

Home Office, Sweet Office

If you're like the over 128,500 home-based businesses incubating in New Hampshire, you may be eligible for tax deductions on a portion of your everyday living expenses. But a word of caution, the Internal Revenue Service (IRS) is paying very close attention to these deductions, so take them carefully and with complete documentation.

The Rules

You can deduct home-office expenses if you use a specific area in your home regularly and exclusively as the principal place of your business, a place to meet or deal with customers, clients or patients in the ordinary course of business, or a place to store inventory or product samples. In addition, there are also special rules for running a daycare out of your home and you may be able to claim deductions for a separate structure (e.g., a detached garage) that is used in connection with your business.

However, you are not entitled to deductions if you simply take work home from your principal place of business. Also, if you are a corporate employee, the home office must be used for the convenience of your employer and as a condition of employment. If you are self-employed, use Form 8829 to figure your home office deduction and report those deductions on line 30 of Schedule C, Form 1040.

Do the Math

How do you calculate the tax deductions for a home office? The home is treated as two separate properties - one used for personal purposes, the other for business.

For simplicity, let's assume you use 10% of your residence as a home office. As a result, you can deduct 10% of your mortgage interest or rent, property taxes, utility bills (gas and electric), cleaning services, private trash removal costs and property insurance as home-office expenses. If you are a homeowner, you are also in line for a depreciation deduction based on 10% of the home's business use.

Generally, you can deduct the full amount of your mortgage interest and property taxes anyway, but when that same mortgage interest and taxes are deducted for the home office, this reduces your business income subject to self-employment taxes. You are also getting a tax bonus for all the other everyday living expenses plus a sizeable depreciation deduction. The percentage may be based on either the square footage in your home or any other reasonable method.

A Case in Point

Let's take Mr. Green who uses one of eight rooms in his home as an office. The entire home is 3,000 square feet, while the office is 300 square feet. In this case, the percentage that he can use for his home-office deductions is 12.5% based on the number of rooms or 10% under the square footage method.

In any event, you cannot use the deductions to create a tax loss. Specifically, your home-office deductions cannot exceed the business income derived from the home office less (1) regular business expenses (e.g., supplies, postage, etc.) less (2) the portion of deductions you could claim in any event (e.g., interest and taxes).

Even if you don't qualify to take your home as part of your deductions, you are still eligible to claim ordinary business expenses such as long-distance, office supplies, mileage and other business-related costs, but again, be sure that you have ample documentation and receipts for every deduction you take. If you are still unsure if you qualify for home-office deductions, talk with your accountant.