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Ken Berry • Aug. 11, 2014

It is well-established that you can deduct home office expenses only if certain tax law requirements are met. Notably, no deduction is allowed unless the taxpayer uses the home office regularly and exclusively for business purposes.

It's the "exclusivity" part of the test that usually trips up clients. However, the Tax Court gave one taxpayer living in a cramped apartment a little more leeway – literally – than the IRS usually allows (Miller, TC Summary Opinion 2014-74).

First, let's recap the basic rules. Generally, a taxpayer qualifies for home office deductions only if he or she uses a portion of the home regularly and exclusively as a principal place of business or a place to meet or deal with customers, clients or patients in the normal course of business. If the taxpayer is an employee, the home office must be used for the convenience of the employer.

Assuming a taxpayer qualifies under these rules, he or she may deduct expenses directly related to the home office, like the cost of painting a room used exclusively for business, plus a proportionate share of other expenses like mortgage interest, property taxes, utilities, repairs, insurance, etc. (Note: The portion of mortgage interest and property taxes attributable to the home office would normally be deductible in any event on Schedule A.) Furthermore, the taxpayer may claim a depreciation allowance based on IRS tables.

Now here's what happened in the new case: Lauren Miller, who lived in a studio apartment in New York City, was the sole New York employee of BrandingIron Worldwide (BIW), a public relations and marketing firm headquartered in Los

Angeles. BIW asked her to work out of her apartment until it could secure local office

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the computer on the desk for work.

Although the office space was used primarily for business purposes, Miller admitted she occasionally used it for personal reasons as well. In fact, she had to walk through this section of the apartment to reach her bedroom. Thus, the IRS denied all the deductions relating to her home office.

The Tax Court observed that BIW had listed Miler's apartment on its website as the address for its New York office; that Miller testified credibly that she regularly used one-third of her apartment space as an office for BIW business; that she regularly met with clients there; and that she was expected to be available to work well into the evening. These facts persuaded the Tax Court that the apartment was Miller's principal place of business and she was using it for her employer's convenience.

Saving grace: The taxpayer used the office space personally, but the use was de minimis and completely attributable to the practicalities of living in a studio apartment with small dimensions. Accordingly, she can deduct one-third of her rent plus a proportionate share of other legitimate household expenses.

Moral of the story: Whenever possible, have your clients stick to the strict letter of the law, avoiding any personal use of a room, or segregated office space within a room, that is devoted exclusively to business. However, don't concede home office deductions if a client engages in nonbusiness use of the space on a minimal basis, especially if it dictated by the home's dimensions.

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