

SAUNDERS PORTUGAL

AND ASSOCIATES, INC.

The Home Office Deduction

Under the IRS rules, a taxpayer is allowed to deduct expenses related to business use of a home, but only if the space is used "exclusively" on a "regular basis". To qualify for a home office deduction you must meet one of the following requirements:

1. Exclusive and regular use as your principal place of business
2. A place for meeting with clients or customers in the ordinary course of business
3. A place for the taxpayer to perform administrative or management activities associated with the business, provided there is no other fixed location from which the taxpayer conducts a substantial amount of such administrative or management activities

A separate structure not attached to your dwelling unit that is used regularly and exclusively for your trade or profession also qualifies as a home office under the IRS definition.

The exclusive-use test is satisfied if a specific portion of the taxpayer's home is used solely for business purposes or inventory storage. The regular-basis test is satisfied if the space is used on a continuing basis for business purposes. Incidental business use does not qualify.

In determining the principal place of business, the IRS considers two factors: Does the taxpayer spend more business-related time in the home office than anywhere else? Are the most significant revenue-generating activities performed in the home office? Both of these factors must be considered when determining the principal place of business.

Employees

To qualify for the home-office deduction, an employee must satisfy two additional criteria. First, the use of the home office must be for the convenience of the employer (for example, the employer does not provide a space for the employee to do his/her job). Second, the taxpayer does not rent all or part of the home to the employer and use the rented portion to perform services as an employee for the employer. Employees who telecommute may be able to satisfy the requirements for the home-office deduction.

Expenses

Home office expenses are classified into three categories:

Direct Business Expenses relate to expenses incurred for the business part of your home such as additional phone lines, long-distance calls, and optional phone services. Basic local telephone service charges (that is, monthly access charges) for the first phone line in the residence generally do not qualify for the deduction.

Indirect Business Expenses are expenditures that are related to running your home such as mortgage or rent, insurance, real estate taxes, utilities, and repairs.

Unrelated Expenses such as painting a room that is not used for business are not deductible.

Simplified Home Office Deduction

If you're one of the more than 3.4 million taxpayers claimed deductions for business use of a home (commonly referred to as the home office deduction), don't forget about the new simplified option available for taxpayers starting with 2013 tax returns. Taxpayers claiming the optional deduction will complete a significantly simplified form.

The new optional deduction is capped at \$1,500 per year based on \$5 a square foot for up to 300 square feet. Though homeowners using the new option cannot depreciate the portion of their home used in a trade or business, they can claim allowable mortgage interest, real estate taxes and casualty losses on the home as itemized deductions on Schedule A. These deductions need not be allocated between personal and business use, as is required under the regular method. Business expenses unrelated to the home, such as advertising, supplies and wages paid to employees are still fully deductible.

Current restrictions on the home office deduction, such as the requirement that a home office must be used regularly and exclusively for business and the limit tied to the income derived from the particular business, still apply under the new option.

Tax Deductions

The "home office" tax deduction is valuable because it converts a portion of otherwise nondeductible expenses such as mortgage, rent, utilities and homeowners insurance into a deduction.

Remember however, that an individual is not entitled to deduct any expenses of using his/her home for business purposes unless the space is used exclusively on a regular basis as the "principal place of business" as defined above.

The IRS applies a 2-part test to determine if the home office is the principal place of business.

- Do you spend more business-related time in your home office than anywhere else?
- Are the most significant revenue-generating activities performed in your home office?

If the answer to either of these questions is no, the home office will not be considered the principal place of business, and the deduction cannot be taken.

A home office also increases your business miles because travel from your home office to a business destination--whether it's meeting clients, picking up supplies, or visiting a job site--counts as business miles. And, you can depreciate furniture and equipment (purchased new for your business or converted to business use), as well as expense new equipment used in your business under the Section 179 expense election.

Taxpayers taking a deduction for business use of their home must complete Form 8829. If you have a home office or are considering one, please call us. We'll be happy to help you take advantage of these deductions.