Feldman v. Commissioner, 84 T. C. 1 (1985)

A taxpayer may deduct home office expenses as rental expenses if a bona fide rental agreement exists, even if the parties are related and the rent exceeds fair market value.

Summary

In Feldman v. Commissioner, Ira Feldman, an employee and shareholder of an accounting firm, rented office space in his home to his employer. The IRS challenged the deductibility of these expenses, arguing the arrangement was a disguised compensation. The Tax Court found the rental agreement to be bona fide, allowing deductions for the expenses related to the rented space, but limited the deductions to the reasonable rent and the percentage of the home used for business. This case highlights the importance of establishing a legitimate rental agreement to claim home office deductions, even in non-arm's length transactions.

Facts

Ira Feldman, a director and shareholder of Toback, Rubenstein, Feldman, Murray & Freeman (TRFMF), built a custom home in 1977 with a designated office space. In 1978, TRFMF agreed to lease this space for $450 per month, along with garage space, to provide Feldman with a private work area. In 1979, TRFMF paid Feldman $5,400 in rent. Feldman reported this as income and claimed deductions for expenses related to the rented space, totaling $2,975, based on 15% of his home's costs. The IRS challenged these deductions, asserting the arrangement was a disguised compensation scheme.

Procedural History

The IRS determined a deficiency in Feldman's 1979 federal income taxes and denied the claimed deductions. Feldman petitioned the Tax Court for a redetermination of the deficiency. The Tax Court reviewed the case and upheld the validity of the rental agreement but adjusted the amount of deductible expenses based on a more precise calculation of the space used and the reasonable rent.

Issue(s)

1. Whether Feldman may deduct the costs of maintaining space in his home that is leased to his employer for his use as a home office?
2. If so, what amounts are deductible?

Holding

1. Yes, because the rental agreement between Feldman and his employer was found to be bona fide, allowing deductions for the expenses related to the rented space.
2. The deductible amounts are limited to the reasonable rent ($3,120 per year) and

© 2025 SCOTUSreports.com. All rights reserved.

the expenses attributable to 9% of the home's total square footage.

Court's Reasoning

The Tax Court applied Section 280A of the Internal Revenue Code, which generally disallows deductions for home office expenses unless specific exceptions apply. The court focused on the exception for rental use under Section 280A(c)(3), requiring a bona fide rental agreement. Despite the close relationship between Feldman and TRFMF and the rent exceeding fair market value, the court found the agreement to be legitimate because it served a business purpose for the employer. The court cited cases like Kansas City Southern Railway v. Commissioner and Place v. Commissioner to support the notion that a valid lease can exist between related parties if it serves a business purpose. The court also considered the reasonableness of the rent and the actual space used, adjusting the deductions to reflect a more accurate allocation of expenses based on the home's total square footage.

Practical Implications

This decision clarifies that home office deductions can be claimed under a rental agreement, even between related parties, provided the agreement is bona fide and serves a legitimate business purpose. It emphasizes the need for careful documentation and reasonable rent calculations to withstand IRS scrutiny. Practitioners should advise clients to ensure any home office rental agreements are structured to clearly demonstrate a business necessity and to use precise methods for calculating the space used and the reasonable rent. This case has been cited in subsequent rulings to support the deductibility of home office expenses under similar circumstances, reinforcing the importance of a well-documented and legitimate rental arrangement.

© 2025 SCOTUSreports.com. All rights reserved.