

# Tax aspects of telecommuting—what employees and employers need to know

More and more employees are telecommuting these days, some full time, others part time, instead of going into the office every day. Telecommuting can cut costs if office space is short, enable employers to hire talent that isn't available locally, and/or help employees balance their personal and professional lives. Telecommuting also can figure into corporate contingency planning, as having some key employees work off-site on a regular or rotating basis makes the enterprise less vulnerable to potential disruptions.

Telecommuting raises tax issues for employees and employers alike. Here's a review of the tax rules and possible opportunities for savings that apply when employees work off-site from their homes.

**Home-office issues.** A threshold question is whether the employee may deduct the direct and indirect expenses of his home office (the space he uses for employment-related work).

- Direct expenses relate only to the home office, such as the cost of painting the room where the home office is located, or repairing the room's leaking ceiling.
- Indirect expenses relate both to the personal portion of the home, and the business-use portion, that is, the home office. Indirect expenses include items such as utilities, real estate taxes, home mortgage interest, rent or depreciation, homeowners insurance, and repairs benefiting the entire property (e.g., furnace repair). (IRS Publication 587, 2008, pg. 8)

Direct expenses and the business-use part of the indirect expenses relating to a home office within a residence are deductible only if part of the home is used regularly and exclusively as (1) a principal place of business, or (2) as a place to meet or deal with customers or clients in the ordinary course of business. Taxpayers who are employees must meet an additional test—their use of the home office must be for the convenience of the employer. (Code Sec. 280A(c)(1)) Unrelated expenses, such as for general landscaping or painting a room other than the one used for business purposes, are not deductible. (IRS Publication 587, 2008, pg. 8; Prop Reg § 1.280A-2(i)(3))

If the qualification test is met, and gross income from the business use of a taxpayer's home equals or exceeds total business expenses (including depreciation), all expenses for the business use of the home can be deducted by the employee on Schedule A as a miscellaneous itemized deduction subject to the 2%-of-AGI limit. If, however, the taxpayer's gross income from that use is less than total business expenses, home office deductions are limited under the gross income test. The deductions are limited to the excess of the gross income derived from business use of the home over the sum of:

- (1) the deductions allocable to business use that are allowable whether or not the dwelling unit (or portion of it) was so used (e.g., mortgage interest, real estate taxes, and casualty and theft losses), and
- (2) the deductions (such as for supplies) allocable to the business activity in which business use of the home occurs, but which aren't allocable to business use of the home. (Code Sec. 280A(c)(5)(B)(ii))

**The convenience of the employer** test is met if the employer asks the employee to work out of his home, or if he's not in the office on a regular basis because of the nature of his job (e.g., he's a sales rep with a wide territory). In general, if the employee asks the employer to telecommute instead of working at the office, this test probably won't be met, and direct and indirect home-office expense deductions will be barred. However, the facts and circumstances may indicate that an employee is working at home for the employer's convenience, even if the employee is the one choosing to telecommute. For example, as part of its contingency planning to deal with disasters, a company may ask for three work-at-home volunteers from an operations staff of 15. Under these

circumstances, those that volunteer would work from home for the employer's convenience, even though the choice is at least partly theirs.

**How home office is used.** In most telecommuting settings, the employee will not be using the home office location to meet or deal with customers or clients in the ordinary course of business. As a result, deductions under Code Sec. 280A will be available only if the home office is used regularly and exclusively as the employee's principal place of business. The principal-place-of-business test is met where the employee telecommutes full-time, but it's a problem if the employee telecommutes some days and commutes to the office on other days. The employee must determine whether the employer's office location or his home-office location is his principal place of business.

A home office is a principal place of business under Code Sec. 280A(c)(1) if it is used for the administrative or management activities of any trade or business of the taxpayer, but only if there is no other fixed location where the taxpayer conducts substantial administrative or management activities of that trade or business. However, the comparative analysis set forth by the Supreme Court in *Com. v. Soliman, Nader*, (1993, S Ct) 71 AFTR 2d 93-463, applies where the statutory test doesn't settle the principal-place-of-business issue. Under **Soliman**, the determination of a taxpayer's principal place of business requires a comparative analysis of: (1) the relative importance of the activities performed at each business location, and (2) the time spent at each place, i.e., the amount of time spent at the home compared with the amount of time spent in each of the other places where business activities occur.

**RIA illustration:** A computer programmer does his assignments at his home office location, but comes to the office regularly to attend meetings and discuss and review assignments and completed projects. He spends more time at home than he does at the employer's office. Under the comparative analysis test, and the statutory administrative or management activities test, the programmer's home office is his principal place of business. However, if the programmer spends the majority of his programming time at his employer's offices, the home office probably won't qualify as a principal place of business under the comparative analysis test or the statutory administrative or management activities test of Code Sec. 280A(c)(1).

**The gross income test** shouldn't be a problem, assuming an employee's home office qualifies under the above rules, because his salary allocable to telecommuting work (i.e., the gross income derived from working at home) should handily exceed the sum of otherwise allowable expenses allocable to the home office and deductions such as supplies allocable to the business activity in which business use of the home occurs.

**Transportation expenses.** If a taxpayer's principal place of business within the meaning of Code Sec. 280A(c)(1)(A) is in his residence, daily transportation expenses between the office in the taxpayer's residence and other work locations related to the same business are deductible. (Curphey, 73 TC 766 (1980); Rev Rul 99-7, 1999-1 CB 361) Thus, a telecommuting employee whose home office is his principal place of business may deduct (subject to the 2%-of-AGI floor) the costs of round-trip travel from home to the employer's offices (e.g., to attend meetings, etc.).

If the employee's office at home doesn't meet the Code Sec. 280A(c)(1)(A) tests, IRS said in Chief Counsel Advice 200025052 that "trips between the residence and other work locations are nondeductible commuting expenses unless the temporary work location rules in Rev Rul 99-7 apply."

**RIA observation:** Stating the rules another way, if a telecommuting employee spends at least part of his workweek at his non-home-office location, his transportation expenses between home and a temporary work location are deductible even if his home office isn't his principal place of business. However, if his home office is his principal place of business under Code Sec. 280A(c)(1)(A), then trips between home and other work locations, such as the employer's office, are deductible even if the other work locations aren't "temporary."

**Computer and related equipment.** An employer that supplies a telecommuting employee with a computer used 100% for business will deduct it the same way it would if the machine were located

in the employer's regular offices. That also applies for related equipment, such as a printer or copier. The employee will treat the computer and related equipment as a working condition fringe benefit, if the conditions outlined below are met.

If the telecommuting employee buys his own computer for employment-related use, he can depreciate it (or expense it under Code Sec. 179) only if it is required as a condition of employment and is used for the convenience of the employer. (Code Sec. 280F(d)(3)) Where the telecommuting employee's home-office deductions don't qualify under Code Sec. 280A(c)(1), his personal computer will be treated as "listed property." (Code Sec. 280F(d)(4)(B)) However, this classification won't affect deductions assuming the computer is used 100% for business (and meets the condition-of-employment/convenience of employer tests). The depreciation or expensing deduction is claimed as a miscellaneous itemized deduction subject to the 2%-of-AGI floor.

**Employment-related business telephone calls.** A taxpayer can't deduct any charge (including taxes) for basic local telephone service with respect to the first telephone line provided to any of the taxpayer's residences. (Code Sec. 262(b)) However, long distance business phone calls on the first or second telephone line, as well as the cost of a second line used exclusively for business, are deductible business expenses even if the taxpayer doesn't qualify for a home-office deduction. (IRS Publication 587, 2008, pg. 9; Hairston, Wayne, (1995) TC Memo 1995-566, affd without op (1997, CA 11) 116 F3d 492) For employees, the deduction is a miscellaneous itemized deduction subject to the 2%-of-AGI floor.

**Reimbursed expenses related to telecommuting.** An employer may supply a telecommuting employee with office supplies and equipment or it may reimburse him for these expenses as well as for some or all of the utilities and maintenance expenses allocable to the home office. Employer-provided property and services qualify as tax-free working condition fringe benefits only if the employee would be entitled to a business expense deduction under Code Sec. 162 or Code Sec. 167 for the items had he paid for them himself. (Reg. § 1.132-5(a)(1)) A cash payment (which presumably includes a reimbursement) made to an employee won't qualify as a WCFB unless the employee is required to:

- (1) use it for a specific or prearranged undertaking which is deductible under Code Sec. 162 or Code Sec. 167,
- (2) verify that the payment actually is used for the expenses specified in (1), above, and
- (3) timely return to the employer any part of the payment not so used. (Reg. § 1.132-5(a)(1)(v))

Under these rules, a telecommuting employee reimbursed for some or all of the utilities and maintenance expenses allocable to his home office could treat the payment as a working condition fringe benefit only if the home office qualified as a principal place of business.