



Do it in the closet – recent tax court decisions with respect to the domestic study

*From the time they get up in the morning and flush the toilet, they're taxed. Then they go and get the cup of coffee, they're taxed....This goes on all day long. Tax, tax, tax.*¹

I. Preface

Whilst having a job these days is closely related to human dignity, and many employees volunteer (more or less) to do additional work at home, the German Income Tax Act (*Einkommenssteuergesetz, EStG*) remains very restrictive with respect to the costs related to outwork. Section 4 paragraph 5 clause 1 no. 6b *clause 1 EStG* basically says that the costs of the domestic study² are not tax deductible. Section 4 paragraph 5 clause 1 no. 6b *clause 2 EStG* makes an exemption, in case the taxpayer does either spend more than 50 % of his overall working time at his study, or has no other workplace at all. Even then, deductible costs are capped at 1,250 Euros, whatever expenses the taxpayer actually may have had.

Taxpayers and their tax consultants have been trying, so far without much success, to widen the tax deductibility. In summer 2003 and early in 2004 two decisions, however, have carried the lantern a littler further, to enlighten possibilities of tax deduction. This paper deals with the core ideas of both decisions.

II. The decision by the Federal Financial Court (*Bundesfinanzhof, BFH*) of August 7th, 2003 (VI R 162/00)

1. The facts of the case (abbreviated)

A bank employee had worked a little more than 42 hours a week at the main hall of his bank. At home, however, he had been very busy, too, working about 400 of his total 550 (paid) overtime hours there.

He deducted the costs for his domestic study, because

- the main hall was too noisy as to be a proper workplace for his demanding job, and
- the air condition was only effective for 42 working hours a week, and
- he otherwise would have been disturbed by the cleaning personnel, and
- the main hall, for security reasons, actually was not accessible at more than 42 hours per week.

2. The view of the tax authority and the court of first instance

The tax authority denied deduction, because the preconditions of section 4 paragraph 5 clause 1 no. 6b *clause 2 EStG* were not met. The Financial Court (*Finanzgericht, FG*) acceded to the view of the tax authority. As to the court, the employee had had another workplace and had not spent more than 50 % of his working hours at home, so that the deduction was to be denied under the norm cited.

¹ (Then candidate, now governor) Arnold Schwarzenegger.

² A domestic study (*häusliches Arbeitszimmer*) is a separate room at your home, dedicated to working. It has to be an „enclave for business“ within your four walls.

The court pointed out, that it was of no concern, whether the working conditions (including noise, disturbances by the cleaning personnel and partially lacking air condition) were appropriate. Under section 4 paragraph 5 clause 1 no. 6b *clause 2 EStG* one only had to ask, whether there was a workplace at all. Since this question was to be answered in the positive, the 50%-rule had to be applied. However, the court left open the question, whether the limited access to the workplace was of any concern. It only regarded decisive the fact that there was a *workplace*.

3. The view of the *BFH*

Basically, the *BFH* in his decision quoted above, agrees with the *FG* as court of first instance. The rather rigid preconditions of section 4 paragraph 5 clause 1 no. 6b *clause 2 EStG*, says the *BFH*, do not make the tax deduction dependent on healthy and convenient working conditions, but simply on the fact that one has, or does not have *another workplace*.

The *BFH* does, however, not agree with the across-the-board refusal of tax deduction. The *BFH* develops the view, that one has to look at the circumstances of the particular case. The court presents the question, whether the employee could have used his workplace for exactly the work he in fact performed at home. The *BFH* thus specifies the question from:

“Is there another workplace at all?”

to:

“Is there a workplace, where the work could have been done?”.

Without deciding the case (because the facts were unclear and to be explored by the court of first instance), the *BFH* ruled that to the extent the bank employee could not have worked the 400 hours overtime at the bank, because the bank was closed, his costs are tax deductible to a maximum amount of 1,250 Euros.

III. The decision – ruled by the Financial Court Cologne (*FG Köln*) of January 22nd, 2004 (10 K 2312/00)

1. The facts of the Case (abbreviated)

A civil engineer deducted the costs of his domestic study from his income. He declared to have been working there for:

- 340 hours on professional training,
- 100 hours on tax law in general and his tax return in particular,
- 60 hours on capital income,
- 40 hours on lease income.

His wife, due to the tax return, had been working in the study for 80 hours on her further education.

2. The decision by the *FG Köln*

a) The denial of tax deduction

On the basis of the figures presented to the court, the latter calculated that the study had been used at more than 16 % (= 100 hours, *vide* above) for preparing the tax revenue and related activities.

Preparing the tax revenue, again, is a private activity. Thus, corresponding costs belong to the – not deductible – private costs.³

³ *Tax consultancy* costs, however, are to be deducted as special expenditures, *Sonderausgaben*, section 10 paragraph 1 no. 6 *EStG*. Using your domestic study, nevertheless, does not generate such costs because the costs of your study (other than, e.g., costs of tax books) are not caused by preparing the tax return. They arise anyway. In an interesting comparison the court says that if such costs were deductible, one could deduct part of the costs of one's living room, in case one would prepare one's tax return there. The court deemed that as going a little too far.

Hence, on the basis of a rule developed by the courts, that the private use of a good to an extend of 10 or more percent means that the entire costs of this good are to be treated as private, i.e. not tax deductible under section 12 EStG, the court decided that the costs of the study were – entirely – not tax deductible.

b) The interesting part of the decision – professional training at the domestic study

The court, however, hinted that tax deduction seems possible not only with respect to the 100 hours spent on capital and lease income, but also with respect to the 340 hours of professional training.

It is obvious, that the taxpayer has no other reasonable place than his study for dealing with his capital or lease income. Less obvious is, that the same may apply to his training activities. Reading business journals, preparing lectures and so on and so forth so far has been regarded as being possible at the workplace in the firm. The court, however, applies a more realistic view. Especially *executives*,⁴ it says, are expected to steadily continue their training, and that not at least during their spare time.

That spare time at home is being spent on outwork, does not necessarily have to be proven by a clause in the contract of employment, prohibiting training at work (as the tax authority unrealistically and highly bureaucratically demanded), but can be proven by the taxpayer himself. The latter only has to show, which activities had to be done at home and why he could not use his given workplace to fulfil these tasks.⁵

Thus, if the taxpayer had worked a little more on his training and/or a little less on his tax return, so that the private use had been less than 10 percent, his tax assessment would have been more favourable, i.e. up to 1,250 Euros would have been deducted.

IV. Consequences

First, in order not to fall under the general rule,⁶ *demonstrate your personal need for a domestic*. Noise etc. does *not* count, but if access to your other workplace is limited, you will have a good argument on your side.

Second, *make notes* in order to prove to the authorities how you use your study.

Third, drop your pencil, before you exceed the time allowed to spend on private affairs. Prepare your tax return in an easy chair, at the kitchen table, or do in the closet.

Since challenging the 1,250-Euros-threshold by the help of German constitutional law or European law does not seem promising, one has to calculate with this sum.

So, fourthly, never spend more money than is deductible (including depreciation!).

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⁴ Since (not only) every white collar professional is expected to keep himself informed, one has to extend the scope of the rule pointed out by the court to all employees, who are expected to think for themselves and to bear some responsibility with regard to their job.

⁵ In very terse terms every job your employer is not going to pay you for (you do not want him to catch you being occupied with instead of “doing your job”, respectively).

⁶ Section 4 paragraph 5 clause 1 no. 6b clause 1 EStG, *vide* above.