

Claiming a Home Office Deduction

To claim a home office deduction, your home office must be used regularly and exclusively:

1. as the principal place of your trade or business;
2. to meet or deal with patients, clients or customers in the normal course of your trade or business; or
3. in connection with your trade or business if it is a separate structure that is not attached to your home.

Employees must meet an additional requirement. Their use of the home for any of the above conditions must be for the convenience of the employer. In addition, home-related deductions are available for space regularly used for inventory storage by a wholesaler or retailer, or for use as a day care facility.

Regular and Exclusive Use

For expenses associated with a home office to be deductible, it must be used on a regular basis. It isn't enough to use the office occasionally. Use must be continuous, ongoing or recurring. If you did not operate a business for the entire year, you can only deduct the expenses paid or incurred for the portion of the year you used your home for business.

The exclusive use test is not met if an area is used exclusively for business purposes during business hours, but for personal purposes at other times. If you use the room to watch TV, house overnight guests or even play games on the computer in that room, it does not qualify for the deduction. Your office space must be a designated area set apart from the rest of the house for only business use. A spare bedroom in the house can be converted to a legitimate home office by removing the bed. The Tax Court has held that a portion of a room can qualify for the home-office deduction even though the room is not divided by a partition or physically separated in some manner. However, this determination is based on facts and circumstances.

Principal Place of Business

If your home is the sole location of your business, and you supply services or sell goods from that location, then you automatically meet the principal place of business test. Beginning in 1999, a home office qualified as a principal place of business if it was used to conduct administrative or management activities of a business or practice, as long as there was no other fixed location used to conduct substantial administrative or management activities.

Deductible Expenses

Certain costs of operating and maintaining the part of the home used for business are deductible.

Indirect expenses are the expenses that cover the entire home. These include rent (if your home is rented), or if owned, real estate taxes, mortgage interest and depreciation of the home. Include only mortgage interest that qualifies as an indirect expense. You cannot include interest on a mortgage loan that did not directly benefit your home (e.g., a home equity loan used to pay off credit card bills, buy a car or pay tuition costs). Other indirect expenses are utilities such as lights and heating, home insurance and repairs. The deductible portion is based on the percentage of your home used for business.

Direct expenses are those that cover only the area used for business, for example, painting, decorating or repairs of your home office. Direct expenses are deductible in full.

Limit on Deductions

Your home office deductions cannot exceed the net income derived from the business. This means you cannot use home office expenses to create or increase a tax loss from your business. However, unallowed home office expenses can be carried over to later years when there is more income from the business.

Effect of Business Auto Deductions

If your home office is your principal place of business, the costs of traveling between the home office and other work locations in the same trade or business, regardless of whether the other work location is regular or temporary, and regardless of its distance, are deductible transportation expenses.

Effect on Sale of Home

Depreciation recapture rules apply to the profit on the portion of the residence used as a home office. Consult your Enrolled Agent for details.

Recordkeeping

Good recordkeeping is vital to ensure that you will be able to substantiate all your deductions in the event of an audit. Save bills, receipts and cancelled checks. Keep a work diary of all hours spent working in and out of the office. Take a picture of your home office so you can show that it indeed existed in the event you move or change offices.