964) (deduction disallowed when taxpayer, a sales engineer, failed to show that his employer required a home office); Kelly v. Commissioner, 23 T.C.M.(CCH) 472, 478 (1964) (deduction disallowed to airline pilot who failed to show that it was necessary for him to have a home office).

34. 25 T.C.M.(CCH) 538 (1966).

35. In *Bischoff*, the employer had issued a memorandum to its employees saying that it expected them to incur some unreimbursed expenditures in connection with their jobs, which the taxpayer contended included an office at home. *Id.* at 538-39.

36. *See* notes 23-25 & accompanying text *supra*.

37. 25 T.C.M. (CCH) at 539.

38. 28 T.C.M.(CCH) 686 (1969), *aff'd*, 432 F.2d 998 (2nd Cir. 1970).

39. *Id.* at 691.

40. *Id.*

41. 290 U.S. 111 (1933). The Supreme Court defined a necessary business expenditure as one which was appropriate and helpful and defined an ordinary expense as a non-capital expense, consistent with business purposes. *Id.* at 113-14.

42. 383 U.S. 687 (1966). The Supreme Court defined an ordinary expense as a non-capital expense. *Id.* at 689-90.

ness expenditures, made no exception for a home office expense.<sup>43</sup> The Second Circuit, focusing on the employee's business needs, affirmed the decision and stated that the taxpayer in *Newi* might miss some of the television programming he needed to view if he had to return to the office building in the evenings; therefore, he needed an office in his home.<sup>44</sup>

After *Newi*, the Tax Court made subtle distinctions as to what constituted business reasons for the office in the home, disallowing deductions when the office in the home seemed to be purely for personal convenience<sup>45</sup> but otherwise allowing such deductions.<sup>46</sup> In doing so, it completely ignored the Revenue Ruling 62-180 requirement that the home office must be a condition of employment in order for there to be a deduction.<sup>47</sup>

The Tax Court continued in this direction until the Fourth Circuit overturned its decision in *Bodzin v. Commissioner*.<sup>48</sup> The circuit court disallowed the \$100 home office deduction taken for apartment rental expenses by an attorney who worked for the Internal Revenue Service. The Tax Court had held that because "the maintenance of the home office can be characterized as 'a matter of convenience' due to the existence of duplicate employer-provided facilities, [that fact] does not void the conclusion that the expenditure is appropriate and helpful."<sup>49</sup> The appellate court dist-

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43. See 28 T.C.M. at 691.

44. 432 F.2d at 1000.

45. See, e.g., *O'Connell v. Commissioner*, 31 T.C.M.(CCH) 837, 843 (1972) (disallowed a deduction to comptroller for office in the home used purely for taxpayer's convenience).

46. See, e.g., *Johnson v. Commissioner*, 31 T.C.M.(CCH) 941, 943 (1972) (allowed a deduction to a tool salesman even though he was not required to use an office in his home, using the same standard for an employee as used for someone in a trade or business); *Rink v. Commissioner*, 51 T.C. 746, 754 (1969) (allowed a deduction for a home office used for research); *Thomas v. Commissioner*, 28 T.C.M.(CCH) 575, 577 (1969) (allowed a deduction for a home office for an income tax preparer).

47. In *Gillis v. Commissioner*, 32 T.C.M.(CCH) 429 (1973), the court allowed home office expenses to be deducted by a district sales manager for an insurance company even though not required by the employer because the home office was appropriate and helpful. The court stated:

[n]either the absence of an employer requirement that a home office be maintained nor the mere existence of duplicate facilities in and of itself demands the disallowance of a deduction of home office expenses. Rather, the test is whether, like any other business expense, the maintenance of an office in the home is appropriate and helpful under the circumstances or simply serves the personal convenience of the taxpayer.

*Id.* at 431-32.

48. 60 T.C. 820 (1973), *rev'd*, 509 F.2d 679 (4th Cir. 1975), *cert. denied*, 423 U.S. 825 (1975).

49. 60 T.C. at 825-26 (footnotes omitted).



inguished *Newi* and held that the apartment rental was a personal expense because it was not used as a place of business. As a result, the court found it unnecessary to decide whether or not the expenditure was appropriate or helpful.<sup>50</sup>

During the interval between the Tax Court's decision in *Bodzin* and the circuit court's reversal, the Tax Court pushed the home office deduction to its limits by allowing a deduction to a taxpayer who managed his own investments from the family room of his home.<sup>51</sup> However, after the Fourth Circuit's decision in *Bodzin*, the Tax Court tightened up on allowability of home office deductions by using a variety of reasons for disallowing previously allowable deductions. In *Meehan v. Commissioner*,<sup>52</sup> the court held that an office in the home was not a place of business in "terms of either quantum or quality of activity, as contemplated by the regulation."<sup>53</sup> The regulation the court referred to was section 1.262-1(b)(3) which disallows deductions for personal living expenses.<sup>54</sup> The court also utilized a *Fausner*<sup>55</sup> type of analysis, stating that the taxpayer did not show any additional expense was incurred because of his home office.<sup>56</sup>

The Tax Court subsequently repudiated the *Bodzin* holding in *Sharon v. Commissioner*.<sup>57</sup> In *Sharon*, the taxpayer, an attorney for the Internal Revenue Service, was not allowed to deduct expenses for his home office used to review files and prepare briefs in connection with his employment and to monitor and manage his personal investments.<sup>58</sup> The court held that section 262 of the Code,<sup>59</sup> which disallowed the deduction of personal expenses, takes precedence over section 162,<sup>60</sup> which allows the deduction of ordinary and necessary business expenditures. The taxpayer's incidental use of the home office was not enough to establish the of-

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50. 509 F.2d at 681.

51. In *Anderson v. Commissioner*, 33 T.C.M.(CCH) 234 (1974), the Tax Court allowed the deduction based on the taxpayer's involvement in a section 212 activity—the collection or production of income.

52. 66 T.C. 794 (1976).

53. *Id.* at 807.

54. Treas. Reg. § 1.262-1(b)(3) (1958).

55. *Fausner v. Commissioner*, 413 U.S. 838, 839 (1973). In *Fausner*, the Supreme Court disallowed a deduction taken by an airline pilot for his expense in transporting his luggage to the airport in his car. The court said that no expense in addition to his normal commuting expense (which is a personal expense) was incurred by the taxpayer.

56. 66 T.C. at 808.

57. 66 T.C. 515 (1976).

58. *Id.* at 524-25.

59. Section 262 of the Code provides that "no deduction shall be allowed for personal, living or family expenses." I.R.C. § 262.

60. See note 12 *supra*.

office as a place of business.<sup>61</sup> The court rejected the application of the "appropriate and helpful" test<sup>62</sup> when a mixture of personal and business uses existed.<sup>63</sup>

Continuing to apply a strict view, the Tax Court also disallowed deductions to taxpayers who could not show that their homes were better suited for their work than their offices,<sup>64</sup> or who could not demonstrate that their homes were their places of business,<sup>65</sup> or who could not prove that any additional expense had been incurred.<sup>66</sup> Occasionally, strict adherence to these rules led to some questionable results. In *Monsky v. Commissioner*,<sup>67</sup> a home office deduction was denied to a professor who lived seven miles from campus and who depended on public transportation to get to work. A round trip to and from campus in the evenings would have taken approximately 3 hours on the public transportation system. Nevertheless, the court said that the professor failed to show that: 1) his home office was better suited than his campus office; 2) his home was a place of business; or 3) additional expense at home had been incurred.<sup>68</sup> The court said that the taxpayer could have chosen to live closer to campus, and then distinguished the *Peiss*<sup>69</sup> case because *Monsky's* home office was supposedly not better suited for work than his campus office.<sup>70</sup>

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61. 66 T.C. at 524.

62. See notes 37-39 & accompanying text *supra*.

63. 66 T.C. at 524.

64. See, e.g., *Monsky v. Commissioner*, 36 T.C.M.(CCH) 1046 (1977) (denying a professor a home office deduction on the grounds that his apartment was not better suited for his work than the office space provided at school); *Salviati v. Commissioner*, 36 T.C.M.(CCH) 1041, 1041-43 (1977) (disallowing a deduction for a home office taken by a teacher because she had adequate office facilities during the day, even though she did not have access to her schoolroom in the evening). Cf. *Shields v. Commissioner*, 37 T.C.M.(CCH) 537, 543 (1978) (allowing a deduction for minister's home office used to do literary writing); *Harris v. Commissioner*, 36 T.C.M.(CCH) 1426, 1430 (1977) (allowing a deduction for home office used more than incidentally to correlate and summarize research).

65. See, e.g., *Monsky v. Commissioner*, 36 T.C.M.(CCH) 1046 (1977); *Salviati v. Commissioner*, 36 T.C.M.(CCH) 1041 (1977).

66. See, e.g., *Salviati v. Commissioner*, 36 T.C.M.(CCH) 1041 (1977); *Cobb v. Commissioner*, 35 T.C.M.(CCH) 1480, 1481-82 (1976) (disallowing an attorney who worked for the Service a home office deduction because his use of the home office was incidental (following *Sharon*) and because no additional expense was incurred (following *Fausner* and *Meehan*)).

67. 36 T.C.M.(CCH) 1046 (1977).

68. *Id.* at 1049.

69. See note 28 & accompanying text *supra*.

70. 36 T.C.M.(CCH) at 1049.

### C. The Tax Reform Act of 1976

As part of the Tax Reform Act of 1976,<sup>71</sup> Congress attempted to clarify the allowable home office deduction by enacting section 280A.<sup>72</sup> Section 280A specifically addresses home office deductions and as a general rule, provides that "no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence."<sup>73</sup> This general rule does not operate to disallow deductions (such as interest expense and taxes) that are allowable to a taxpayer without regard to the deduction's "connection with his trade or business (or with his income-producing activity)."<sup>74</sup> Several exceptions to the general rule are provided in section 280A(c), including one allowing deductions if a portion of the taxpayer's home is used exclusively and regularly as the taxpayer's principal place of business.<sup>75</sup> However, an employee is allowed a home office deduction only if the "exclusive use referred to . . . is for the convenience of the employer."<sup>76</sup> Section 280A(c)(5) further limits all of the home use deductions to the amount of gross income derived from such office use less the deductions allocable to such use under the Code without regard to the home office deduction.<sup>77</sup>

The legislative history of section 280A indicates that Congress recognized a need to curtail the widespread abuse of home office deductions.<sup>78</sup> Such deductions under section 162 of the Code cre-

71. Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (codified in scattered sections of 26 U.S.C.).

72. I.R.C. § 280A. Section 280A was added to the Code because Congress felt a "need for definitive rules to resolve the conflict that exists between several recent court decisions and the position of the Internal Revenue Service as to the correct standard governing the deductibility of expenses attributable to the maintenance of an office in the taxpayer's personal residence." S. REP. NO. 938, 94th Cong., 2nd Sess. 147, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 3439, 3579 (hereinafter cited as SENATE REPORT); H.R. REP. NO. 658, 94th Cong., 2nd Sess. 160, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 2897, 3053 (hereinafter cited as HOUSE REPORT).

73. I.R.C. § 280A(a).

74. *Id.* § 280A(b).

75. *Id.* § 280A(c)(1)(A). Another exception is provided for a home office used exclusively and on a regular basis as a place to meet with clients, patients or customers. *Id.* § 280A(c)(1)(B). There are also special rules pertaining to separate structures not attached to the dwelling, *id.* § 280A(c)(1)(C); storage use, *id.* § 280A(c)(2); rental use, *id.* § 280A(c)(3); and use in providing licensed day care services, *id.* § 280A(c)(4).

76. *Id.* § 280A(c)(1).

77. *Id.* § 280A(c)(5).

78. Both the House and Senate reports reveal concern regarding a taxpayer being able to convert "nondeductible personal, living, and family expenses" into deductible business expenses "simply because . . . it was appropriate and

ated administrative problems<sup>79</sup> and were difficult for the Service to monitor because they were taken by many taxpayers in all income brackets.

Deductions for home offices used in connection with section 212 income producing activity seemingly are excluded by section 280A. In order to qualify for a home office deduction, an activity must reach the "trade or business" level and not be merely an investment.<sup>80</sup> Furthermore, the provision establishes a "convenience of the employer" test (similar to the "condition of employment" requirement of Revenue Ruling 62-180)<sup>81</sup> and thereby eliminates the "appropriate and helpful" test.

### III. THE *CURPHEY* DECISION

The *Curphey*<sup>82</sup> case presented the Tax Court with its first opportunity to interpret the meaning of "principal place of business" as used in section 280A. The court chose a liberal construction, holding that a taxpayer can have more than one principal place of business and that the test for deductibility is whether the home office is the principal place for conducting a particular business.<sup>83</sup> However, the court was careful not to lay down any general rule, stating that deductibility would depend upon the facts and circumstances of each case.<sup>84</sup>

#### A. Facts

In *Curphey*, the taxpayer was a fifty-two year old dermatologist employed by a hospital in Hawaii who also owned and managed six rental properties which were held for production of income and for an intended source of income upon his retirement at age sixty-

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helpful" to his job even though "only minor incremental expenses were incurred." SENATE REPORT, *supra* note 72, at 147; HOUSE REPORT, *supra* note 72, at 160.

79. The House and Senate reports provide that "the 'appropriate and helpful' test increases the inherent administrative problems" of determining which deductions are to be allowed. SENATE REPORT, *supra* note 72, at 147; HOUSE REPORT, *supra* note 72, at 160.

80. The Senate Finance Committee report provided:

expenses paid or incurred with respect to the use of a dwelling unit which is used by the taxpayer both as a residence and in connection with income producing activities (Sec. 212) will not be allowable as deductions under the provisions of this section unless the income producing activity constitutes a trade or business.

SENATE REPORT, *supra* note 72, at 149; see HOUSE REPORT, *supra* note 72, at 161.

81. See notes 26-27 & accompanying text *supra*.

82. *Curphey v. Commissioner*, 73 T.C. 766 (1980).

83. *Id.* at 776-77.

84. *Id.* at 775.

five.<sup>85</sup> In 1976, the taxpayer lived in a two-bedroom condominium, using one bedroom exclusively as the office out of which he managed his rental properties.<sup>86</sup> The room contained a bookcase, desk, filing cabinet, calculators and a "code-a-phone answering service."<sup>87</sup> The closet in the room contained items used to furnish, prepare or repair his rental units.<sup>88</sup> The room was not used for any other purposes. In 1976, gross income from the rental property was \$24,760 and the net loss was \$23,043 with a negative cash flow of \$6,242.<sup>89</sup> By retirement age, the taxpayer expected to have a positive cash flow of \$100 to \$200 per month from each unit.<sup>90</sup> On his 1976 tax return, the taxpayer deducted \$549 for depreciation and other expenses associated with the use of his home office to manage his real estate.<sup>91</sup> The Service determined that the taxpayer had a deficiency based, in part, on his deduction of the home office expenses.<sup>92</sup> Before trial, the Service conceded that the taxpayer's use of the home office in conjunction with the rental activity met the "exclusive use" and "regular basis" requirements of section 280A.<sup>93</sup> Thus, the two issues presented to the court for determination were: (1) whether the taxpayer's management of the rental property constituted a trade or business; and (2) if so, whether the taxpayer had more than one principal place of business or whether the taxpayer's only principal place of business was at the hospital, where he earned the greater portion of his income.

## B. Analysis of the Decision

Relying upon substantial legislative history,<sup>94</sup> the Tax Court agreed with the Service's position that no deduction for home office expense would be allowable if the office was used in connection with income producing activities<sup>95</sup> that did not constitute a trade or business. However, the court stated that "under appropriate circumstances, such type of activity [section 212 production of income] could constitute a trade or business."<sup>96</sup>

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85. *Id.* at 767-68.

86. *Id.* at 768.

87. *Id.*

88. *Id.*

89. *Id.*

90. *Id.*

91. *Id.*

92. *Id.* at 767.

93. *Id.* at 769.

94. See note 80 & accompanying text *supra*.

95. Section 212(2) of the Code allows deductions for all ordinary and necessary expenses associated with the "management, conservation, or maintenance of property held for the production of income. . . ." I.R.C. § 212(2).

96. 73 T.C. at 771.

The court relied on an amendment to section 280A adopted by the Senate which incorporated section 212(2) language into the definition of "business use of a home."<sup>97</sup> Although the Conference Committee had rejected the amendment,<sup>98</sup> the Tax Court reasoned that the amendment had been omitted because the Committee viewed it either as surplusage (based on Senator Bartlett's statement that the amendment specifically clarified what the joint committee intended to be included)<sup>99</sup> or as an extension of the Committee intentions in automatically allowing investors in securities to qualify as a trade or business, and thereby to qualify for a home office deduction.<sup>100</sup> In conclusion, the court said, "We do not read the legislative history as supporting the conclusion that Congress intended to modify the long-established judicial treatment of the ownership of rental properties as constituting a trade or business within the meaning of Section 162."<sup>101</sup> However, the Tax Court qualified its holding on this issue, by stating that "[W]e are not prepared to conclude that, in every case, the ownership and management of such properties would, *as a matter of law*, constitute a trade or business for such purposes."<sup>102</sup> The court stated that the issue was ultimately factual and the scope of ownership and management activities may be important in reaching a determination.<sup>103</sup> Because the taxpayer in *Curphey* managed his rental property by himself, including seeking new tenants and furnishing, cleaning and preparing apartments, the court concluded that his activities were "sufficiently systematic and continuous" to establish that the taxpayer was in the business of real estate rental.<sup>104</sup>

*Curphey* indicates that although a factual determination will be made as to the nature of the activity, a taxpayer cannot take a deduction for a home office used to manage or oversee investments or other types of activities that do not constitute a trade or business. A trap for the unwary may lie in the characterization of income in similar situations. If an activity rises to the level of a trade

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97. *Id.*. The amendment, offered on the Senate floor by Senator Bartlett, provided: "Business use of homes includes in its meaning for the use of management, conservation, or maintenance of property held for the production of income, and which is the substantial business of the taxpayer." 122 CONG. REC. 26138 (1976).

98. H.R. CONF. REP. NO. 1515, 94th Cong., 2nd Sess. 160, *reprinted in* [1976] U.S. CODE CONG. & AD. NEWS 4118, 4144; S. CONF. REP. NO. 1236, 94th Cong., 2nd Sess. 397, 455.

99. 73 T.C. at 772 (*citing* 122 CONG. REC. 26138 (1976) (remarks of Sen. Bartlett)).

100. 73 T.C. at 772.

101. *Id.*

102. *Id.* at 774 (citations omitted).

103. *Id.* at 775.

104. *Id.*

or business, the income generated will be ordinary income as opposed to capital gain treatment available to investment gains.

The second issue presented to the court was whether Curphey's office in his home could qualify as his principal place of business. The Service contended that if a taxpayer has more than one trade or business, a home office is deductible only if, considering all of the taxpayer's businesses together, "his home office is his principal place of business as determined by evaluating the time spent, the degree of business activity, and the financial return from the activity at each business post."<sup>105</sup> In other words, the Service was willing to allow a home office deduction only for the principal place of business of the principal business of the taxpayer.<sup>106</sup> The Tax Court rejected this standard, stating that section 280A refers to the home as a "specific situs in which a business is carried on."<sup>107</sup>

Although the legislative history of section 280A does not indicate what meaning Congress intended to be given to the phrase "principal place of business," the court chose to rule in favor of the taxpayer on this issue. The test as announced by the court was that in each case a factual determination must be made "as to whether, with respect to a particular business conducted by a taxpayer, the home office was his principal place for conducting that business."<sup>108</sup>

Under this test, the Tax Court held that Curphey was entitled to a home office deduction based upon the court's determination that his rental property constituted a trade or business and the Service's concession that Curphey's office in his home was his principal place of business with respect to his rental activity.<sup>109</sup> The court pointed out that in some situations there may be a question as to whether the taxpayer's home or the rental property itself would constitute the principal place of business.<sup>110</sup>

The Tax Court's position that a taxpayer may have more than one principal place of business for purposes of section 280A raises an unanswered question of where the line will be drawn between what constitutes a second trade or business and what is merely another facet of the same trade or business. This question is important because the court will have to find a second trade or business before most home offices can qualify for a deduction. If an activity is only an extension of the same trade or business, the principal place of business will almost always be located at the job

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105. *Id.* at 776.

106. *Id.* at 777.

107. *Id.* at 776.

108. *Id.*

109. *Id.* at n. 11.

110. *Id.*

site. For example, a professor with offices at both school and home who has written several texts would have to prove that the book writing was a separate trade or business in order to qualify for the deduction of home office expenses. The level that an activity must reach to be considered a trade or business for purposes of section 280A has not been specifically defined. However, cases under other Code sections indicate that minimal activity may be all that is required.<sup>111</sup>

However, two months after the *Curphey* decision, the Service issued Private Letter Ruling 8030024 which held that a "taxpayer can have only one principal place of business."<sup>112</sup> This private letter ruling involved a professor engaged in consulting who used his home office to provide consulting services. The Service based its position on the legislative history of section 280A, stating that "Congress intended to severely restrict the deductibility of expenses attributable to the use of an office in a residence. To allow the taxpayer to have two principal places of business would negate Congress' intention to restrict the deductibility of expenses."<sup>113</sup> The Service also felt that the literal language of section 280A indicated that a "taxpayer can have only one principal place of business."<sup>114</sup>

However, a strong argument can be made that the literal language of the section, ambiguous at best, supports the position that a taxpayer may have more than one principal place of business. Section 280A limits the allowable deduction for a home office to the amount of income derived from the use of the office in the home.<sup>115</sup> This limitation prevents abuse of the home office deduction by not allowing the deduction to offset income in excess of the amount of income derived from the trade or business carried on from the home office. This seems to indicate congressional recognition that

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111. Case law indicates that a taxpayer must have a profit motive, *Lamont v. Commissioner*, 339 F.2d 377, 380 (2nd Cir. 1964), which "need not be reasonable, only genuine," *Jackson v. Commissioner*, 59 T.C. 312, 316 (1972), in order to be considered to be in a trade or business. These cases were decided on a definition of trade or business contained in Code sections 162 and 167. See I.R.C. §§ 162, 167.

112. Priv. Ltr. Ruling 8030024 (Apr. 28, 1980).

113. *Id.*

114. *Id.* The Service said that "[t]he exception in Section 280A(c)(1)(A) applies specifically to the taxpayer's principal place of business, not the principal place from which the various businesses of the taxpayer may be conducted." *Id.*

115. I.R.C. § 280A(c)(5). Section 280A(c)(5) provides that a deduction under section 280A "for the taxable year by reason of being attributed to . . . [a use under § 280A(c)(1)-(4)] shall not exceed the excess of . . . the gross income derived from such use . . . over the deductions allocable to such use . . . whether or not such unit (or portion thereof) was so used." *Id.*



a taxpayer may have more than one trade or business and that the deduction may be taken without regard to which trade or business is involved so long as it is not used to offset income other than the income derived from the use of the home office.

#### IV. STANDARDS FOR DETERMINING A PRINCIPAL PLACE OF BUSINESS FOR ONE BUSINESS

After *Curphey*, the Tax Court was first confronted with the problem of determining the principal place of business where only one business was involved in *Baie v. Commissioner*.<sup>116</sup> In *Baie*, the court disallowed a section 280A(a) deduction for a home office used exclusively and on a regular basis for the bookkeeping operation associated with the taxpayer's operation of a hot dog stand seven-tenths of a mile from his home. The hot dog stand measured ten feet by ten feet, could not easily have been expanded and was not capable of housing all the activities associated with operation of the business.<sup>117</sup> The court found that the principal place of business was the hot dog stand where the sales occurred, and not the office in the home.<sup>118</sup> Thus, *Baie* establishes that even if the taxpayer's home is used in connection with a trade or business, the question remains whether the home or another location is the principal place of business.

Two subsequent cases also have resulted in taxpayers being denied a deduction. In *Hynes v. Commissioner*,<sup>119</sup> a decision rendered after the issuance of the proposed regulations for section 280A,<sup>120</sup> a television newsman was not allowed to deduct home office expenses because his principal place of business was at the television station. The court mentioned that the taxpayer did not demonstrate that the home office was for the convenience of the employer. In *Chauls v. Commissioner*,<sup>121</sup> the court disallowed a deduction taken by a music instructor who frequently used his home to meet the students and prepare for recitals. Although the taxpayer presented evidence of the number of hours he had used his home for these purposes, the court stated that the number of hours spent on the business premises compared to the number of hours spent working at home was not the criteria for determining

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116. ¶ 74.12 TAX CT. REP. DEC. (P-H) 58 (1980).

117. *Id.* at 59.

118. *Id.* at 60. The *Curphey* case was not precedential for the *Baie* decision because the Service had conceded that the home office in *Curphey* was the principal place of business. *Id.* at n. 6.

119. 74 T.C. 93 (Sept. 1980).

120. See note 10 *supra*.

121. T.C.M. (P-H) ¶ 80,471 (1980).

which was the principal place of business.<sup>122</sup> The court concluded that Congress must have meant "principal place of business" to mean the "focal point of the taxpayer's activities."<sup>123</sup> This unfortunate choice of words only further confuses the definition of "principal place of business."

## V. CONCLUSION

The Service's supposedly literal interpretation of section 280A as requiring only one principal place of business seems unwarranted. At best, the statutory language is ambiguous. Furthermore, the Code appears to permit more than one trade or business by limiting home office deductions for a trade or business to the income generated by that trade or business.

The Tax Court correctly ruled in *Curphey* that a taxpayer can logically have more than one principal place of business and it is hoped that the court will eventually find the appropriate case to invalidate the proposed regulation, if adopted in its present form. The court, however, has been unduly restrictive in refusing to recognize that for many businesses conducted outside of a personal residence, the home itself may be the principal place of business. The court should reexamine its position taken in *Baie*, *Hynes* and *Chauls* to ensure that valid and legitimate business expenses incurred in the use of an office in the home are deductible, while ensuring that the legislative purpose of section 280A is achieved: preventing deductions for the use of a home for purposes which are primarily personal.<sup>124</sup>

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122. *Id.*

123. *Id.*

124. SENATE REPORT, *supra* note 72, at 147-48; HOUSE REPORT, *supra* note 72, at 160.