IT MAY BE TIME FOR A CHANGE: EXTREME MAKEOVER: HOME EDITION, EXPLOITATION, REGRESSIVITY AND INTERNAL REVENUE CODE § 280A(g)

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INTRODUCTION

Few images warm the heart like the “big reveal” at the end of an episode of Extreme Makeover: Home Edition as a deserving family comes back from a week vacation and find their former hovel transformed into a palace replete with amenities designed to accommodate their special needs.1 No one watching could deny that this deserving family had received something of considerable value.2 So how is this needy family going to pay the taxes on this giant windfall? If this were any other giveaway show, there would be great joy at the receipt of the prize, but for the tax savvy prize winner it would be followed by an equally sizable shiver of fear as the image of the upcoming tax bill began dancing in the recipient’s head.3 But according to

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2. The value takes many forms: monetary, spiritual, and psychic. But the government does not tax spiritual or psychic value (generally). What is at the heart of the issue is the monetary enrichment the homeowners are receiving from participating in this show. The tax code defines gross income very broadly to include “all income from whatever source derived” I.R.C. § 61 (West 2004).

3. See Lucio Guerrero, Oprah’s Car Giveaway Not Totally ‘Free’; Recipients Learn They May Owe Thousands in Income Taxes, CHICAGO SUN-TIMES, Sept. 22, 2004 (one of the winners of Oprah’s car giveaway was quoted as saying, “paying the taxes was the first thing that popped into my head”).
the show’s producers, there will be no additional income taxes for these lucky winners.  

The delivery of the prize is structured so that the winners allegedly do not owe any federal income tax. “[T]he show pays each family $50,000 to rent its house for 10 days.” While normally this rental payment would have to be declared as income, Internal Revenue Code ("IRC" or the "Code") § 280A(g) provides a convenient loophole which excludes from gross income the rent derived from the lease of a taxpayer’s residence for any period less than 15 days per year. And since the show leases the home from the selected family, any improvements they make to the home are not taxable as income to the lessor. It is a nice way to provide a deserving group with a significant benefit which is seemingly outside the reach of the federal government.

4. See Jose L. Sanchez Jr., Extreme Homecoming: 2,000 People Welcome Penngrove Family to New $1.5 Million House, THE PRESS DEMOCRAT, July 16, 2004, A1 (indicating the production company “helps ‘Extreme Makeover’ homeowners to legally avoid counting the work as a taxable gift”).

5. Id.


7. I.R.C. § 280A(g) (West 2004) (establishing the rule that the rent received for the lease of a residence for less than 15 days within a tax year does not give rise to taxable income).

8. See I.R.C. § 109 (West 2004) Improvements by lessee on lessor's property. The rule is “[g]ross income does not include income (other than rent) derived by a lessor of real property on the termination of a lease, representing the value of such property attributable to buildings erected or other improvements made by the lessee.”

9. It is likely that if the Internal Revenue Service should choose to challenge the income tax returns from the winning families who have benefited from Extreme Makeover: Home Edition, the exclusions would not hold up to scrutiny. See Jennifer M. Nasner, Comment, The Unexpected Tax Consequences of “Extreme Makeover: Home Edition, 40 GONZ. L. REV. 481, 501 (concluding that a substance over form analysis may show the lease used on Extreme Makeover: Home Edition to actually be a license and therefore not eligible for the § 280A(g) or § 109 income exclusions); Brian Hirsch, Comment, The Extreme Home Renovation Giveaway:
Providing a tax preferred benefit to a deserving group is laudable, but it begs the question; who were the intended beneficiaries of IRC § 280A subsection (g) and is the subsection being abused? In order to begin answering this question Part I of this Comment looks at the historical rationale for IRC § 280A(g) and analyzes the language of the statute to understand the requirements for income exclusion. Part II looks at the ways IRC § 280A(g) is used and abused in practice. Part III suggests alternative formulations to the rule and analyzes their benefits and weaknesses. Part IV concludes that modifying the rule by both placing an income exclusion limit and restricting the exclusion to an individual’s primary residence would most efficiently limit abuses, while continuing to provide an income exclusion for appropriate situations.

I. HISTORY, RATIONALE AND INTERPRETATION

Prior to the passage of the Tax Reform Act of 1976, no income exclusion existed for short-term rental income. Gross Income, defined as “all income from whatever source derived,” necessarily included rental income regardless of the term of the lease. However, in 1976 Congress was concerned with taxpayers converting “nondeductible personal expenses into deductible rental expenses” and enacted what became codified as IRC § 280A (of which subsection (g) is a part) to curtail abuses. This Code section is broadly intended to provide


guidelines for which expenses incurred in the business use of a home or the rental of a vacation home cannot be claimed as a deduction. \textsuperscript{12} Although the strict requirements of IRC § 280A had the effect of increasing taxable revenue for the Government, \textsuperscript{13} subsection (g) of IRC § 280A has created a small but significant exclusion that has been expanded to encompass situations likely far beyond the intent of its authors. \textsuperscript{14}

One would expect that a tax exemption for an unspecified amount of income would receive considerable analysis before being enacted into law, not so for subsection (g). While the general provisions of IRC § 280A received considerable Congressional review and discussion, subsection (g) passed through Congress without a single recorded discussion of its intent or justification. \textsuperscript{15} The subsection has since 1976 provided a significant benefit to taxpayers that rent their residence for less than 15 days per year. \textsuperscript{16} The rule itself has been aptly described as a de minimis exception to the complex requirements for income tax compliance prescribed under the Internal Revenue Code with respect to residences, a portion of which are rented out (“mixed-

\textsuperscript{12} I.R.C. § 280A is titled “Disallowance of certain expenses in connection with business use of home, rental of vacation homes, etc.”

\textsuperscript{13} By decreasing the conversion of nondeductible personal expenses into deductible business expenses net tax revenue will, all else being equal, rise.

\textsuperscript{14} See examples \textit{infra} Part II.

\textsuperscript{15} I.R.C. § 280A is discussed within the Tax Reform Act of 1976 under proposed section 601, but this discussion never reaches the issue of the de minimis rule or any exclusion of income for rentals under 15 days. \textit{TAX REFORM, 1976: A LEGISLATIVE HISTORY OF THE TAX REFORM ACT OF 1976 (PUBLIC LAW 94-455), WITH RELATED AMENDMENTS} (Bernard D. Reams & Emelyn B. House, eds., 1992) (1976). The first mention of subsection (g) identified, besides its presence in the 1976 Tax Reform Act, appears in 1992 when subsection (g) was put on the chopping block as a needlessly expensive provision which was of value to only a small subset of taxpayers. \textit{H.R. Rep No. 102-668}, at 7 (1992).

\textsuperscript{16} In 1992 it was estimated that revocation of subsection (g) would raise $333 million in additional revenue. 138 \textit{Cong. Rec.} S15085, 15088 (statement of Sen. Holmes) (discussing a potential amendment to bill \textit{H.R. 2735} which had passed the House, and called for the removal of § 280A(g) from the tax code).
use” residences). However, it has come under fire several times - starting in 1992 - as a specialized provision which should be repealed or significantly modified to raise much needed tax revenue. IRC § 280A(g) is that rarest of tax loopholes, the kind that is intentionally created by Congress.

The intuitive explanation for subsection (g) is that Congress recognized, that the compliance requirements for mixed-use residences were onerous and thus it was appropriate to create an exception for those taxpayers that were not renting out their residence with a long-term business

17. 138 CONG. REC. S15085, supra note 16 at 15090 (quoting Letter from Coopers & Lybrand to Kay Rucchio, Legislative Assistant, Office of Senator Jesse A. Helms (Sept. 17, 1992) (describing the difficulty taxpayers would have trying to comply with “the inordinately complex maze of rules which govern . . . mixed-used residences.” The requirements for compliance include, reading and understanding the rules, documenting “the annual cost for utilities, insurance, and other deductible expenses; basis must be established and depreciation calculated (IRS estimates an average of 36 hours of recordkeeping and 7 hours for filing Form 4562, Depreciation and Amortization Schedule); Schedule E must be completed (another estimated 6 hours)” all because one rented their home or a portion thereof.).


19. It normally requires a tax attorney and/or an accountant to find a loophole with or between one or several statutes and regulations, but here Congress was direct in setting forth a complete income exclusion which anyone capable of reading is able to take advantage of it.
objective. Contemporaneously with its inclusion in the 1976 Tax Reform Act the subsection (g) language was being called the “de minimis” exception to the IRC § 280A. Although the legislative history itself is devoid of any specific discussion conducted concerning the subsection (g) de minimis exception, the numerous subsequent attempts to modify or remove this subsection provide some insight into the likely Congressional motivation behind the passing of this rule.

A. The Intended Beneficiaries – High Point, NC

The most significant legislative discussion of an attempt to repeal IRC § 280A(g) occurred in July of 1992. As indicated in the legislative record, the audience intended to be benefited by IRC § 280A(g) were individuals living in rural locations which host major events that bring in a large number of visitors far in excess of the hotel capacity within a reasonable driving distance of the event. High Point, NC is the prototypical example of this type of situation. Twice a year High Point hosts the International Home Furnishings Market “the largest furnishings industry trade show in the world.” Without the capacity to provide commercial housing for the majority of visitors that attend the market, High Point citizens have since 1903 been opening up their homes.

20. See 138 CONG. REC. S15085, supra note 17 (discussing the Coopers & Lybrand letter explaining the complexity of compliance with the mixed-residence tax provisions).


22. See supra note 18 listing the various attempts to alter or repeal § 280A(g).

23. See 138 CONG. REC. S15085, supra note 16 at 15088 (spanning 7 pages of Congressional Record and providing the full text of the Senate’s debate over suggested modifications to the removal of I.R.C. § 280A(g) and revealing that I.R.C. § 280A(g) does provide considerable benefits and was likely intended to do so for a specific class of taxpayer, such as those found in High Point, NC).

24. Id.

25. Id.

homes.27 The legislative argument as put forth by North Carolina Senator Jesse A. Helms, contends that these generous individuals shouldn’t have to include the rent they earn in their taxable income because it would cause them to have to increase the rent they charge attendees, and thus make the International Home Furnishings Market more expensive to attend, or it might cause some citizens to decide not to rent out their homes which could in turn make it impossible for the town to continue hosting the event.28 It makes sense that the Congress would want to aid individuals and communities in the type of situation described here.29 The aggregate income excluded in the above scenario is likely negligible in comparison to the revenue lost from the abusive uses of IRC § 280A(g).30 However, this proposal, like all subsequent attempts at alteration or revocation of subsection (g) failed.31

B. De Minimis Rule

It is likely no accident that subsection (g) was being described as the “de minimis” exception contemporaneously with the passage of the 1976 Tax Reform Act. A de minimis rule is one that is intended to exclude “trifles” from consideration.32 Thus, when something is

27. See 138 CONG. REC. S15085, supra note 16 at 15088-89 (discussing in detail the High Point, NC furnishings market).

28. Id.

29. The citizens of High Point could either raise the prices they charge to visitors or simply decide to stop hosting visitors without any change in the tax law. The idea that the fate of this market and the revenue it brings into the state of North Carolina are so tenuously dangling on the revenue exception in I.R.C. § 280A(g) is a bit of a stretch. However, this is not a wealthy area of the country and the individuals that are receiving this benefit are for the most part in the lower marginal tax brackets and thus the impact of this exclusion on governmental fundraising is minimal while the benefit to the individuals is likely significant.

30. See infra Part II. (describing various abusive uses of I.R.C. § 280A(g)).

31. Proof of the failures of these provisions is contained in I.R.C. § 280A(g) (West 2004) the language of which has not changed since its inception in 1976.

32. See Ringgold v. Black Entertainment Television, Inc., 126 F.3rd 70, 74 (2nd Cir. 1997) (explaining that the legal concept de minimis derives from the latin expression “de
perceived to be below a minimum threshold to make it relevant it is often classified as de
minimis and ignored. When this label is being applied appropriately it can save administrative
expenses which would likely outweigh the benefit derived from attempting to enforce the law in
the absence of the de minimis exception. This label must have seemed accurate when it was first
applied in 1976.

Moreover, the statute accomplishes its explicit goal of sparing those who rent out their
residence for a period which does not exceed 14 days in a taxable year.33 However, when you
leave the barn door open, you can’t act surprised when all the horses run away. The presumption
underlying a true de minimis rule is that the effect is actually minimal. But like any sanctioned
tax exclusion, IRC § 280A(g) has been exploited over time and the de minimis turned into
significance as a host of unintended beneficiaries have adopted this rule as their own.34

C. Simplicity

Another possible reason for the adoption of the IRC § 280A(g) exclusion is the complexity
of the tax code. It is widely believed that the tax code is far too complex.35 Such complexity
makes it too hard for taxpayers to understand what should be included and what can be excluded
from their tax returns. Thus, complex rules favor the wealthy who are able to hire experts to
decipher the more obscure rules, while penalizing the less wealthy.36 In addition, complexity

\[ \text{minimis non curat lex} \] which is interpreted to mean “the law does not concern itself with
trifles.”)

33. I.R.C. § 280A(g) (West 2004).
34. \textit{See infra} Part II. (describing various abusive uses of I.R.C. § 280A(g)).
35. \textit{See}, e.g., Joseph A. Snoe, \textit{Tax Simplification and Fairness: Four Proposals for
   Fundamental Tax Reform}, 60 ALB. L. REV. 61 (1996); Kenneth H. Ryesky, \textit{Tax Simplification:
   So Necessary and So Elusive}, 2 PIERCE L. REV. 93 (2004); Binh Tran-Nam, \textit{Tax Reform and Tax
   Simplification: Some Conceptual Issues and a Preliminary Assessment}, 21 SYDNEY L. REV. 500
   (1999).
   Effort at Deficit Reduction, But a Step Toward Tax Integrity}, 49 HASTINGS L.J. 1, 73 (1997)
   (discussing tax complexity and the bias towards the wealthy).
leads to misunderstanding and because of this, individuals tend to make mistakes calculating how much tax they actually owe the government.\(^{37}\) This can result in individuals unintentionally filing incorrect tax returns and a reduction in the government’s tax revenue. If the tax code were simpler, it would be easier for taxpayers to understand and comply with it. Therefore, more people understanding the tax code will arguably result in higher taxpayer compliance rates and more revenue generation.\(^{38}\)

Thus, IRC § 280A(g) can be seen as an attempt by Congress to spare the “little guy” from the burden of complying with the mixed-use residence requirements of the code.\(^{39}\) Completing the complex requirements for mixed-use residences rented for a portion of the year can take in excess of 40 hours of preparation.\(^{40}\) If an individual is confronted with the option of renting out their home and earning a small return and a significant administrative tax burden – even if they hire a professional tax preparer, because this will significantly increase the cost of the preparation – versus choosing to not rent out their home and avoiding the headache, it would likely make for an easy choice.\(^{41}\) However, regardless of the effect, the underlying justification provides a plausible explanation for including IRC § 280A(g) in the 1976 Tax Reform Act.

D. Complying with the Exclusion

Regardless of Congress’ rationale for adopting IRC § 280A(g), in order to take advantage of the provision taxpayers need to understand exactly how to qualify. While statutory interpretation

\(^{37}\) See Mark P. Gergen, *Afterword: Apocalypse Not?*, 50 TAX L. REV. 833, 847 (1995) (“compliance will be worse under a complex . . . rule than it would be under a simple and clear . . . rule.”)

\(^{38}\) *Id.*

\(^{39}\) See 138 CONG. REC. S15085, *supra* note 17.

\(^{40}\) *Id* (discussing the time requirements for different elements of tax return preparation associated with a mixed-use return).

\(^{41}\) This is assuming that the individual was aware of the tax affects of their choice to rent a portion of their home out. Additionally, this assumes that the individual would not be earning a return sufficient to overcome the administrative burden. However, a rational individual will pass costs through to their renters and thus offset the extra tax burden by raising rates.
is the province of the courts, understanding the meaning of a statute can be accomplished by employing the same methodology that the courts use. The Supreme Court explained “that courts must presume that a legislature says in a statute what it means and means in a statute what it says there.” “Our first step in interpreting a statute is to determine whether the language at issue has a plain and unambiguous meaning . . .” It is only if one finds ambiguity in the plain meaning of the statute that it becomes necessary to look further.

Thus, determining who can take advantage of IRC § 280A(g) requires a close analysis of the language of the provision. Parsing out IRC § 280A(g) reveals four basic requirements for exclusion of rental income: (i) a dwelling unit, (ii) used as a residence, (iii) rented, (iv) for less than 15 days during the taxable year. Each term or phase has a specific meaning defined either under the IRC or from its common English usage.

The term “dwelling unit” is defined in IRC § 280A (f)(1) as including “a house, apartment, condominium, mobile home, boat, or similar property, and all structures or other property appurtenant to such dwelling unit,” but excluding “that portion of a unit which is used exclusively as a hotel, motel, inn, or similar establishment.” This definition of permissible locations is cast with an extremely wide net, encompassing almost any conceivable living environment. Broad coverage is presumably intended to enable any citizen, regardless of what they call their home, to take advantage of the tax free rental income. The exclusion of commercial properties is designed to prevent individuals that live in a commercial facility from trying to get two weeks of tax-free income. By specifying “that portion of a unit” the statute permits someone with a mixed-use residence to use the exception on the portion of their home

42. “It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule.” Marbury v. Madison, 5 U.S. 137, 177 (1803).
45. I.R.C. § 280A(f)(1)(A)
47. The fact that this broad language is used lends support to the premise that this rule was designed for lower income individuals in rural communities, such as in High Point, NC.
which is normally not rented out. For example, a person who lives in and runs a bed and breakfast could use this exclusion if they rented out their own personal bedroom for less than 15 days per year.48

The Code provides that a dwelling unit is considered to be used as a “residence” if the taxpayer “uses such unit (or portion thereof) for personal purposes for a number of days which exceeds the greater of . . . 14 days, or . . . 10 percent of the number of days during such year for which such unit is rented at a fair rental.49 The rationale behind this seemingly loose standard is grounded in the more general intention of this statute to exclude many expenses incurred from the rental of a vacation home. Rather than viewing this as an overly permissive definition of the concept of residence, it should be viewed as a broad definition designed to exclude many deductions that individuals would otherwise be able to take advantage of with respect to the rental of their vacation homes, or the whole or a part of any other residence.

This is an example of the double edged nature of tax jurisprudence; reducing tax deductions on one side while opening up new tax avoidance opportunities on the other.50 Viewed from this alternate perspective this provision is very expansively defining residence to encompass locations that many would likely prefer to be classified otherwise for the opportunity to take advantage of the tax benefits available to a business such as depreciation and expense deduction. It is possible that this definition solves the greatest number of revenue generation, administrative and enforcement problems, while creating the fewest.51 Regardless of the intent, however, this definition does allow for considerable latitude and potential abuse.

48. See I.R.C. § 280A(g) (West 2004).
50. This phenomenon is a natural corollary to tax regulation. Professor Martin Ginsberg eloquently explained that “every stick crafted to beat on the head of a taxpayer will, sooner or later, metamorphose into a large green snake and bite the Commissioner on the hind part.”
51. It is hard without empirical data to perform this calculation, but it was clearly a significant enough tax loss for Congress to initially put the § 280A statute in place. Likewise providing subsection (g) was probably viewed as de minimis and helpful administratively. It is only as individuals have gotten more audacious with the uses of subsection (g) that the extent of
The IRC defines what constitutes rental income in a number of sections, but these sections focus on what type of deductions can be taken from rental income for tax purposes and so do not appear on point.\textsuperscript{52} However, where no other intention is specifically indicated, the plain English definition of a word is used.\textsuperscript{53} The dictionary definition of “rented” is “[t]o grant temporary occupancy or use of (one’s own property or a service) in return for regular payments.”\textsuperscript{54} In this context any temporary occupancy of one’s dwelling unit or a portion thereof for which remuneration is received qualifies as rented. This can be broadly construed to allow for almost any type of arrangement to qualify. The key requirements to renting are the occupancy and the payments. Occupancy implies a human presence performing the occupancy, but one could conceive of other arrangements that could fall within this broad definition of rent.

Finally, the time limitation of “less than 15 days within a taxable year” correlates inversely with the definition of residence discussed above. This definition above pegs the concept of residence as occupancy for greater than 14 days.\textsuperscript{55} Thus, two weeks seems to have been carved out for tax purposes as the minimum time one must occupy a dwelling unit before it is considered a residence, and inversely it is the maximum time one can allow another to rent a residence without having to pay income tax on the rental income. The timing is significant mostly because it is the only limitation which could be conceived of as confining the scope of the tax revenue loss has become significant. See 138 CONG. REC. S15085, \textit{supra} note 16 at 15088 (discussing the estimated cost of subsection (g) at $333 million).

\textbf{52.} \textit{E.g.}, I.R.C. \textsection{} 543 (defining “What constitutes rent payments” but only with reference to personal holding companies).

\textbf{53.} Courts often refer to the “plain meaning” of a statute, and will when necessary look to a dictionary to clarify the usage of a word. Clark v. U.S. 69 Fed. Cl. 443, 446 (2006). \textit{See also} U.S. v. Jenkins 275 F.3d 283, 287 (3\textsuperscript{rd} Cir. 2001) (quoting United States v. Clayton, 172 F.3d 347, 356 (5th Cir.1999) discussing the legal cannons of statutory interpretation and plain English analysis).


\textbf{55.} \textit{Supra} note 49.
this provision and is likely the source of the de minimis title. However, as will be explored below, this is a limitation of form more than substance.  

II. EXPLOITATION AND REGRESSIVITY

IRC § 280A(g) is both overly inclusive and overly exclusive. It is overly inclusive because it allows people who were not intended beneficiaries of the subsection to exploit the ruling to legally avoid taxes on significant income.  

It is overly exclusive because it fails to apply to those taxpayers who provide the type of service intended to be benefited, but who consciously or inadvertently surpass the 14 day limit. One important effect of this provision is that it adds a significant regressive component to a tax system which is intended to be progressive (where those who earn the most pay a greater share of their income in taxes). Regressivity arises from the consequence of subsection (g) providing a significant tax free source of income for a class of taxpayer that generally does not need this benefit and who are not likely to change their behavior if this provision were modified or removed. The individuals who are able to benefit most from IRC § 280A(g) are often in the highest income brackets. These individuals have homes that are capable of hosting large groups and earning significant rents. This is especially true for individuals that rent out their homes during large festivals and athletic events, and those who have the opportunity to rent out their homes for film production purposes. These uses of IRC § 280A(g) are explored further below.

A. Extreme Makeover: Home Edition

The most public example of an abuse of IRC § 280A(g) is found on Extreme Makeover: Home Edition. The fortunate families chosen to be contestants on Extreme Makeover: Home Edition

56. See infra Part II. (describing the uses and abuses of I.R.C. § 280A(g)).
57. See infra B., C.
58. A renter could decide to stay longer than their original intentions, or circumstances could change which require the renting of one’s dwelling unit for additional days beyond the statutory 14 days maximum to maintain tax free status.
59. The current federal tax system has a marginal rate progressivity structure.
Edition have already won their prizes when their episode begins.\textsuperscript{60} They won as soon as the producers decided to renovate their homes.\textsuperscript{61} However, this type of prize is distinguishable from that found in the classic case on the taxation of prize winnings, Pulsifer v. Commissioner of Internal Revenue where a father and three of his children won $48,000 in the Irish Sweepstakes and although the money for the children was set aside for them when they reached 21, or when an appropriate party applied for the funds, it was considered income to them in the year they won the Sweepstakes under the economic-benefit theory.\textsuperscript{62} In the Extreme Makeover: Home Edition situation, there is a difference because the extent of the work that will be performed is not known ahead of time, nor can the family likely decide when they will receive the award, rather it is determined by the producers of the show. So, the full extent of the prize is not determined. Puslifer was answering the question of when something becomes income, which is not the significant issue in the Extreme Makeover: Home Edition context. The significant issue which Extreme Makeover: Home Edition must answer is whether or not the prize itself is income?\textsuperscript{63}

The proper categorization of the prize might be best accomplished by dividing the value of the prize into component parts. The first component is the $50K of appliances provided as the payment for the lease of the home for 10 days.\textsuperscript{64} A great deal of the work that goes into the

\begin{itemize}
  \item \textbf{60.} These families are fortunate because they are receiving the incredible opportunity offered by the show; they are unfortunate because it is only deserving families that are coping with some form of loss or handicap that are selected by the shows producers for a home makeover.
  \item \textbf{61.} Granted this prize is still executory and if the show was cancelled or some other misfortune was to occur it is possible that the family would not actually receive the prize.
  \item \textbf{62.} 64 T.C. 245 (1975).
  \item \textbf{63.} The producers clearly would answer this question in the negative, but it remains to be seen how the IRS would classify the prize. There is anecdotal evidence to suggest that the IRS is choosing to look the other way; the show has been on the air for three years now and there has been no public report of one of the starring families having to pay the federal income tax on their prize.
  \item \textbf{64.} As a fixed sum paid for the lease of the home, this portion seems to clearly fit within the § 280A(g) rental income exclusion.
\end{itemize}
home improvement is labor that is donated by neighbors and members of the community. Therefore the second component would likely be the gift of the labor to improve the home.\textsuperscript{65} The third component is the value of the materials used in performing the improvements. The companies that donate these materials are likely not eligible to exclude them as gifts because they are receiving considerable value in product placement on the show in return.

The show itself is all about how the prize is delivered to the deserving family. Starting with an early morning wakeup call from the shows host, the game is afoot.\textsuperscript{66} The family is interviewed, their predicament discussed and their deserving qualifications revealed. Then the family is sent out of town on a vacation and the renovation begins. The drama comes from the tight timeframe and long hours put in by volunteer laborers, usually neighbors of the fortunate unfortunate. As mentioned previously in the introduction, the winners of Extreme Makeover: Home Edition are advised that they can exclude from gross income the full value of their home renovation.\textsuperscript{67} This advice seems ill conceived.

The family will receive a prize whose value exceeds $100K, including a significant amount of new appliances and the usually complete remodeling of their home.\textsuperscript{68} As reported the family is compensated $50,000 worth of appliances for the lease of their home.\textsuperscript{69} This is $50,000 for a 10 day rental of a home that is not suitable for living in once the construction begins (which is almost immediately). The rent exclusion is courtesy of IRC § 280A(g). And the producers

\textsuperscript{65} A reasonable argument could be maintained that even if I.R.C. § 280A(g) was not applicable to the winners on Extreme Makeover: Home Edition, it would be possible to classify a significant portion of their winnings as a gift. See C.I.R. v. Duberstein 363 U.S. 278, 286 (1960) (establishing the gift standard as based on the “donative intent” of the giver and requiring the gift to proceed from detached and disinterested generosity). This level of generosity seems to genuinely exist on Extreme Makeover: Home Edition and thus it is possible that this portion of the value of the home improvement could be reclassified as a gift.

\textsuperscript{66} Jose L. Sanchez Jr., It’ll Be a Dream Home; Family on Vacation While Crew Rebuilds House in 5/12 Days, PRESS DEMOCRAT, July 9, 2004 at A1.

\textsuperscript{67} See Sanchez, supra note 4.

\textsuperscript{68} Id.

\textsuperscript{69} Supra note 64.
recommend a further shelter for the prize by identifying the home remodel as lessee improvements which are not taxable to the owner until they sell the property.\textsuperscript{70} Although the families are deserving, the use of IRC § 280A(g) is an abuse of the tax rules and a conversion of the intent of the rules, even if the Service chooses to look the other way.\textsuperscript{71}

B. Home Rental for Movie Production

Another area of abuse is the rental of personal homes as sets for movie production. In the greater Los Angeles area, it is not uncommon for one’s house to be a movie star, complete with a manager and a portfolio of work.\textsuperscript{72} “About 70% to 80% of location filming in Southern California occurs in private residences.”\textsuperscript{73} This creates an opportunity for an extremely lucrative and tax free side business. Home rental rates for film shoots can range from $2,000 to $20,000 per day.\textsuperscript{74} For a $20,000 per day shoot lasting 14 days, the homeowner can walk away with $280,000 of tax free income, hardly a de minimis amount. If the shoot runs long by even one day, the full $280,000 and any revenue from the additional day or days of shooting is subject to taxation at regular income rates.\textsuperscript{75} The effect is to create a tax cliff over which no rationale

\textsuperscript{70}. See \textit{supra} note 8. See also \textit{supra} note 65 (providing a plausible argument for exclusion of a portion of the value of the prize related to the gift of labor from the community).

\textsuperscript{71}. \textit{See} Hirsch, \textit{supra} note 8 at 1676-79 (discussing the IRS predilection for avoiding high profile cases which could cast the Service in an overly negative light, such as with a fan that might catch a major home run record breaking ball and return it to the hitter not having any tax liability) see also Nasner, \textit{supra} note 9 at 501 (referring to the IRS’ “difficult decision” allowing the goodwill to continue).

\textsuperscript{72}. \textit{See} Jamie Diamond, \textit{Best House in a Leading Role}, L.A. Times, Oct. 7, 2004, Home at 1 (discussing how many homes in the Los Angeles area get more movie roles than many actors and how some homes have dedicated managers).

\textsuperscript{73}. Danny Miller, \textit{The Star Treatment, Want a Film Set in Your Living Room? It’s All About Looks, Marketing and Good Neighbors}, L.A. Times, Mar. 5, 2006, Real Estate at 1.

\textsuperscript{74}. \textit{Id.}

\textsuperscript{75}. Talk about a ridiculously high marginal tax rate. The return went from $280,000 down to $280,000 x (1-.35%) = $182,000. The extra day creates a net loss of $98,000. It would
individual would want to fall. At a marginal rate of 35% (which is the likely rate considering any home worth $20,000 per day has to be an enormous place and is not likely owned by an impoverished family) it would take a little over seven and a half additional days of rental use in order to get back to an after tax return just under $280,000.\footnote{21.5 days of rental at $20,000/day = $430,000 x (1- 35%) = $279,500 of net income.}

C. Mardi Gras, the Masters, the Olympics, and the Superbowl

Enormous events which occur in small locations on a regular schedule provide opportunities for IRC § 280A(g) use and abuse. For example, the fortunate residents of the properties that line the streets of the French Quarter in New Orleans are able to rent out their homes at exorbitant rates to the eager throngs that flock to the city to participate in the famous libidinous festival. These residents are able to exclude from income this windfall every year thanks to IRC § 280A(g). If they lived even 5 miles away from the French Quarter this opportunity would not be available to them. While the maxim of real estate is location, location, location, the expression refers to the value of one’s property; it should not correlate with tax free income.

The abuse potential is rampant with other major events, such as the Masters Golf Tournament in Augusta, Georgia. Once a year the golf world descends on Augusta and willing homeowners are able to profit tax free from the event. There are reports of homeowners charging $75,000 and up for the rental of their home for the week of the tournament.\footnote{Christopher Allen, \textit{October 2002 Tax Tip: Renting Your Home -- Tax Free}, Walter & Schuffain, P.C. http://wscpa.com/taxinfo/2002/10/.} There is nothing implicitly wrong with a homeowner taking advantage of the strategic location of their home and charging a market rate to rent out their property, but it hardly seems reasonable that the federal government subsidizes this activity by excluding this income from taxation. These same types of windfall profits are experienced by homeowners that live near the Superbowl, the Olympics, or any other large yearly event which attracts affluent spectators.\footnote{Id.}

be interesting if one were able to review the yearly shooting schedule for homes in Los Angeles and determine what percentage were used less than 15 days per year. It would not be surprising if this number represented a significant fraction of the total pool.
D. Business Owners

Other groups have found a way to take advantage of IRC § 280A(g). Individuals that own a business can use IRC § 280A(g) to obtain the tax equivalent of a grand slam homerun against the government by renting out their homes to their business for board meetings and any other business event requiring facilities outside of their main location.\textsuperscript{79} This approach works a whipsaw by generating tax free income to the homeowner / business owner (provided they don’t rent out their residence for more than 14 days) and a deductible expense for the business.

If the homeowner is aggressive, they can charge above market rates for the rental of their home.\textsuperscript{80} However, while this is the standard of practice for movie production because of the specialized nature of the work, it is riskier for a typical business to consent to paying above market rates. Anytime a business pays above market rates, it is opening itself up to a potential challenge from the Service.\textsuperscript{81} The Service could make the argument that the rent payment should be reclassified to more accurately reflect the substance of the transaction.\textsuperscript{82} However, regardless of the magnitude of the profit earned through this approach, it is another clear example of an authorized bastardization of the tax code.

\textsuperscript{79} Joe Woshcamper, $7,000 of Tax-Free Income Every Year, TRADERS ACCOUNTING, http://www.traderslog.com/taxfree.htm (laying out the scheme by which taxpayers can exploit IRC § 280A(g)).

\textsuperscript{80} As Extreme Makeover: Home Edition illustrates, I.R.C. § 280A(g) does not include or incorporate a fair market value limitation which would restrict homeowners from taking advantage of potential renters.

\textsuperscript{81} Rental income can be deducted by a business under I.R.C. § 162(a)(3) provided it is properly classified as “ordinary and necessary.” With respect to rental payments, “Where there is an absence of arm's length dealing, the Commissioner may inquire into what constitutes reasonable rental to determine whether the amount paid exceeds what would have been paid had the parties dealt at arm's length.” Southeastern Canteen Co. v. Commissioner, 410 F.2d 615, 619 (6th Cir. 1969).

\textsuperscript{82} If the business entity was a corporation, this could lead to them potentially reclassifying the payments as part rent, part dividend to the extent that the corporation has either current or accumulated Earnings and Profits. I.R.C. § 243 (West 2004).
All of these approaches allow individuals that were almost certainly not the intended beneficiaries of IRC § 280A(g) to earn sizable tax free income from the rental of their homes. Fortunately a simple modification to IRC § 280A(g) should alleviate a majority of this abuse, while still allowing appropriate individuals to benefit from a reasonable exclusion.

III. SUGGESTED MODIFICATIONS

In order to curb the abuses that have run rampant over this seemingly innocent and innocuous income exclusion a number of approaches bear consideration. The most dramatic and probably least appropriate approach would call for the complete abolishment of IRC § 280A(g). Since this approach would unnecessarily burden the intended beneficiaries of IRC § 280A(g), it will not be considered further. The approaches which warrant consideration include, A. Exclusion of a set amount of income from a de minimis rental of one’s residence, B. Exclusion of a set percentage of rental income from a de minimis rental of one’s residence, C. Restricting the remuneration for exclusion to the fair market value rental rate of the property, and D. Limiting the rental location to an individual’s primary residence. The various elements of these approaches will be considered and their strengths and weaknesses discussed.

A. Limit the Exclusion to a Fixed Amount

Capping the exclusion value of a de minimis rental should significantly reduce the abuses found under the current unrestricted version of the rule. It would in fact be able to make the rule truly de minimis, not just in number of days, but in the value of the rental income earned. Determining the appropriate size of the limitation could present a challenge, as the tax code is replete with provisions that are not tied to inflation and thus over time cause significant unexpected consequences. However, as an income exclusion, it is unlikely that IRC § 280A(g) would ever have a truly negative effect, so failing to tie it to inflation would only cause the rule

83. This approach has been tried 5 times already and failed each time. It does not appear to be a viable approach to reforming the tax code. See supra note 18.
84. See 2005 Tax Reform, supra note 18 (proposing a $2,000 limitation).
85. The prime example of this is the Alternative Minimum Tax which was not tied to inflation and has over the years affected increasing numbers of taxpayers.
to become increasingly marginalized. However the number is chosen, a rental income cap for IRC § 280A(g) would be an effective means of increasing government income and significantly reducing the regressive component of this rule.

B. Limit the Exclusion to a Fixed Percentage

Instead of a fixed exclusion amount, another proposal which is worth considering would be the exclusion of a set percentage of the revenue earned from renting a residence for less than 15 days. This approach appears to be fairer as it would allow those with more expensive homes to earn more money than those renting very inexpensive homes. Of course, this is the epitome of the free enterprise system, and market forces being allowed to work unimpeded by tax law. That being said, it is almost certain that individuals will adjust their rental rates to continue receiving the same level of income they were receiving under the unaltered IRC § 280A(g) regime.

There are several potential problems with a set percentage revenue cap. First, it would likely be administratively complex. It would make investigation more time consuming forcing IRS agents to review the total income and the amount excluded.\(^\text{86}\) Second, it in essence negates the main benefit of IRC § 280A(g) by forcing all taxpayers that use the provision to have to declare some portion of their rental income as taxable. Third, those taxpayers who rent for longer than 14 days could make the argument that they too should be given the fixed percent exclusion as it would be no more administratively complex and they could argue they are equally deserving of this benefit. Whether this third argument has merit will depend on the facts and circumstances of the claim, but one could certainly conceive of many situations which would be just beyond the bounds of the IRC § 280A(g) regulation but so close as to appear substantially equivalent.\(^\text{87}\)

\(^{86}\) This is as compared to a revenue cap which would be administratively simple and would likely not even require review.

\(^{87}\) \textit{E.g.,} if a taxpayer rented their home for a small amount for 15 or 16 days per year they are in an almost identical position as the taxpayer that rents for only 14 days. Likewise, someone that rents their car out for less than 15 days could reasonably claim that they should get an income exclusion as well, as the car rental is de minimis as well. Ultimately these claims would likely be resolved by reference to the plain meaning of the statute but they illustrate the
C. Limit Rent Exclusion to Fair Market Value

As a standard throughout the law, fair market value could be applied as an explicit restriction on the rental income exclusion allowed. However, using fair market value is perhaps the most administratively complex, and thus the least attractive approach to capping the rental exclusion. While there is an inherent sense of proportion when one ties limits to a fair market value, it creates a situation where the question of the relevant market becomes a problem. For example, in Los Angeles, the fair market value of a home used as a movie set might be $4,000 per day, where that same home in Los Angeles, used for a corporate meeting might only garner a fair market value of $500 per day. But, this is the same home in the same regional market. This could create an issue for the taxpayers and the IRS to determine which of these two prices is actually the fair market value of the home for rental purposes. And if it depends on the use, we are then favoring certain uses and disfavoring others, a consequence which is certainly within the sphere of tax legislation, but which should arise from clear Congressional intent. When the bias is an unintended side affect, it should be removed or minimized in order to avoid potential discrimination problems.

Moreover, the ability of individuals to disagree over fair market value makes this issue a ripe topic for litigation. And even if the issue doesn’t reach litigation, the mere expense of having to prove fair market value if questioned by the Service makes this proposal unattractive. Whenever possible, taxpayers will prefer clarity in their tax rules, and while fair market value is the standard for many tax rules,88 in the area of de minimis rules, it is best avoided.

D. Restrict Rental to an Individual’s Primary Residence

Restricting the de minimis exclusion to an individual’s primary residence is a simple change to the regulation which would reduce the abuse and the regressivity of the provision. Since it is mostly wealthier taxpayers that have more than one residence, by adding this limitation the danger of shifting to a percentage limitation as it would seem equally fair to apply in alternate scenarios. The same can be said for the fixed amount limitation, but because of its more limited benefit it is less likely to become an issue.

88. See, e.g. Southeastern Canteen Co., supra note 81 (discussing the arms length dealing standard for businesses, which is a shorthand for establishing fair market value).
intended audience of IRC § 280A(g) should not be impacted. Those that are impacted are likely taking advantage of this provision and by taking it away additional tax revenue should be raised. This modification can co-exist with any of the rental value provisions discussed above and thus should be considered a viable candidate in any revision of IRC § 280A(g).

IV. CONCLUSION

In the interest of horizontal equity the revenue exclusion of subsection (g) under IRC § 280A should be reformed to more precisely tailor the permissible uses. The best approach to reform IRC § 280A(g) should be the simplest and most administratively inexpensive. These requirements point to the combination of two of the above discussed approaches: adding a cap to the amount of rental income which can be excluded by a taxpayer renting their primary residence for less than 15 days in a taxable year. The revenue limitation coupled with the restriction to one’s primary residence will efficiently weed out the larger abusers, while still allowing the more deserving (lower income) individuals to receive a benefit. While this approach will not stop Extreme Makeover: Home Edition from giving away large prizes in a tax preferred manner, it is not clear that this is a bad thing. 89

89. The producers will likely respond by reducing the rent paid for the lease to the cap amount and using I.R.C. § 109 to continue allowing the families to receive their prizes without paying federal income tax.