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Test Your Tax IQ: Home-Office Tax Deduction with Regular Office

Situation

Eddie Fiss works 40 hours a week at his small downtown office that he owns.

He also spends 12 hours a week working at home doing all the administrative tasks required for his consulting business.

Questions

Can Eddie claim tax deductions for any of these?

A. His downtown office only

B. His home office only

C. Neither office

D. Both offices

Answer

D. Eddie can claim deductions for both offices.

Explanation

Over the years, we've come across many small-business owners and tax advisors who believe that a home office is not deductible unless it's the *only* place of business.

We designed this question-and-answer scenario to debunk the only-office misconception and illustrate that office space *inside* your home may qualify for a home-office deduction even if you also have an office for the same business *outside* your home.

Repairs and other costs related to maintaining a home are normally considered non-deductible personal expenses under the tax code.[1] But exceptions apply.

One of the most notable is Section 280A(c)(1)(A), which allows for deductions of costs allocable to a portion of the home the taxpayer uses "exclusively on a regular basis" as his "principal place of business." (We'll explain what each of these underlined terms means later.)

So which office is Eddie's "principal place of business"?

Logic suggests it's the downtown office, since Eddie spends 40 hours there and only 12 in the home office.

But, alas, many are the occasions when tax law and logic go their separate ways. And as we'll see, under tax law rules, the home office *is*, in fact, Eddie's "principal place of business." Result: Eddie can claim deductions on both offices. So D is the correct answer.

Why Wrong Answers Are Wrong

A is wrong because Eddie can claim his home office as his principal place of business.

To see why this is true, look at Section 280A(c)(1) of the tax code:[2]

The term "principal place of business" includes a place of business which is used by the taxpayer for the administrative or management activities of any trade or business of the taxpayer if there is no other fixed location of such trade or business where the taxpayer conducts substantial administrative or management activities of such trade or business.

Since Eddie does all his administration in the home office and none in the downtown office, the home office is his principal office. Here, tax law overrules the Merriam-Webster definition of what is "principal."

And the IRS agrees with the administrative part and goes on to say:[3]

You can have more than one business location, including your home for a single trade or business.

Translation. Having a second office location doesn't rule out the home-office deduction.

Question. When *is* the home-office deduction allowed when you have more than one business location?

We'll answer that question when we talk about Choice C below.

B Is Wrong

B is wrong because Eddie can deduct his downtown office. The home-office deduction has no effect on Eddie's downtown office tax deductions.

C Is Wrong

C is wrong because you may deduct both offices.

Principal Place of Business

Let's prove that the home office is the principal place of business.

To do this, take a quick look back at the quoted language from Section 280A(c)(1)(A). Note that we underlined three words/phrases—"exclusive" use, "regular" use and "principal place of business." To claim the home-office deduction the way he wants, Eddie must meet all three of these requirements.

Since the Code doesn't specifically define these terms, we need to find the crucial missing details in the IRS guidance, legislative history, and case law. Let's now go through the requirements one by one.

Requirement 1: Exclusive Use

To meet the "exclusive use" requirement, Eddie must use a specific area of his home, i.e., a room(s) or other "separately identifiable space," *only for* his trade or business.

EXAMPLE
An Illinois attorney named Paul Sengpiehl used the dining room of his house as a conference room to host clients. He and his family also dined in the room on weekends. **Result.** The tax court upheld the IRS's decision to deny Mr. Sengpiehl a home-office deduction for the room, because he violated the "exclusive use" rule.[4]

Rule of thumb. Use the office area exclusively for the business for which you seek the deduction and for nothing else.

***De minimis* personal use.** Tax courts tolerate some personal or mixed use as long as it's *de minimis*, i.e., minor to the point of insignificant.

What's the difference between *de minimis* personal use and personal use significant enough to violate the "exclusive use" requirement?

The answer varies from case to case.

WINNERS AND LOSERS Here are two actual cases illustrating when personal use is and is not *de minimis*:	
Taxpayer Wins	**Taxpayer Loses**
Claimed deduction. Taxpayer claims home-office deduction for walk-in closet, which takes up 20 percent of the area of his studio apartment. (The 20 percent is not a typo!)	**Claimed deduction.** Taxpayer claims home-office deduction for breakfast area of his home.
Personal Use. Taxpayer had to walk through the closet to get to the bathroom.	**Personal Use.** Taxpayer admits that he and his family might have eaten in the breakfast area on one or two occasions during the year.
Ruling. Deduction allowed. The taxpayer's personal use was *de minimis* and didn't violate the exclusive use rule.[5]	**Ruling.** Deduction disallowed. The taxpayer's personal use was not *de minimis* and violated the exclusive use rule.[6]

Takeaway. Do not hope that the *de minimis* rule will save your home-office deduction. Instead, use the home-office area exclusively for business.

Requirement 2: Regular Use

To claim the home-office deduction, Eddie must also use the office on a "regular" basis. "Incidental or occasional business use" is *not* regular use, notes the IRS.[7]

According to the IRS audit manual,[8] "regular use" means use "on a continuing basis."

In court, the following uses survived "regular use" scrutiny:

- *New York Times* editor used his home office for an average of one conversation per night (including many conversations requiring more than one call to complete) with politicians, labor leaders, and other public figures.[9]

- Account executive used his home office to field client calls 2.25 hours a night for five nights a week because he couldn't be reached during the day.[10]

If you want a clear target for the number of hours to meet the regular use test, we suggest it's using the office for 10 or more hours a week. Note that the 10 or more hours can include all activities (administrative, sales, etc.).

Requirement 3: Principal Place of Business

Eddie has three choices for the home-office deduction. He can deduct a home office when he uses a portion of his home exclusively and regularly[11]

1. as his principal place of business;
2. as a meeting place for patients, clients, or customers; or
3. in the case of a separate structure that's not attached to the dwelling, in connection with Eddie's business.

So that he can eliminate commuting mileage from his home to his regular office, Eddie wants his home office to qualify as his principal place of business.

Section 280A(c)(1) says that your home office qualifies as a principal place of business when you use it for your business's administration or management and you use no other fixed location to conduct substantial administrative or management activities.[12] The IRS gives you the following examples of administrative or management activities:[13]

- Billing customers, clients, or patients
- Keeping books and records
- Ordering supplies
- Setting up appointments
- Forwarding orders
- Writing reports

In addition, the IRS gives you examples of activities that *won't* disqualify you from getting the home-office deduction, including:[14]

- having others conduct administrative or management activities at locations other than the home, e.g., hiring another company to do billing for the taxpayer's business at the billing company's location;
- conducting administrative or management activities at locations that are not fixed locations of the taxpayer's business;
- "occasionally" conducting "minimal" administrative or management activities at a fixed location outside the taxpayer's home;
- conducting "substantial" non-administrative or non-management business activities outside the home, e.g., meeting with clients at outside locations; and
- choosing to conduct administrative or management activities at home even though the taxpayer has suitable space to conduct them outside the home.

Eddie's home office meets the tests. Accordingly, it's his principal place of business and Eddie can claim his home-office deduction. Moreover, because of the "principal place of business" qualification, Eddie gets the second benefit of "no commuting" from his home office to his regular office.

Are you like Eddie? Do you have a home office? Is it a principal office that eliminates commuting?

If you are not getting this double benefit, be more like Eddie.

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1 IRC Section 280A(a).
2 IRC Section 280A(c)(1).
3 IRS Pub. 587, Business Use of Your Home (2012), Jan. 5, 2013, p. 3.
4 Paul M. Sengpiehl v Commr., TC Memo 1998-23.
5 Hughes v. Commr., TC Memo 1981-140.
6 Rayden v. Commr., TC Memo 2011-1.
7 IRS Pub. 587, Business Use of Your Home (2012), Jan. 5, 2013, p. 3.
8 Internal Revenue Manual Exhibit 4.10.10.3—Standard Explanation Paragraph 4814 Test for Home Office.
9 Frankel v. Commr., 82 TC 318.
10 Green v. Commr., 78 TC 428; Rev'd on another issue, 52 AFTR 2d 83-5130.
11 IRC Section 280A(c)(1).
12 Ibid.
13 IRS Pub. 587, Business Use of Your Home (2012), Jan. 5, 2013, p. 4.
14 Ibid.