



American Institute of CPAs
1455 Pennsylvania Avenue, NW
Washington, DC 20004-1081

May 7, 2013

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Rev. Proc. 2013-13), Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Revenue Procedure 2013-13 – Safe Harbor Method for Home Office Deduction

Dear Sir/Madam:

The American Institute of Certified Public Accountants (AICPA) is pleased to provide comments in response to Revenue Procedure 2013-13. These comments were developed by the AICPA Individual Income Taxation Technical Resource Panel and approved by the AICPA Tax Executive Committee.

The AICPA is the world's largest membership association representing the accounting profession, with nearly 386,000 members in 128 countries and a 125 year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

The AICPA commends the Internal Revenue Service (IRS) and the Department of Treasury (Treasury) for issuing Rev. Proc. 2013-13, which provides an optional safe harbor method for the home office deduction for individual taxpayers. This method would simplify the tax preparation and record-keeping process for many taxpayers and small business owners who are eligible for the deduction but who do not currently deduct home office expenses. However, the AICPA recommends that the IRS and Treasury reevaluate selected details of their proposal to implement the safe harbor method for the home office deduction. We also believe that for taxpayers who have been claiming (or may in the future claim) the home office deduction under the actual expense method, the safe harbor method creates additional administrative burdens which need to be considered.

Background

The IRS issued Rev. Proc. 2013-13 to provide an optional safe harbor method that individuals may adopt to determine the amount of deductible expenses attributable to certain business use of

a residence during the taxable year. IRS IR-2013-5 also solicited feedback on the optional method “to improve it for tax year 2014 and later years.”

Specific Comments and Recommendations

Depreciation Expense and Recapture

Under Rev. Proc. 2013-13, for taxpayers using the safe harbor method to calculate their home office deduction, “[t]he depreciation deduction allowable for that portion of the home for that taxable year is deemed to be zero.”¹ Rev. Proc. 2013-13 also provides that a taxpayer may elect (from taxable year to taxable year) either the safe harbor method or to calculate and substantiate the actual expenses incurred.²

The AICPA is concerned that there is no “allowable” depreciation under the safe harbor method. This Rev. Proc. increases complexity of maintaining accurate records for the adjusted depreciable basis of a residence if a taxpayer elects to switch in and out of the safe harbor method each year. Taxpayers typically track taxable accumulated depreciation using software that calculates “allowed or allowable” depreciation and the remaining taxable basis. In addition, with regard to the depreciation recapture rules upon the sale of a residence, “allowable” depreciation is calculated and recaptured in the taxable gain or loss of the sale of a residence. It appears the IRS and Treasury have chosen to override the default rules on “allowed or allowable” depreciation, as no depreciation deduction is allowed by taxpayers using the safe harbor method in that year.

The AICPA recommends that the IRS and Treasury consider allowing taxpayers to deduct depreciation expense in addition to the home office deduction using the safe harbor method.

Carryover of Disallowed Home Office Deductions

Rev. Proc. 2013-13 provides that a taxpayer who uses the safe harbor method for a taxable year may not deduct, in that taxable year, any disallowed amount carried over from a prior taxable year in which the taxpayer calculated and substantiated actual expenses for purposes of Internal Revenue Code (“Code”) section 280A.³ A taxpayer who calculated and substantiated actual expenses in a prior taxable year and whose deduction was limited by the gross income limitation in Code section 280A(c)(5) may deduct the disallowed amount, subject to all other applicable restrictions, in the next succeeding taxable year in which the taxpayer calculates and substantiates actual expenses.⁴

The AICPA is concerned that the safe harbor method creates a significant administrative burden on taxpayers in tracking allowed and disallowed deduction carryforwards of the home office

¹ Section 4.06 of Rev. Proc. 2013-13.

² Section 4.03 of Rev. Proc. 2013-13.

³ All references in this letter to the Internal Revenue Code are to the Internal Revenue Code of 1986, as amended.

⁴ Section 4.08 (3) of Rev. Proc. 2013-13.

deduction. When a taxpayer uses the actual expense and safe harbor methods over multiple years, tracking and maintaining disallowed amounts carried from a prior year becomes exceedingly difficult for the taxpayer and tax practitioner.

The AICPA recommends that the IRS and Treasury permit taxpayers to deduct any home office disallowed deduction carryforward in the next year, regardless of the method used, subject to the limitations of section 280A(c)(5). We further recommend that ordering rules should be established, such that the carryforwards are applied first, and then the current year's deduction (safe harbor or actual method). Any unused deduction, which was generated by use of the actual method, would be allowed to carry forward to the next tax year.

Example 1: In Year 1, the taxpayer uses the actual method of home office expenses and has expenses of \$5,000 disallowed due to the limitations of section 280A(c)(5). In Year 2, the taxpayer chooses to use the safe harbor method, which generates a current year deduction of \$1,500. Before taking any home office deduction, the taxpayer's net income from the qualified business use of the home is \$6,000. The taxpayer first applies the \$5,000 carryforward from Year 1 and is then allowed to use \$1,000 of the Year 2 safe harbor deduction to reduce taxable income from the business to \$0. The taxpayer has *NO* carryforward to Year 3, as the remaining \$500 of safe harbor deduction cannot be carried forward under the Rev. Proc.

Example 2: Same facts as Example 1, except that the Year 2 net income from the qualified business use of the home is \$4,000. Taxpayer uses \$4,000 of the \$5,000 carryforward from Year 1 and has a \$1,000 carryforward to Year 3, and no carryforward is permitted for the entire Year 2 home office deduction generated under the safe harbor method.

Administrative Burden

The AICPA appreciates the intent and efforts of the IRS and Treasury to provide the safe harbor method for taxpayers. We believe that Rev. Proc. 2013-13 will simplify the recordkeeping and compliance for many taxpayers who are not currently aware of and who have not been using the home office deduction. However, this will create a large administrative burden for many taxpayers who currently use the actual method, as well as taxpayers who may start to use the safe harbor method and later switch to the actual method for the home office deduction. The taxpayer or tax preparer will need to compute the deduction under both methods in order to determine which method provides the optimal deduction for the taxpayer.

For example, taxpayers will need to take into consideration the overall limitation on itemized deductions (commonly referred to as the "Pease limitation") under Code section 68 when using the safe harbor method. Under the actual method, a portion of the itemized deductions would be allocated to Schedule C, *Profit or Loss from Business*, and not subject to the Pease limitation. Also, Alternative Minimum Tax will be affected, as this tax disallows the itemized deduction for real estate taxes.

Taxpayers will also need to take into consideration self-employment taxes. For example, taxpayers using the safe harbor method deduct certain expenses related to the home (e.g., mortgage interest and real estate taxes) exclusively on Schedule A, *Itemized Deductions*. This treatment could result in fewer business deductions on Schedule C and an increase in net profit, which is used in calculating a taxpayer's self-employment taxes.

We recommend that the IRS and Treasury be mindful of the additional administrative burdens when drafting future guidance and forms for both the safe harbor and actual methods.

The Maximum Deduction and Cost of Living Adjustment

Rev. Proc. 2013-13 sets the allowable deduction for home office expense at \$5 per square foot for a maximum of 300 square feet of qualified home office space used, for a maximum yearly deduction of \$1,500. The AICPA commends the IRS and Treasury for providing an option to simplify the calculation of the home office deduction for many eligible taxpayers. While section 4.01(3) of the Rev. Proc. does indicate that the IRS and Treasury Department may update this rate from time to time as warranted, we believe that failing to specify up front future cost of living adjustments will make the deduction less useful and valuable to taxpayers in the future. In addition, estimates of the average home-office deductions historically range from \$2,000 (from the National Association for the Self Employed) to \$3,000 (from the IRS).

The AICPA recommends a designated method of establishing a yearly or periodic cost of living adjustment to reflect inflation. Also, we recommend that the initial maximum deduction be increased such that it is closer to the average home office deduction (\$2,000-3,000) currently taken using the actual method.⁵

Conclusion

The AICPA supports the concept of a simplified method to deduct home office expenses, as the safe harbor method will increase the availability of home office deductions for taxpayers who are eligible for the deduction and have not been claiming it. We recommend that the IRS and Treasury reevaluate and alter some of the details of their proposal to implement the safe harbor method. For taxpayers who have been claiming (or may in the future claim) the home office deduction under the actual expense method, unanticipated administrative burdens have been created for the taxpayer, which should be considered when the IRS and Treasury draft future guidance and forms for both the safe harbor and actual methods of home office deductions.

* * * * *

We appreciate your consideration of these comments. If you have any questions regarding this submission, please feel free to contact me at (304) 522-2553 or jporter@portercpa.com; Jonathan

⁵ *NY Times*, "New Home Office Deduction Is Simpler, but Smaller" at <http://boss.blogs.nytimes.com/2013/01/29/new-home-office-deduction-is-simpler-but-smaller/>

Internal Revenue Service

May 7, 2013

Page 5 of 5

Horn, Chair of the AICPA Individual Taxation Technical Resource Panel, at (212) 744-1447 or jmhcpa@verizon.net; or John Scheid, AICPA Technical Manager, at (202) 434-9268 or jscheid@aicpa.org.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent.

Jeffrey A. Porter, CPA
Chair, AICPA Tax Executive Committee

cc: Christopher W Call, Office of the Associate Chief Counsel, Income Tax & Accounting,
Internal Revenue Service