

**NORTHERN ILLINOIS UNIVERSITY**

**The Home Office Deduction**

**A Thesis Submitted to the**

**University Honors Program**

**In Partial Fulfillment of the**

**Requirement of the Baccalaureate Degree**

**With University Honors**

**Department of Accountancy**

**by**

**Nick Tsagalis**

**DeKalb, Illinois**

**December 1994**

**HONORS THESIS ABSTRACT  
THESIS SUBMISSION FORM**

**AUTHOR:** Nick Tsagalis

**THESIS TITLE:** The Home Office Deduction

**ADVISOR:** Dr. Gregory Carnes

**ADVISOR'S DEPT:** ACCY

**DISCIPLINE:** Taxation

**YEAR:** 1994

**PAGE LENGTH:** 55    **BIBLIOGRAPHY:** Footnotes    **ILLUSTRATED:** None

**PUBLISHED(YES OR NO):** No    **LIST PUBLICATION:** N/A

**COPIES AVAILABLE:** Hard Copy, Diskette

**ABSTRACT:** As a result of a recent Supreme Court decision, *Commissioner v. Soliman*, stricter guidelines have been imposed upon taxpayers regarding their eligibility to take a home office deduction under the "principle place of business" election. As a result of *Soliman*, determining a taxpayer's principal place of business went from a "facts and circumstances" test, tailored to each individual case, to tests that consider only two factors. Several pronouncements and publications have prescribed guidelines and examples that explain this decision. *Soliman*, however, has been subject to criticism by the tax profession. Some professionals believe these tests are too strict. The pronouncements have also been subject to scrutiny for being vague. The purpose of this thesis was to gather information from the practicing tax profession to determine what its views were regarding *Soliman* and the subsequent pronouncements. Surveys were given to fifteen tax professionals. The purpose of the surveys was to determine whether *Soliman* provided adequate guidelines for determining a taxpayer's principal place of business, as well as to analyze whether the recent IRS pronouncements are consistently interpreted and applied. Survey results support the finding that the effects of *Soliman* are not universally accepted, and that interpretation of its guidelines do not always produce consistent and dependable conclusions. Therefore, it is proposed that the courts revert to the "facts and circumstances" test that was used prior to *Soliman*.

Student name: Nick Tsagalis

Approved by: Gregory A. Carter

Department of: Accountancy

Date: 12/16/94

## TABLE OF CONTENTS

|  | <b>Page</b> |
|--|-------------|
| <b>I.</b> Project Proposal                             | 1           |
| <b>II.</b> Home Office Deduction - In General          | 2           |
| <b>III.</b> Evolution of "Principal Place of Business" | 4           |
| <b>IV.</b> Implications of <i>Soliman</i>              | 16          |
| <b>V.</b> Purpose of Survey                            | 18          |
| <b>VI.</b> Survey Analysis/Results                     | 21          |
| <b>VII.</b> Conclusion/Recommendation                  | 32          |
| <b>VIII.</b> APPENDIX                                  |             |

## SENIOR CAPSTONE PROJECT

Nick Tsagalis  
ACCY 456  
Fall 1994

1305 N. Annie Glidden Apt.924  
Reference #4042  
October 3, 1994

1. Title of project.

Home Office Deductions

2. Describe, in detail, the focus of the work.

In the past, home office expenses were fairly easy to take as a deduction on one's tax return. Through time, these deductions have been more difficult to claim. The focus of this paper will be to trace the evolution of home office deduction tax law. There exists a current court case, *Com. v. Soliman*, that influences the way in which professionals view eligibility for this deduction, this case will be discussed. Tax professionals' opinions concerning this case will be obtained, as well as proposals for change in the current law.

3. Please list major works dealing with your topic that you intend to investigate.

Internal Revenue Code  
Treasury Regulations  
CCH-Standard Federal Tax Reporter  
Judicial Decisions  
Cumulative Bulletin  
Current relevant tax articles

4. Describe the methodology of the proposed study.

I will explain the emergence of the home office deduction and related tax law. Primary and secondary resources will be used to qualitatively analyze the evolution of this law and where it stands today. Fifteen to twenty tax professionals will receive surveys to obtain their ideas of how they interpret the current law and how they interpret the *Com. v. Soliman* court case related to home office deductions. They will be given several scenarios that depict situations in which a tax professional would have a difficult decision as to the eligibility of the deduction and be asked how they would react to each one. Proposals for changes in the current tax law will also be gathered.

5. What is the time frame for completion.

December 1994

6. List any courses taken that provide background for this study.

ACCY 455

## HOME OFFICE DEDUCTION - IN GENERAL

Under §280A(c)(1) of the Internal Revenue Code (IRC), a taxpayer is allowed a deduction for home office expenses “allocable to a portion of the dwelling unit” that is in connection with the taxpayer’s trade or business providing that certain requirements are met. In order to qualify for a home office deduction, a taxpayer must exclusively and regularly use a portion of his home solely for business purposes. If a taxpayer works in his home office occasionally, the “regular use” requirement of §280A(c)(1) is not met. Likewise, if the designated portion of the home is used for activities not related to the taxpayer’s trade or business, such as an exercise facility, the home office deduction will be disallowed.<sup>1</sup> It is important to note that using a home office as a passageway to other parts of the home does not inhibit the “exclusive use” requirement.<sup>2</sup>

Section 280A(c)(1) provides three requirements, one of which must be met, to allow a home office deduction, assuming the home office is used exclusively and regularly by the taxpayer as follows. The home office must be:

1. The taxpayer’s principal place of business for any trade or business,
2. A place of business that is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of his trade or business, or
3. A separate structure not attached to the dwelling unit, a place used in connection with the taxpayer’s trade or business.

If a taxpayer can prove that he falls under any of the three possible requirements, a home office deduction will be allowed. If the taxpayer is an employee, the IRC additionally requires that the

---

<sup>1</sup> CCH Explanation Par. 14,854.03, Prop. Reg. §1.280A-3, p. 31,031.

<sup>2</sup> *Ibid.*

home office be used for the convenience of his/her employer.

Under current tax law, a taxpayer may deduct expenses (i.e. rent, utilities, depr., etc.) allocable to the portion of the home used for business purposes. These expenses are limited to the gross income from the business less all other business expenses relating to the activity.<sup>3</sup> All expenses that are already allowable itemized deductions, such as interest and taxes, are deducted first from the business net income. All other expenses are deducted next, with depreciation of the home office taken last. Any expenses that exceed the income limitation are carried forward indefinitely to future tax years.<sup>4</sup> See Exhibit One of the Appendix for an example of the home office deduction calculation.

Reporting these expenses on a taxpayer's return differs between a taxpayer who is an employee and a taxpayer who is self-employed. An employee reports the allowable expenses on Schedule A of his individual tax return(1040) as an itemized deduction. As a Schedule A item, the allowable expenses are combined with all other items classified as miscellaneous expenses and the deduction is limited to the excess expenses greater than 2% of the taxpayer's adjusted gross income (AGI). A self-employed individual reports the allowable expenses on Schedule C of the tax return. These expenses are taken in full and are not limited to the 2% of AGI limitation. It is important to note that certain expenses that are not used because of the home office deduction income limitation, such as interest and taxes, are eventually deductible as an itemized deduction.

Sometimes it is difficult to determine whether a taxpayer meets one of the three requirements provided by the IRC. The second and third alternatives provide distinct guidelines

---

<sup>3</sup> Prop. Reg. §1.280A-2(i).

<sup>4</sup> §280A(c)(5).

for this determination. However, the meaning of the first alternative, in which the taxpayer claims a deduction because the home office is the “principal place of business”, has been controversial throughout the years; therefore, it is the focus of this paper.

### **EVOLUTION OF “PRINCIPLE PLACE OF BUSINESS”**

Prior to 1976, taxpayers were given liberal rules under §162 that allowed them to deduct home office expenses that were “appropriate and helpful” to conduct their trade or business.<sup>5</sup> These rules had been exploited and often allowed a taxpayer to deduct personal living expenses that were otherwise nondeductible. As a result, Congress enacted §280A of the IRC as part of the Tax Reform Act of 1976.<sup>6</sup> Section 280A was established in order to provide a set of objective rules to determine how a taxpayer can qualify for a home office deduction. The general provision in §280A states that “no deduction ... shall be allowed with the respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence”. However, 280A does provide numerous exceptions to this general provision.

Section 280A(c)(1) of the IRC states requirements that must be met by a taxpayer who elects to deduct home office expenses relating to his/her trade or business. Congress allows a home office deduction if a taxpayer’s residence is used regularly and exclusively as the taxpayer’s “principal place of business” for any trade or business [§280A(c)(1)(A)], a place for meeting with patients, clients, or customers [§280A(c)(1)(B)], or a separate structure not attached to the dwelling unit [§280A(c)(1)(C)].

---

<sup>5</sup> *Newi v Com.*, 70-2 USTC Par. 9,669 (CA-2, 1970).

<sup>6</sup> See Staff of Joint Committee on Taxation, 94th Cong., 2d. Sess., GENERAL EXPLANATION OF THE TRA OF 1976 .



The “principal place of business” provision set forth by Congress does not provide a clear and decisive meaning for taxpayers to use in determining their eligibility for home office deductions. When a taxpayer has more than one location at which business activity is conducted, §280A(c)(1)(A) does not provide a definitive guideline that defines the “principal place of business”. In situations where the taxpayer has patients or clients visiting the home office, or the home office is a separate structure to the home, a taxpayer may rely on §280A(c)(1)(B) and (C) to take a home office deduction. However, taxpayers claiming a deduction under §280A(c)(1)(A) may be subject to intense scrutiny by the IRS because the “principal place of business” has an ambiguous meaning.

Due to the lack of guidance set forth by Congress, the Tax Court had developed an objective “focal point” test that would determine a taxpayer’s principal place of business. The focal point test compared the locations a taxpayer used for the business and concluded that the “focal point” of a taxpayer’s business activities, which largely relied on the point of contact with clients or customers, determined the principal place of business.<sup>7</sup>

In a 1980 Tax Court case, *Baie v. Com.*, the taxpayer used the kitchen in her home to prepare food to sell at a foodstand near her residence.<sup>8</sup> Although the “exclusive use” requirement of §280A(c) was an overwhelming factor against the taxpayer, the Tax Court relied on the focal point test to disallow her home office deduction. “The sales of petitioner’s fast food product generated her income . . . Even though preliminary preparation may have been beneficial to the efficient operation of petitioner’s business, both the final packaging for consumption and

---

<sup>7</sup> Michael M. Megaard and Susan L. Megaard, “Supreme Court Narrows Home Office Deduction in Soliman,” *The Journal of Taxation*, March 1993.

<sup>8</sup> *R Baie*, 74 TC 105, Dec. 36,907, (1980).

sales occurred on the premises of the Gay Dog (the foodstand) . . . We therefore take it that what Congress had in mind was the focal point of a taxpayer's activities, which, in the case before us, would be the Gay Dog itself."<sup>9</sup>

In 1981, G.H. Weightman, an associate professor, was denied a home office deduction because the Tax Court did not consider his home office a "principal place of business".<sup>10</sup> Although preparation of lectures, grading papers and exams, and professional development involving research were conducted at the taxpayer's home office, the Tax Court states, "While preparation of lectures, grading of papers and exams, and professional development, including research activities, are important and indeed essential to the work of a college professor, they do not serve to shift the focal point of a professor's activities from the school to his office in his home".<sup>11</sup> It is important to note that teachers have consistently been denied the home office deduction.

In a 1982 U.S. Supreme Court case, *Loughlin v. U.S.*, the taxpayer was an airline pilot who occasionally used a portion of his home for business purposes.<sup>12</sup> Although the "regular use" requirement of §280A(c) could have been used to deny the taxpayer a deduction, the Tax Court relied on the focal point test. "Mr. Loughlin's occupation is that of an airline pilot . . . His principal place of business is not his home but rather the airport, cockpit, or the airline headquarters . . . it is clear that the focal point of Mr. Loughlin's business is not the area adjoining his kitchen."<sup>13</sup>

---

<sup>9</sup> *R Baie*, 74 TC 105, Dec. 36,907, (1980), p. 3162.

<sup>10</sup> *G.H. Weightman*, 42 TCM 104, Dec. 37,986(M), TC Memo 1981-301.

<sup>11</sup> *Ibid.*, p. 108.

<sup>12</sup> *J.O. Loughlin*, DC- Minn., 82-2 USTC Par. 9543.

<sup>13</sup> *Ibid.*, p. 84,951.

During this period, the IRS issued Proposed Regulations to help clarify the ambiguity in determining a taxpayer's principal place of business.<sup>14</sup> These regulations were proposed in 1980 and amended in 1983, but never made final.<sup>15</sup> The Service established a "facts and circumstances" test in Prop. Reg. §1.280A-2(b)(2) and provided examples of its application in Prop. Reg. §1.280A-2(b)(3). In Prop. Reg. §1.280A-2(b)(2), the Service stated that a taxpayer "may have only one principal place of business regardless of the number of business activities in which that taxpayer may be engaged . . . it is necessary to determine the principal place of the taxpayer's overall business activity in light of all facts and circumstances (pertinent to each individual case)".<sup>16</sup>

These regulations proposed a subjective test that compared all facts and circumstances with respect to each business location. This test emphasized the following factors:

1. The portion of the total income from business activities which is attributable to activities in each location,
2. The amount of time spent in business activities in each location, and
3. The facilities available to the taxpayer at each location.<sup>17</sup>

The IRS also issued Publication 587 which provided additional examples similar to those cited Prop. Reg. §1.280A-2(b)(3).<sup>18</sup>

Proposed Regulation §1.280A-2(b)(2) states that a taxpayer can have only one principle place of business. It is important to note that this requirement relates to a comparison of

---

<sup>14</sup> Prop. Regs. §1.280A-2, LR 261-76, 8/7/80, amended 7/21/83.

<sup>15</sup> Michael M. Megaard and Susan L. Megaard, "Supreme Court Narrows Home Office Deduction in Soliman," *The Journal of Taxation*, March 1993..

<sup>16</sup> Prop. Reg. §1.280A-2(b)(2), (1983).

<sup>17</sup> *Ibid.*

<sup>18</sup> Pub. 587, "Business Use of Your Home," Principal Place of Business.

activities in each type of business a taxpayer maintains. A taxpayer may claim a home office deduction when activities from several different businesses are conducted in one office. This deduction is valid as long as the “exclusive” and “regular” use requirements are met, as well as one of the three alternatives.<sup>19</sup> However, if any of the activities is related to a business that is not eligible for a home office deduction, the “exclusive use” requirement of the home office is tainted and no deduction is allowed for any of the business activities.<sup>20</sup>

Although the Proposed Regulations were never made final, the influence of these regulations can be seen with the Appellate Courts’ gradual shift away from the strict focal point test used by the Tax Court.<sup>21</sup> In a court case involving a musician, the Tax Court applied the focal point test to establish that the musician’s “principal place of business” was at his employer’s premises where the taxpayer performed.<sup>22</sup> The employer provided no space for the taxpayer to practice and most of the taxpayer’s time spent practicing was in a studio in his home. The Second Circuit reversed the Tax Court’s decision and stated, “we see no need to disturb the Tax Court’s ruling that the taxpayers are in the business of being employees of the Met . . . . Rather, we find this the rare situation in which an employee’s principal place of business is not that of his employer . . . . Both in time and in importance, home practice was the ‘focal point’ of the appellant musicians’ employment-related activities”.<sup>23</sup>

In 1984, a college professor, who spent the majority of his time in his apartment doing research and writing required by his job, was denied a home office deduction by the Tax Court.<sup>24</sup>

---

<sup>19</sup> P.L. 97-119, Black Lung Benefits Revenue Act of 1981.

<sup>20</sup> *Hamacher v Com.*, 94 TC 348 (1990).

<sup>21</sup> Michael M. Megaard and Susan L. Megaard, “Supreme Court Narrows Home Office Deduction in *Soliman*,” *The Journal of Taxation*, March 1993.

<sup>22</sup> *Drucker*, 715 F.2d 67 (CA-2, 1983), REV’G 79 TC 605 (1982).

<sup>23</sup> *Ibid.*, p. 87,961.

<sup>24</sup> *Weissman*, 751 F.2d 512(CA-2, 1984), REV’G TCM 1983-724.

The Tax Court had used its strict version of the focal point test to state that the focal point of the professor's job was when he taught at school. The Second Circuit reversed the Tax Court's decision and criticized its form of the focal point test. "When the *Drucker* standard is applied to this case, it becomes clear that Professor Weissman has also satisfied the convenience-of-employer test . . . The commissioner attempts to distinguish *Drucker* on the ground that the employer there provided no space for practice, while here the employer provided some space, i.e., a shared office and the library . . . *Drucker* is not so easily distinguished, however, for there, as here, the relevant fact is that the employer provided no suitable space . . . it spared the employer the cost of providing a suitable private office and thereby served the convenience of the employer."<sup>25</sup> In comparing *Weightman* and *Weissman*, it is important to note the differing tax consequences in light of the similar circumstances.

As a result of the Appellate Court's continual reversal of Tax Court decisions, the Tax Court began to shift away from its strict focal point test to more subjective tests. The Tax Court began using numerous factors to determine eligibility for a home office deduction. Factors used included time spent at each location, the place where the most important business functions are performed, the location where the majority of income is generated, and availability of space.<sup>26</sup> The Tax Court's change clearly resembled the "facts and circumstances" test given in Proposed Regulation §1.280A-2(b)(2).

---

<sup>25</sup> *Ibid.*, p. 87,028.

<sup>26</sup> *Pomerantz*, TCM 1986-461, AFF'D 867 F.2d 495(CA-9), 1988); *Kisicki*, TCM 1987-245, AFF'D 871 F.2d 1088 (CA-6, 1989); *Dudley*, TCM 1987-607, AFF'D 860 F.2d 1078 (CA-6, 1988).

## COMMISSIONER V. SOLIMAN

In a 1993 U.S. Supreme Court case, *Com. v. Soliman*, the Supreme Court denied the taxpayer a home office deduction.<sup>27</sup> This case is very important because the Supreme Court criticized the use of the strict “focal point” test implemented by the Tax Court, as well as the “facts and circumstances” test suggested in the Proposed Regulations. This case resulted in the emphasis of two factors to be used in determining a “principal place of business”.

During the 1983 tax year, respondent Soliman, an anesthesiologist, spent 30 to 35 hours per week administering anesthesia and postoperative care in three hospitals, none of which provide him with an office. He also spent two to three hours per day in a room in his home that he used exclusively as an office, where he did not meet patients but did perform a variety of tasks related to his medical practice. His claimed federal income tax deduction for the portion of his household expenses attributable to the home office was disallowed by petitioner Commissioner, who determined that the office was not Soliman’s “principal place of business” under §280A(c)(1)(A). The Tax Court disagreed and allowed the deduction. In affirming, the Court of Appeals adopted the test used in the Tax Court, under which a home office may qualify as the “principal place of business” if (1) the office is essential to the taxpayer’s business; (2) the taxpayer spends a substantial amount of time there; and (3) there is no other location available for performance of the business’ office functions.<sup>28</sup>

Initially, the Service had disallowed Soliman’s home office deduction by relying on the original focal point test used by the Tax Court. Since Soliman did not actually perform the activities from which he earned income at his home, he was denied the deduction. However, the Tax Court, influenced by the views of the Appellate Courts in the early 80’s, adopted the subjective “facts and circumstances” test. “The Tax Court abandoned that test (focal point), citing criticism by two Courts of Appeals (noting Meiers, Weissman, and Drucker).”<sup>29</sup> The

---

<sup>27</sup> *Com. v. Soliman*, 93-1 USTC Par. 50,014 (1993). Reversing 935 F.2d 52(1991).

<sup>28</sup> *Ibid.*, p. 87,052.

<sup>29</sup> *Ibid.*, p. 87,054.

Commissioner appealed the Tax Court decision; however, the Appellate Court affirmed. On January 12, 1993, the U.S. Supreme Court reversed the Fourth Circuit.

### REASONING OF THE COURTS

The Tax Court, acknowledging that Soliman did not perform his primary income-generating services at home, based its decision on the growing popularity of the subjective “facts and circumstances” test. This subjective test declared that a home office deduction could apply where (1) a home office is essential to the taxpayer’s business, (2) the taxpayer spends substantial time there, and (3) there is no other location available to perform the office functions of the business.<sup>30</sup> However, the Tax court did not compare the amount of time spent at each of Soliman’s business locations.

The Fourth Circuit affirmed the Tax Court stating that the Proposed Regulations suggested “a policy to allow home office deductions for taxpayers who maintain ‘legitimate’ home offices, even if the taxpayer does not spend a majority of his time in the office”.<sup>31</sup> However, similar to the Tax Court, the Appellate Court failed to make a comparison of the activities and time spent at each of Solimans’ locations. As a result, the Supreme Court decided to hear the case.

The Supreme Court analyzed several factors that the lower courts had used as support for their decisions. First, the Supreme Court criticized the lower courts negligence to make a comparison of activities and time spent at each of the locations. “In deciding whether a location is the ‘principal place of business,’ the common sense meaning of ‘principal’ suggests that a

---

<sup>30</sup> Robert T. Kelley, “Home Office Deductions Restricted by Supreme Court,” *Taxation for Accountants*, April 1993.

<sup>31</sup> *Com. v. Soliman*, 93-1 USTC Par. 50,014 (1993). Reversing 935 F.2d 52(1991), p. 87,054.

comparison of locations must be undertaken.”<sup>32</sup> The Supreme Court looked to the definition of the word “principal” as meaning “most important, consequential, or influential”. The Court stated that the essence of Soliman’s profession was to treat patients in the hospitals at which he was employed. This determination resembled the focal point test originally implemented by the Tax Court. The Court acknowledged this issue and stated that although the home office does not necessitate the meeting of patients, clients, or customers, such factors should be given considerable weight. Critics argue that §280A(c)(1)(B) might shadow over §280A(c)(1)(A) by implying that client or customer contact is necessary to determine the “principal” location; however, the Court “disagree(s) with the implication that whether those visits occur is irrelevant . . . The Court stresses the significance of the point of delivery where the nature of the taxpayer’s business requires delivery of goods or services at a facility with unique or special traits”.<sup>33</sup>

The Supreme Court also criticized the three factors the lower courts used to make their decisions. Whether a home office is “essential” to the business is not a conclusive factor in determining the allowance of a home office deduction. The court emphasized that a comparison of the activities performed at each location must be conducted to determine which activities are “principal” in nature. No such comparison was performed. The Court concluded that although the activities at the home were “legitimate”, a comparison shows the most important and “essential” activities were performed away from Soliman’s home office. The Court criticizes the “availability” factor stating that, “While that factor may be relevant in deciding whether an employee taxpayer’s use of a home office is ‘for the convenience of the employer, §280A(c)(1),

---

<sup>32</sup> *Ibid.*, p. 87,053.

<sup>33</sup> *Ibid.*, p. 87,056.



it has no bearing on the inquiry whether a home office is the principal place of business".<sup>34</sup> The Court also points out that whether or not the taxpayer spends a "substantial amount of time" at his home office, it is a factor that aids in the determination of a "legitimate" rather than the "principal" location.

In deciding Soliman's "principal place of business", the Court looked at the following two factors respectively: importance of business activities with respect to the location performed and time allocated to each location. An analysis of the activities performed concluded that the treatment of his patients at the hospitals were more important than his office duties. An analysis of time showed that Soliman only spent 25-30% of his work week performing activities in his home office. As a result, the Court denied his home office deduction.

Does this two-pronged formula provide adequate and clear guidelines to determine a "principal place of business"? Unfortunately, the Court acknowledged that, "we cannot develop an objective formula that yields a clear answer in every case . . . and there may be cases when there is no principal place of business, and the courts and the Commissioner should not strain to conclude that a home office qualifies for the deduction simply because no other location seems to be the principal place".<sup>35</sup> Amongst the criticism, it is important to note that the Court did not state the manner in which these two factors should be applied, the relative weight attached to each, or the conclusion to be drawn if they yield contradictory results.<sup>36</sup>

Shortly after *Soliman*, the IRS tried to clarify matters with Revenue Ruling 94-24.<sup>37</sup>

---

<sup>34</sup> *Ibid.*, p. 87,056.

<sup>35</sup> *Ibid.*

<sup>36</sup> Robert T. Kelley, "Home Office Deductions Restricted by Supreme Court," *Taxation for Accountants*, April 1993.

<sup>37</sup> Rev. Rul 94-24, 1994-15 IRB 5.

The Service announced how it will interpret Soliman by way of four examples. The Service issued this ruling to state that it would first apply a "relative importance" test. This test compares business activities at each location to determine which ones are most important to the business or that fully characterize the nature of that business. If the importance test does not lead to a definitive answer, the Service will apply a "time" test to determine at which business location the most time is spent. If no resolution comes out of the tests, the Service points out that it is possible that no principal place of business exists.

Revenue Ruling 94-24 has answered the manner in which the "relative importance" test and "time" test are to be applied; however, the relative weight assigned to each and the conclusion to be drawn when they yield contradictory results still remains undetermined. What if, for example, Soliman spent the majority of his time at the home office? According to Revenue Ruling 94-24, the Service would have denied the home office deduction because the importance test would have shown that the most important activities related to the nature of Soliman's profession, treating patients, are performed in hospitals. If the Supreme Court had faced a situation where Soliman did spend more time at the home office, would it have changed its decision knowing that the "time" test did not support the "importance" test?

As a result of the Soliman decision, taxpayers who had previously deducted home office expenses did not know how the new ruling would affect their tax position. Shortly after Soliman, the IRS also released Notice 93-12, which stated that taxpayers relying on Proposed Regulation §1.280A-2(b)(3) or IRS Publication 587 would not be adversely affected for tax years prior to 1992.<sup>38</sup> Notice 93-12 had also changed the existing examples in Proposed

---

<sup>38</sup> Notice 93-12, 1993-1 CB 298, *Business Use Of Your Home*.

Regulation §1.280A -2(b)(3) and Publication 587 to reflect the Soliman decision.<sup>39</sup> In addition, on May 20, 1994, LR 261-76 withdrew Prop. Regs. §1.280A-2(b)(2) and §1.280A-2(b)(3) as proposed in 1983.<sup>40</sup>

---

<sup>39</sup> See Exhibit Two for the new examples integrated into Prop. Reg. §1.280A-2(b)(3).

<sup>40</sup> LR 261-76. 59 Fed. Reg. 26466 (5/20/94).

## IMPLICATIONS OF *SOLIMAN*

Was justice served by *Soliman*? *Soliman* did not have an office at any of the hospitals in which he was employed. He conducted legitimate and necessary business activities regularly and exclusively in his home office. Although he did not spend the majority of his time in the home office, these functions were necessary to perform his job. The Supreme Court emphasized that a comparison of the activities performed at each location was necessary to determine the principal place of business; however, its conclusion relied largely on the point of delivery. Relying on this factor closely resembles the strict focal point test originally implemented by the Tax Court. The Appellate Courts attempted to move away from this test because it placed more importance on visible work rather than on dominant activities. *Soliman* emphasized the location the which primary income-generating services are provided, but is this the interpretation of §280A(c)(1) Congress intended in 1967?

How will the importance of activities with respect to the nature of a taxpayer's business be determined? There are many possible arguments when determining the most important activities inherent to the nature of a taxpayer's profession. A musician who practices in his home studio all week to prepare for performances that last 2-3 hours will claim that his most important activity is practicing. However, the Service, with guidance from the *Soliman* decision, may state that the musician's most important activity occurs when performing. What will happen if the most important work is done at home and the majority of time is spent away? General contractors spend a majority of there time visiting construction sites, but perform essential administrative duties in there home office. The Court might identify that the most important activities are performed at the construction sites where supervision and meeting

clients occur; however, a contractor may argue that most important functions are talking with clients and making bids on contracts over the phone.

Revenue Ruling 94-24 states that the Service will first apply the relative importance test and will only apply the time test if the first test yields no definitive answer. However, is this a proper interpretation of *Soliman*? In *Soliman*, the Court stated that a comparison of the activities performed and the amount of time spent at each location must be made. Is it right for the Service to place more weight on the relative importance test with the possibility that analyzing the time spent at each location might not be necessary? In *Soliman*, the Supreme Court criticized the Tax and Appellate courts for failing to make this comparison.

## PURPOSE OF SURVEY

Health care professionals, construction trades, teachers, artists, insurance professionals, realtors, and salesmen are only a few of the professions that must now face the implications of *Soliman*. However, as stated earlier, the element of ambiguity that a taxpayer must face when determining eligibility for a home office deduction under the “principal place of business” still exists after *Soliman*. Revenue Ruling 94-24 and the newly issued examples in Proposed Regulations §1.280A-2(b)(3) provide guidelines to help clarify this issue; however, they leave two pertinent questions unanswered. How are the most important activities of a profession relating to the “essence” of a business determined? And, what conclusion will be drawn if the relative importance test and time test yield significant contradictory results? In order to analyze these questions more thoroughly, feedback from practicing tax professionals was obtained.

A survey was drawn up and distributed to fifteen tax professionals working in public accounting firms. The purpose of the survey was to analyze the opinions of the tax profession regarding the most important activities inherent in different businesses or professions, as well as how the tax profession would apply the tax law to home offices after the *Soliman* decision.

The survey consisted of eight scenarios. The majority of the scenarios provided difficult and unclear situations that tested the eligibility of a taxpayer to take a home office deduction under the “principal place of business” election. Each tax professional was required to read the scenario and respond to two statements. The purpose of these two statements were to ask for professionals’ opinions whether the most important activities were conducted at the home office and if he/she would recommend the taxpayer take a home office deduction in light of the *Soliman* case. The survey is depicted in Exhibit 3 of the Appendix.

The tax professionals were given a scale of 1-7, in which 7 denoted strong agreement with the statement and 1 denoted strong disagreement. Analysis is divided into three parts: (1) the percentage of responses scaling 1-3 as disagreement, (2) the percentage of responses choosing 5-7 as agreement, and (3) the percentage indicating 4 that remained neutral. The results are displayed in Exhibits 4 and 5 of the Appendix.

The participants were additionally required to answer whether they agreed with the requirements set forth by the *Soliman* case and to provide the reasoning behind their decisions. The last question of the survey asked the participants what they would propose as a proper interpretation of a "principal place of business". Demographic information, such as the professionals' positions in the firm, highest educational level, and years of tax experience were also obtained.

The chart on the following page shows how the two factors used in determining the principal place of business in *Soliman*, time and importance, are given in each scenario. The chart shows where the most time is spent by the taxpayer and where the most important activities are performed by indicating whether it is "home" or "away". Some scenarios have situations in which the location of the most important activities is vague, these scenarios will denote the importance factor with a question mark. Other scenarios have situations where time is split between business conducted away from home and business conducted at home, these scenarios denote the time factor as non-applicable (N/A).

| <b>Scenario</b> | <b>Time</b> | <b>Importance</b> |
|-----------------|-------------|-------------------|
| 1               | Away        | ?                 |
| 2               | Home        | ?                 |
| 3               | Home        | ?                 |
| 4               | N/A         | ?                 |
| 5               | Away        | Away              |
| 6               | N/A         | ?                 |
| 7               | Home        | ?                 |
| 8               | Home        | Home              |



## SURVEY ANALYSIS/RESULTS

The following section discusses each scenario in detail. The underlying purpose or question of each scenario is discussed first, followed by a comparison of how the Service would probably have treated the deduction against how it is treated by the tax professionals participating in the survey. It is important to note that the first page of the survey briefed the participants on §280A(c)(1) and the results of the Soliman decision, and not Revenue Ruling 94-24 or the change in the Proposed Regulations.

In Scenario One, the interpretation of the new examples implemented in Proposed Regulations §1.280A-2(b)(3) were questioned. The Proposed Regulations carry two examples of salesmen in which one taxpayer is eligible for a home office deduction and the other is not (See Exhibit 2 of the Appendix). In Example 2, “the essence of Joe’s business as a salesperson requires him to meet with customers primarily at the customer’s place of business”. Joe Smith spends more time and makes more sales away from his home office. In example 3, “the essence of Fred’s business as a salesperson requires him to make telephone or mail contact with customers primarily from his office, which is in his home”. Fred Jones spends more time and makes more sales in his home office. Both situations appear the same except for the location where the majority of sales are made, as well as the amount of time spent at the home office. Therefore, how are the essence of these two businesses being determined? Is it the location where the most sales are made or where activity that signifies the essence of a business occurs? The examples do not clearly indicate how this “essence” or where the most important activities are determined. Scenarios One, Four, and Seven analyze how the tax profession would respond to similar salesmen-type situations. The purpose was to analyze if the most important

activities are directly related to the location where the majority of sales are made. These scenarios will all be discussed first.

***Scenario One***

Eli is a salesman. Eli spends an average of 30 hours a week visiting customers and 10 hours a week at his home office. Eli's business is selling products to customers at various locations within the metropolitan area where he lives. He uses a room in his house exclusively to set up appointments, store product samples, sell products over the phone, and write up mail orders and other reports for the companies whose products he sells. Phone sales from Eli's home office account for about 55% of his revenues.

Scenario One was set up in a manner similar to the characteristics given to Joe Smith's business in Example 2 of the Proposed Regulations, therefore Eli's most important activities are not deemed to occur at the home office. Under Revenue Ruling 94-24, if the activities that represent the essence of a business are not conducted at the home office, a home office deduction should not be allowed.

***Results:***

(See Exhibit 6 in the Appendix)

*The home office is where the most important activity related to the job is performed.*

|     |           |
|-----|-----------|
| 66% | agreed    |
| 27% | disagreed |
| 7%  | neutral   |

Sixty-six percent of the responses agreed that the most important activities were conducted at home. Does this support a theory that the principal place of business in a sales profession is determined by the location where the most sales are made? Eli's business was given the same characteristics as Joe Smith's in Example 2 of the Proposed Regulations. Joe Smith's most important activities are not performed at his home office. The only variable changed in the scenario is where the most sales are made. As a result, do the examples in the Proposed Regulations provide adequate and clear guidelines in determining a principal place of business?

*I would recommend that the taxpayer take the home office deduction on his return.*

67% agreed  
20% disagreed  
13% neutral

Sixty-seven percent recommended the home office deduction in light of the *Soliman* decision. The results clearly differ from the conclusion drawn by the Proposed Regulations and Revenue Ruling 94-24. Not only do the professionals disagree where the most important activities occur, their application of *Soliman* differs from the application pronounced in Revenue Ruling 94-24 and the vague examples given in the Proposed Regulations.

***Scenario Seven***

John is a salesman. His only office is a room in his house used regularly and exclusively to set up appointments, store product samples, sell products over the phone, and write up orders and other reports for the companies whose products he sells. John spends an average of 30 hours a week working at his home office and 12 hours a week visiting prospective clients. John spends a lot of time trying to sell over the phone, but usually makes most of his sales by visiting potential customers.

Scenario Seven is the complete opposite of Scenario One. Scenario Seven was set up in a manner similar to the characteristics given to Fred Jones' business in Example 3 of the Proposed Regulations; therefore, John's most important activities were deemed to occur at his home office by the IRS. However, in Scenario Seven, the most sales were made away from the home office. Also, under Revenue Ruling 94-24, if the activities that represent the essence of the taxpayer's business are conducted at the home office, a home office deduction should be allowed.

***Results:***

( See Exhibit 7 in the Appendix)

*The home office is where the most important activity related to the job is performed.*

60% agreed  
33% disagreed  
7% neutral

The results of this scenario oppose the theory that the principal place of business is based on the location where the most sales are made. However, now there is a discrepancy in the responses. Is sales or where the most time spent indicative of the most important activities? If time is the factor that sways the responses in Scenario Seven to favor the home office, can the Service pronounce an effective Revenue Ruling that places time and importance on an unequal scale?

*I would recommend that the taxpayer take the home office deduction on his return.*

67% agreed  
20% disagreed  
13% neutral

Sixty-seven percent responded favorable to taking the home office deduction. This should be the proper application that is suggested in Revenue Ruling 94-24; however, it has now been shown that the interpretation of *Soliman* by the Service, especially in Revenue Ruling 94-24, is not always consistent with the interpretations by the profession.

#### ***Scenario Four***

Peter is a salesman. Peter spends an average of 20 hours a week working at his home office and 20 hours a week visiting prospective customers. He uses a room in his house exclusively to set up appointments, sell products over the phone, store product samples, and write up orders and other reports for the companies whose products he sells. Peter's business is selling products to customers at various locations within the metropolitan area where he lives, whether over the phone or at the customer's place of business. Peter sells more than 50% of these products from his home office, either by mail or over the phone.

Scenario Four removes the effects of time and allocates the majority of sales at home.

Attempting to relate this scenario to the *Soliman* case, or other recent pronouncements, has proven very difficult; therefore, an assumption of the proper interpretation concerning the new

tax law is not conducted. However, *Soliman* does point out that the relative importance test and time test may not lead to the principal place of business in every case, which could possibly be the circumstances in this case. That is, there may be no principal place of business.

**Results:**

(See Exhibit Eight in the Appendix.)

*The home office is where the most important activity related to the job is performed.*

|     |           |
|-----|-----------|
| 86% | agreed    |
| 7%  | disagreed |
| 7%  | neutral   |

*I would recommend that the taxpayer take the home office deduction on his return.*

|     |           |
|-----|-----------|
| 93% | agreed    |
| 7%  | disagreed |

With the time factor eliminated, it appears as though the tax profession favors the principal place of business based on where the most sales occur. Therefore, there are two conflicting interpretations and applications of *Soliman*. The profession favors determining the principal place of business at the point of sale; however, if time is significant, as seen in Scenario Seven, it can alter this judgment. The Service will look to the most important activities in order to determine the principal place of business. However, as shown in Scenario One, determining the most important activities of a profession can lead to conflicting opinions. As a result, interpreting *Soliman* can lead to inconsistencies in the application of the tax law.

**Scenario Two**

Julie is a violinist. She spends 35 hours a week practicing in a studio in her home. The studio is exclusively used for her practicing. In this studio, she also schedules her weekly concerts. Her other time spent working consists of performing 2-3 concerts per week. The concerts are performed at various locations and last 2 hours.

Scenario Two addresses the affects that *Soliman* may have on musician and artists maintaining home studios. *Drucker* had shown that musicians with studios had been allowed deductions in the past; however, the *Soliman* case favors the location at which income-generating activities occur. Is performing more important than practicing?

**Results:**

(See Exhibit Nine in the Appendix.)

*The home office is where the most important activity related to the job is performed.*

|     |           |
|-----|-----------|
| 20% | agreed    |
| 67% | disagreed |
| 13% | neutral   |

Sixty-seven percent of the responses favored the income-generating performances as the most important activity. This position parallels the interpretation set forth by *Soliman*, in which the activities that produce income are weighted more heavily.

*I would recommend that the taxpayer take the home office deduction on her return.*

|     |           |
|-----|-----------|
| 26% | agreed    |
| 67% | disagreed |
| 7%  | neutral   |

Sixty-seven percent of the tax professionals would not recommend a home office deduction. It is important to note that this interpretation clearly opposes the conclusion that was drawn in *Drucker*. Also, since substantial time spent at the home office tends to favor a home office deduction, it is interesting to see that the responses neglected the time factor in this scenario; whereas it was a critical factor in recommending John the salesman a home office deduction in Scenario Seven.

***Scenario Three***

Faye is an artist. She paints in an empty studio in her apartment 30 hours a week. The studio is used regularly and exclusively for this activity. On the weekends she enters her paintings in exhibitions. Faye can financially support herself with the sale of these paintings that occur on the weekends.

Scenario Three was implemented to help aid on how *Soliman* would affect musicians and artists. Scenario Two showed how tax professionals applied the *Soliman* case to a musician. Scenario Three addresses whether there will be any difference between these two types of artists.

*Soliman* has shown that the location at which income is generated is weighted heavily in determining the principal place of business. This stance resembles the focal point test used the Tax Court in its decision in *Baie*. Similar circumstances exist in this scenario; therefore, it is assumed the Service would not allow Faye a deduction.

***Results:***

( See Exhibit 10 in the Appendix)

*The home office is where the most important activity related to the job is performed.*

|     |           |
|-----|-----------|
| 79% | agreed    |
| 14% | disagreed |
| 7%  | neutral   |

*I would recommend that the taxpayer take the home office deduction on her return.*

|     |           |
|-----|-----------|
| 80% | agreed    |
| 20% | disagreed |

The results appear to place importance on the location at which the product is made, and not sold. This interpretation clearly opposes the results in Scenario Two. What differences are there that would allow the artist, but not the musician, to take a home office deduction?

Perhaps the view is that the artist creates a product at home, whereas the musician creates his product or service during performances. In either case, the recommendation clearly opposes

the decision in *Baie*. *Baie* and Scenario Three both carry similar circumstances in which the product is created at home and sold at a different location. Since *Soliman* almost parallels the strict focal point test used by the Tax Court, it is assumed that the Service would most likely disallow the deduction; however, this is not the position taken by the majority of professionals participating in the survey.

***Scenario Five***

Don is a self-employed TV repairman. He spends approximately 25 hours a week going to customers' homes and fixing their TVs and approximately 15 hours a week in his home office performing administrative activities. Don also employs a full-time unrelated employee, who performs additional administrative services, such as answering the telephone, scheduling Don's appointments, ordering supplies, keeping Don's books, and monitoring the inventory of parts.

Scenario Five depicts a situation similar to that of an example given in Revenue Ruling 94-24 (See Exhibit 11 of the Appendix). In this ruling, a self-employed plumber was disallowed a home office deduction. The purpose of this scenario was to determine if the tax profession would properly apply the two tests given in *Soliman*, as applied by the Service.

***Results:***

(See Exhibit 12 in the Appendix)

*The home office is where the most important activity related to the job is performed.*

|     |           |
|-----|-----------|
| 46% | agreed    |
| 41% | disagreed |
| 13% | neutral   |

*I would recommend that the taxpayer take the home office deduction on his return.*

|     |           |
|-----|-----------|
| 53% | agreed    |
| 27% | disagreed |
| 20% | neutral   |



It appears as though the participants were fairly divided in determining the location of the most important activity, and were not confident in whether Don should receive the deduction. This scenario is a perfect example of how the interpretation of *Soliman* and its application can differ between the Service and the practicing tax profession.

***Scenario Six***

Assume the same facts as in scenario five, except that Don spends approximately 20 hours a week going to customers' homes to fix their TVs and 20 hours a week fixing TVs in his home office.

The purpose of this situation was to analyze how the profession would treat a situation in which the same activities considered as the essence of a taxpayer's business were conducted at two locations of equal time allocation. Under *Soliman*, this scenario would probably fall under the exception provided in which no principal place of business may be determined.

***Results:***

(See Exhibit 13 of the Appendix)

*The home office is where the most important activity related to the job is performed.*

80% agreed  
20% disagreed

*I would recommend that the taxpayer take the home office deduction on his return.*

93% agreed  
20% disagreed

*Soliman* had pointed out that in some situations the courts should not strain to determine a principle place of business, and that a principal place of business may not exist. This scenario appears to fit that description; however, the responses clearly determined a principal place of business and favored a home office deduction.

### ***Scenario Eight***

Kristen is an elderly lady who knits blankets 7 hours a day 4 days a week in a room at her home. She makes the blankets for her daughter, Elizabeth, who owns a store in the local mall. Elizabeth buys the blankets from Kristen and then sells them in the store. The room that Kristen knits in is used exclusively for her knitting.

Scenario Eight was included as the control of the survey. Kristen should be allowed a home office deduction for her activity. Any professionals that did not answer this scenario correctly may have suspect judgement. As it happened, 53% of the participants did not recommend that Kristen take the deduction. It was astonishing to see such a gross misapplication of the tax law; however, a thorough analysis of the scenario indicates that the participants may have been misled by responding to Elizabeth's business rather than Kristen's. Due to the lack of time to correct this mistake, all fifteen surveys were included for analysis.

After answering the above scenarios, the participants were asked to answer two more questions. These questions asked whether the professionals agreed with the requirements set forth by *Soliman*, and whether they had an opinion on the proper interpretation of a "principal place of business".

*Do you agree with the requirements set forth by the Soliman case?*

*Yes or No*

60% yes

40% no

During analysis, it appeared as though tax professionals with greater than five years of experience did not agree with *Soliman* as much as the professionals with less than five years of experience. Of the 40% who said "No", 67% of them were

professionals with greater than five years of experience (See Exhibit 14 in the Appendix). As a result, a further breakdown of the results was conducted. The surveys were divided into two groups: (1) professionals with greater than 5 years experience, and (2) professionals with five or fewer years of experience. Five years of experience was used as the dividing line because it is assumed that at that point of a tax professionals career, he/she should be past the initial compliance work and should have experienced more planning and theory. "Position in the firm" was not used because not all firms carry the same levels of advancement, whereas years of experience is more universal.

In the "over 5 year class", it was interesting to note that 57% of the professionals did not agree with the requirements set forth by *Soliman* (See Exhibit 15 in the Appendix). In the "5 year or fewer class", only 25% of the participants disagreed (See Exhibit 16 in the Appendix). It was interesting to see that the professionals included in the "5 year or fewer class" tended to agree more with *Soliman*.

Several of the professionals provided reasons for their response to the previous question. These responses are give in Exhibit 17 of the Appendix. In addition, each quotation will indicate the position the professional holds in his/her firm.

*What would you propose as a proper interpretation of a "principal place of business"?*

Exhibit 18 of the Appendix lists several responses. Only the opinions from professionals with greater than five years of tax experience were included since the majority of the professionals with less than five years of experience tended to agree with *Soliman* and did not provide alternative propositions.

## CONCLUSION/RECOMMENDATION

*Soliman* has resulted in the focus of two factors when determining a taxpayer's principal place of business, the location where the most time is spent and the location where the most important activities occur. The Service has interpreted *Soliman* by stating that it would first apply the relative importance test, and if no definitive answer prevails, a time test will be applied. However, is the Service correct in applying these tests in this manner? The Supreme Court did not imply how these two tests should be applied, nor the relative weight that should be attached to each factor. Is it right for the Service to apply the results of one case to other taxpayers that may have differing situations than *Soliman*? The Court admits that the facts and circumstances of each individual case should be considered before determining the principal place of business. The survey results clearly show how the tax profession's interpretation of *Soliman* can be inconsistent with the pronouncements by the Service.

It is obvious that there needs to be a change. There exists too much ambiguity for the tax profession to rely on when advising a client as to taking a home office deduction. Currently, taking a home office deduction is signaling a red flag to the IRS. Whether a taxpayer's home is used legitimately or not, if clients or customers do not frequent this location, current law would often disallow a deduction. I think that the courts should revert back to the "facts and circumstances" test that had been proposed in 1983; if the Service determines that taxpayers are abusing the law, Congress could take measures to limit the amount of the deduction, rather than attacking the more subjective side of determining eligibility.

# APPENDIX

## EXHIBIT ONE

### Example of home office deduction calculation:

(Taken from Prop. Reg. §1.280A-2)

A, a self-employed individual, uses an office in the home on a regular basis as a place of business for meeting with clients of A's consulting service. A makes no other use of the office during the taxable year and uses no other premises for the consulting activity. A has a special telephone line for the office and occasionally employs secretarial assistance. A determines that 10% of the general expenses for the dwelling unit are allocable to the office. On the basis of the following figures, A determines that the sum of the allowable deductions for the use of the office is \$1,050.

|   |            |            |              |
|---|------------|------------|--------------|
| Gross income from consulting services:                    |            |            | \$1,900      |
| Expenses for secretary                                    | \$500      |            |              |
| Business telephone  | 150        |            |              |
| Supplies  | <u>200</u> |            | <u>(850)</u> |
| Gross income derived from use of unit (Income Limitation) |            |            | 1,050        |
| First, deduct already allowable itemized deductions:      |            |            |              |
| Mortgage Interest (10%)                                   | \$5,000    | 500        |              |
| Real Estate Taxes (10%)                                   | 2,000      | <u>200</u> | <u>(700)</u> |
| Limit on further deductions                               |            |            | 350          |
| Second, deduct other expenses:                            |            |            |              |
| Insurance (10%)   | 600        | 60         |              |
| Utilities (10%; other than phone)                         | 900        | <u>90</u>  | <u>(150)</u> |
|   |            |            | 200          |
| Third, deduct depreciation:                               |            |            |              |
| Depreciation (10%)  | 3,200      | <u>320</u> |              |
| Amount Allowable  |            |            | <u>(200)</u> |
| Net Income  |            |            | 0            |

Since A is a self-employed taxpayer, these deductions would appear on Schedule C of his 1040. A may claim the remaining \$6,300 paid for mortgage interest and real estate taxes as itemized deductions.

## EXHIBIT TWO

### **“Principal place of business” examples:**

[Taken from Prop. Reg. § 1.280A-2(b)(3), as of 1993]

The first example, which portrays the *Soliman* case, will not be stated.

Example Two: Joe Smith is a salesperson. His only office is a room in his house used regularly and exclusively to set up appointments, store product samples and write up selling orders and other reports for the companies whose products he sells. Joe’s business is selling products to customers at various locations within the metropolitan area where he lives. To make these sales, he regularly visits the customers to explain the available products and to take orders. Joe makes only a few sales from his home office. Joe spends an average of 30 hours a week visiting customers and 12 hours a week working at his home office. The essence of Joe’s business as a salesperson requires him to meet with customers primarily at the customer’s place of business. The home office activities are less important to Joe’s business than the sales activities he performs when visiting customers. In addition, a comparison of the 12 hours per week spent in the home office to the 30 hours per week spent visiting customers further supports the conclusion that Joe’s home office is not his principal place of business. Therefore, he cannot deduct expenses for the business use of his home.

Example Three: Fred Jones, a salesperson, performs the same activities in his home office as Joe Smith in Example (2), above, except that Fred makes most of his sales to customers by telephone or mail from his home office. Fred spends an average of 30 hours a week working at his home offices and 12 hours a week visiting prospective customers to deliver products and occasionally take orders. The essence of Fred’s business as a salesperson requires him to make telephone or mail contact with the customers primarily from his office, which is in his home. Actually visiting customers is less important to Fred’s business than the sales activities he performs from his home office. In addition, a comparison of the 30 hours per a week spent selling to customers from the home office with the 12 hours per week spent visiting customers further supports the conclusion that Fred’s home office is his principal place of business. Therefore, he can deduct expenses for the business use of his home.

## EXHIBIT THREE

### Survey: Home Office Deductions

Section 280A(c)(1) of the Internal Revenue Code states that home office deductions may be taken providing that the unit is exclusively used on a regular basis for one of the following three reasons:

1. The unit is the principal place of business for any trade or business of the taxpayer.
2. It is a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of the taxpayer's trade or business.
3. It is 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, an employee is only entitled to a deduction for the use of his/her dwelling unit if the exclusive use is for the convenience of the employer.

The "principal place of business" condition has required judicial interpretation throughout the years. In a 1993 Supreme Court case, *Comm'r v. Soliman*, the Court identified two factors that determine whether a home office is the taxpayer's "principal place of business" for purposes of section 280(c)(1)(A). The two requirements are:

1. A comparison of the relative importance of the activities performed at home or at another location with consideration to the nature of the business.
2. A comparison of the amount of time spent on business at home with time spent on other locations.

While these factors attempt to clarify the meaning of a "principal place of business", the guidelines that weigh the importance of one requirement over the other are not always clear.



Please read the following scenarios and indicate your agreement with the statements that follow.

**Scenario One**

Eli is a salesman. Eli spends an average of 30 hours a week visiting customers and 10 hours a week at his home office. Eli's business is selling products to customers at various locations within the metropolitan area where he lives. He uses a room in his house exclusively to set up appointments, store product samples, sell products over the phone, and write up mail orders and other reports for the companies whose products he sells. Phone sales from Eli's home office account for about 55% of his revenues.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on his return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Two**

Julie is a violinist. She spends 35 hours a week practicing in a studio in her home. The studio is exclusively used for her practicing. In this studio, she also schedules her weekly concerts. Her other time spent working consists of performing 2-3 concerts per week. The concerts are performed at various locations and last 2 hours.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on her return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Three**

Faye is an artist. She paints in an empty studio in her apartment 30 hours a week. The studio is used regularly and exclusively for this activity. On the weekends she enters her paintings in exhibitions. Faye can financially support herself with the sale of these paintings that occur on the weekends.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on her return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Four**

Peter is a salesman. Peter spends an average of 20 hours a week working at his home office and 20 hours a week visiting prospective customers. He uses a room in his house exclusively to set up appointments, sell products over the phone, store product samples, and write up orders and other reports for the companies whose products he sells. Peter's business is selling products to customers at various locations within the metropolitan area where he lives, whether over the phone or at the customer's place of business. Peter sells more than 50% of these products from his home office, either by mail or over the phone.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on his return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Five**

Don is a self-employed TV repairman. He spends approximately 25 hours a week going to customers' homes and fixing their TVs and approximately 15 hours a week in his home office performing administrative activities. Don also employs a full-time unrelated employee, who performs additional administrative services, such as answering the telephone, scheduling Don's appointments, ordering supplies, keeping Don's books, and monitoring the inventory of parts.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on his return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Six**

Assume the same facts as in scenario five, except that Don spends approximately 20 hours a week going to customers' homes to fix their TVs and 20 hours a week fixing TVs in his home office.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on his return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Seven**

John is a salesman. His only office is a room in his house used regularly and exclusively to set up appointments, store product samples, sell products over the phone, and write up orders and other reports for the companies whose products he sells. John spends an average of 30 hours a week working at his home office and 12 hours a week visiting prospective clients. John spends a lot of time trying to sell over the phone, but usually makes most of his sales by visiting potential customers.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on his return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

**Scenario Eight**

Kristen is an elderly lady who knits blankets 7 hours a day 4 days a week in a room at her home. She makes the blankets for her daughter, Elizabeth, who owns a store in the local mall. Elizabeth buys the blankets from Kristen and then sells them in the store. The room that Kristen knits in is used exclusively for her knitting.

The home office is where the most important activity related to the job is performed.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

I would recommend that the taxpayer take the home office deduction on her return.

|                      |   |   |         |   |   |                   |
|----------------------|---|---|---------|---|---|-------------------|
| 1                    | 2 | 3 | 4       | 5 | 6 | 7                 |
| Strongly<br>Disagree |   |   | Neutral |   |   | Strongly<br>Agree |

Do you agree with the requirements set forth by the *Soliman* case?

Yes or No

Please provide the reasoning for your response.

What would you propose as a proper interpretation of a "principal place of business"?

**Demographic Information**

Position in firm: Partner  
Senior Manager  
Manager  
Senior  
Staff

Highest educational level attained:

High School  
College  
Masters  
J.D.  
LL.M.  
Ph.D.

Number of years of tax experience:

## EXHIBIT FOUR

Percentage of Responses (%)

Scale

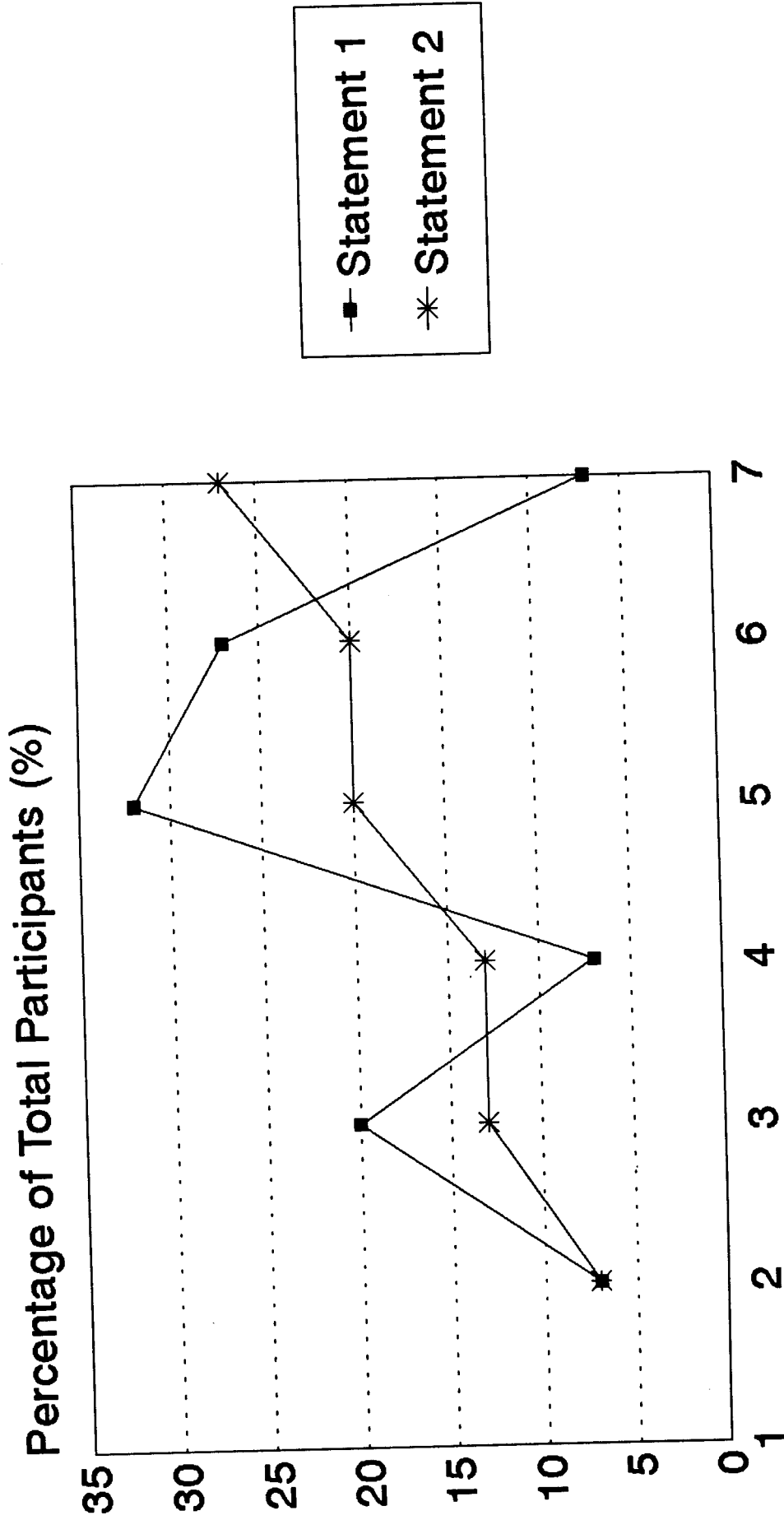
| Scenario | Question | Scale |    |    |    |    |    |    |
|----------|----------|-------|----|----|----|----|----|----|
|          |          | 1     | 2  | 3  | 4  | 5  | 6  | 7  |
| 1        | 1        | 0     | 7  | 20 | 7  | 32 | 27 | 7  |
|          | 2        | 0     | 7  | 13 | 13 | 20 | 20 | 27 |
| 2        | 1        | 27    | 33 | 7  | 13 | 7  | 13 | 0  |
|          | 2        | 20    | 34 | 13 | 7  | 13 | 13 | 0  |
| 3        | 1        | 7     | 0  | 7  | 7  | 7  | 52 | 20 |
|          | 2        | 13    | 0  | 7  | 0  | 7  | 53 | 20 |
| 4        | 1        | 0     | 0  | 7  | 7  | 33 | 33 | 20 |
|          | 2        | 0     | 0  | 7  | 0  | 40 | 27 | 26 |
| 5        | 1        | 7     | 7  | 27 | 13 | 26 | 13 | 7  |
|          | 2        | 7     | 0  | 20 | 20 | 27 | 13 | 13 |
| 6        | 1        | 0     | 0  | 0  | 20 | 40 | 13 | 27 |
|          | 2        | 0     | 0  | 0  | 7  | 40 | 26 | 27 |
| 7        | 1        | 7     | 13 | 13 | 7  | 20 | 26 | 14 |
|          | 2        | 7     | 13 | 0  | 13 | 27 | 20 | 20 |
| 8        | 1        | 13    | 20 | 20 | 7  | 0  | 27 | 13 |
|          | 2        | 20    | 20 | 13 | 0  | 13 | 20 | 14 |

## EXHIBIT FIVE

Percentage of Responses (%)

| Scenario | Question | Disagreed | Neutral | Agreed |
|----------|----------|-----------|---------|--------|
| 1        | 1        | 27        | 7       | 66     |
|          | 2        | 20        | 13      | 67     |
| 2        | 1        | 67        | 13      | 20     |
|          | 2        | 67        | 7       | 26     |
| 3        | 1        | 14        | 7       | 79     |
|          | 2        | 20        | 0       | 80     |
| 4        | 1        | 7         | 7       | 86     |
|          | 2        | 7         | 0       | 93     |
| 5        | 1        | 41        | 13      | 46     |
|          | 2        | 27        | 20      | 53     |
| 6        | 1        | 0         | 20      | 80     |
|          | 2        | 0         | 7       | 93     |
| 7        | 1        | 33        | 7       | 60     |
|          | 2        | 20        | 13      | 67     |
| 8        | 1        | 53        | 7       | 40     |
|          | 2        | 53        | 0       | 47     |

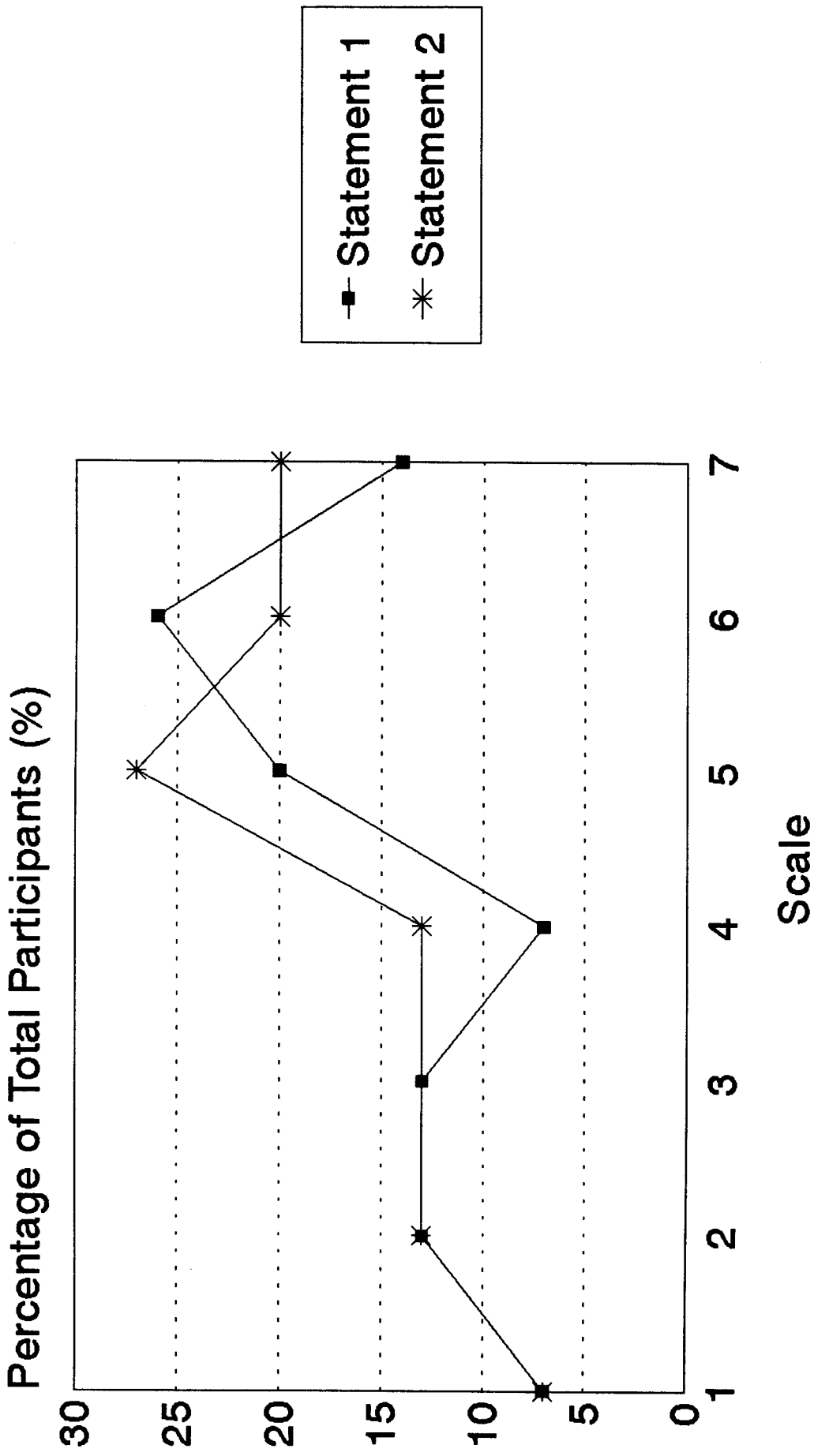
# SCENARIO ONE



One denotes strong disagreement.  
Seven denotes strong agreement.



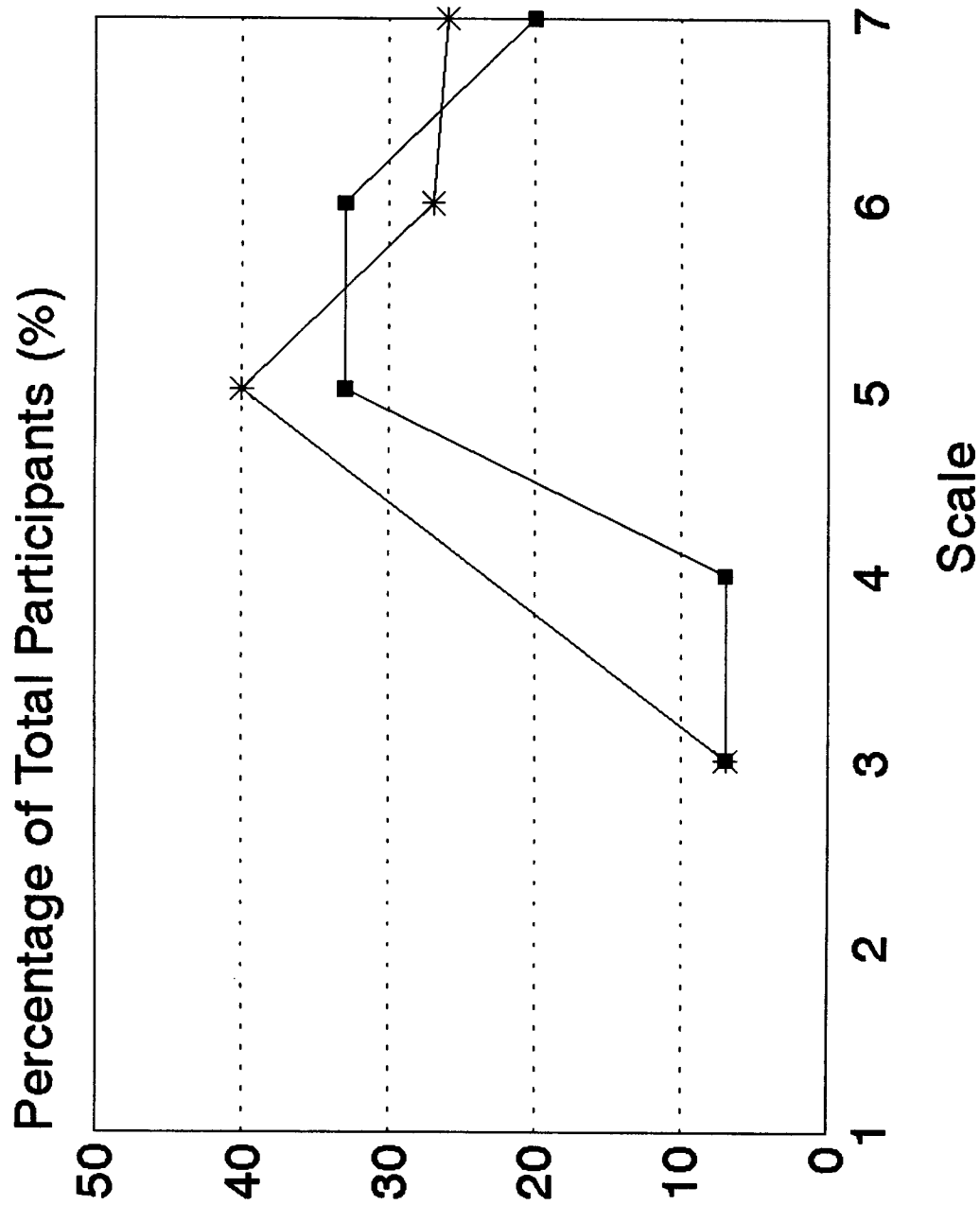
# SCENARIO SEVEN



One denotes strong disagreement.  
Seven denotes strong agreement.

Exhibit Seven

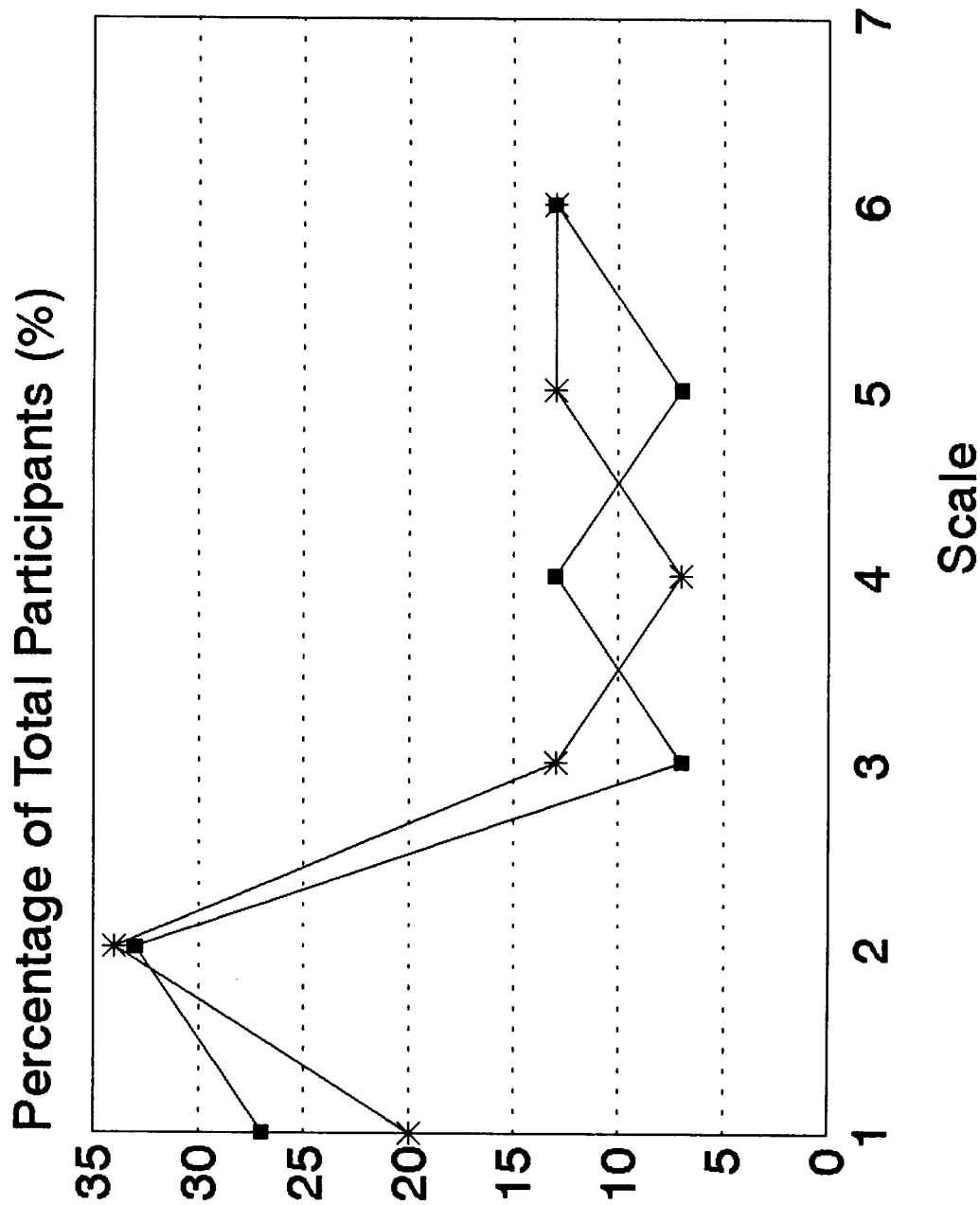
# SCENARIO FOUR



Exhibit

Flight  
One denotes strong disagreement.  
Seven denotes strong agreement.

# SCENARIO TWO

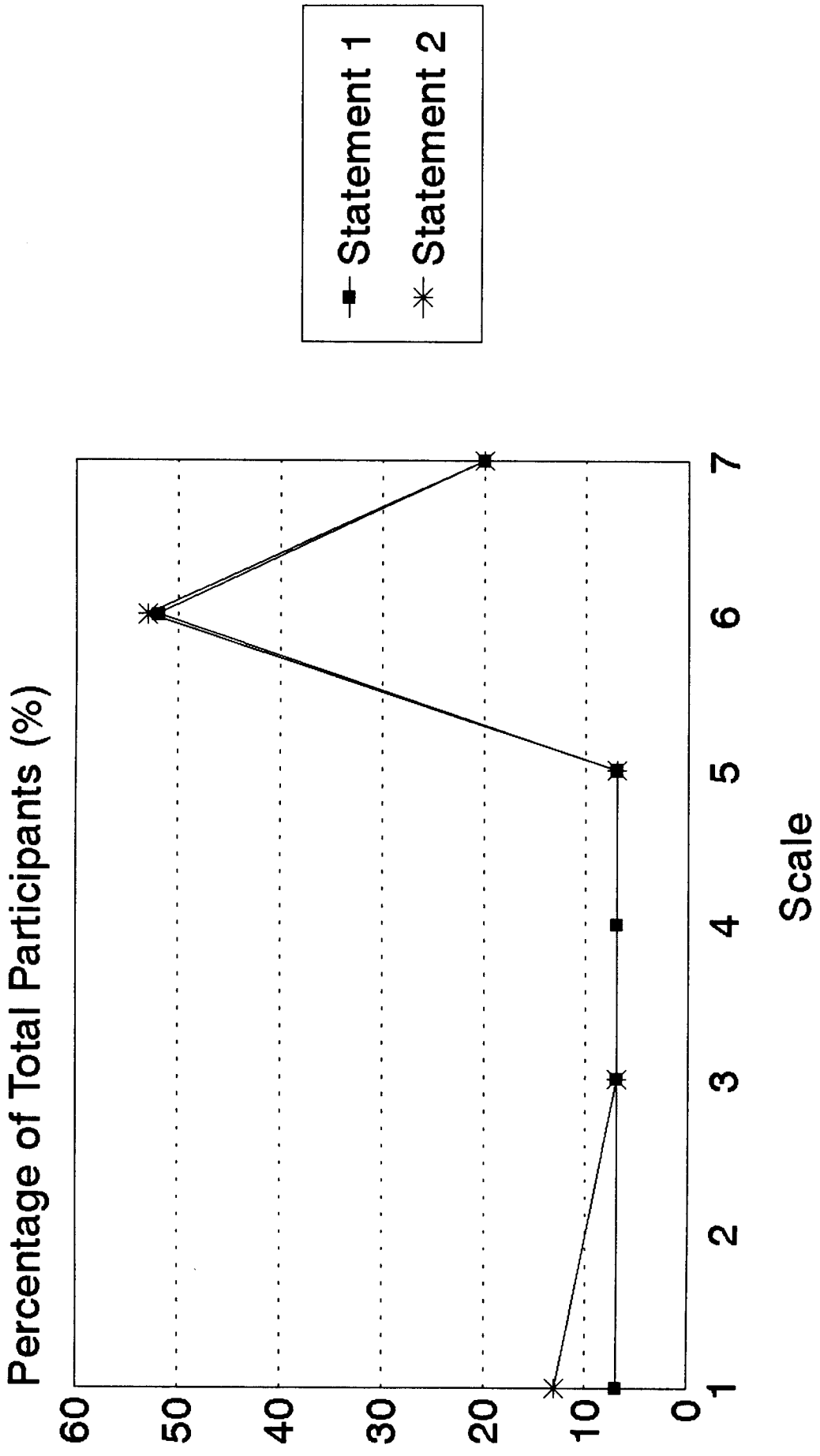


Exhibit

Nine

One denotes strong disagreement.  
Seven denotes strong agreement.

# SCENARIO THREE



One denotes strong disagreement.  
Seven denotes strong agreement.

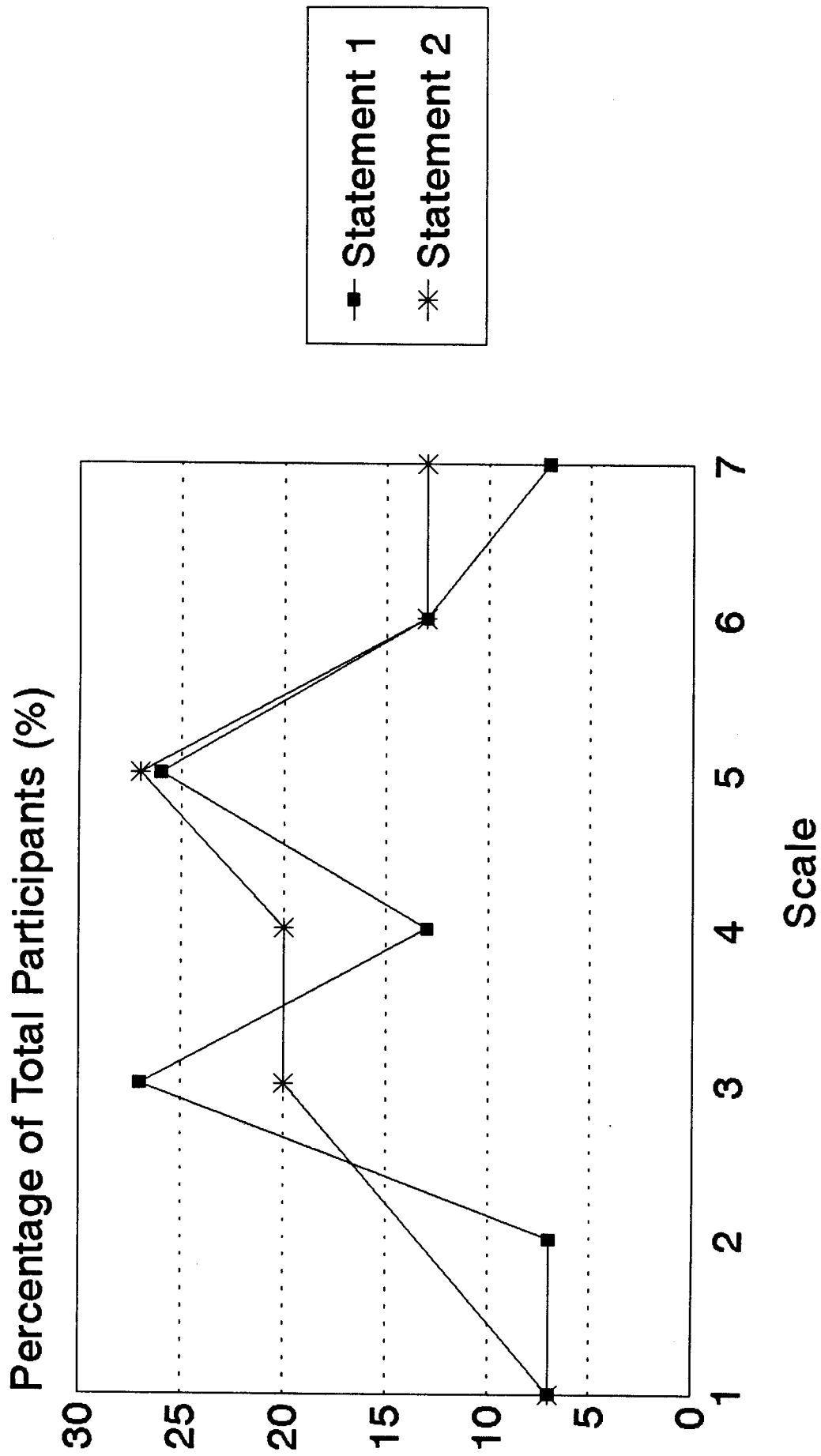
## EXHIBIT ELEVEN

### Revenue Ruling 94-24, Example 5:

Albert is a self-employed plumber who installs and repairs plumbing in customers' homes and offices. Albert spends approximately 40 hours of his worktime per week at these customer locations, with approximately 10 hours of his worktime per week spent in an office in his home talking with customers on the telephone, deciding what supplies to order and reviewing the books of the business. Albert also employs Edna, a full-time unrelated employee, in that office to perform administrative services such as answering the telephone, scheduling Albert's appointments, ordering supplies, and keeping Albert's books.

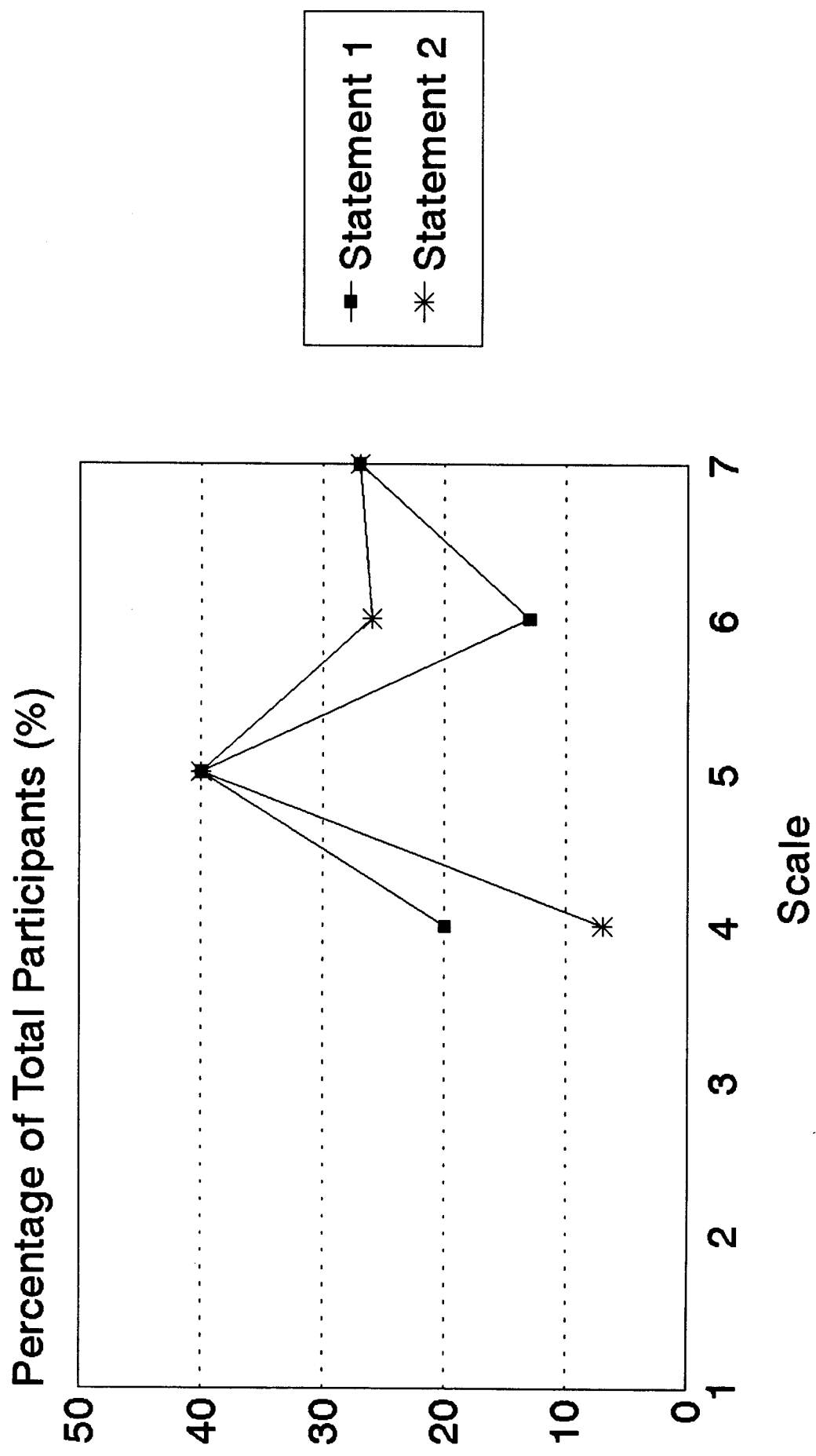
Rev. Rul. 94-24 states that the essence of Albert's trade or business as a plumber requires Albert to perform services and deliver goods at the homes or offices of his customers. The telephone activities, supply ordering, and bookkeeping review that Albert performs at his home office, although essential, are less important and take less time than his service calls to customers. Therefore, Albert's office in the home is not his principal place of business, and Albert cannot deduct expenses for the business use of the home. The fact that Edna, Albert's employee, performs administrative activities at Albert's home office does not alter this result.

# SCENARIO FIVE



One denotes strong disagreement.  
Seven denotes strong agreement.

# SCENARIO SIX



One denotes strong disagreement.  
Seven denotes strong agreement.

Exhibit Thirteen

# AGREEMENT WITH SOLIMAN?

Total Participants

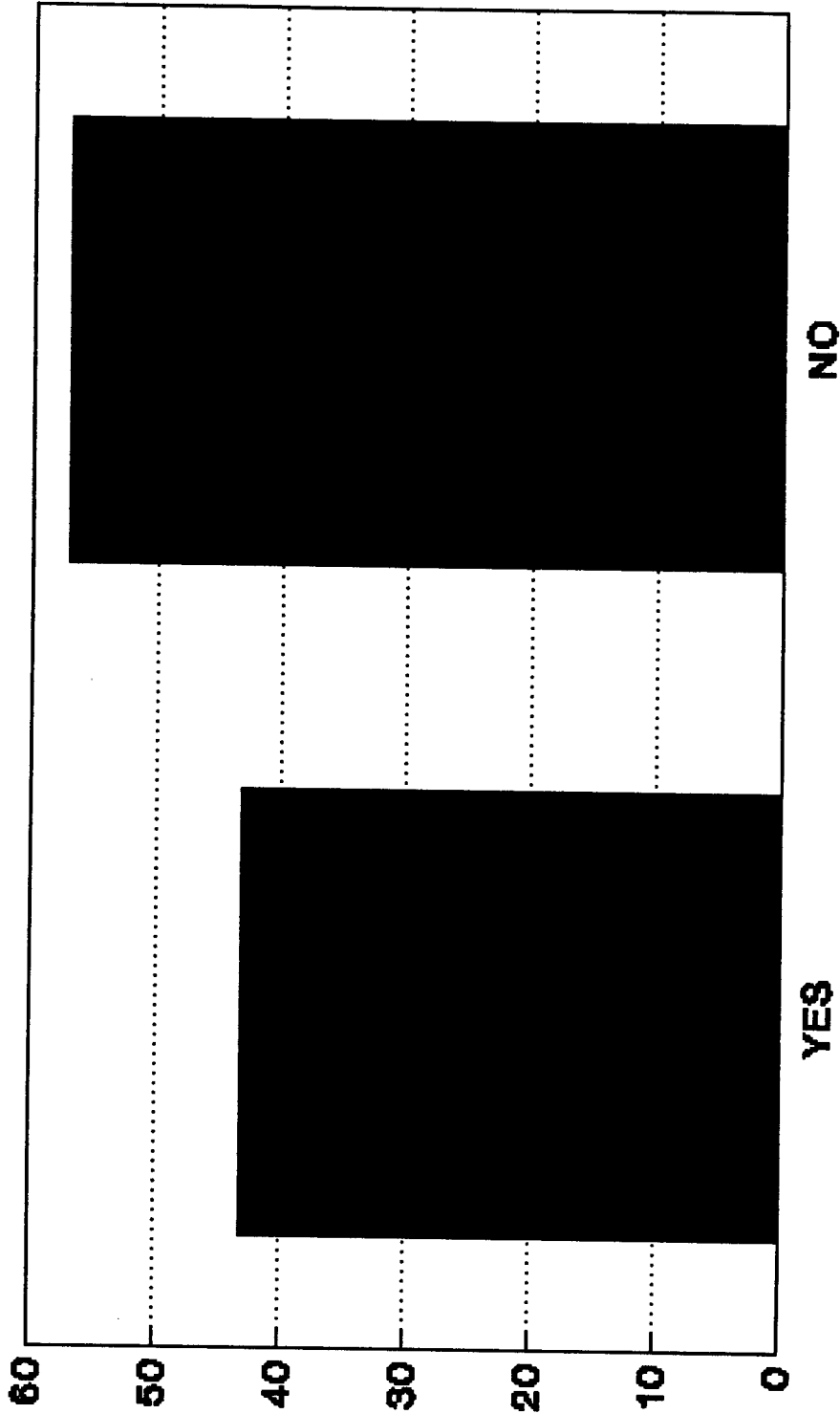


Of the 40% replying No, 67% are participants with greater than five years of tax experience.



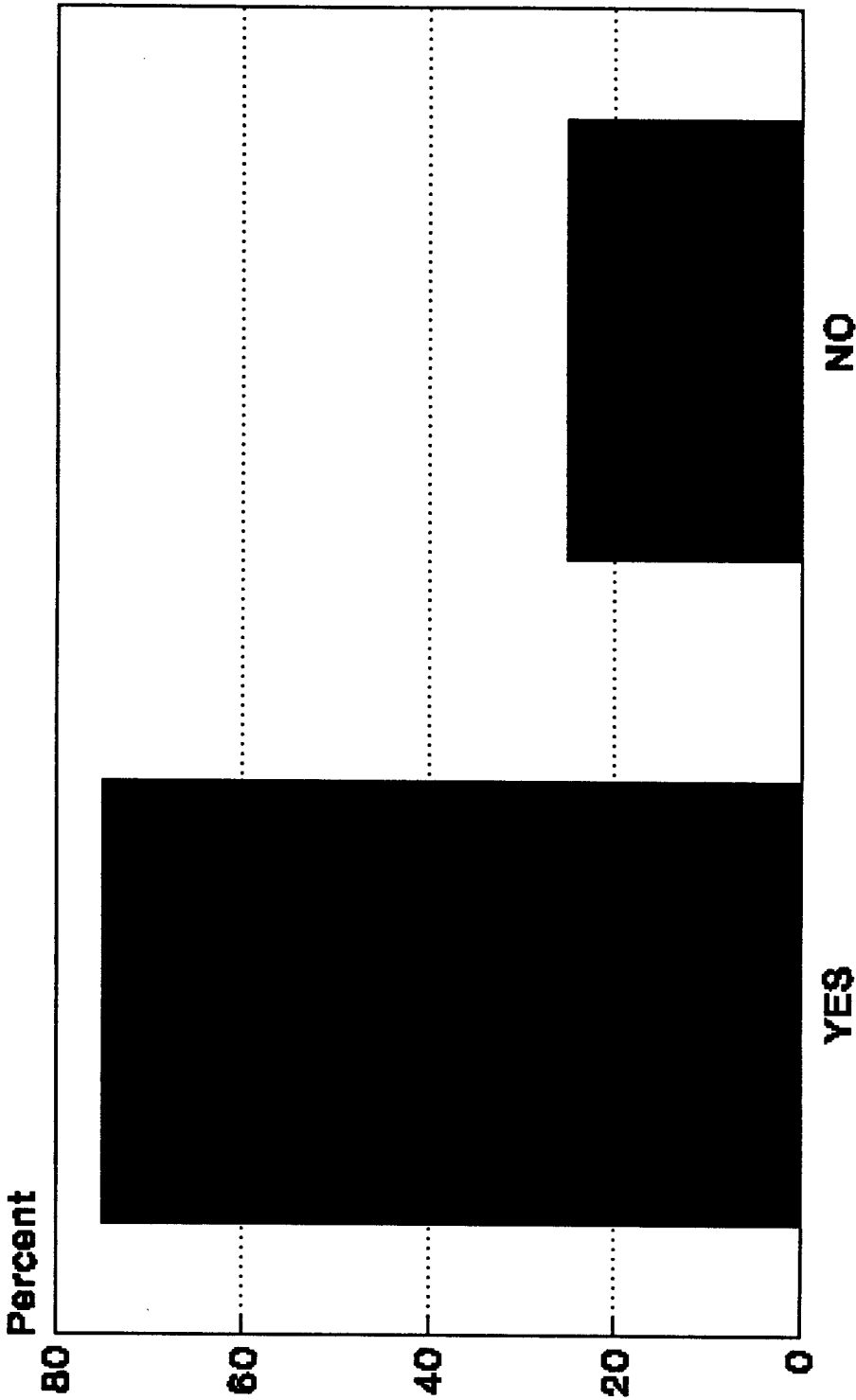
# AGREEMENT WITH SOLIMAN?

Participants w/ > 5 yr. experience



# AGREEMENT WITH SOLIMAN?

Participants w/ 5yr. or less experience



## EXHIBIT SEVENTEEN

The following quotations were given as reasons for agreement or disagreement towards the requirements set forth by the *Soliman* case.

### Agreement

“ I think it sets up a reasonable basis test for taxpayer to deduct costs.” -- Senior

“It provides a reasonable and objective approach to determining the extent of the need for a home office and its ultimate deductibility.” -- Manager

“The case highlights ‘relative importance’ and ‘time spent’ as the critical factors. My interpretation of this is ‘where is the value added to the product?’” -- Staff

“Often the office in the home is a cost saving device and simply a convenience, as in the case of doctors who use it for billing, reading medical information, etc. It doesn’t necessarily have to do with the person’s main income earning responsibilities. Therefore a comparison of the importance of the work done in a home office is extremely relevant.”  
-- Senior

### Disagreement

“Too subjective to determine relative value, and time spent is not conclusive of value. Preparation of work may be more valuable than actual sale. Is the sale the result of visit or telephone call?” -- Partner

“The *Soliman* case can result in no home office in some cases even though the taxpayer has no other office and does all of the administrative work in the home office. This can happen when it is determined that the relative importance of the activity outside the home is greater than the activity in the home office (often the case for a traveling salesman).” -- Senior Manager

“The comparison of importance and time is subjective.” -- Manager

“The need for ‘clients’ to visit your ‘office’ should not be the major deciding factor.”  
-- Senior Manager

“Most work outside of office administrative work must be done outside of the office (salesmen, doctors). I think they should include when records and all pertinent information is stored(file cabinets, computer, etc.)” -- Staff

“TOO STRICT” -- Staff

## EXHIBIT EIGHTEEN

*What would you propose as a proper interpretation of a "principal place of business"?*

"It's hard to define since it is affected by the profession, the person, the income stream, etc. I feel it should be judged by facts and circumstances." -- Senior

"Exclusive use on a regular or normal basis, where the home office is an integral and necessary part of the business. Where the work performed requires a business facility."  
-- Partner

"Go to Proposed Regulations §1.280A-2(b)(2)(iii) whereby consideration is given to facilities available at each location for the purpose of that business. The example here would allow a traveling salesman a home office deduction if there was no other office available." -- Senior Manager

"Do you have any other 'regular' place of business that is more significant than your home office?" -- Senior Manager