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ACCOUNTING AND PAYROLL ■ INCOME TAX PREPARATION ■ FINANCIAL BUSINESS CONSULTING

### The Ins and Outs of the Home Office Tax Deduction

By Carol G. Poulin, CPA, CFP®

If you're self-employed and conduct business out of your home, or if you telecommute to your job in your pajamas, the Internal Revenue Service (IRS) may allow you to take advantage of the home office tax deduction.

Before you deluge your accountant with receipts for expensive office furniture and electricity, however, proceed cautiously. There are specific requirements that must be met in order to claim this, and they can be confusing for many people.

If the technical requirements—described below—are met, you may be able to deduct a percentage of real estate taxes, mortgage interest, rent, utilities, insurance, depreciation, painting, and repairs. This deduction is available to either homeowners or renters. Furthermore, the IRS defines a “home” as a house, condo, apartment unit, or even a boat. Self-employed individuals typically find it easier to qualify for this deduction. The IRS has established two requirements that must be satisfied beforehand, however:

1. You must use that part of your home regularly and exclusively for business purposes.
2. The business part of your home, including a detached garage or guesthouse, must be either your principal place of business or the location where you meet with clients or customers in the normal course of business.

Let's review these one at a time.

#### The regular- and exclusive-use requirement

The regular-use requirement is not clearly defined by the IRS. In general terms, however, it means that you must use a designated part of your home for business purposes on a continuous basis—not just for occasional business use. This requirement can likely be met by working from home a few hours each day or a couple of days a week.

The exclusive-use requirement strictly means that you use this designated portion of your home solely for business. Therefore, if you have a home office with a computer, you cannot use this computer to send personal e-mails. This activity would be a violation of the requirement and preclude qualification for the home office deduction.

The IRS does offer two exceptions to the exclusive-use rule:

1. You operate a certified day-care facility from home.
2. You use your home to store inventory or product.

In the latter case, you can qualify for the deduction whether or not the storage area of your home is used exclusively for business. For example, if you are a salesperson who stores inventory or product samples in your basement, you may also use the same area of the basement for personal use, such as a workshop. You can deduct expenses for the storage space, even though that portion of the basement is not used exclusively for business purposes.

It is important to be aware of the limitations with this exception. If you have an office, or any other business location other than your home, you will not qualify for the deduction. Then, the items have to be stored in a specific, dedicated place, such as a garage, closet, or spare room.

### **The headquarters or meeting place requirement**

If you operate out of more than one business location, including your home, you must determine whether your home is your principal place of business.

A home will automatically qualify as a principal place of business if you conduct administrative or management activities of your business solely from your home and no other fixed location. You must meet both of these provisions. For example, if you are a consultant who performs services for various clients at various locations, you might regularly use your home office for bookkeeping or scheduling appointments. This would qualify for the deduction.

Alternatively, employees who work at home may also be able to qualify for this deduction if they also satisfy the standards noted above for self-employed individuals. The twist for an employee, however, is that the use of a home office **must be for an employer's convenience**.

For example, if your company does not provide space at its location for you to work, requiring you to operate out of a home office, you would likely qualify for the deduction. But if you have an office at your employer's location and telecommute occasionally for convenience, this will generally preclude you from taking the deduction.

### **Next steps if you qualify**

Generally, the amount that you can deduct depends on the percentage of your home that is used for business. The deduction will be limited if your gross income from your business is less than your total business expenses. Employees must be able to itemize deductions, using Schedule A. Self-employed individuals would report their deduction on Schedule C.

Finally, be prepared to demonstrate to the IRS that you qualify for the home office deduction. For example, take photographs of your office, have your business mail sent home, set up a separate phone line exclusively for business purposes, and log the time that you spend working at home.

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