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Rev. Rul. 94-24

Part I

Section 280A - Disallowance of certain expenses in connection with business use of the home, rental of vacation homes, etc.

ISSUE

How will the Internal Revenue Service apply the "relative importance" and "time" tests set forth in *Commissioner v. Soliman*, 113 S. Ct. 701 (1993), to determine whether an office in the taxpayer's home is the taxpayer's principal place of business for purposes of section 280A(c)(1)(A) of the Internal Revenue Code?

FACTS

In each of the following situations, the taxpayer uses the office in the home regularly and exclusively for the taxpayer's trade or business.

Situation 1. A is a self-employed plumber who installs and repairs plumbing in customers' homes and offices. A spends approximately 40 hours of A's work time per week at these customer locations, with approximately 10 hours of A's work time per week spent in an office in A's home talking with customers on the telephone, deciding what supplies to order, and reviewing the books of the business. A also employs E, a full-time unrelated employee, in that office to perform administrative services such as answering the telephone, scheduling A's appointments, ordering supplies, and keeping A's books.

Situation 2. B is employed as a teacher. B is required to teach and meet with students at the school, and to grade papers and tests. In addition to a small shared office at the school, B maintains a home office for use in class preparation and for grading papers and tests. B spends approximately 25 hours per week of B's work time at the school, with an additional 30 to 35 hours of B's work time per week spent in B's home office.

Situation 3. C is a self-employed author who uses a home office to write. C spends 30 to 35 hours of C's work time per week in the home office writing. C also spends another 10 to 15 hours of C's work time per week at other locations conducting research, meeting with C's publishers, and attending promotional events.

Situation 4. D is a self-employed retailer of costume jewelry. D orders the jewelry from wholesalers and sells it at craft shows, on consignment, and through mail orders. D spends approximately 25 hours of D's work time per week in D's home filling and shipping mail orders, ordering supplies, and keeping the books of D's business. D also spends approximately 15 hours of D's work time per week at craft shows and consignment sale locations. D generates a substantial amount of income from each type of sales activity.

LAW AND ANALYSIS

Section 162(a) provides a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Section 262 provides that no deduction is allowed for personal, living, or family expenses.

Section 280A(a) generally prohibits otherwise allowable deductions with respect to the use of a dwelling unit which is used by a taxpayer as a residence. This deduction prohibition does not apply to any deduction, such as interest or taxes, that is allowable without regard to its connection with the taxpayer's trade or business. Section 280A(b).

Under section 280A(c)(1), the section 280A deduction prohibition does not apply to the portion of a dwelling unit which is exclusively used on a regular basis -

- (A) as the principal place of business for any trade or business of the taxpayer,
- (B) as a place of business which is used by patients, clients, or customers in meeting or dealing with the taxpayer in the normal course of the taxpayer's trade or business, or
- (C) in the case of a separate structure which is not attached to the dwelling unit, in connection with the taxpayer's trade or business.

In the case of an employee, the preceding sentence applies only if the exclusive use is for the convenience of the employer.

In *Commissioner v. Soliman*, 113 S. Ct. 701 (1993), the Supreme Court identified two primary factors in determining whether a home office is the taxpayer's principal place of business for purposes of section 280A(c)(1)(A):

- (1) the relative importance of the activities performed at each business location; and
- (2) the amount of time spent at each location.

A comparison of the relative importance of the activities performed at each business location depends on the characteristics of each business. If the nature of a trade or business requires a taxpayer to meet or confer with clients or patients or to deliver services or goods to customers, the place where that contact occurs must be given great weight in determining where the most important activities of the business are performed. If the nature of the business requires that its services are rendered or its goods are delivered at a facility with unique or special characteristics, this is a further and weighty consideration in determining where the most important activities of the business are undertaken.

In addition to comparing the relative importance of the activities performed at each business location, *Soliman* also directs that a comparison be made of the time spent on business at home with the time spent on business at other locations. This time test is particularly significant when a comparison of the relative importance of the activities performed at each business location yields

no definitive answer to the principal place of business inquiry. This may happen when a taxpayer performs income-generating activities at both the office in the taxpayer's home and at some other location.

Consistent with the Supreme Court's analysis in *Soliman*, the Service will first apply the "relative importance" test, comparing the activities performed at each business location, to determine whether an office in the taxpayer's home is the taxpayer's principal place of business for purposes of section 280A(c)(1)(A). If the relative importance test yields no definitive answer to the principal place of business inquiry (which may occur, for example, if the taxpayer delivers services or goods to customers both at the office in the taxpayer's home and elsewhere), the Service will look to the "time" test. However, as the Supreme Court specifically noted in *Soliman*, in some cases the application of the relative importance and time tests may result in a determination that there is no principal place of business for purposes of section 280A(c)(1)(A).

Situation 1. The essence of A's trade or business as a plumber requires A to perform services and deliver goods at the homes or offices of A's customers. The telephone activities, supply ordering, and bookkeeping review that A performs at A's home office, although essential, are less important and take less time than A's service calls to customers. Therefore, A's office in the home is not A's principal place of business, and A cannot deduct expenses for the business use of the home. The fact that E, A's employee, performs administrative activities at A's home office does not alter this result.

Situation 2. The essence of B's trade or business as a teacher requires B to teach and meet with students at the school. The class preparation and grading of papers and tests that B performs at B's home office, although essential and more time consuming, are less important than B's activities at the school. Therefore, B's office in the home is not B's principal place of business, and B cannot deduct expenses for the business use of the home. Because B's office in the home is not B's principal place of business, it is not necessary to determine whether B maintains the office for the convenience of B's employer.

Situation 3. The essence of C's trade or business as an author is writing. C's research, meetings with publishers, and attendance at promotional events, although essential, are less important and take less time than C's writing. Therefore, C's office in the home is C's principal place of business, and C can deduct expenses for the business use of the home.

Situation 4. The essence of D's trade or business as a retailer of costume jewelry requires D to sell jewelry to customers. D does this at craft shows, at consignment shops, and through catalog orders filled from the office in D's home. D generates substantial income from the sales made at each of these locations. Because the most important activities of D's business, sales to customers, are performed in more than one location, D's principal place of business cannot be determined definitively based on a comparison of the relative importance of the activities performed at D's home office and at D's other business locations. In this circumstance, the time spent on business activities at each business location assumes particular significance. D spends approximately 25 hours of D's work time per week in the home office filling and shipping mail orders, ordering supplies, and keeping the books of D's business. D also spends approximately 15 hours of D's work time per week at craft shows and consignment shops. Accordingly, D's office in the home is D's principal place of business, and D can deduct expenses for the business use of the home.

HOLDING

To determine whether an office in the taxpayer's home is the taxpayer's principal place of business for purposes of section 280A(c)(1)(A), the Service will first apply the "relative

importance" test in *Soliman* to compare the activities performed at each business location. If the relative importance test yields no definitive answer to the principal place of business inquiry (which may occur, for example, if the taxpayer delivers services or goods to customers both at the office in the taxpayer's home and elsewhere), the Service will look to the "time" test. However, as the Supreme Court specifically noted in *Soliman*, in some cases application of the relative importance and time tests may result in a determination that there is no principal place of business for purposes of section 280A(c)(1)(A).

EFFECT ON OTHER DOCUMENTS

Notice 93-12, 1993-1 C.B. 298, is amplified.

DRAFTING INFORMATION

The principal author of this revenue ruling is Marilyn E. Brookens of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Brookens on (202) 622-1585 (not a toll-free call).