

The Home Office Tax Deduction

Running a business from home can help you lower your tax bill.

When you use part of your home for business, you may be able to deduct expenses for what the IRS calls the "business use of your home." If you meet the technical requirements of the tax law, you should be able to deduct a percentage of many of the costs of running your home, such as utilities, rent, insurance, depreciation, mortgage interest, real estate taxes, and some casualty losses, repairs, and improvements (if they relate to the part of the house you use for business). The home office deduction is available to renters and homeowners alike. It is available for office space and other areas you use for business in your home -- such as a studio, workshop, or garage. And according to the IRS, your "home" can be a house, condo, or apartment unit -- or even a mobile home or boat, as long as you can cook and sleep there. However, you must meet two tax law requirements to qualify for the home office deduction:

Requirement #1: Regular and exclusive use. You must *regularly* use part of your home *exclusively* for a trade or business.

Requirement #2: Principal place of business. You must also be able to show that you use your home as your principal place of business. Alternatively, you must be able to show at least *one* of the following:

- You meet patients, clients, or customers at home.
- You use a separate structure on your property exclusively for business purposes.

Ordinary business expenses are deductible even if you don't qualify for the home office deduction. If you don't meet the rules above, you can still deduct ordinary and necessary business expenses that you incur at home -- for instance, long-distance phone calls, a separate business telephone line, and the cost of office supplies and equipment. The above IRS rules apply only to the expenses of actually running and maintaining your home, such as utilities, rent, depreciation, home insurance, mortgage interest, real estate taxes, and repairs.

Regular and Exclusive Use

To take deductions for home-related expenses, you must regularly use part of your home exclusively for your trade or business.

Regular use. The IRS doesn't offer a clear definition of regular use -- only that you must use a part of your home for business on a continuing basis, not just for occasional or incidental business. You can probably meet this test by working a couple of days a week from home, or a few hours each day.

Exclusive use. Exclusive use means that you use a portion of your home only for business. If you use a room of your home for your business and also for personal purposes, you don't meet the exclusive use test. However, you can set aside a portion of a larger room to be used only for business, as long as your personal activities don't stray into it.

Example

-Brook, a lawyer, uses a den in his home to write legal briefs and prepare contracts. He also uses the den for poker games and hosting a book club. Because he uses the den for both business and pleasure, Brook can't claim business deductions for using the den.

-Marvin has a den he uses only for business. He also puts a business calendar, desk, and computer in his kitchen, but continues to cook and eat there as well. Marvin can claim business deductions for the den, but not the kitchen.

There are two exceptions to the exclusive use rule: You don't have to meet the exclusive use test if you use part of your home to store inventory or product samples, or if you run a qualified day care facility at your home. (The storage exception is discussed just below. For the day care rules, check IRS Publication 587, *Business Use of Your Home*, at www.irs.gov.)

Storing inventory or product samples at home. If you store inventory or samples at home, you can deduct expenses for the business use of your home, whether or not you use the storage space exclusively for business.

There are two limitations, however: First, you won't qualify for the deduction if you have an office or other business location outside of your home. Second, you have to store the products in a particular place -- your garage, for example, or a closet or bedroom. It's okay to use the storage space for other purposes as well, as long as you regularly use it for storing inventory or samples.

Example

Jim sells heating and air conditioning filters to small businesses. His home is the only fixed location of his business. Jim regularly stores his inventory of filters in half of his basement. He sometimes uses the same area for working on his racing bikes. Jim can deduct the expenses for the storage space, even though he doesn't use that part of his basement exclusively for business.

Finally, the home office deduction is available only if you are running a bona fide business. If the IRS decides that you are indulging a hobby rather than trying to earn a profit, it won't let you take the home office deduction.

In addition to using part of your home regularly and exclusively for a business, your home must be your "principal place of business." If you conduct your business only from home, then you meet this requirement. But if you have more than one business location (including your home) for a single trade or business, you must determine whether your home is your principal place of business for that enterprise.

Your home automatically qualifies as your principal place of business if *both* of the following are true:

- **You conduct the administrative or management activities of your business from home.**
- **You have no other fixed location where you conduct those activities.**

Example

Ellen, a wallpaper installer, performs services for clients in their homes and offices. She also has a home office that she uses regularly and exclusively to keep her books, arrange appointments, and order supplies. Ellen is entitled to deduct home office expenses for that part of her home (assuming she also satisfies the "regular and exclusive use" rule, above).

In other words, your home doesn't have to be the place where you generate most of your business income. It's enough that you regularly use it for tasks such as keeping your books, scheduling appointments, doing research, and ordering supplies. As long as you have no other fixed location where you do these things -- for example, an outside office -- you should be able to take the deduction.

Alternatives to principal place of business rule. Even if your home is not your principal place of business or you have another location, there are two other ways to fulfill the principal place of business requirement:

- **You meet clients or customers at home.** If you regularly use part of your home to meet with clients, customers, or patients, you may qualify for the deduction. Doing so even one or two days a week is probably sufficient. You can use the business space for other business purposes, too -- doing bookkeeping, for example, or other business paperwork -- but you'll lose the deduction if you use the space for personal purposes, such as watching videos.
- **Keep records.** Maintain an appointment book in which you carefully note the name of the client or customer and the date and time of each meeting at your home. Save these books for at least three years. These logs will document your business use of your home if your tax return is audited by the IRS.
- **You use a separate building for your business.** You can deduct expenses for a separate, freestanding structure that you use regularly and exclusively for your business. This might be a studio or a converted garage or barn, for example. The structure doesn't have to be your principal place of business or a place where you meet patients, clients or customers. But be sure you use the structure only for your business: You can't store garden supplies there or use it for the monthly meeting of a club.

How to Claim the Home Office Deduction

If you qualify for the home office deduction, you must figure the amount of your deduction on IRS Form 8829, *Expenses for Business Use of Your Home*. (You can find this and other tax forms at the IRS website, www.irs.gov.) Then you enter the total amount of the deduction on Schedule C, *Profit or Loss from Business*. Attach both Form 8829 and Schedule C to your Form 1040 tax return.

Be ready to prove to the IRS that you are entitled to take the home office deduction. Here are some steps you can take to help establish your legal right to deduct home office expenses:

- Photograph your home office and draw a diagram showing the location of the office in your home. Keep this information in your tax folder.
- Have your business mail sent to your home.
- Use your home address on your business cards and stationery and in all business ads.
- Get a separate phone line for the business.
- Have clients or customers visit your home office -- and keep a log of those visits.
- Keep track of the time you spend working at home.