

Home Office Basics

What: A deduction is allowed for a business owner's qualified business use of the home. The deduction is limited to net income from the activity.

Who: To take the Home Office deduction, you must have an area that is regularly and exclusively used as:

- The principal place of your business.
- A place you deal with customers in the normal course of your business.
- The principal place where you perform administrative and management activities. There can be no other fixed location where these activities can be performed.
- A place to store inventory or samples.
- A daycare facility.

Regular use defined: To meet the regular use test, you must use the exclusive use area on a continuing a basis. Occasional use of the exclusive use area does not meet the test. Using the office weekly if not daily would help satisfy the test. It is wise to keep a log of time usage with appointment books, e-mail or phone records to show regular use.

Exclusive use defined: The law states exclusive so don't ruin the deduction with personal use items in the space or after hours personal use. Rooms like living rooms and dining rooms would have a difficult time qualifying as 100% business, but a portion of any room might qualify. Daycare facilities are exempt from this particular test.

What you need to take the deduction:

Option 1

- First you must measure the exclusive space and the total usable space to arrive at the exclusive use percentage. According to IRS Publication 587, you can use any reasonable method to determine this percentage.
- Gather the following household expenses to apply to the calculated percentage. Mortgage interest, property taxes, insurance, rent, repairs, maintenance, utilities and services, Association fees and security.
- Direct expenses related to the office itself can be deducted in full.
- You must also calculate depreciation on your Home Office. To do this, an accounting of the total investment in your home is needed. The first year's home improvements will be added to the depreciation section each year thereafter. When the home is sold, any gain resulting from this depreciation element will be taxed.

Option 2

The IRS has provided A simplified home office deduction instead of calculating all of the above information. \$5 per square foot can be deducted to a maximum of \$1500. The IRS estimates the simplified calculation saves taxpayers 1.6 million hours per year.

Why take the deduction?

The Home Office deduction is instrumental in maximizing the business mileage deduction. Keeping in mind that commuting is not deductible, consider the following three scenarios.

- If you have an office outside your home, you cannot deduct commuting to work.
- If you work out of your home but do not have a qualified Home Office, the distance between home and your first stop and the distance between your last stop and home is not deductible.
- If you qualify for a Home Office, all of your business related mileage is deductible.