

Deducting Your Home Office Expenses

By Inc Magazine

Home office deductions can offer excellent tax savings for entrepreneurs. However, there are very specific rules that home-based business owners *must* follow in order to qualify.

Your home office must be your principal place of business. In tax law, this means that you earn your money from home, or use your home office for significant administrative or managerial activities and do not have another business location. Freelancers working from home usually can satisfy the test easily. Consultants, however, who spend most of their time at clients' offices, may have a tougher time. For example, if you're a plumber or an interior decorator and earn money in the field, you can claim a home office deduction only if you can show that you use a home office to schedule appointments and keep your books for work and have no other office.

Even if your home office isn't your principal place of business, you can still deduct expenses if it's the place you meet or deal with clients, customers or patients in the normal course of business. This use cannot be occasional or incidental; it must be a regular part of your business. Note that special rules apply to the use of a separate structure or storage space.

If you work for someone else, your home office use must be for the convenience of your **employer** and not a personal preference on your part. This means your employer does not have desk space for you at headquarters or wants you to work remotely. It may be helpful for your tax records to obtain a letter from your employer expressing the company's reason for your working from home.

Even if you meet the first threshold, you must also show that you use a portion of your home regularly and exclusively for business. This means you cannot use the space for work during the day and for family use at night. A kitchen table cannot be your workspace because you are not using it exclusively for business. The space need not to be an entire room. A portion of the room, say the corner of your bedroom, can constitute a home office and no physical partition of the space is required.

You can deduct the portion of expenses that relate to your home office. Usually the allocation is based on square footage (note that special rules apply to day care providers). For example, if you use 10% of your living room space for work, you can deduct 10% of your utilities, insurance, rent (if you lease) or mortgage interest and real estate taxes (if you own your own home). You can also claim a depreciation allowance for your home office if you own your own home. Painting the office space and the cost of cleaning, security monitoring and pest control can be listed as deductions.

Establishing a home office creates a secondary benefit: the ability to deduct travel expenses from home to business locations and back again. Since the home becomes a business location, driving from it to see a customer or vendor and returning home is a deductible business expense.

Certain types of property that have both a personal and business use, such as a computer and cellular phone, are treated under the tax law as "listed property". To claim accelerated depreciation or first-year expensing for the purchase of these items, it's usually necessary to prove that business use exceeds 50%. However, if you have a home office, this business use is presumed and tax-favored deductions are allowed.

If you own your home, claiming a home office deduction does not prevent you from claiming the home sale exclusion to avoid tax on gain up to \$250,000 (\$500,000 on a joint return). However any depreciation claimed with respect to the home office after May 6, 1997, is "recaptured" at the rate of 25%. This means you report the amount of depreciation and pay one quarter of it back in taxes.

If all this sounds too good to be true, it can be. So, as a final reminder, here are some important items to keep in mind in order to meet the strict criteria for home office deductions:

- You must be profitable to benefit from a home office deduction.
- Your annual write-off cannot exceed income from the business, though unused deductions can be carried forward and used in a future year.

For more information, check IRS Publication 587 - ***Business Use of Your Home***, at www.irs.gov. And, plan on using a tax professional to help you prepare your yearly returns.

If you would like FREE business counseling, please contact the Lynn Area Chamber of Commerce staff at 781-592-2900 or info@LynnAreaChamber.com