

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Small Claims
Income Tax

JAMES E. ERWIN and DIANE L. ERWIN,)	
)	
Plaintiffs,)	No. 010727F
)	
v.)	
)	
DEPARTMENT OF REVENUE,)	
STATE OF OREGON,)	
)	
Defendant.)	DECISION AND JUDGMENT

The Plaintiffs appealed from a Notice of Tax Assessment for tax year 1997. This appeal involves deductions for the Plaintiffs' business use of their home and claimed car and truck expenses. A telephone trial was held on October 8, 2001. Dawn Morton, Licensed Tax Consultant, appeared for the Plaintiffs. James Erwin appeared as a witness. Mary Beth Wright, Tax Auditor, appeared for the Defendant.

STATEMENT OF FACTS

During the year in question, the Plaintiffs distributed and sold E'ola Products (E'ola). E'ola is a line of herbal products and includes items such as nutritional supplements, vitamins and diet products. E'ola is sold through multi-level marketing. In other words, Plaintiffs were trying to sell their products **and** develop a down-line. The bigger the down-line, the bigger the profit.

The Plaintiffs had two locations where they conducted business. They maintained an office in their home. In addition to keeping the business records at the home office, the Plaintiffs also maintained a small display area of their product line and stored their inventory there. All product deliveries were made to the home office. They

held sales and informational meetings at their home.¹ They sold some E'ola from their home, both to their down-line and some retail sales. The Plaintiffs presented no evidence as to whether the sales to their down-line were made over the telephone or in-person at the periodic meetings. It is also unknown how the sales were made to the retail customers, via telephone or in-person.

They also sold E'ola through a cart at the Valley River Center. The bulk of the Plaintiffs' sales, 59.5 percent, were from the cart.² (Def's Ex B at 3.) Mr. Erwin testified that the main goal of the cart was to show people the product so they would become interested in selling, i.e., to become part of the Plaintiffs' down-line. The Plaintiffs submitted their lease for five months of 1997. (See Ptf's Ex 1.) The term of the lease was from February 1, 1997, through June 30, 1997. (*Id.* at 4.) The lease required the Plaintiffs to "keep [their] principal office at 155 Emerald St., Sutherlin, OR[.]"³ (*Id.* at 7.) The Plaintiffs were required by the terms of the lease to use the cart "only for the "[r]etail sale of E'ola products." (*Id.* at 7 and 4.) One of the Plaintiffs went to the cart everyday.

To show the use of the home office, the Plaintiffs submitted six months of phone records. (See Ptf's Ex 10.) For one of the months, the Plaintiffs had one telephone line that reflected the Plaintiffs' home address. (*Id.* at 7.) For two of the months, the Plaintiffs had two telephone lines, that reflected the address "293 Valley River Center." However, one of the lines was the same telephone number as an earlier month with a

¹It appears that the Plaintiffs used more than the home office for their business. However, they are only claiming that the home office was exclusively used for their business.

²Presumably, the balance of the sales were from the Plaintiff's home. However, whether these sales were in-person or over the telephone is unknown.

³The address was the Plaintiffs' home address at the time of the lease.

number of calls made to the cart in Eugene. (*Id.* at 15 and 25.) The remaining month had a third telephone line, an "800" number. (*Id.* at 38, 44 and 53.) The Plaintiffs regularly made a number of long distance calls, usually several a day. At the telephone line at the Plaintiffs' home, the calls were primarily made in the evening, with some also being made in the morning. As an example, on March 18, 1997, the Plaintiffs made ten long-distance calls. Two calls were made in the morning; the second call was made at 9:12 a.m. The remaining eight calls were made in the early evening to late evening. The third call was made at 5:48 p.m.; the last call of the day was made at 10:30 p.m. (Ptf's Ex 10 at 10-11.)

In connection with their business, the Plaintiffs claimed a deduction for the costs of maintaining the home office. These amounts included a pro-rata share of the real estate taxes, insurance, utilities, and depreciation. The Plaintiffs also claimed their transportation costs incurred in traveling between the home office and their cart at the Valley River Center.

The Defendant disallowed the above-mentioned costs. The home office expenses were disallowed due to the Defendant's view that the home office was not exclusively used for business purposes. To that end, the Defendant introduced a copy of the contact record between the Plaintiffs and the Defendant. (See Def's Ex C at 9-13.) On January 18, 2001, at 12:52 p.m., Ms. Wright spoke to both of the Plaintiffs about whether they had used the home office exclusively for their business. The Plaintiffs told her that "they did not have exclusive use. They have a treadmill in the office and personal items in the bedroom where the rack with the products is." (*Id.* at 12.) The next day, Ms. Wright received a follow-up call from Mr. Erwin and the Plaintiffs' then-representative, Mark Kent; the two men told her that the treadmill was a

prize in a contest that had not yet been picked up. Questioning the previous day's conversation, Mr. Erwin told Ms. Wright that she "'caught him off-guard' yesterday." (*Id.* at 13.) At trial, Mr. Erwin testified that the treadmill was a prize in a promotional drawing that was never picked up. Eventually, the Plaintiffs gave it to their best salesperson.

The Defendant also disallowed the transportation costs the Plaintiffs incurred in traveling between the home office and their car at the Valley River Center. The Defendant gave two reasons for disallowing those costs. The first reason was that, in the Defendant's view, the Plaintiffs did not exclusively use their home office for business purposes. Therefore, follows the reasoning, the Plaintiffs were not traveling between two business locations, they were commuting to their business location. The second reason is that even if the Plaintiffs did exclusively use their home office for business purposes, it was not their primary place of business. If the home office is only a secondary place of business, according to the Defendant, transportation expenses to their primary place of business are so intertwined with commuting expenses that they are not allowed.

The Plaintiffs' position is that not only did they exclusively use their home office for business purposes, their home office was their primary place of business because they were required by the terms of their lease to maintain their principal office in their home. Additionally, the Plaintiffs point to the meetings and other activities held in their home.

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ISSUES

There are two issues before the court. The first is whether the Plaintiffs exclusively used their home office for business purposes such that they are entitled to claim their expenses associated with the business use of their home. As a sub-issue, if the Plaintiffs did exclusively use their home office for business purposes, was their home office their principal place of business or did they regularly deal with their customers in the normal course of business. The second issue is whether or not the Plaintiffs are entitled to deduct their transportation costs between their home office and their car in the Valley River Center.

COURT'S ANALYSIS

Home Office

The general rule relating to the deduction of expenses associated with the business use of the home is set forth in IRC § 280A (a).⁴ It provides that:

"Except as otherwise provided in this section, in the case of a taxpayer who is an individual or an S corporation, no deduction otherwise allowable under this chapter shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the taxable year as a residence."

One of the exceptions is for certain business use of the home. IRC § 280A (c)(1) provides that:

"Subsection (a) shall not apply to any item to the extent such item is allocable to a portion of the 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 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.

⁴All citations to the Internal Revenue Code are to 2002 unless otherwise noted.

"In the case of an employee, the preceding sentence shall apply only if the exclusive use referred to in the preceding sentence is for the convenience of his employer. For purposes of subparagraph (A), 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."⁵ (Emphasis added.)

Claiming the business use of a taxpayer's home entails a three-part test. First, the property must be exclusively used for business. Second, the property must be regularly used for business. Third, the property must either be: a) the taxpayer's principal place of business, b) used by clients in meeting or dealing with the taxpayer in the normal course of business, **or** c) a separate structure used in connection with the taxpayer's business. The telephone records clearly establish the Plaintiffs' home office was regularly used for business. Additionally, the Plaintiffs were required by the term of their lease with the Valley River Center to maintain their principal office at their home.

What is less clear is whether the home office was exclusively used for business. As the United States Tax Court stated, "[t]he exclusive use requirement of section 280A(c)(1) is an **'all-or-nothing standard.'** Combined personal and business use precludes deductibility of the cost of the residence." *Speers v. Commissioner*, 67 TCM (CCH) 2653, 2656 (1994) (quoting *Hamacher v. Commissioner*, 94 TC 348, 357 (1990)) (other citation omitted) (emphasis added). There was conflicting evidence on whether the home office was exclusively used for business. The Plaintiffs submitted no evidence relating to exclusive use except for the evidence relating to the treadmill. Based on the limited evidence before it, the court is not convinced that the home office was exclusively used for business. As in *Speers*, the Plaintiffs "have failed to establish

⁵This last sentence was added by Pub L 105-34 § 932. It applies to tax years beginning after December 31, 1998. See Pub L 105-34 § 932 (a) and (b). Because the tax year at issue is 1997, it is not directly relevant to the present case although it is useful in the analysis.

that these areas were used *exclusively* for business purposes." *Id.* Because the court finds that the home office was not exclusively used for business purposes, it need not decide if the home office was either: a) the Plaintiffs' principal place of business, b) used by clients in meeting or dealing with the Plaintiffs in the normal course of business, **or** c) a separate structure used in connection with the Plaintiffs' business.⁶

Transportation Expenses

In order for the Plaintiffs' transportation expenses between their cart in the Valley River Center and their home office to be considered ordinary and necessary business expenses, and therefore deductible, the home office must be a business location such that it "satisfies the principal place of business requirements of [IRC] § 280A (c)(1)(A)."

Rev. Rul. 99-7. If, as in this case,

"an office in the taxpayer's residence does not satisfy the principal place of business requirements of § 280A(c)(1)(A), then the business activity there (if any) is not sufficient to overcome the inherently personal nature of the residence and the daily transportation expenses incurred in going between the residence and regular work locations." *Id.*

⁶The court has some concerns that even if the Plaintiffs' home office satisfied the exclusive use requirement of IRC § 280A (c)(1) it may not have qualified as the Plaintiffs' principal place of business or where the Plaintiffs met with clients or customers in conducting their business.

As noted above, the Plaintiffs earned 59.5 percent of their income from their cart in the Valley River Center. (See Defs' Ex B at 3.) Additionally, Mr. Erwin testified that the goal of the cart was not only to sell E'ola but to develop their down-line. The United States Supreme Court in *Commissioner v. Soliman*, 506 US 168, 175, 113 S Ct 701, 121 L Ed 2d 634 (1993), held that, "[t]here are, however, two primary considerations in deciding whether a home office is a taxpayer's principal place of business: the relative importance of the activities performed at each business location and the time spent at each place." Further, "the point where goods and services are delivered must be given great weight in determining the place where the most important functions are performed." *Id.* It appears that under the standard set forth by the Supreme Court in *Soliman*, the Plaintiffs' home office is not their principal place of business. Nor is the fact that there is no other fixed location for the administrative or management functions of the business dispositive. As noted in note 5 above, the sentence in IRC §280A (c) relating to administrative or management functions of a business applies only to tax years beginning after December 31, 1998.

The court agrees that the Plaintiffs met with at least their down-line in their home. However, it is not at all clear that the in-person contact with their down-line took place in the home office. From the pictures the Plaintiffs submitted, it appears that, in the normal course of business, the office functioned only as an office.

This is because "[t]he primary motivation for petitioner's trips from his major place of employment to his residence was personal. The primary purpose for these trips was to be home (in the popular sense of the term)." *Mazotta v. Commissioner*, 57 TC 427, 429 (1971). Transportation expenses have been disallowed even when the taxpayer was an airline pilot who worked in his home office with certain materials weighing 30 to 40 pounds that he was required to transport between his residence and the airport he flew from. See *Fryer v. Commissioner*, 33 TCM (CCH) 403 (1974). Even though the Plaintiffs were transporting their inventory from their home to their cart, the main purpose for the trips was personal, i.e., to commute between their home and their primary place of business.

CONCLUSION

In any proceeding before the Magistrate Division, the party seeking affirmative relief bears the burden of proof. ORS 305.427 (2001). The Plaintiffs did not meet their burden relating to the exclusive use of their home office. As a result, not only are the claimed costs for maintaining the home office not allowed, neither are the claimed transportation costs. Now, therefore,

IT IS HEREBY ADJUDGED AND DECREED that the Plaintiffs' appeal is denied.

Dated this _____ day of April, 2002.

SALLY L. KIMSEY
MAGISTRATE

THIS DOCUMENT WAS SIGNED BY MAGISTRATE SALLY L. KIMSEY ON APRIL 30, 2002. THE COURT FILED THIS DOCUMENT ON APRIL 30, 2002.