

WHEN HOME IS WHERE THE JOB IS: TAX RULES FOR BUSINESS USE OF THE HOME

The number of people who work from home continues to grow. Entrepreneurs, telecommuters, service people, daycare providers and sales representatives, to name a few, all can claim deductions for the business use of their home. Having an office in your home allows you to deduct items that are not normally deductible, such as depreciation, utilities, and insurance. Part of your mortgage interest and taxes will also figure into the home office deduction.

Does bringing paperwork home count?

Whatever business you're in, to claim a deduction, your "office" must be used regularly and exclusively for business. Generally that means a separate room, although under certain conditions a part of a larger room may be used as an office. In that case, you must have an identifiable area that is exclusively used for business and serves no other function.

Your home office must also be your principal place of business. That means:

- It is used for administrative or management functions (examples: billing, bookkeeping, ordering supplies), or
- It is a place to meet customers, patients, or clients.

Business use: If you are an employee, the office must be used for your employer's convenience – *not* your own convenience. For example, if you work from home because you don't like the space provided for you by your employer, you may not claim the home office deduction. Also, your employer must not pay your rent for the use of your home office.

A sales representative or plumber who conducts the bulk of his business outside the home can still claim a deduction if he or she uses the home office for fielding calls and performing administrative functions.

Exclusive use: Generally, the room or area in the home must be used solely for business. There is an exception to this exclusive use principle for people who provide daycare in their home. This group must meet other standards, which are discussed below.

The Deduction

The home office deduction is calculated on Form 8829, *Expenses for Business Use of Your Home*. First, determine the square footage of the area of your house used for business. The office area divided by the entire square footage of your home results in the "business percentage" needed to calculate the deduction.

Home office expenses are generally divided into two categories: direct and indirect. Direct expenses benefit only the office area of the home, such as painting, lighting, etc. Indirect expenses such as mortgage, insurance, and taxes benefit the entire home. Generally, you can deduct the business percentage of the indirect expenses and 100 percent of the direct expenses. However, the total home office deduction cannot be more than the net income from the business for the year. Excess expenses are carried over to the next year.

NOTE: If you are using a separate structure for storage, such as a shed or garage, you must include the square footage of the structure in both the numerator (business area) and denominator (total area of the home) of your calculation.

Deductions for daycare providers: special rule

Licensed daycare providers who regularly take care of children, senior citizens or people who are physically or mentally incapable of caring for themselves can deduct a portion of their home expenses even if they use the space for other purposes. For example, if you use your

basement as a daycare during working hours, you can still use it as a family room in the evenings. Unlike an office, the space does not have to be exclusive.

To figure the deduction, you must multiply the business percentage (discussed above) by the hours per year that you use the space for business. This gives daycare operators the percentage of costs they can deduct from items such as mortgage interest and upkeep of the home.

You've deducted — Now it's time to depreciate

Depreciation is an allocation of the cost of your home over time. You will need to know the adjusted basis of your home (generally what you originally paid for it plus the cost of major improvements minus the cost of the land) and the fair market value (FMV) of the home (not including the land) at the time you began using it for business. The smaller of these two figures is then multiplied by the business percentage (figured earlier) to get the business-use basis of the building. Remember that the business-use

basis does not include the land.

The business-use basis of the building is then multiplied by a depreciation percentage obtained from a table supplied with the Form 8829 instructions. You will be directed to use the percentage that corresponds with the month you began using the home for business.

The home office deduction is claimed on Schedule C if you are self-employed or Schedule A if it is part of your employee business expenses. Although the calculations involved in figuring deductions for your home business can give you a headache, the opportunity to start the workday in your pajamas probably more than compensates for it.

IMPORTANT NOTE ABOUT YOUR MORTGAGE:

You must let your lender know if you are purchasing a home with the intention of using part of it for business. Some types of businesses (such as daycare) can change the loan program, rate, and other terms of the loan and qualifying parameters.