

The Home Office Deduction

What actually qualifies - and which method may fit your situation

Compliments of Lenny G. Letcher, EA, RFC

THE SHORT ANSWER

A home office can be deductible when the space meets the tax rules for business use. For most self-employed taxpayers, the starting point is regular and exclusive business use. There are special rules for certain inventory storage and day-care uses.

Who should pay attention to this?

This guide is aimed primarily at self-employed individuals and small-business owners who use part of a home for business. Employees generally cannot claim a federal home-office deduction for employee business use of their homes under the rules covered in this course.

The basic qualification tests

- **Exclusive use.** The business area generally must be used only for business. Incidental or de minimis personal use may not necessarily destroy the deduction, but regular personal use of the same space is a problem.
- **Regular use.** Occasional or sporadic business use is not enough.
- **Principal place of business.** A home office can qualify when it is used exclusively and regularly for administrative or management activities and there is no other fixed location where substantial administrative or management activities are conducted.
- **Separate structure.** A detached garage, studio, workshop, or similar structure may qualify if it is used exclusively and regularly for the trade or business.

Two important exceptions

The exclusive-use rule has special exceptions for qualifying inventory storage when the home is the only fixed location of a wholesale or retail business, and for qualifying day-care use that meets the applicable licensing rules.

Two ways to calculate the deduction

	Simplified method	Regular method
Calculation	\$5 per square foot, up to 300 sq. ft.	Actual qualifying direct expenses plus the business share of qualifying indirect expenses
Maximum	\$1,500	No fixed dollar maximum, but the Section 280A income limitation applies
Depreciation	None; depreciation for the year is deemed zero	May be allowed on the business portion of the home

Unused amount	No carryforward of an unused simplified-method deduction	Certain expenses and depreciation limited by the income rule may carry forward
Form	Claimed using the simplified method rather than regular Form 8829 expense computations	Schedule C taxpayers generally use Form 8829

What expenses are we talking about?

Under the regular method, expenses are generally divided into direct and indirect costs. Direct expenses relate only to the business portion of the home. Indirect expenses benefit the entire home and are allocated between business and personal use. Examples discussed in the course include utilities, insurance, repairs, rent, mortgage interest, real estate taxes, and depreciation, subject to the rules that apply to each item.

LENNY'S TAKE

Don't start with the deduction - start with the facts. Tell us exactly what space you use, how you use it, whether anyone uses it personally, and whether you have another office. Once we know that, we can decide whether the home office qualifies and which calculation method makes sense.

A few rules clients often miss

- The deduction generally cannot create or increase a business loss; the gross-income limitation may postpone some regular-method expenses.
- If more than one business uses the home, the qualification and expense-allocation rules can become more complicated.
- Using the regular method can create depreciation deductions, and depreciation may matter later when the home is sold.
- The simplified method avoids home depreciation for the years it is used, which can make recordkeeping easier.

What should you keep?

- Measurements or other support for the business-use percentage of the home.
- Records showing how the space is actually used.
- Receipts and statements for home expenses if using the regular method.
- Depreciation records for years the regular method is used.
- Information about any other office or fixed business location you use.

Before you claim it

Home-office deductions are highly fact-specific. A space that looks like an office does not automatically qualify, and the method producing the largest deduction in one year is not always the best choice over several years. Bring the facts and records to your tax professional before deciding how to report it.

Prepared for client education by Lenny G. Letcher, EA, RFC

This handout is general educational information and is not a substitute for advice based on your individual facts. Tax rules change, and additional limitations or exceptions may apply.