

The ideal introduction to tax research: Soliman and the home business deduction

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ABSTRACT

There has been a longstanding demand among those in academic circles for high-quality, interesting cases that would possibly engage students both inside and outside the classroom. Ideally, these cases would also enhance students' knowledge about relevant subject matter. This manuscript addresses just such a necessity, at least for tax educators, by detailing a sequence of cases focused on what has been historically a very grey area, taxpayers' home office deductions. It offers guidance for instructors to assist students in developing a robust understanding of the tax treatment of the home office deduction, a familiarity with judicial hierarchy, and an appreciation for the tax code as a fluid set of rules greatly impacted by court cases at the trial, appellate, and Supreme Court levels.

Keywords: Home Office Deduction, Tax Research, Accounting Education, Judicial Rulings

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INTRODUCTION

Students often perceive tax accounting to be a difficult subject, and one of questionable relevance, as they typically have had limited exposure to taxation and are assuming that the conventional university tax course focuses exclusively on tax compliance (Hart, 2022). Although these perceptions are often erroneous, it is important for instructors to recognize that it is critical to combat these misperceptions by developing strategies that: 1) demonstrate the practical relevance of tax in real-life scenarios; 2) illustrate how the tax code is formed; and, 3) bring some level of enjoyment to the tax classroom. This manuscript attempts to fill that void by providing an analysis of a series of court cases on home business deductions involving an individual taxpayer, Nader E. Soliman. These cases span several levels of the courts, cover a controversial matter (e.g., a deduction that is thought to significantly increase a taxpayer's audit likelihood), involve a landmark case, and yet are interesting enough that students might possibly be entertained (and by extension, engaged) when reading about the twists and turns within the string of judicial findings. The Soliman cases, representing a series of judicial and legislative actions on a topic even a tax-naïve student may find relatable, offer instructors considerable advantages in illustrating a unique perspective of the tax field and its processes.

In short, this work provides a summary of the back-and-forth developments on the home business deduction using the cases involving Nader Soliman. The home office deduction is quite pertinent to current times for the basic reason that it has the possibility of affecting more and more individuals. (Schreiber, 2013) surmises, "as more people work at home and are not provided a space to work at their employer's premises, it may be easier for employees to establish that it is being done for the employer's convenience" (pp. 32-33). In addition, during and post Covid-19, there has been substantial growth in self-employment (Gregory, Harding, & Steinberg, 2022)(Utz, Cai, & Baker, 2022) (Cai, J. Y., & Baker, D., 2023). The home business deduction has resided in the "grey area" for years, as various legislative and judicial actions have caused the potential for a deduction to vacillate between a stricter stance which would disallow a deduction in the typical case, and a more flexible one, allowing a deduction in a broader array of situations. However, it is that "grey area" where, arguably, the most interesting cases on taxation, if not most topics, reside.

THE HOME OFFICE DEDUCTION IN 1990

Prior to the Tax Reform Act of 1976 (Tax Reform Act of 1976. Public Law 94-455. 1976), Section 162(a) allowed a deduction for home office expenses if the expenditure was merely "ordinary and helpful" (United States Code. 26 U.S.C. §162(a), 1970). Section 280A of the Internal Revenue Code (IRC), instituted as part of the Tax Reform Act of 1976, generally prohibited the deduction of expenses related to a taxpayer's personal residence. However, section 280A(c)(1) provided an exception to that general rule, allowing taxpayers to take a home business deduction if the home is used "exclusively" and on a "regular basis" as:

- (A) "the principal place of business of the taxpayer,
- (B) 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
- (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" (26 U.S. Code § 280A -

Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.).

At one time, an additional requirement applied if the taxpayer wishing to take advantage of the home office deduction was an employee (26 U.S. Code § 280A - Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.). To qualify for the deduction, an employee had to show that the portion of the home used exclusively and regularly for business purposes also served for the “convenience of the employer” (e.g., the employer does not provide space for the taxpayer to do his/her job). Note that the Tax Cuts and Jobs Act (Tax Cuts and Jobs Act. Public Law 115-97, 2017) removed the possibility of an employee to claim the deduction. Regardless of whether employees did or did not qualify for the deduction over the years, defining what qualifies as the principal place of business has been vital in determining whether a taxpayer could deduct home-related office expenses such as utilities and repairs (Fleischman, G.M., Payne, T.H., 1999). However, the inherent ambiguity in section 280A has allowed various courts over the years, particularly at the Tax Court and appellate levels, to ascribe a variety of interpretations to the “principal place of business” concept.

THE SOLIMAN TAX COURT CASES

Soliman and the U.S. Tax Court

Nader Soliman was a self-employed anesthesiologist in Northern Virginia who used a spare bedroom in his own apartment 10-15 hours per week to “exclusively and regularly” perform office functions (e.g., billing, bookkeeping, preparing for patients, and continuing medical education) related to his business as an independent contractor within a professional services corporation. Soliman furnished this room with a chair, a desk, a couch, a telephone, an answering machine, a copier, and a filing cabinet. Within this room, he stored and maintained all patient records, read his medical journals, prepared for presentations, and contacted surgeons, patients, and hospitals both for the admission of patients and to prepare for surgeries (Soliman v. CIR.1991). His only “personal” use of this space was to balance his checkbook, which combined his business and personal dealings. Soliman spent an average of 30-35 hours per week at three hospitals in Bethesda, Maryland, Rockville, Maryland, and Leesburg, Virginia, preparing patients for surgery and caring for them post-surgery, including administering pain medication. He was not provided office space at any of the hospitals to perform the administrative functions related to his role as an anesthesiologist (Soliman v. Commissioner, 1990).

The Internal Revenue Service (IRS) took issue with several of Soliman’s claims per his 1983 tax return. Among them, the IRS disallowed \$1,259 of home office expenses or deductions, and they also rejected \$3,758 of expenses related to Soliman’s use of an automobile for transporting himself between the three hospitals and between his home and the hospitals. Thus, Soliman sued the IRS for these disallowed expenses with the hope that the Tax Court might be more amenable to the deductibility of what were, in his opinion, expenses related to his running a business.

Attempting to reconcile a variety of appellate court decisions on the home business deduction, the Tax Court adopted a new standard for what constitutes a taxpayer’s “principal

place of business,” thus rejecting the “focal point” test applied previously under (*Baie v. Commissioner*.1980), adopting the “facts and circumstances” test. The latter evaluation takes the answers to the following three questions into consideration when determining whether a taxpayer’s home is his/her principal place of business: (1) Are the functions performed in the home office essential to the conduct of the business? (2) Does the taxpayer spend a substantial amount of time in the home office? and, (3) Is there alternative suitable office space outside the home office? (*Soscia*, 1995)

In the majority opinion (ten judges, with six judges as part of two dissenting opinions), the Tax Court stated, “where no other suitable office is provided for essential organizational activities of a business, the fact that goods or services are delivered elsewhere should not per se require a conclusion that a home office is other than the principal place of business” (*Soliman v. Commissioner*.1990) Thus, the Tax Court found that Soliman’s home is his “principal place of business,” and that he is entitled to deductions related to his home office, along with expenses from operating his vehicle (including depreciation).

Judge Nims, in one of the two dissenting opinions, thought that the majority were taking us back to the “ordinary and helpful” days prior to section 280A, or even that the majority was set to allow deductions in the event that the expenses were incurred at an “important place of business” (*Soliman v. Commissioner*.1990). Judge Ruwe, wrote in the other dissent that the focal point test in 280A had consistently been, per the Circuit Courts’ findings, the be “the place where the dominant portion of the work is accomplished” and that this is where the taxpayer would typically spend the majority of their time (*Soliman v. Commissioner*.1990)

(*Rosen*, 1992) is among those who questioned the Tax Court’s finding in *Soliman*, especially when that conclusion is compared to the Tax Court’s judgment in a case with similar circumstances (*McDonald v. Commissioner*.1991). In that particular case, the owner of a television, radio, and stereo repair business who had his wife doing the business’ bookkeeping and payroll at home was found not to be entitled to a home business deduction. The Tax Court’s Memorandum decision found that the functions provided by Mrs. McDonald were “incidental” to the primary business operations, which were performed at Mr. McDonald’s repair shop. Thus, Mr. McDonald’s home office could not be the principal place of business.

Soliman and the U.S. 4th Circuit Court of Appeals

Stinging from the defeat on such an important issue, and obviously not being fond of the Tax Court’s revision of what constituted a taxpayer’s principal place of business, the IRS Commissioner appealed the 1990 decision. However, on June 5, 1991, the 4th Circuit Court of Appeals, in a two-to-one decision, affirmed the Tax Court’s choice to allow Soliman a deduction for expenses pertaining to his home office, based on his home being his principal place of business. The affirmation of the Tax Court’s decision was not based on the focal point test previously developed and applied by the Tax Court in the case of (*Baie v. Commissioner*.1980), but rather the Appellate Court deemed that the new “facts and circumstances” test the Tax Court employed in the *Soliman* case was proper. This test allowed for the home office to be the principal place of business (thus, eligible for the deduction) if managerial or administrative activities essential to the taxpayer’s business are performed in that home office, the taxpayer

spends a “substantial” amount of time there, and there is not another location available where these business office functions could be carried out (Soliman v. CIR.1991).

Additionally, the Commissioner sought the Appellate Court's reversal of the Tax Court's decision based on the notion that the Tax Court's interpretation of Section 280A would create a loophole that all taxpayers working from home would exploit (Soliman v. CIR.1991). The Appellate Court rejected that argument and found, again, that the Tax Court's new “facts and circumstances” test was indeed consistent with Congressional intent in Section 280A, and that this test simply replaced what it saw as an “inflexible and potentially unjust” focal point test. In the majority opinion, the Appellate Court stated that the new “facts and circumstances” test would allow taxpayers who maintain “legitimate” home offices, but who do not spend a majority of the time in this home office, to continue to take the deduction. Judge Phillips, in the dissenting opinion, argued that there could be only one principal place of business, and the hospital, in this case, was just that for Soliman (Soliman v. CIR.1991).

Soliman and the U.S. Supreme Court

In a majority decision delivered by Justice Kennedy, the Supreme Court reversed the 4th Circuit's decision, finding that Soliman's home was not his principal place of business, thus disqualifying the deductions related to his home office. The Court took issue with the Appellate Court's failure to use a comparative analysis to determine the “principal” place of business among various locations. The Court dismissed the Appellate Court's focus on the “necessity” of the functions performed at the home office, and instead looked at the types of functions performed at all comparative locations, with extra weight given to the location in which the fundamental nature of the business was performed. The Court ruled that there should be two primary factors taken into consideration when determining if a taxpayer's home office is his/her principal place of business: (1) the relative importance of the functions (but not the “essentiality” as the Court of Appeals found) performed at the various business locations; and given that this analysis does not yield a definitive answer, then (2) a comparison of the amount of time spent at the home office versus the various other business locations should be undertaken (Commissioner v. Soliman.1993).

In addition, the Court rejected the Appellate Court's notion that Soliman having no alternative office space provided by any of the three hospitals should be considered, stating that the availability of office space other than the home office holds no relevance. The Court emphasized that if the comparative analyses within the context of the two factors do not generate a clear answer, then the home office does not qualify as the principal place of business by default. Based on the application of these two factors to Soliman, the Court concluded that his home office was not his principal place of business if it was a place of business at all, and that he was not entitled to a deduction related to the expenses related to that home office (Commissioner v. Soliman.1993).

REVENUE RULING 94-24

Based on the Supreme Court's 1993 Soliman decision regarding home office deductions, the IRS provided guidance in determining the taxpayer's principal place of business for purposes of section 280A(c)(1)(A) in Revenue Ruling 94-24 (IRS, 1994). The IRS indicated that it would follow the Supreme Court's approach, first looking at the relative importance of activities performed at each business location, and if that tactic does not "yield a definitive answer," then, evaluating the actual time spent at each business location (IRS, 1994). The IRS recognized in Revenue Ruling 94-24 that these two tests may not always produce a decisive "principal place of business." Consequently, the Revenue Ruling then provides four constructive examples which demonstrate how the IRS will apply the "Soliman tests" (IRS, 1994).

The first example has a plumber who spends ten hours per week in his home office talking with customers on the telephone, reviewing his bookkeeping records, and deciding on supplies orders. The IRS concluded that because the plumber spent considerably more time (40 hours per week) providing services to customers, the home office was not his principal place of business. In the second example, a teacher spends 25 hours a week at school and 30-35 hours per week preparing in her office at home. The IRS again concluded that the teacher's home office was not the "principal place of business" since the activities the teacher performs at home are "less important" than those performed at school (IRS, 1994).

The second example involves a school teacher who uses a home office for class preparation and grading. The teacher spends about 25 hours per week at a small shared office at the school, and about 30 to 35 hours each week in the home office. The IRS concluded that in this situation, the home office would not be the teacher's principal place of business. While noting that those activities performed in the home office were essential and even more time-consuming than those activities performed at school, they were less important to the overall employment than the teacher's activities at school (IRS, 1994).

The third of four examples has an author who writes at home for 30-35 hours per week while spending 10-15 hours per week conducting research, meeting with publishers, and attending promotional events. The IRS agrees that in this example, the "essence of the author's business" is the writing, hence, the author's home office is her principal place of business, and expenses related to that space would be deductible. In the final example, Revenue Ruling 94-24 depicts a self-employed retailer who sells costume jewelry from his home (via mail orders) and at craft shows and consignment locations. The retailer spends about 25 hours per week working from home, and about 15 hours per week servicing the craft show and consignment sale locations. The IRS concluded that since activities directly relevant to the business's objective were performed at both the home office and other locations, the time test "assumes particular significance," and the home office does indeed serve as the principal place of business for the retailer (IRS, 1994).

The final example describes a self-employed retailer who orders costume jewelry from wholesalers and then sells the product at craft shows, on consignment, and via mail orders. The retailer spends more time (25 hours per week) at her home office filing and shipping mail orders, ordering supplies, and keeping the business's books. A less substantial period of time (15 hours per week) is spent at the craft shows and the consignment sale locations. Because the most

important activities of the business—the sales to customers—are performed at various locations, the IRS noted that a principal place of business cannot be determined based on comparing the relative importance of the activities performed at those locations. The IRS said that “the time spent at each business location assumes particular significance” and, thus, it concludes that the retailer’s home office is her principal place of business and a home office deduction would be allowed in this situation (IRS, 1994).

TAXPAYER RELIEF ACT OF 1997

In a concurring opinion within (Commissioner v. Soliman.1993), Judge Blackmun writes, “Congress must change the statute’s words if a different result is desired as a matter of tax policy.” This aligns precisely with what Congress did in the Taxpayer Relief Act of 1997, with respect to its policy on the home business deduction. The Taxpayer Relief Act of 1997 took effect on January 1, 1999. It expanded the definition of the “principal place of business” to also include a taxpayer’s home office if it is used exclusively and regularly to perform administrative or management activities related to a trade or business, and there is no other fixed location where a substantive portion of these activities are carried out. If the taxpayer is an employee, then the home office must be “for the convenience” of his/her employer (Kasich, 1997).

The Taxpayer Relief Act extended the home business deduction to those who were previously ineligible to claim it after the 1993 Soliman case. In addition, those taxpayers could now deduct the cost of traveling to and from their home offices and other places of business. In other words, this legislative change would have made Dr. Soliman’s home office expenses deductible. However, the change cannot be applied retroactively.

Many CPAs and tax policymakers had perceived the Soliman two-part test as anti-small business. One set of authors posed the question in this form: “Why should a large business that leases offices be allowed a deduction when a small business, allocating time and essential business activities across multiple locations, is precluded from taking?” (Fleischman, G.M., Payne, T.H., 1999). In addition, these authors decried that the law failed to consider cultural and technological changes enabling home-based businesses to stimulate economic growth and job creation, resulting in inefficient energy consumption and resource allocation.

THE CURRENT STATUS OF HOME BUSINESS DEDUCTIONS

The IRS makes it clear that very little has changed on the home business deduction front since the Taxpayer Relief Act took effect in 1999 in its Publication 587 (IRS, 2016)(IRS, 2024a)In fact, one of the four examples provided by the 2016 Publication 587 to illustrate what does or does not constitute a principal place of business mimics Dr. Soliman’s scenario (e.g., a self-employed anesthesiologist who performs administrative and managerial duties in his home office). This example was used to demonstrate a situation in which an anesthesiologist facing the same set of events would be able to take the home office deduction. The example also appears again in the most recent Publication 587 (IRS, 2024a).

One of the other three examples in the 2016 publication describes a self-employed plumber who performs administrative and management activities for his business at a home

office. This happens to be the same example previously used in Revenue Ruling 94-24 (IRS, 1994) to illustrate a situation in which the home office was not the principal place of business. However, with the newly added Taxpayer Relief Act provisions, Publication 587 in both 2016 and 2024 show that the plumber's home office is his principal place of business. The next example describes a sales representative who does the bulk of her administrative and management duties at her home office, and the rest at hotel rooms while she is on the road. Since the hotel rooms are not "fixed locations" per the Taxpayer Relief Act of 1997, the sales representative is allowed a home business deduction.

The last example described in the 2016 Publication 587 is a teacher in a similar situation to the one in Revenue Ruling 94-24, in which a teacher primarily engages in administrative duties related to her teaching assignment. As an employee with an office provided by her employer at the school, the teacher does not work out of her home as a "convenience to her employer." Therefore, even if her home office qualified as her principal place of business under the Taxpayer Relief Act, the teacher is unable to take the home business deduction." As indicated in Figure A (Appendix), Publication 587 (IRS, 2024a) also provides a very useful flowchart to assess whether a home office deduction would be allowed in various situations. Interestingly enough, the last example in the 2016 Publication 587 dealing with a teacher no longer appears in the current version.

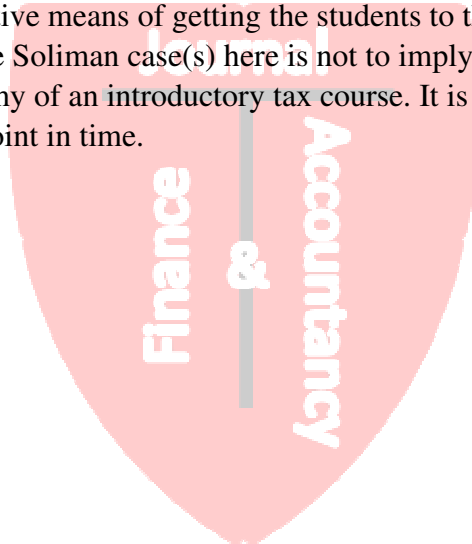
Currently, there are 12.7% of full-time employees working from home, and 28.2% of employees having adapted to a hybrid work model (Haan, 2023). It is estimated that by 2025, the number of Americans working remotely will reach 36.2 million, marking 22% of the American workforce (Ozimek, 2020). As more and more U.S. workers chose to do some or all their job duties from home, the home business deduction will—or it could be argued that it should—be on the radar of more and more taxpayers. (Logan, 2017) breaks down who currently takes the home business deduction by industry. The author also states that IRS data from the 2014 tax year indicate that \$9.5 billion in home office deductions (insurance, rent, repairs, and utilities) were claimed. However, (Eisenberg, 2013) reports that despite the fact that 26 million Americans have home offices, only 3.4 million taxpayers claimed home office deductions in 2013. This trend persisted in 2021, the latest year for which IRS line item estimates for Individual Income Tax Returns are available, with about 4.4 million taxpayers filing for home office deductions out of a total of 160.8 million individual tax returns filed, with these filers taking advantage of just over \$12.8 billion in home office business deductions (IRS, 2024b). Taken as a whole, these numbers illustrate that the home office deduction may be significantly underutilized by U.S. taxpayers.

CONCLUSION

The contentious nature of the topic and the twists and turns within the courts make an educational analysis of the home business deduction very appealing in the tax classroom. The Soliman case is interesting at each judicial level, and nearly all students are familiar with business owners or employees who are working from home, or they themselves aspire to be entrepreneurs, possibly working from home. If the home business deduction is contrasted with

arguably more staid topics such as the alternative minimum tax or passive activity loss rules, it is clear why the trials and tribulations of Dr. Nader Soliman provide such a wonderful initial foray into tax research. The justice system's treatment of the home business deduction takes students on a trip from the very lenient (via the Tax Court and 4th Circuit Court decisions), to the stringent (per the Supreme Court decision), and back to a more compassionate stance for the taxpayer (by way of Revenue Ruling 94-24 and the 1997 Taxpayer Relief Act).

Many students assume tax accounting focuses exclusively on tax compliance (Hart, 2022) and were under the impression that the Tax Code was black and white. The Soliman case can thus become their introduction to the "grey" nature of accounting and particularly the "grey" character of the Tax Code. By using the Soliman case in the classroom, students are exposed to real-life situations in which intelligent persons within the legal and tax communities can disagree about how a tax matter should be settled. The real beauty of this case study approach, however, is that it could be applied to any contentious tax matter adjudicated by the courts. The result is that students are much more likely to have some frame of reference regarding home business deductions (or the chosen topic) than they might have had if an instructor simply lectured for 30 minutes or used some alternative means of getting the students to think about the topic at hand. The purpose of addressing the Soliman case(s) here is not to imply it is the only interesting, contentious, case matter worthy of an introductory tax course. It is just the best option that the authors are aware of at this point in time.



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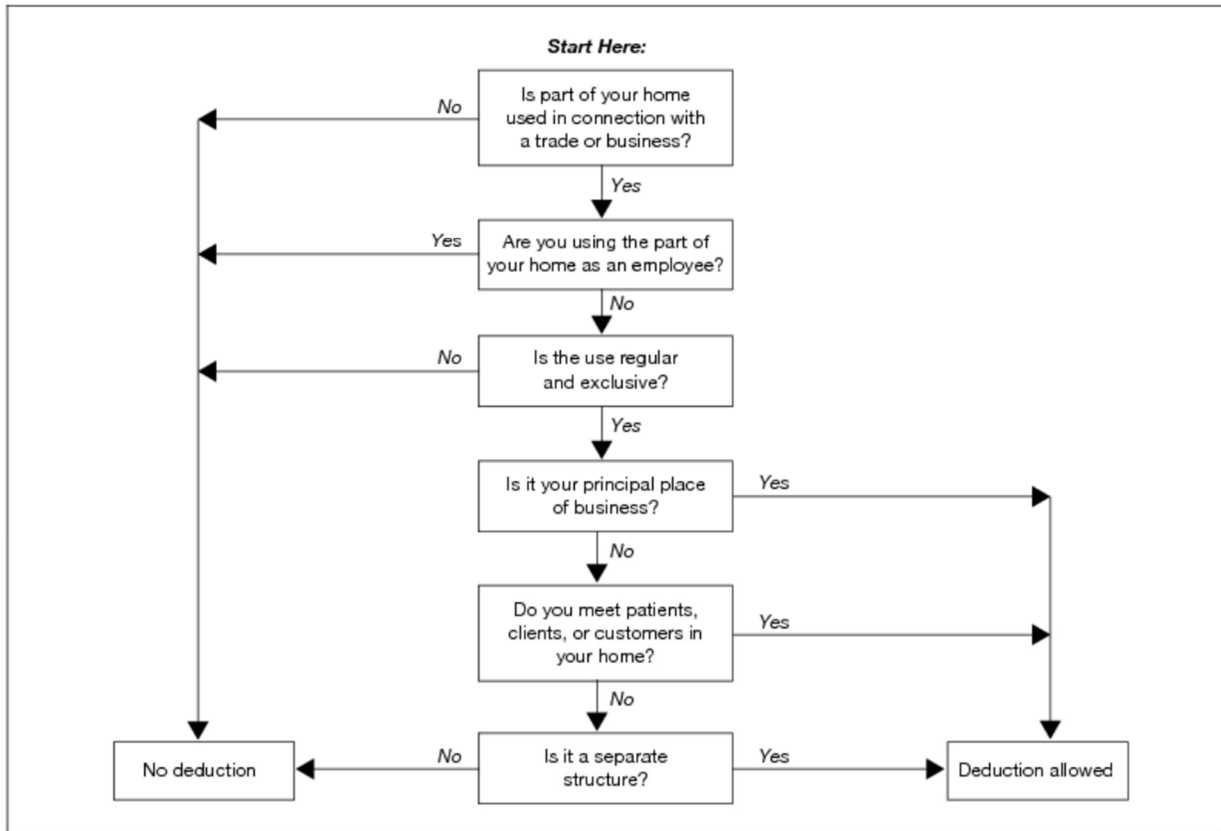
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APPENDIX A

Figure A. **Can You Deduct Business Use of the Home Expenses?** Do not use this chart if you use your home for the storage of inventory or product samples, or to operate a daycare facility. See *Exceptions to Exclusive Use*, earlier, and *Daycare Facility*, later.



<https://www.irs.gov/publications/p587>