Home Office Deduction

Contents

Introduction to the Course

Each year the U.S. Census Bureau publishes what it refers to as nonemployer statistics that may provide information about the increased importance of the business use of taxpayers' homes. A "nonemployer," for purposes of the statistics, is defined as a business that has no paid employees, has annual business receipts of at least $1,000 and is subject to federal income taxes. These nonemployers may be organized as corporations, partnerships or sole proprietorships. Because they have no paid employees, nonemployers are more likely than others to operate their businesses from their homes and seek a home office tax deduction.

The data supplied on nonemployers show a generally increasing number of these businesses, from a total of 19.5 million in 2004 to 26.5 million in 2018. Although they have no paid employees, they account for significant receipts. In 2004 they produced receipts of $887 billion; by 2018, those receipts had grown to $1.3 trillion. Clearly, the likelihood that any tax return preparer will be required to prepare a taxpayer's tax return with a home office deduction is significant and is becoming more likely each year.

This course will examine the federal income tax deduction for business use of a home and will discuss:

- Qualifying for a home office tax deduction;
- Determining a taxpayer's home office deduction using the actual expense and simplified methods;
- The special home-office deduction rules that apply to daycare facilities;
- The taxpayer's home-office deduction recordkeeping requirements; and
- Where to take the deduction and the forms a tax preparer must use in connection with it.

Learning Objectives

Upon completion of this course, you should be able to:

- Apply the home-office deduction qualification rules;
- Identify the types of home office use to which the exclusive use requirement does not apply;
- Describe the various types of taxpayer expenses that may be used to support a deduction for business use of a home;
- Apply the rules applicable to the simplified method of figuring the home-office deduction;
- Identify the tax forms on which a home-office deduction should be taken; and
- Recognize the recordkeeping requirements applicable to documents supporting a taxpayer's home-office deduction.

Chapter 1 – Qualifying for a Home Office Deduction

Introduction

Increasing numbers of U.S. taxpayers are deriving some or all of their annual income from activities that permit them to deduct business expenses directly from that income. Many of these taxpayers operate businesses from offices located in their homes and may also qualify for a home-office deduction.

Qualifying for a home-office deduction requires that the rules related to exclusive and regular use of the space in performing the activities incident to a trade or business be met. This chapter will examine those requirements in some depth.

Chapter Learning Objectives

When you have completed this chapter, you should be able to:

- Recognize the general requirement for exclusive use applicable to home-office deduction and the exceptions to the requirement;
- List the requirements that apply to a taxpayer's qualifying for a home-office deduction for purposes of storage of product samples or inventory;
- Identify the conditions a taxpayer must meet in order to qualify for the exception to the exclusive use rule when operating a daycare facility;
- Recognize the factors that must be considered to determine if a taxpayer's home is the principal place of business for purposes of the home-office deduction; and
- List the exceptions to the requirement that a home office must be the taxpayer's principal place of business in order to qualify for a home-office deduction.

Home-Office Deduction Requirements

Although certain exceptions apply, qualifying for a home-office deduction for business use of a taxpayer's home generally requires that the taxpayer use part of his or her home:

- Exclusively and regularly as the principal place of business;
- Exclusively and regularly as a place where the taxpayer meets or deals with patients, clients or customers in the normal course of a trade or business;
- On a regular basis for certain storage use;
- For rental use; or
- As a daycare facility.

If the part of the taxpayer's home used is a separate structure, qualifying for a home-office deduction for its use requires that the separate structure be used exclusively and regularly in connection with the taxpayer's trade or business. However, the structure does not have to be the taxpayer's principal place of business or where he or she meets patients, clients, or customers.

Exclusive Use Requirement

The general rule that applies to qualifying for a home-office deduction requires that the taxpayer use a specific area of the home ***only*** for the trade or business. Thus, the ***genera*****l** rule mandates that the portion of the home used:

- Be a specific area, i.e. a room or other separately identifiable space; and
- Must be used ***solely*** in the taxpayer's trade or business.

Despite the general rule requirement that the part of the home used for an office be a specific area, the space used need not be marked off by a permanent partition. However, under the general rule requiring exclusive use, a taxpayer will not qualify for a home-office deduction if the area is used for both business and personal purposes. Consider the following examples:

Ellen's Use Qualifies under Exclusive Use Requirement
Ellen engages in the practice of law and uses a room in her home exclusively for writing legal briefs, preparing documents and meeting with clients. The room is used for no other purpose. Since the room in Ellen's house is a separately identifiable space and is used only in her legal practice it meets the exclusive use requirement and may qualify for a home-office deduction under the general rule.

Arthur's Use Does Not Meet Exclusive Use Requirement
Arthur recently graduated from law school and uses a room in his home to prepare tax returns for his clients. When he is not using the room to prepare tax returns, he and his wife use it as a place to watch television. Because the room Arthur uses as his office is also used for personal purposes by the family—as a TV room, in this case—Arthur would not qualify for a home-office deduction since the room is not used exclusively in Arthur's business; in other words, it fails to meet the exclusive use requirement.

Exceptions to Exclusive Use Requirement

Although the general rule requiring exclusive use in a taxpayer's trade or business in order to take a home-office deduction for business use applies to all other uses, two exceptions to that exclusive use requirement exist. Those exceptions apply to the taxpayer's use of part of the home:

1. For the storage of inventory or product samples; or
2. As a daycare facility.

Except for these two uses, any part of the taxpayer's home used for business purposes must meet the exclusive use test in order to qualify for a home office deduction. Let's consider the requirements that apply to each of these uses.

Storing Inventory or Product Samples

Selling occupies a large part of the civilian population in the United States. According to the Bureau of Labor Statistics 2018 Current Population Survey, 15.1 million people—about 10% of the employed U.S. population age 16 or older—work in sales and related occupations[1]. Many of those involved in sales are likely to store product samples or inventory in their homes; doing so may entitle them to a home-office deduction without the requirement that the space used for such storage meet the exclusive use test.

In order for a taxpayer to be able to deduct expenses for the business use of his or her home for storage of inventory or product samples, without the need to satisfy the general rule requiring exclusive use of the space, the taxpayer (and the space) must meet ***all*** the following tests:

- The taxpayer sells products at wholesale or retail as a trade or business;
- The taxpayer keeps the inventory or product samples in his or her home for use in the trade or business;
- The taxpayer's home is the only fixed location of his or her trade or business;
- The taxpayer uses the storage space on a regular basis; and
- The space used by the taxpayer is separately identifiable and suitable for storage.

[1] CPS Tab 23. Persons at work by occupation https://www.bls.gov/cps/tables.htm#charemp.

Consider the following example:

Audrey's Storage Area Not Subject to Exclusive Use Rule

Audrey is a pharmaceutical representative whose only fixed location of her business is her home. Her job requires her to call on physicians, and she maintains a large supply of product samples in part of a spare room in her home. She also uses the spare room as an occasional workout area. Although Audrey does not use the spare room solely to house her product samples, the expenses she incurs for her storage of samples are deductible since this is an exception to the exclusive use rule.

Use as a Daycare Facility

The second exception to the exclusive use requirement normally applicable to taking the home-office deduction for business use of a taxpayer's home applies to the taxpayer's use of space in the home for providing daycare. In order for a taxpayer to qualify for the daycare exception to the exclusive use rule, the taxpayer must:

1. Be in the trade or business of providing daycare for –
    a) children,
    b) persons age 65 or older, or
    c) persons who are physically or mentally unable to care for themselves; ***and***
2. Have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group daycare home under state law.

It is important to understand that in order for a taxpayer to qualify for the home-office deduction as a daycare provider even though the space is not used exclusively for business purposes, the taxpayer must meet both the above requirements. Thus, if the taxpayer's application was rejected or license or other authorization was revoked, the exception to the exclusive use rule does not apply.

The following example may provide clarification:

Shirley's Adult Daycare Business Exempt from Exclusive Use Rule

Shirley is licensed by the state to operate an adult daycare business. She provides care during daylight hours to persons age 65 or older in a large, airy room of her home. When the room is not being used for her adult daycare business, it is used by her and other family members as a television and game room. Even though the room Shirley uses to conduct her adult daycare business is not used exclusively for the business, she may take a home-office deduction since operation as a daycare facility constitutes an exception to the exclusive use rule applicable to the home-office deduction for business use of a taxpayer's home.

Regular Use for Trade or Business Requirement

In addition to the exclusive use requirement generally applicable to a taxpayer's ability to take a home-office deduction for business use of the home, the taxpayer must also meet the requirements that the space be used:

- For business on a regular basis; ***and***
- In connection with a trade or business.

If either of these requirements is not met, no home-office deduction for business use is permitted.

Home Office Used on Regular Basis

In order for a taxpayer using part of his or her home for business purposes to qualify for a home-office deduction, the specific area of the home used for business must be used on a ***regular basis***. Thus, space in a home that is used for business purposes only on an occasional or irregular basis would not qualify the taxpayer for a home office deduction. In order to determine if part of a taxpayer's home is used on a regular basis for business purposes, all facts and circumstances surrounding the business use of the space should be considered.

Although the exclusive use rule and its exceptions are fairly straightforward and simple to apply, the requirement that a taxpayer use the space on a regular basis in order to qualify for the home-office deduction is far less straightforward. Examples of proof of regular use of a home office that may be offered by a taxpayer are shown below:

Logs and Corroborative Documents Show Regular Use

A taxpayer can generally rely on two types of information to prove his or her regular use of a home office for purposes of the deduction:

1. A contemporaneous log of time spent in the office; and
2. Documents corroborating time spent in the office, such as –
    - emails sent,
    - a guest log signed by clients, or
    - telephone billing statements indicating the taxpayer made telephone calls from the home office during the times indicated in the log.

Home Office Used in Connection with a Trade or Business

A taxpayer may maintain a home office as a place in which to engage in various types of activities. However, those activities may or may not entitle the taxpayer to a home-office deduction. It is important, in order for the taxpayer to qualify for a home-office deduction, that the home office be used in a trade or business. If the office is used for some function other than as a place in which to engage in a trade or business—including engaging in a profit-seeking activity that does not constitute a trade or business—no home-office deduction is permitted.

Consider the use of a home office that does not qualify for a home-office deduction in the following example:

No Trade or Business means No Home-Office Deduction

Arthur retired last year and received a substantial early retirement buyout that he uses for investment purposes. Although he does not operate as a broker or dealer, he spends several hours each day in his home office reading financial periodicals, deciding on various strategies for increasing his wealth and making trades for his own account. While Arthur clearly is engaged in a profit-making activity and uses his home office to further that objective, the fact he is not engaged in a trade or business means that no home-office deduction is permitted.

Principal Place of Business Requirement

As noted earlier, in order for a taxpayer to be able to take the home-office deduction for business use of a home, the home office normally must be used exclusively and regularly as the taxpayer's principal place of business. We have already looked at the exclusive and regular use requirements and will turn our attention now to the principal place of business test.

A taxpayer may have more than one business location at which he or she engages in a single trade or business. Despite having multiple locations, however, a taxpayer may still qualify for a home-office deduction. Qualifying to deduct the expenses for the business use of a home under the principal place of business test requires that the taxpayer's home must be the principal place of business for the trade or business. Making the determination as to whether the taxpayer's home is his or her principal place of business requires consideration of:

- The relative importance of the activities performed at each place where the taxpayer conducts business; and
- The amount of time the taxpayer spends at each place where he or she conducts business.

Thus, a taxpayer's home office qualifies as his or her principal place of business if the taxpayer:

- Uses the home-office exclusively and regularly for administrative or management activities of the trade or business; and
- Has no other fixed location where he or she conducts substantial administrative or management activities of the trade or business.

If the taxpayer's home cannot be identified as the principal place of business after considering the relative importance of the activities performed in it and the amount of time spent there—and the home-office deduction is not otherwise allowed as a place to meet patients, clients or customers or as a separate structure—no home-office deduction is permitted.

Administrative or Management Activities

Note that a home office may qualify as a taxpayer's principal place of business if it is used for administrative or management activities of the trade or business. But, what constitute administrative or management activities?

Although other functions may be considered administrative or management activities, the following activities—when performed in connection with the trade or business—are examples:

- Billing customers, clients or patients;
- Keeping books and records;
- Ordering supplies;
- Setting appointments; and
- Forwarding orders or writing reports.

Sometimes a taxpayer will have administrative or management activities performed at other locations by the taxpayer or by someone else; the performance of those activities away from the home office will not disqualify the taxpayer's home office from being the principal place of business. The following activities may be performed by the taxpayer or others without disqualifying the taxpayer's home office from being his or her principal place of business:

- Others conduct the taxpayer's administrative or management activities at locations other than his or her home;
- The taxpayer conducts administrative or management activities at places that are not fixed locations of the taxpayer's business;
- The taxpayer occasionally conducts minimal administrative or management activities at a fixed location outside his or her home;
- The taxpayer conducts substantial non-administrative or non-management business activities at a fixed location outside his or her home, such as meeting with or providing services to customers outside the home; and
- The taxpayer has suitable space to conduct administrative or management activities outside the home but chooses, instead, to use the home office for those activities.

Taxpayers with More than One Trade or Business

A taxpayer may have more than one trade or business and use the same home office as the principal place of business for each of those separate business activities. However, determining whether the taxpayer's home office is the principal place of business for more than one business activity must be done separately for each activity.

The taxpayer must use the home office exclusively and regularly for one or more of the following purposes:

- As the principal place of business for one or more of the taxpayer's trades or businesses;
- As a place to meet or deal with patients, clients or customers in the normal course of one or more of the taxpayer's trades or businesses; or
- If the taxpayer's home office is a separate structure, the taxpayer must use it in connection with one or more of his or her trades or businesses.

In connection with a taxpayer's use of a home office for more than one trade or business, it is important to bear in mind that the office ***cannot be used for any nonbusiness activities***, with the exception of a daycare facility or the storage of inventory/product samples. Except for these specified activities, a taxpayer’s use of a home office for non-business purposes will result in a loss of the home-office deduction.

An example may help to clarify:

Peter's Non-exclusive Home Office Use is Disqualifying

Peter teaches freshman English at a local college and also writes regular articles for several popular magazines. The college supplies Peter with an office in which he may meet with students, prepare lesson plans and engage in other activities associated with his teaching assignment. Although Peter uses his home office as the place in which he researches and writes his magazine articles, he also uses the office as a more convenient place for him to prepare lesson plans and, occasionally, meet with his students.

Because Peter's home office is used by him for both business purposes in preparing magazine articles and for non-business purposes—to prepare lesson plans to meet his teaching requirements—his use of the home office is not exclusive to the business, and his use of the office does not qualify for a home-office deduction.

Exceptions to Principal Place of Business Rule

In certain limited cases a home office may qualify for a home-office deduction even though the space used for the home office is not the taxpayer's principal place of business. Those exceptions apply to the following situations:

- Part of the taxpayer's home is used to meet with patients, clients or customers; or
- The premises is a free–standing, separate structure that is used exclusively and regularly for the taxpayer's business.

Let's look more closely at each of these exceptions.

A Place to Meet Patients, Clients or Customers

If the taxpayer meets or deals with patients, clients, or customers in his or her home in the normal course of the taxpayer's business, the taxpayer may take the home-office deduction even if he or she also engages in the business at another location. Furthermore, the part of the taxpayer's home used exclusively and regularly to meet patients, clients or customers need not be the taxpayer's principal place of business.

However, in order to take the home-office deduction for business use of the home despite not being the taxpayer's principal place of business, the taxpayer must meet both the following tests:

1. The taxpayer must physically meet with patients, clients or customers on the premises; ***and***
2. The taxpayer's use of his or her home must be substantial and integral to the conduct of the taxpayer's business.

In most cases, doctors, dentists, attorneys and other professionals who maintain offices in their homes and meet clients or patients there generally satisfy this requirement. Consider the following example:

Dan's Use of His Home to See Patients Qualifies for Home-Office Deduction

Dan is a psychologist and licensed professional counselor who maintains his principal place of business in the downtown metropolitan area. He routinely sees patients at that location three days each week. In addition, however, he uses an office in his home exclusively and regularly to meet patients the other two days each week. Because Dan physically meets with patients in his home office and the use of that home office is both substantial and integral to his business, the office qualifies for the home-office deduction.

A Separate Structure

Separate structures—similar to home offices in which taxpayers meet with patients, clients or customers—are also subject to somewhat different home-office deduction requirements. When the premises is a free–standing, separate structure used exclusively and regularly for the taxpayer's business rather than a room in the taxpayer's home, it may qualify for the home-office deduction even though it is not the taxpayer's principal place of business or a place where the taxpayer meets patients, clients or customers.

Consider the following example:

Maggie's Studio Qualifies for a Home-Office Deduction as a Separate Structure
Maggie is an equine artist who has a painting studio in a structure separate from her home on land on which her home is situated. Even though she also maintains a studio in a downtown metropolitan area in which she paints, the home office in which she paints qualifies for the home-office deduction provided Maggie uses it exclusively and regularly in her painting business.

Summary

A taxpayer's qualifying for a home-office deduction for his or her business use of a home requires that certain tests be met. The space must be a) used exclusively and regularly as the principal place of business, b) used exclusively and regularly as a place where the taxpayer meets or deals with patients, clients or customers in the normal course of a trade or business, c) used on a regular basis for certain storage use, d) used for rental purposes, or e) used as a daycare facility.

In most cases, the part of the home used must also be a specific area—even if not permanently separated by a partition—that is used only in the taxpayer's trade or business. With the exception of use of a part of the home for the storage of inventory or product samples used in the taxpayer's business or as a daycare facility, the taxpayer's business use of the space must be its only use in order to qualify for the home-office deduction. Other than these two exceptions, an area used for both personal and business purposes does not qualify for a home-office deduction.

In order for a taxpayer to take a home-office deduction based on the use of part of the home for the storage of inventory or product samples, the space must be separately identifiable and suitable for storage, the taxpayer's home must be the only fixed location of the trade or business, and the taxpayer must meet certain tests. To meet those tests, the taxpayer must a) sell products at wholesale or retail as a trade or business, b) keep the inventory or product samples in his or her home for use in the trade or business, and c) use the storage space on a regular basis.

To qualify for the exception to the usual home-office deduction rules as a daycare provider, the taxpayer must be in the trade or business of providing daycare for children, persons age 65 or older, or persons who are physically or mentally unable to care for themselves. Additionally, the taxpayer must have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group day care home under state law.

The taxpayer must also meet requirements related to ***regular*** business use. Thus, a taxpayer who otherwise qualifies for a home-office deduction for business use of the home will qualify for the deduction only if the space is used on a regular basis in connection with a trade or business. If the use in not regular—if its use is irregular or occasional, in other words—a home-office deduction would not be permitted.

In the case in which a taxpayer has multiple business locations, a home office usually must be the taxpayer's principal place of business in order to qualify for the home-office deduction. To determine whether or not it is the taxpayer's principal place of business, the factors that must be considered are a) the relative importance of the activities performed in the various locations, and b) the amount of time spent in the home office. If, after considering those two factors, the taxpayer's home cannot be identified as the principal place of business no home-office deduction is permitted unless the home-office deduction is allowed because it is used as a place to meet patients, clients or customers or the space used is a separate structure. If a taxpayer has more than one trade or business and uses the same home office for each of the separate business activities, a determination as to whether the taxpayer's home office is the principal place of business must be made separately for each business activity.

Although a home office normally must be a taxpayer's principal place of business to qualify for the home-office deduction, it may qualify for the deduction even though it is not the taxpayer's principal place of business if either of two exceptions applies: a) part of the taxpayer's home is used to meet with patients, clients or customers, or b) the space involved is a free–standing, separate structure used exclusively and regularly for the taxpayer's business.

Home-Office Deduction Qualification Thumbnail	
Exclusive use	Unless an exception to exclusive use applies because a) the space is used for storage of inventory or product samples used in the business, or b) the business is a qualified daycare facility, the space used must be used solely as the principal place of the taxpayer’s business to qualify for the home-office deduction.
Regular use	The specific space in the taxpayer’s home must be used for business on a regular basis to qualify for the home-office deduction. Incidental or irregular use of the space for business purposes is insufficient to qualify for a home-office deduction.
Principal place of business	In the situation in which a taxpayer has multiple locations at which business is conducted, the space in the taxpayer’s home must be the principal place of business to qualify for a home-office deduction unless an exception applies because a) the space is used by the taxpayer to meet patients, clients, or customers in the normal course of business, or b) the space is a separate structure used exclusively and regularly in the taxpayer’s business.

Chapter Review

1. Philip is employed as an attorney by a large local law firm and also does legal work from home as a sole proprietor. If he reviews client documents in his office and also uses it as a family TV room, why would he be denied a home office tax deduction?

   A. Philip’s status as an employee disqualifies him from taking a home-office deduction as a sole proprietor

   B. Because the space is not used solely for business purposes

   C. Because the use of the office space is not for the convenience of Philip’s employer

   D. Because he does not see clients in his home office

2. In which of the following cases does the requirement for exclusive use in order to qualify for a home-office deduction NOT apply?

   A. To Sally who operates a daycare facility in her home

   B. To Shirley, a psychologist, who meets with patients in her home

   C. To Bob, a local artist, who uses a separate structure as his studio

   D. To Bill, an attorney, who meets with clients in his home

Chapter 2 – Figuring the Home Office Deduction

Introduction

A taxpayer who qualifies for a home-office deduction by meeting the tests discussed in Chapter 1 may use actual expenses or a simplified method to determine the deduction, each of which are subject to a deduction limit. In this chapter we will examine how home-office deductions are figured using both regimes. In addition, this chapter will discuss the special rules applicable to figuring the home office deduction for daycare facilities.

Chapter Learning Objectives

When you have completed this chapter, you should be able to:

- Distinguish between the actual expense method and simplified method of figuring the home-office deduction;
- List the expenses normally deductible by taxpayers using a home for business purposes who use the actual expense method;
- Recognize the limits applicable to a home-office deduction; and
- Calculate the home-office deduction for daycare facilities

Methods of Figuring the Home-Office Deduction

If a taxpayer qualifies for a home-office deduction by satisfying the tests discussed in Chapter 1, the next step is to figure the amount of tax deduction for which he or she qualifies. Two methods are available to calculate the home-office deduction:

- The actual expense method; and
- The simplified method.

Let's examine each of these methods.

Actual Expense Method

The actual expense method of figuring a home-office deduction uses the actual expenses incurred by the taxpayer as the basis for determining the deduction allowable for business use of the taxpayer's home. Bear in mind when using the actual expense method to figure the home-office deduction that a taxpayer cannot deduct expenses for the business use of a home incurred during any part of the year he or she did not use the home for business purposes. Thus, a taxpayer who begins using part of his or her home for business purposes beginning on July 1st of the year and who qualifies for a home-office deduction cannot consider expenses for the period prior to July 1st. Instead, the taxpayer may consider only those expenses for the period July 1 through December 31 in figuring the allowable deduction.

When using the actual expense method for figuring the home-office deduction for a client, a tax return preparer must determine:

- The nature of the expense; and
- The percentage of the home used for business purposes.

Nature of the Expense

When determining the nature of the taxpayer's expense, expenses are placed into one of the following three categories:

- Direct expenses;
- Indirect expenses; and

- Unrelated expenses.

Direct expenses are expenses applicable to and affecting only the business part of the taxpayer's home. Except for daycare facility expenses that may be only partially deductible as discussed later under **Daycare Facility**, these expenses are deductible in full, subject to any applicable deduction limit. (See **Deduction Limit** below.)

> **Direct Expense Example**
>
> Examples of direct expenses that may be deductible in full, subject to the deduction limit, include expenses for:
>
> Painting,
> Making needed repairs, and
> Cleaning carpets
> …only in the area used for business purposes.

Indirect expenses are those expenses the taxpayer incurs for keeping up and running his or her entire home. Such indirect expenses are deductible under the home-office deduction in an amount based on the percentage of the taxpayer's home used for business purposes. Similar to direct expenses, the deduction of indirect expenses is subject to the applicable deduction limit.

> **Indirect Expense Example**
>
> Examples of indirect expenses that may be deductible in part, based on the percentage of the home used for business purposes and subject to applicable deduction limits, include expenses for:
>
> - Insurance,
> - Utilities,
> - General repairs, and
> - Homeowner association dues.

The third category of taxpayer expenses—expenses that are unrelated—are expenses applicable only to the parts of the taxpayer's home that are not used for business purposes. These unrelated expenses are not deductible.

> **Unrelated Expense Example**
>
> Unrelated expenses incurred by a taxpayer whose business use of a home qualifies for a home-office deduction for direct and allocable indirect expenses include expenses for:
>
> - Lawn maintenance, and
> - Painting of rooms not used for business purposes.
>
> Such unrelated expenses are not deductible for purposes of the home-office deduction.

Percentage of the Home Used for Business

Although direct expenses attributable to business purposes are deductible under the home-office deduction irrespective of the percentage of the home actually used by the taxpayer for business purposes, indirect expenses are not. Instead, indirect expenses are deductible under the home-office deduction only in an amount equal to the total of such indirect expenses multiplied by the percentage of the home used for business.

> **Indirect Expenses Attributable to Business Purposes Example**
>
> Suppose a taxpayer's indirect expenses amounted to $5,000 and 10% of the home was used for business purposes. The amount of the indirect expense attributable to business purposes would then be $500. ($5,000 x 10% = $500)

Calculating Percentage of Home Used for Business

A taxpayer is permitted to use any reasonable method to determine the percentage of his or her home used for business purposes. Two methods commonly used for determining the applicable percentage of a home for purposes of the home-office deduction are:

1. Dividing the square footage of the home used for business purposes by the total square footage of the home; and
2. Dividing the number of rooms used for business by the total number of rooms in the taxpayer's home.

Percentage Based on Square Footage Example
To determine the percentage of a taxpayer's home used for business purposes based on square footage, simply divide the square footage of the space used for business by the square footage of the entire house. For example, suppose the size of the entire house is 2,000 ft.^{2} and the taxpayer uses a single room measuring 12' x 12' for business purposes. Since the space used for business purposes is 144 ft.^{2}—the square footage of the room is calculated by multiplying 12' x 12'—determining the percentage of the home used for business requires only that 144 be divided by 2,000. In this case the applicable percentage is 7.2%. (144 ÷ 2,000 = .072 = 7.2%)

Determining the percentage of a taxpayer's home used for business purposes by dividing the number of rooms used for business by the total number of rooms in the house should be used only if the rooms in the house are all of approximately the same size.

Percentage Based on Number of Rooms Example
To determine the percentage of a taxpayer's home used for business purposes based on the number of rooms in the house compared with the number of rooms used for business purposes generally produces approximately the same result. To make the calculation requires only that the number of rooms used for business be divided by the total number of rooms in the home. For example, suppose the entire house has eleven rooms of approximately equal size and the taxpayer uses one of those rooms for business purposes. The percentage of the house used for business purposes would be 9.1%. (1 ÷ 11 = .0909 = 9.1%)

Deductible Expenses for Home-Office Deduction

Expenses that are deductible under the home-office deduction fall into two categories and include the following:

- Expenses that are deductible by the taxpayer whether or not the taxpayer uses the home for business purposes, i.e. they are deductible by all homeowners; and
- Expenses that are deductible by the taxpayer only if the taxpayer uses the home for business purposes.

Expenses Deductible by All Homeowners

Expenses that are deductible by all homeowners, whether or not the home is used for business purposes, include the following:

- Real estate taxes;
- Deductible mortgage interest; and
- Casualty losses due to a federally-declared disaster.

If the taxpayer qualifies for the home-office deduction, these amounts should be multiplied by the percentage of the home used for business purposes to figure the taxpayer's total business use of the home deduction.

Determining Home-Office Deduction for Expenses Deductible by All Homeowners Example

We can see how the home-office deduction is determined for the expenses deductible by all homeowners. Suppose a taxpayer who qualifies for a home-office deduction and has no deductible casualty losses for the year pays the following amounts:

- Real estate taxes - $2,400, and
- Deductible mortgage interest - $1,600.

The total of such expenses is $4,000. ($2,400 + $1,600 = $4,000) If the percentage of the home used for business purposes was 10%, the portion of the home-office deduction derived from expenses deductible by all homeowners would be $400. ($4,000 x 10% = $400) The balance of these expenses would be deductible by the homeowner-taxpayer in the usual manner.

Expenses Deductible by Taxpayers Using a Home for Business

In addition to those expenses that are deductible by all homeowners, many additional expenses are deductible by homeowners who use their homes for business purposes. These are expenses that would not normally be deductible by the homeowner.

Principal among those expenses that are deductible by a homeowner who uses the home for business purposes, in an amount determined by the percentage of the home used for business, are the following:

- Depreciation;
- Insurance;
- Rent paid for the use of unowned property used in the taxpayer's trade or business;
- Repairs;
- Security system maintenance and monitoring expenses; and
- Expenses for utilities and services.

Although these expenses are deductible by a taxpayer using his or her home for business purposes, it is important to keep in mind that only the ***business percentage*** of these expenses is deductible.

Let's examine these deductible expenses more closely.

Depreciation

A taxpayer who owns a home and qualifies for a home-office deduction for its business use by meeting the requirements discussed in Chapter 1 can claim a deduction for depreciation. That depreciation deduction is designed to reflect the wear and tear on the portion of the taxpayer's home used for business. The cost or value of the land on which the home is situated is not depreciable; only the portion of the structure used for business purposes may be deducted.

Figuring the Depreciation Deduction

The method used for figuring the depreciation on a taxpayer's home used for business purposes depends on whether the home was used for business purposes in prior years. If the home was used for business in years before the current year, the taxpayer should continue using the same method of depreciation used in those prior years. However, if the home was placed in use for business purposes in the current year, the business part of the home should be depreciated as nonresidential business property under the modified accelerated cost recovery system (MACRS). The MACRS system depreciates nonresidential real property using the straight-line method over 39 years.

In order to figure the deduction allowable for depreciation, the home's depreciable basis must be calculated. The "depreciable basis" is calculated by multiplying the percentage of the taxpayer's home used for business by the smaller of the home's:

- Adjusted basis (excluding land) on the date the taxpayer began using his or her home for business; or

- Fair market value (excluding land) on the date the taxpayer began using his or her home for business.

Both of these terms are defined next.

Adjusted Basis

The "adjusted basis" of the taxpayer's home is equal to its cost, plus the cost of any permanent improvements made by the taxpayer to the home before the taxpayer began using the home for business, minus any casualty losses or depreciation deducted in earlier tax years. (Note: the costs of permanent improvements made by the taxpayer after he or she begins using the home for business purposes and which affect the business part of the taxpayer's home are depreciated separately.)

Thus, adjusted basis is equal to:

Cost	+	Permanent improvements	(Casualty losses + prior years' depreciation deducted)	=	Adjusted basis

We can see how a home's adjusted basis would be determined by substituting numbers into the above formula. For example, suppose the taxpayer purchased the home for $500,000 ten years ago; if the land on which the home is situated had a value of $100,000 at the time of the purchase of the home, the "cost" used in the formula would be $400,000. ($500,000 - $100,000 = $400,000)

If the taxpayer made permanent improvements to the home equal to $50,000, that amount would be added as a "permanent improvement" in the formula. Let's further suppose the taxpayer took no casualty loss deductions on the house but took (or could have taken) depreciation in prior years totaling $5,000. By substituting the appropriate numbers in the above formula we determine that the taxpayer's adjusted basis is $445,000.

$400,000	+	$50,000	($0 + $5,000)	=	$445,000

As noted, the cost of permanent improvements made to the property must be added to the cost of the structure. In determining the cost of permanent improvements that can be added in the formula, bear in mind that a "permanent improvement" is one that:

- Increases the value of the property;
- Extends the life of the property; or
- Gives the property a new or different use.

An expenditure that does not result in one of those three consequences is not considered an expenditure made for a permanent improvement. Thus, in identifying expenses for permanent improvements made by the taxpayer, the tax preparer must distinguish between repairs and improvements. The cost of repairs to the home may be fully or partially deductible (rather than adding to the taxpayer's basis) depending on whether they are considered direct or indirect expenses, as discussed earlier.

Repairs keep a taxpayer's home in good working order over its useful life. Falling within the category of common repairs are:

- Patching walls and floors;
- Painting;
- Wallpapering;
- Repairing roofs and gutters; and
- Mending leaks.

Although the cost of repairs doesn't usually affect a home's adjusted basis, in certain cases—repairs made as part of an extensive remodeling or restoration effort, for example—such repair costs would be considered expenditures made for a permanent improvement and would, therefore, affect the home's adjusted basis. Consider the following example:

Common Repairs May be Considered a Permanent Improvement
Suppose a taxpayer purchases an older home and turns one of the rooms into an office that he or she uses for business purposes. In so doing, the taxpayer performs the typical repairs, such as patching walls and painting. In addition, a door leading to the outside is added, and new wiring and a window are installed. Although the cost of patching the walls and painting them would normally constitute a deductible repair expense, since the work performed gives the property a new use the entire remodeling job would be considered a permanent improvement, and the entire cost of the project would be added to the taxpayer's basis. No portion of the repair expense would be deductible.

As noted earlier, the taxpayer's basis also must be adjusted for depreciation deducted in prior years. Accordingly, the taxpayer's basis in the property must be decreased by the depreciation that was deducted or *could have been deducted* in those earlier years.

Fair Market Value

The "fair market value" of a taxpayer's home is the price at which the property would change hands between a buyer and a seller, assuming neither is under a compulsion to buy or sell, and both possess reasonable knowledge of all necessary facts concerning the transaction. If the fair market value of the taxpayer's home (excluding land) is less than his or her adjusted basis in the home (excluding land), the fair market value is used to figure the depreciation deduction.

Sales of similar property, on or about the time at which the taxpayer began using his or her home for business, may be helpful in determining the property's fair market value for purposes of depreciation.

Depreciation Table

The depreciation table used in connection with the home-office deduction depends on when the business use of the property began. If the home was used for business in years before the current year, the taxpayer should continue using the same method of depreciation used in prior years. If the business use of the home began in the current year, the business part of the home should be depreciated under the modified accelerated cost recovery system (MACRS) using the straight line method over 39 years.

The taxpayer's depreciable basis—calculated by using the smaller of the home's adjusted basis or fair market value *times* the percentage use of the home—must be multiplied by the percentage from the depreciation table for the first month the taxpayer uses his or her home for business. Thus, the depreciation deduction for business use of a taxpayer's home beginning in the current year is equal to the taxpayer's depreciable basis multiplied by the following percentage:

MACRS Percentage Table for 39-Year Nonresidential Real Property – First Year	
Month Home is First Used for Business Purposes	**Percentage to Use**
1	2.461%
2	2.247%
3	2.033%
4	1.819%
5	1.605%
6	1.391%
7	1.177%
8	0.963%
9	0.749%
10	0.535%
11	0.321%
12	0.107%

Let's look at an example of how the depreciation deduction would be calculated:

Calculating the Depreciation Deduction Example

Sharon began using a 10' x 20' room in her 2,000 ft.² home in June of the current year as her studio for making costume jewelry she sells to local retail outlets. She purchased the home five years ago for $200,000 and made permanent improvements costing $10,000. The value of the land on which the home is situated was $25,000 at the time of purchase. The value of the home has increased and the structure is currently valued at $250,000, while the land has increased in value to $50,000.

Sharon's adjusted basis in her house is equal to $185,000, comprised of the price of the structure ($175,000) plus the cost of the permanent improvements ($10,000). Since Sharon's home's adjusted basis, at $185,000, is less than its current market value ($250,000), her adjusted basis is used to determine her depreciable basis. Because the square footage of her studio is 200 ft.² and the total square footage of her home is 2,000 ft.², the business percentage is 10%. (200 ÷ 2,000 = .10) Thus, her depreciable basis is $18,500. ($185,000 x .10 = $18,500)

Assuming Sharon's use of the space qualifies for a home-office deduction, if she files her return based on a calendar year and began using the studio for business purposes in June, the depreciation deduction available in the first year is $257.34. ($18,500 x .01391 = $257.34) (See highlighted percentage in the table above.)

The entire MACRS percentage table for 39-year nonresidential real property is as follows:

Year	Month Home is First Used for Business Purposes											
	1	2	3	4	5	6	7	8	9	10	11	12
1	2.461%	2.247%	2.033%	1.819%	1.605%	1.391%	1.177%	0.963%	0.749%	0.535%	0.321%	0.107%
2 – 39	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%	2.564%
40	0.107%	0.321%	0.535%	0.749%	0.963%	1.177%	1.391%	1.605%	1.819%	2.033%	2.247%	2.461%

Thus, if nothing changed in the example just above in years 2 through 39 the depreciation deduction would be $474.34. ($18,500 x .02564 = $474.34) In the 40th year, the depreciation deduction would be $217.75. ($18,500 x .01177 = $217.75)

Insurance

In addition to the depreciation that may be deducted, a taxpayer qualifying for a home-office deduction may qualify for a deduction for the cost of insurance covering the business part of his or her home. If the insurance premium paid by the taxpayer gives the taxpayer coverage for a period that extends beyond the end of the current tax year, the taxpayer can deduct only the business percentage of the part of the premium providing coverage for the tax year. The taxpayer can deduct the business percentage of the part of the insurance premium applicable to the coverage provided for the following year in that year.

Consider the following example:

Insurance Premium Deduction Example

Sally used 10% of her house as a home office for the entire current year. The premium for her homeowners insurance that also covers the business part of her home is payable each July 1st. Last year the annual premium was $1,200, and this year the premium was $1,500. Since insurance for the first half of the current tax year was $600 ($1,200 ÷ 2 = $600) and $750 for the second half of the current tax year was $750 ($1,500 ÷ 2 = $750) and her business percentage is 10%, her current year insurance tax deduction is $135. ($600 + $750 = $1,350; $1,350 x .10 = $135)

Rent Paid on Unowned Property

If the taxpayer rents the home he or she occupies and meets the requirements for business use of part of the home, the taxpayer can deduct part of the rent paid as a home-office deduction. The portion of the rent paid that is deductible as part of the home-office deduction is equal to the total rent payments for the period the home was used for business multiplied by the percentage of the home used for business purposes. For example, if the home was used for business for the entire year, the annual rental was $12,000 and the percentage of the home used for business purposes was 10%, the deduction would be $1,200. ($12,000 x .10 = $1,200)

Repairs

The cost of repairs to a home, part of which is used for business purposes, is deductible in whole or in part depending upon whether the repair costs are direct expenses or indirect expenses.

If the repair costs are direct expenses, i.e. expenses only for the business part of the home, such as repairing or painting the walls of the home-office, the entire cost of the repairs is deductible. However, if the repair costs are indirect expenses, i.e. expenses for keeping up and running the entire home, such as repairing the roof, only the portion of the costs equal to the cost of repairs multiplied by the percentage of the home used as a home office is deductible. Thus, indirect repair costs of $2,000 for repairing the roof of a home, 10% of which is used for a home-office, would result in deductible repair expenses equal to $200. ($2,000 x .10 = $200)

Security System

The total cost for security systems include both a) installation costs, and b) costs for maintaining and monitoring the system. They are treated differently for purposes of the home-office deduction.

Costs for installation of the security system are subject to the depreciation regimen discussed earlier since the system increases the value of the property. In contrast, if the security system protects all the doors and windows in the taxpayer's home, the taxpayer can deduct the business part of the expenses incurred to maintain and monitor the system. Thus, if the annual cost for maintaining and monitoring the security system is $500 and the business percentage of the home is 10%, the home-office deduction for maintaining and monitoring the security system would be $50. ($500 x .10 = $50)

Expenses for Utilities and Services

The expenses incurred by a taxpayer for utilities and services—the costs for electricity, gas, trash removal and similar costs, in other words—are deductible under the home-office deduction in an amount equal to the costs incurred for the utilities and services times the percentage of business use. An exception applies with respect to telephone service.

In the case of telephone service costs, the basic local telephone service charge, including taxes, for the first telephone line into the taxpayer's home is a nondeductible personal expense. However, charges for business long-distance phone calls on that line as well as the cost of a second line used exclusively for business are deductible business expenses. Telephone expenses should not be included as a cost of using the taxpayer's home for business. Instead, deductible telephone charges in connection with a home-office deduction should be deducted separately on the appropriate form or schedule. For example, if the taxpayer files Schedule C (Form 1040) these expenses should be deducted on line 25, Utilities, rather than on line 30, Expenses for business use of your home.

Deduction Limit

The home-office deduction is not unlimited. Instead, if a taxpayer uses the actual expense method for claiming a home-office deduction, the deduction of otherwise nondeductible expenses—expenses such as insurance, utilities and depreciation allocable to the business—is limited to the taxpayer's gross income from the business use of the home minus the sum of the following:

1. The business portion of expenses the taxpayer could deduct even if he or she did not use the home for business purposes. Such expenses include mortgage interest, real estate taxes and casualty and theft losses allowable as itemized deductions on Schedule A (Form 1040); and
2. The business expenses that relate to the business activity in the home but not to the home itself. Such expenses include the costs of business telephone, supplies and equipment depreciation. (A self-employed taxpayer should not include in the business expenses that must be subtracted from gross income the one half of self-employment tax the taxpayer is permitted to deduct.)

In applying the deduction limit to a taxpayer's home-office deduction, the depreciation deduction should be taken last. If the taxpayer's home-office deduction in any year is reduced by the deduction limit, the taxpayer may carry over the excess to the next year in which he or she uses the actual expense method in claiming a home-office deduction. The carried-over expenses are subject to the deduction limit for the year to which they are carried over, whether or not the taxpayer lives in the same home during that year.

Consider the following example:

Home-Office Deduction Limitation Example

Phil meets the requirements to allow him to take a home-office deduction in connection with his self-employed business activities; the business-use percentage of his home is 20%. His gross income from the business is $10,000, and he has the following expenses:

Deductible mortgage interest - $18,000
Real estate taxes - $3,500
Business expenses for phone, internet, supplies and equipment depreciation - $3,000
Maintenance, insurance and utilities - $12,000
Depreciation allowed - $2,000

Phil's home-office deduction is reduced as shown below:

Gross income from the business	$ 10,000
Minus:	
Business part of deductible mortgage interest (20%)	3,600
Business part of real estate taxes (20%)	700
Business expenses for phone, supplies and equipment depreciation (100%)	3,000
Deduction limit	2,700
Minus other expenses allocable to business use of home:	
Maintenance, insurance and utilities (20%)	2,400
Depreciation allowed (20% but subject to balance of deduction limit)	300
Other expenses up to deduction limit	2,700
Depreciation carryover to following year	1,700

Phil's $10,000 gross income from his business activity establishes an upper limit on the amount of home-office deduction he can claim. That upper limit is then reduced by the business part of the expenses he could deduct even if he did not use his home for business—his deductible mortgage interest and real estate taxes, in this case—and his business expenses that are not related to his business use of the home: expenses for phone, supplies and equipment depreciation. By deducting those amounts from his $10,000 gross income from the business, we see that the limit for his home-office deduction is reduced to $2,700. ($10,000 - $3,600 - $700 - $3,000 = $2,700)

That $2,700 deduction limit is then applied to Phil's other expenses that would not be deductible expect for his business use of his home. Thus, Phil's expenses allocable to his business use of the home, i.e. expenses for maintenance, insurance, utilities and depreciation, cannot exceed $2,700. Since his maintenance, insurance and utility expenses amount to $12,000, and the applicable business percentage is 20%, the home-office deduction for them is $2,400. ($12,000 x .20 = $2,400) Since $300 of the deduction limit remains unused, only $300 is allowed for depreciation even though the allowable depreciation is $2,000. Phil may carry over the $1,700 balance of expenses to the next year he uses the actual expense method.

Figuring the Deduction Limit when Taxpayer has Multiple Places of Business

A taxpayer may have multiple businesses, some of which use a part of the home and others that do not. When a taxpayer derives his or her gross income from more than one trade or business and a portion of the gross income comes from business use of part of the taxpayer's home and a portion from a place other than the taxpayer's home, the tax return preparer must determine how much of the taxpayer's gross income is attributable to the business use of the taxpayer's home before figuring the limit that applies to the home-office deduction. In making that determination, the time the taxpayer spends at each location, the business investment in each location and any other relevant facts and circumstances must all be considered.

Simplified Method

Instead of using the actual expense method of determining a taxpayer's home-office deduction, a simplified method—available for years beginning January 1, 2013—may be used. When calculating the home-office deduction using the simplified method, the deduction is equal to the area of the taxpayer's home used for a qualified business use (not exceeding 300 $ft.^2$) multiplied by the prescribed rate. The current prescribed rate is $5, but the Internal Revenue Service and the Treasury Department may update the prescribed rate from time to time.

Election of the simplified method is irrevocable for the year made. The taxpayer's election of whether to use the actual expense method or simplified method is one that is made each year. The election to use the simplified method to figure the home-office deduction must be made on a ***timely filed***, original federal income tax return. Samples of the **Simplified Method Worksheet** and **Daycare Facility Worksheet** are shown below:

Simplified Method Worksheet

Use this worksheet if you file Schedule F (Form 1040) or you are a partner, and you are using the simplified method to figure your deduction for business use of the home. Use a separate worksheet for each qualified business use of your home.

1.	Enter the amount of the gross income limitation. See instructions for the Simplified Method Worksheet	1.	
2.	Allowable square footage for the qualified business use. Do not enter more than 300 square feet. See instructions for the Simplified Method Worksheet	2.	
3.	Simplified method amount		
	a. Maximum allowable amount	3a.	$5
	b. For daycare facilities not used exclusively for business, enter the decimal amount from the Daycare Facility Worksheet; otherwise, enter 1.0	3b.	
	c. Multiply line 3a by line 3b and enter result to 2 decimal places	3c.	
4.	Multiply line 2 by line 3c	4.	
5.	**Allowable expenses using the simplified method.** Enter the smaller of line 1 or line 4. If zero or less, enter -0-. See *Where to Deduct*, earlier, for where to enter this amount on your return.	5.	
6.	**Carryover of unallowed expenses from 20xx that are not allowed in 20xx.**		
	a. Operating expenses. Enter the amount, if any, from your last Worksheet To Figure the Deduction for Business Use of Your Home, line 40. See the Instructions for the Simplified Method Worksheet.	6a.	
	b. Excess casualty losses and depreciation. Enter the amount, if any, from your last Worksheet To Figure the Deduction for Business Use of Your Home, line 41. See the Instructions for the Simplified Method Worksheet.	6b.	

Daycare Facility Worksheet (for simplified method)

1.	Multiply days used for daycare during the year by hours used per day	1.	
2.	Total hours available for use during the year. See Instructions for the Daycare Facility Worksheet	2.	
3.	Divide line 1 by line 2. Enter the result as a decimal amount here and on line 3b of the Simplified Method Worksheet	3.	

Depreciation and Actual Expenses Related to Use of Home not Deductible

If a taxpayer elects to use the simplified method of determining the home-office deduction, neither depreciation nor any actual expenses other than those not related to use of the home, may be deducted. (Business expenses not related to the taxpayer's use of the home continue to be deductible.)

No Deduction of Actual Expense Carryover

If a taxpayer used the actual expense method to figure the home-office deduction in a previous year and has an expense carryover because the deduction was limited in that year, no portion of the carried-over amount may be deducted in any year in which the taxpayer uses the simplified method. In such a case, the taxpayer will continue to carry over the disallowed amount to the next year in which he or she uses actual expenses to figure the home-office deduction.

Expenses Deductible Irrespective of Business Use

The expenses that would be deductible by a taxpayer whether or not claiming a home-office deduction are treated differently, depending on whether the actual expense method or simplified method is used. Unlike the expense treatment under the actual expense method of expenses that are deductible irrespective of business use of the taxpayer's home—expenses such as mortgage interest, real estate taxes and casualty losses—such expenses must be treated as personal expenses by a taxpayer using the simplified method of determining the home-office deduction.

Special Rules Applicable to Simplified Method

Special rules apply to a taxpayer using the simplified method to determine the home-office deduction under certain circumstances. Those special rules are applicable in the case of:

- Shared use of a home;
- Multiple qualified business uses;
- Multiple homes; and
- Part year use or area changes.

Let’s consider each of these circumstances and the special rules that apply to them.

Shared Home Use

If a taxpayer shares his or her home with someone else who also uses the home in a business that qualifies for the home-office deduction, each user must make his or her own election as to the method used for calculating the deduction.

Multiple Qualified Business Uses

If a taxpayer conducts multiple businesses that qualify for the home-office deduction, the taxpayer’s election to use the simplified method applies to all of the taxpayer’s qualified business uses of that home. Thus, a taxpayer cannot choose the simplified method for one business and the actual expense method for a second business in the same home.

More than One Home During the Year

A taxpayer who uses more than one home—he or she changes residences during the year, for example—can elect to use the simplified method of calculating the home-office deduction for only one of the homes. The taxpayer must figure the deduction for any other home used during the year by using the actual expense method.

Part Year Use or Area Changes

In some cases, a taxpayer may have a qualified business use only for part of the taxable year—the taxpayer may have a seasonal business, for example—or may change the square footage of the home office during the year. In either case, the taxpayer’s deduction for the home office is based on the average monthly allowable square footage used.

To calculate the average monthly allowable square footage, the tax return preparer must add the amount of allowable square feet used by the taxpayer each month and divide the sum by 12. The preparer cannot take more than 300 ft.^{2} into account for any one month. Furthermore, if the taxpayer’s qualified business use was for less than 15 days in any month, the preparer must use zero for that month.

For example, consider how a taxpayer with a seasonal business—such as one limited to the months during which customers are boating—would determine the average monthly square footage to be used as illustrated below:

Determining Average Monthly Square Footage for a Seasonal Business Example

Harry is in the business of carrying boat owners and their guests from the shore to their boats anchored in the harbor. In the current tax year, he opened the business early in May and used a 10’ x 15’ home office for that month. In June, he hired an additional boat handler and increased the home office space to 15’ x 20’ for the months of June through August. In September, as the boating season neared its end and his employee returned to college, he reduced the size of his home office to 10’ x 15’ and kept the business open for only 12 days during the month.

Based on the size of the home office and its use, Harry’s average monthly allowable square footage for purposes of his home-office deduction is 87.5 ft.^{2}.

Month	Square Feet Used	Days Actually Used	Square Footage Credited
January	0	0	0

February	0	0	0
March	0	0	0
April	0	0	0
May	150	16	150
June	300	30	300
July	300	30	300
August	300	30	300
September	150	12	0
October	0	0	0
November	0	0	0
December	0	0	0

Harry's average monthly allowable square footage of 87.5 ft.² is determined by adding the square footage credited each month (note no square footage was credited in September because the office was used for fewer than 15 days) and dividing by 12. ((0 + 0 + 0 + 0 + 150 + 300 + 300 + 300 + 0 + 0 + 0 + 0) ÷ 12 = 87.5)

A sample of the **Area Adjustment Worksheet** is shown below:

Area Adjustment Worksheet (for simplified method)

If you used the same area for your qualified business use for the entire year, complete only Part I; otherwise skip Part I and complete Part II using lines 1 through 5 to help you figure the amount to enter for each month. All amounts reported on this worksheet must be in square feet.

Part I. Same area was used for the entire year.

1.	Area used for this qualified business use	1.	
2.	Shared use. Complete line 2 if someone else also used the home to conduct business that qualifies for the deduction; otherwise, enter 300 on line 2d and go to line 3		
	a. Area not shared. Enter portion of line 1 that was not shared with another person's qualified business use of the home	2a.	
	b. Total area shared with another person's qualified business use. Subtract line 2a from line 1	2b.	
	c. Reasonable allocation of shared area to this qualified business use	2c.	
	d. Add lines 2a and 2c	2d.	
3.	Multiple qualified business uses. Complete line 3 if you used the home for more than one qualified business use; otherwise, enter 300 on line 3d and go to line 4		
	a. Total area of home used for all your qualified business uses	3a.	
	b. Maximum area	3b.	300
	c. Enter the smaller of line 3a and 3b	3c.	
	d. Reasonable allocation of line 3c to this qualified business use	3d.	
4.	Maximum area	4.	300
5.	Enter the smaller of lines 1, 2d, 3d and 4. Enter the result on line 2 of the Simplified Method Worksheet	5.	

Part II. Area changed during the year or was used for only part of the year.

6. Complete lines 6a through 6n if you used the area for this qualified business use for part of the year or the area used for this qualifying business use changed during the year.

	(i) Month	**Note.** If your qualified business use was less than 15 days in a month, enter _0_ in column (ii) for that month; otherwise, use lines 1 through 5 above for each month, and enter the amount you get for line 5 in column (ii) for that month.	(ii) Area
a.	January		
b.	February		
c.	March		
d.	April		
e.	May		
f.	June		
g.	July		
h.	August		
i.	September		
j.	October		
k.	November		
l.	December		

m.	Add lines 6a through 6l, column (ii)	6m.	________
n.	Average monthly allowable square footage. Divide line 6m by 12. Enter the result on line 2 of the Simplified Method Worksheet	6n.	________

Gross Income Limitation

Somewhat similar to the deduction limit applicable to the actual expense method for determining the home-office deduction, a gross income limitation applies to the home-office deduction available under the simplified method. Under the gross income limitation applicable to the simplified method, a taxpayer's home-office deduction is limited to an amount equal to the taxpayer's gross income derived from the qualified business use of the home reduced by the business deductions that are unrelated to the use of the taxpayer's home.

Consider the following example:

Gross Income Limitation under the Simplified Method Example

Arthur meets the requirements allowing him to take a deduction for business use of his home in connection with his self-employed business activities and elects the simplified method for determining his home-office deduction. He uses a 15′ x 20′ home office for the entire 12 months of the tax year (300 ft.^{2}). The prescribed rate for the home-office deduction under the simplified method is $5.

His gross income from the business is $25,000, and he has business expenses for phone, supplies, advertising and equipment depreciation amounting to $24,000

Because of Arthur's gross income and business expenses, his home-office deduction is reduced as shown below:

Gross income from the business	$ 25,000
Minus business expenses unrelated to business use of the home	24,000
Deduction limit	1,000

Based on the 300 ft.^{2} home office and the prescribed rate, Arthur's home-office deduction would be $1,500. That deduction is reduced, however, because his business expenses unrelated to the home-office deduction, when subtracted from Arthur's gross income from the business, limit his home-office deduction to no more than $1,000.

If the business deductions unrelated to the use of the taxpayer's home are greater than the gross income the taxpayer derived from the qualified business use, the home-office deduction for business use of the home is disallowed.

Determining the Home-Office Deduction for Daycare Facilities

Taxpayers using space in their homes for providing daycare services generally may use either the actual expense method or the simplified method to determine their home-office deduction. An exception to the qualification rules applicable to daycare facilities, however, can add some complexity to the rules for figuring the home-office deduction for such use when the deduction is figured using the actual expense method.

As discussed in Chapter 1, daycare facilities are not required to comply with the exclusive use rule in order to qualify for a home-office deduction as long as the taxpayer meets the appropriate daycare facility requirements and its use is regular. When a taxpayer's use of the space in the home for providing daycare is not its exclusive use ***and the taxpayer uses the actual expense method*** to determine the home-office deduction, the tax return preparer must figure the percentage of time that the part of the home is used for daycare. (A taxpayer may use the simplified method without being required to figure the percentage of time that the space is used for daycare even though not its exclusive use.)

To find the percentage of time the taxpayer actually uses his or her home for providing daycare, the tax return preparer must compare the total time used for business to the total time that part of the home can be used for all purposes. To make that calculation, the preparer can compare the hours of business use in a week with the number of hours in a week, i.e. 168 hours. (24 x 7 = 168)

Alternatively, the preparer can compare the hours of business use for the year with the number of hours in the year—8,760 in a non-leap year. (24 x 365 = 8,760) If the taxpayer started or stopped using the home for daycare during the year, the preparer must prorate the number of hours based on the number of days the home was available for daycare.

Consider the following example:

Non-Exclusive Use as a Daycare Facility Example

Eleanor uses three rooms in her rented home to operate an adult daycare business for adults age 65 and over. Since the square footage of her home is 2,000 ft.², and the total square footage of the three rooms is 1,000 ft. ² the business percentage of the space used is 50%. (1,000 ÷ 2,000 = .50)

She offers adult daycare services 50 weeks each year on Monday through Friday beginning at 7 a.m. and ending at 7 p.m. During the remaining 12 hours each day, the rooms are available to, and used by, her family for other purposes. Based on Eleanor's use, the total number of hours during which the space is used each year to provide adult daycare is 3,000. (12 x 5 x 50 = 3,000) Thus, the percentage of the time the three rooms are used for providing adult daycare is 34.25%. (3,000 hours used for daycare each year/8,760 hours in a year = .3425)

Based on those business percentages, Eleanor can deduct 34.25% of all ***direct*** expenses for the three rooms used for adult daycare—expenses for painting the walls of the three rooms, for example. Because her ***indirect*** expenses apply to the entire house—and only half of the house is given over to providing daycare—she is permitted to deduct only 17.13% of those indirect expenses. (34.25% x 50% = 17.13%)

The tax return preparer should complete Form 8829, Part I to figure the percentage of Eleanor's home used for business, as illustrated below (preparer entries highlighted:

Part I	Part of Your Home Used for Business				
1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)			1	1,000
2	Total area of home			2	2,000
3	Divide line 1 by line 2. Enter the result as a percentage			3	50 %
	For daycare facilities not used exclusively for business, go to line 4. All others go to line 7.				
4	Multiply days used for daycare during year by hours used per day	4	3,000 hr		
5	Total hours available for use during the year (365 days x 24 hours) (see instructions)	5			
6	Divide line 4 by line 5. Enter the result as a decimal amount	6	.3425		
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3			7	17.13 %

To figure Eleanor's allowable home-office deduction, the tax return preparer should complete Part II of Form 8829. Eleanor's gross income for the year from her daycare business is $50,000, and she incurred expenses not related to the business use of her home amounting to $20,000—the total expenses shown on Schedule C, line 28. Subtracting the expenses from her gross income for the year—expenses such as the cost of advertising, licensing fees and wages—results in a tentative profit from her daycare business of $30,000. ($50,000 - $20,000 = $30,000); that amount is entered on Schedule C, line 29 and on Form 8829, line 8.

The other expenses she incurred during the year were $9,000 for rent, $900 for utilities and $600 for painting the three rooms in which she provides daycare. Part II should be completed by the tax return preparer as illustrated below (preparer entries highlighted):

Part II	Figure Your Allowable Deduction							
8	Enter the amount from Schedule C, line 29 **plus** any gain derived from the business use of your home, minus any loss from the trade or business not derived from the business use of your home (see instructions).					8	30,000	
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses		(b) Indirect expenses			
9	Casualty losses (see instructions)	9						
10	Deductible mortgage interest (see instructions)	10						
11	Real estate taxes (see instructions)	11						
12	Add lines 9, 10 and 11	12						

13	Multiply line 12, column (b) by line 7			13			
14	Add line 12, column (a) and line 13					14	0
15	Subtract line 14 from line 8. If zero or less, enter -0-					15	30,000
16	Excess mortgage interest (see instructions)	16					
17	Excess real estate taxes (see instructions)	17					
18	Insurance	18					
19	Rent	19			9,000		
20	Repairs and maintenance	20	206				
21	Utilities	21			900		
22	Other expenses (see instructions)	22					
23	Add lines 16 through 22	23	206		9,900		
24	**Multiply line 23, column (b) by line 7**			24	1,696		
25	**Carryover of prior year operating expenses (see instructions)**			25			
26	**Add line 23, column (a), line 24, and line 25**					26	1,902
27	**Allowable operating expenses. Enter the smaller of line 15 or line 26**					27	1,902
28	**Limit on excess casualty losses and depreciation. Subtract line 27 from line 15**					28	
29	**Excess casualty losses (see instructions)**			29			
30	**Depreciation of your home from line 42 below**			30			
31	**Carryover of prior year excess casualty losses and depreciation (see instructions)**			31			
32	**Add lines 29 through 31**					32	
33	**Allowable excess casualty losses and depreciation. Enter the smaller of line 28 or line 32**					33	
34	Add lines 14, 27, and 33					34	1,902
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684** (see instructions)					35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions					36	1,902

Eleanor's expenses for rent and utilities—$9,000 and $900, respectively—are indirect expenses and are entered, as shown, on lines 19 and 21 in column (b). They are totaled, and the $9,900 total is entered on line 23, column (b); the total of indirect expenses is then multiplied by the percentage shown on line 7, i.e. 17.13%, and the result is entered on line 24.

The $206 direct expense entered on line 23 is added to the $1,696 allowable indirect expense, and the $1,902 total is entered on line 26. ($206 + $1,696 = $1,902) Since the amount entered on line 26 is smaller than the amount on line 15, it is also entered on line 27.

Eleanor has no casualty losses, deductible mortgage interest, real estate taxes or depreciation, so the amount on line 27 is also entered on lines 34 and 36. The amount on Form 8829, line 36 should also be entered on Schedule C, line 30, and Form 8829 should be attached to Schedule C.

A sample Form 8829, **Expenses for Business Use of Your Home,** is shown below:

Form **8829**
Department of the Treasury
Internal Revenue Service (99)

Expenses for Business Use of Your Home

File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.

Go to www.irs.gov/Form8829 for instructions and the latest information

OMB No. 1545-0074
20xx
Attachment
Sequence No. 176

Name(s) of proprietor(s)	Your social security number

Part I — Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for daycare, or for storage of inventory or product samples (see instructions)			1	
2	Total area of home			2	
3	Divide line 1 by line 2. Enter the result as a percentage			3	%
	For daycare facilities not used exclusively for business, go to line 4. All others go to line 7.				
4	Multiply days used for daycare during year by hours used per day	4	hr		
5	Total hours available for use during the year (365 days x 24 hours) (see instructions)	5			
6	Divide line 4 by line 5. Enter the result as a decimal amount	6			
7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3			7	%

Part II — Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29 **plus** any gain derived from the business use of your home, minus any loss from the trade or business not derived from the business use of your home (see instructions).					8	
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses		(b) Indirect expenses		
9	Casualty losses (see instructions)	9					
10	Deductible mortgage interest (see instructions)	10					
11	Real estate taxes (see instructions)	11					
12	Add lines 9, 10 and 11	12					
13	Multiply line 12, column (b) by line 7			13			
14	Add line 12, column (a) and line 13					14	
15	Subtract line 14 from line 8. If zero or less, enter -0-					15	
16	Excess mortgage interest (see instructions)	16					
17	Excess real estate taxes (see instructions)	17					
18	Insurance	18					
19	Rent	19					
20	Repairs and maintenance	20					
21	Utilities	21					
22	Other expenses (see instructions)	22					
23	Add lines 16 through 22	23					
24	Multiply line 23, column (b) by line 7				24		
25	Carryover of prior year operating expenses (see instructions)				25		
26	Add line 23, column (a), line 24, and line 25					26	
27	Allowable operating expenses. Enter the **smaller** of line 15 or line 26					27	
28	Limit on excess casualty losses and depreciation. Subtract line 27 from line 15					28	
29	Excess casualty losses (see instructions)				29		
30	Depreciation of your home from line 42 below				30		
31	Carryover of prior year excess casualty losses and depreciation (see instructions)				31		
32	Add lines 29 through 31					32	
33	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 28 or line 32					33	
34	Add lines 14, 27, and 33					34	
35	Casualty loss portion, if any, from lines 14 and 33. Carry amount to **Form 4684** (see instructions)					35	
36	**Allowable expenses for business use of your home.** Subtract line 35 from line 34. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions					36	

Part III — Depreciation of Your Home

37	Enter the **smaller** of your home's adjusted basis or its fair market value (see instructions)	37	
38	Value of land included on line 37	38	
39	Basis of building. Subtract line 38 from line 37	39	
40	Business basis of building. Multiply line 39 by line 7	40	
41	Depreciation percentage (see instructions)	41	%
42	Depreciation allowable (see instructions). Multiply line 40 by line 41. Enter here and on line 30 above	42	

Part IV — Carryover of Unallowed Expenses to 20xx

43	Operating expenses. Subtract line 27 from line 26. If less than zero, enter 0-	43	
44	Excess casualty losses and depreciation. Subtract line 33 from line 32. If less than zero, enter -0-	44	

Deducting the Cost of Meals and Snacks

If a daycare provider also provides food for daycare recipients, the food expense should be claimed as a separate deduction on the taxpayer's Schedule C rather than as a cost of using the taxpayer's home for business purposes. The amount of the food costs that may be claimed as an expense by a daycare provider are:

- 100% of the actual cost of food consumed by daycare recipients;
- 50% of the actual cost of food consumed by daycare employees; and
- 0% of the cost of food consumed by the taxpayer and the taxpayer's family.

Although only 50% of the cost of food consumed by daycare employees is the general rule, a daycare provider can deduct 100% of the cost of food consumed by daycare employees if its value can be excluded from their wages as a *de minimis* fringe benefit, i.e. one considered trifling or of minimal importance, in other words.

If a daycare provider receives reimbursements for food provided from a sponsor under the Child and Adult Care Food Program of the Department of Agriculture, only those food costs in excess of reimbursements may be claimed as an expense. If such reimbursements exceed the actual cost of the food provided, the amount by which reimbursements exceed cost should be shown as income in Part I of Schedule C.

Instead of claiming the actual cost of meals and snacks provided to daycare recipients, a taxpayer operating a daycare facility may choose to use the optional standard meal and snack rates shown below.

Standard Meal and Snack Rates

If the taxpayer qualifies as a family daycare provider, the standard meal and snack rates may be used instead of actual food costs to compute the deduction for the cost of meals and snacks provided to eligible children. For purposes of a taxpayer's ability to use the standard meal and snack rates, the following definitions apply:

- A "family daycare provider" is a person engaged in the business of providing family daycare;
- "Family daycare" is childcare provided to eligible children in the home of the family daycare provider. The care must be nonmedical, not involve a transfer of legal custody and generally last less than 24 hours each day; and
- "Eligible children" are minor children receiving family daycare in the home of a family daycare provider. Eligible children do not include children who are full-time or part-time residents in the home where the childcare is provided or children whose parents or guardians are residents of the same home. In addition, eligible children do not include children who receive daycare services for personal reasons of the provider.

An eligible daycare provider can compute the deductible cost of each meal and snack actually purchased and served to an eligible child during the time period the taxpayer provided family daycare using the standard meal and snack rates.[2] The standard rates are as follows:

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[2] Rates may be accessed at

https://www.cacfp.org/rates-of-reimbursement/

Location of Family Daycare Provider	Breakfast		Lunch		Dinner		Snack	
	7/2022 thru 6/2023	7/2023 thru 6/2024	7/2022 thru 6/2023	7/2023 thru 6/2024	7/2022 thru 6/2023	7/2023 thru 6/2024	7/2022 thru 6/2023	7/2023 thru 6/2024
States other than Alaska and Hawaii	$1.66	$1.65	$3.04	$3.12	$3.04	$3.12	$0.97	$0.93
Alaska	$2.59	$2.63	$4.87	$5.05	$4.87	$5.05	$1.52	$1.50
Hawaii	$1.91	$2.12	$3.55	$4.05	$3.55	$4.05	$1.12	$1.20

When using the standard meal and snack rates, an eligible daycare provider is limited to a maximum of one breakfast, one lunch, one dinner and three snacks per eligible child each day. If the daycare provider receives reimbursement for a particular meal or snack, the taxpayer can deduct only the portion of the applicable standard meal or snack rate that is more than the amount of the reimbursement.

A taxpayer may use either the standard meal and snack rates or actual costs to calculate the deductible cost of food for any particular tax year and may change from one regime to the other each tax year. However, if the taxpayer chooses to use the standard meal and snack rates for a particular tax year, the taxpayer must use those rates for all the deductible food costs for eligible children during that tax year.

Sale or Exchange of a Taxpayer’s Home Used for Business

Taxpayers may be able to exclude up to $250,000 ($500,000 for certain married persons filing a joint return) of any gain derived from the sale or exchange of their homes, provided they meet certain ownership and use tests. However, that ability to exclude gain may be affected by a taxpayer’s use of his or her home for business purposes.

If the part of the taxpayer’s property used for business is within the taxpayer’s home—in contrast to a separate part of the property, such as an out building—the taxpayer is not required to allocate gain on the sale between the business part of the property and the part used as a home, regardless of whether the taxpayer was entitled to claim any depreciation. However, the taxpayer cannot exclude the part of any gain equal to depreciation allowed or allowable after May 6, 1997. Thus, when determining the amount of gain the taxpayer can exclude on the sale or exchange of property, the tax preparer must reduce the total gain excluded by any depreciation allowed or allowable on the portion of the taxpayer’s home used for business after May 6, 1997. If the taxpayer used any part of the home for business, he or she must adjust the basis of the home for any depreciation that was allowable for its use, even if the taxpayer did not claim it.

A taxpayer who claims depreciation as part of the home office deduction is required to recapture the total amount of depreciation taken, or which could have been taken, at the time the property is sold as “unrecaptured Section 1250 gain.” Accordingly, the taxpayer is required to recognize any gain on the sale of the part of residential property used as a home office, even if the total gain is less than the amount that may normally be excluded in the case of the sale of a home, up to the amount of depreciation that was taken or could have been taken.

If the taxpayer held the property for 12 months or less, the tax rate on the recaptured depreciation is equal to the taxpayer’s ordinary income tax rate. However, if the taxpayer held the property for more than one year, the recaptured depreciation that must be recognized is taxable at a maximum 25% rate rather than the lower maximum capital gains rate available in the case of the sale of stock.

Final Regulations on Deduction vs. Capitalization of Tangible Property Costs

Final regulations concerning when costs expended in connection with the purchase, improvement or maintenance of property may be deducted and when they must be capitalized are effective for tax years beginning on and after January 1, 2014 and may affect a taxpayer's home office deduction. Although somewhat complex, the regulations generally provide that costs must be capitalized (and depreciated) rather than deducted if expended:

- To purchase or produce real or personal property;
- To facilitate the acquisition or production of real or personal property; or
- To make repairs to such assets before placing them in service.

Routine maintenance costs are treated differently. Costs expended by a taxpayer for routine maintenance of buildings and other property may be currently deducted rather than having to be capitalized. (Note that the definition of "routine maintenance" varies slightly depending on whether the costs for such maintenance are expended on property that is a building or for property other than a building.)

Although the regulations provide a safe harbor election that allows qualifying small taxpayers to currently deduct (rather than capitalize) a limited amount of costs expended for improvements to building property having an unadjusted basis of $1 million or less, the general rule provides that costs expended to improve, restore or adapt property to a new and different use must be capitalized.

Summary

A taxpayer who qualifies for a home-office deduction may calculate that deduction using the actual expense method or the simplified method.

Using the actual expense method of determining the home-office deduction requires that the taxpayer's expenses be identified as a) direct expenses, b) indirect expenses, and c) unrelated expenses. Direct expenses apply to and affect only the business part of the taxpayer's home. Generally, these expenses are deductible in full. In contrast, indirect expenses are incurred by the taxpayer for keeping up and running his or her entire home and are deductible under the home-office deduction based on the percentage of the taxpayer's home used for business purposes. The deductibility of both direct and indirect expenses is subject to the applicable deduction limit. Unlike direct expenses that are normally deductible in their entirety, indirect expenses are deductible under the home-office deduction only in an amount equal to the total of such indirect expenses multiplied by the percentage of the home used for business.

Although a taxpayer may use any reasonable method to determine the percentage of the home used for business purposes, two methods are commonly used: a) dividing the square footage of the home used for business purposes by the total square footage of the home, and b) dividing the number of rooms used for business by the total number of rooms in the taxpayer's home.

Deductible expenses under the home-office deduction include: a) expenses that are deductible by all homeowners whether or not the home is used for business purposes and b) expenses that are deductible by the taxpayer only if the taxpayer uses the home for business. Expenses deductible by all homeowners include real estate taxes, deductible mortgage interest and federally-declared disaster area casualty losses.

Additionally, many other expenses are deductible by homeowners who use their homes for business purposes, including depreciation, insurance, rent paid for the use of unowned property used in the taxpayer's trade or business, repairs, security system maintenance and monitoring expenses, and expenses for utilities and services.

The home-office deduction is limited. If a taxpayer uses the actual expense method for claiming a home-office deduction, the deduction of otherwise nondeductible expenses is limited to the taxpayer's gross income from the business use of the home minus the sum of a) the business portion of expenses the taxpayer could deduct even if he or she did not use the home for business purposes, and b) the business expenses that relate to the business activity in the home but not to the home itself. In applying the deduction limit to a taxpayer's home-office deduction, the depreciation deduction should be taken last. If the taxpayer's home-office deduction in any year is reduced by the deduction limit, the taxpayer may carry over the excess to the next year in which he or she uses the actual expense method in claiming a home-office deduction. The carried-over expenses are subject to the deduction limit for the year to which they are carried over, whether or not the taxpayer lives in the same home during that year.

When a taxpayer derives his or her gross income from more than one trade or business and a portion of the gross income comes from business use of part of the taxpayer's home and a portion from a place other than the taxpayer's home, the tax return preparer must determine how much of the taxpayer's gross income is attributable to the business use of the taxpayer's home before figuring the limit that applies to the home office deduction. In making that determination, the time the taxpayer spends at each location, the business investment in each location and any other relevant facts and circumstances must all be considered.

When calculating the home-office deduction using the simplified method, the deduction is equal to the area of the taxpayer's home used for a qualified business use (not exceeding 300 ft.^{2}) multiplied by the "prescribed rate." The current prescribed rate is $5 and is subject to change. A taxpayer electing to use the simplified method of determining the home-office deduction cannot deduct depreciation or any actual expenses other than those not related to use of the home.

The home-office deduction of a taxpayer who has a qualified business use only for part of the taxable year or who changes the square footage of the home office during the year is based on the average monthly allowable square footage used. A gross income limitation also applies to the home-office deduction available under the simplified method. In the case of the simplified method, a taxpayer's home-office deduction is limited to an amount equal to the taxpayer's gross income derived from the qualified business use of the home reduced by the business deductions that are unrelated to the use of the taxpayer's home.

Taxpayers operating daycare facilities are not required to comply with the exclusive use rule in order to qualify for a home-office deduction if the taxpayer meets the appropriate daycare facility requirements and use of the space is regular. When a taxpayer's use of the space in the home for providing daycare is not its exclusive use ***and the taxpayer uses the actual expense method*** to determine the home-office deduction, the tax return preparer must figure the percentage of time that the part of the home is used for daycare, and the home-office deduction is based on that use.

If a daycare provider also provides food for daycare recipients, the food expense should be claimed as a separate deduction on the taxpayer's Schedule C rather than as a cost of using the taxpayer's home for business purposes. The amount of the food costs that may be claimed as an expense by a daycare provider are the total of 100% of the actual cost of food consumed by daycare recipients and 50% of the actual cost of food consumed by daycare employees. No part of the cost of food consumed by the taxpayer and/or the taxpayer's family can be claimed. As an alternative to claiming the actual cost of meals and snacks provided to daycare recipients, a taxpayer operating a daycare facility may choose to use the optional standard meal and snack rates. Those rates may be adjusted annually.

A taxpayer who claims depreciation as part of the home office deduction is required to recapture the total amount of depreciation taken, or which could have been taken, at the time the property is sold. This is called "unrecaptured Section 1250 gain." In such a case, the taxpayer is required to recognize any gain on the sale of the part of residential property used as a home office, even if the total gain is less than the amount that may normally be excluded in the case of the sale of a home, up to the amount of depreciation that was taken or could have been taken. If the taxpayer held the property for 12 months or less, the tax rate on the recaptured depreciation is equal to the taxpayer's ordinary income tax rate. However, if the taxpayer held the property for more than one year, the recaptured depreciation that must be recognized is taxable at a maximum 25% rate rather than the lower maximum capital gains rate available in the case of the sale of stock and certain other capital assets.

Chapter Review

1. What is Helen's deduction using the actual expense method if she opened her home office on July 1st, earned $6,000, has a 20% business percentage, incurred $3,000 to paint the office on July 2nd and paid a $1,200 annual homeowners insurance premium?

    A. $420

    B. $2,100

    C. $3,120

D. $4,200

2. What is Harry's deduction, exclusive of depreciation, for a security system installed January 1st if he qualifies for a home-office deduction and uses 10% of his home for business assuming he paid $800 to install the system and $50/month to maintain it?

   A. $60

   B. $140

   C. $860

   D. $1,400

3. What is George's deduction for a 400 square foot office in his rented home, assuming he qualifies for a home office deduction, if he pays $1,200 for business telephone service, uses 20% of the home for business and elects the simplified method?

   A. $1,500

   B. $1,740

   C. $2,000

   D. $2,700

4. What is Harry's deduction for his 400 square foot office if he operates a summer business from home and elects the simplified method, assuming his office is used for 14 days in May, 30 days each month in June through August and 15 days in September?

   A. $375

   B. $500

   C. $665

   D. $835

5. Shirley operates a daycare center and provides meals and snacks for daycare clients. As part of an employee goodwill gesture, she also provides meals for her staff. How much of the cost of staff meals may she deduct?

   A. No part of the cost of food provided to other than clients is deductible

   B. Half of the cost of the food consumed by the staff

   C. Three-quarters of the cost of the food consumed by the staff

   D. All of the cost of food consumed

Chapter 3 – Deducting & Recordkeeping

Introduction

After qualifying for a home-office deduction and determining the amount, a taxpayer must report the deduction on IRS Form 1040 and retain sufficient evidence for a specified period of time to support it. In this chapter we will examine the rules related to where the expenses of a home office are deducted and the recordkeeping requirements applicable to taking and supporting such a deduction.

Chapter Learning Objectives

When you have completed this chapter, you should be able to:

- Identify where expenses of a home office are deducted; and
- Recognize the recordkeeping requirements applicable to taxpayers taking a home-office deduction.

Where to Deduct Expenses of a Home Office

Home-office deductions are taken on IRS Form 1040.

Self-Employed Taxpayer & Statutory Employee Deduction of Home Office Expenses

If a self-employed taxpayer or statutory employee uses his or her home in a trade or business and files Schedule C, the entire deduction for business use of the taxpayer's home should be reported on Schedule C, line 30. If the taxpayer who files Schedule C uses the actual expense method of determining the home office deduction, Form 8829 should be attached to Schedule C.

If the taxpayer uses a home in his or her farming business and files Schedule F, the entire deduction for business use of the home should be reported on line 32 of Schedule F. The words "business use of home" should be entered on the adjacent dotted line.

Expenses Deductible Irrespective of Business Connection

Some expenses related to the taxpayer's use of a home are deductible, whether or not the taxpayer uses the home for business purposes. Such expenses include mortgage interest, real estate taxes, and federally-declared disaster area casualty losses. Where these expenses are deducted depends on how the taxpayer figures the deduction for business use of the home.

If the taxpayer uses the simplified method of determining the home-office deduction, these expenses are simply treated as personal expenses and do not figure into the deduction allowed for business use of the taxpayer's home. However, if the taxpayer uses the actual expense method of figuring the home-office deduction, the tax return preparer should deduct the business portion of these expenses on Schedule C or Schedule F, as appropriate. If the taxpayer itemizes deductions, he or she will deduct the personal portion of these expenses on Schedule A.

Deductible Mortgage Interest

If a taxpayer files Schedule C and has deductible mortgage interest, all of the deductible mortgage interest (both the personal and business portions) should be entered on line 10 of Form 8829. After entering the total of the deductible mortgage interest on line 10, the business part of the deductible mortgage interest must be figured on lines 12 and 13 of Form 8829 by multiplying the amount on line 10 by the percentage entered on line 7. Subtract the amount shown on line 13 from the amount previously entered on line 10. The difference between the two numbers is deductible on Schedule A.

If the taxpayer files Schedule F rather than Schedule C, the business part of the deductible home mortgage would be entered on line 32 of Schedule F, and the nonbusiness part of the deductible mortgage interest would be entered on Schedule A.

Consider the following example shown on IRS Form 8829, Expenses for Business Use of Your Home:

Reporting Deductible Mortgage Interest Example

Suppose a self-employed taxpayer filing Schedule C and claiming a home-office deduction has deductible mortgage interest of $10,000 and a business percentage of 20%. The mortgage interest for purposes of the home-office deduction would be $2,000 and would be entered on form 8829 as shown below (see highlighted entry):

7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3						7	20 %
Part II	**Figure Your Allowable Deduction**							
8	Enter the amount from Schedule C, line 29 **plus** any gain derived from the business use of your home , minus any loss from the trade or business not derived from the business use of your home (see instructions)						8	
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses		(b) Indirect expenses			
9	Casualty losses (see instructions)	9						
10	Deductible mortgage interest (see instructions)	10			10,000			
11	Real estate taxes (see instructions)	11						
12	Add lines 9, 10 and 11	12			10,000			
13	Multiply line 12, column (b) by line 7			13	2,000			

If the taxpayer files Schedule F, the business part of the taxpayer's deductible home mortgage interest should be included with the total business use of the home expenses shown on line 32 of Schedule F. If the facts were as noted earlier, but the taxpayer filed Schedule F instead of Schedule C, the deductible mortgage amount on Schedule F would be as shown below (see highlighted entries):

18	Freight and trucking	18			32	Other expenses (specify):			
19	Gasoline, fuel, and oil	19			a	Business use of home	32a	2,000	
20	Insurance (other than health)	20			b		32b		
21	Interest:				c		32c		
a	Mortgage (paid to banks, etc.)	21a			d		32d		
b	Other	21b			e		32e		
22	Labor hired (less employment credits	22			f		32f		

Real Estate Taxes

If the taxpayer files Schedule C and has paid deductible real estate taxes, all deductible real estate taxes should be entered on line 11 of Form 8829. After determining the business part of the real estate taxes on line 12 and 13 by multiplying the amount on line 11 by the percentage on line 7, subtract that amount from the real estate taxes included on line 11. The remainder is deductible on Schedule A.

If the taxpayer files Schedule F, include the business part of the real estate taxes with the total business use of the home expenses on line 32 of Schedule F. Enter "business use of home" on the dotted line adjacent to the entry. Enter the nonbusiness part of the real estate taxes on Schedule A.

Reporting Real Estate Taxes Example

Suppose a self-employed taxpayer filing Schedule C and claiming a home-office deduction has paid real estate taxes of $5,000 and has a business percentage of 20%. The real estate tax deduction for purposes of the home-office deduction would be $1,000 and would be entered on Form 8829 as shown below (see highlighted entry):

7	Business percentage. For daycare facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3						7	20 %
Part II	**Figure Your Allowable Deduction**							
8	Enter the amount from Schedule C, line 29 **plus** any gain derived from the business use of your home, minus any loss from the trade or business not derived from the business use of your home.(See instructions.)						8	
	See instructions for columns (a) and (b) before completing lines 9-22.		(a) Direct expenses		(b) Indirect expenses			
9	Casualty losses (see instructions)	9						
10	Deductible mortgage interest (see instructions)	10						
11	Real estate taxes (see instructions)	11			5,000			
12	Add lines 9, 10 and 11	12			5,000			
13	Multiply line 12, column (b) by line 7			13	1,000			

If the taxpayer files Schedule F, the business part of the taxpayer's real estate taxes should be included with the total business use of the home expenses shown on line 32 of Schedule F. If the facts were as noted earlier, but the taxpayer filed Schedule F instead of Schedule C, the deductible real estate taxes on Schedule F would be as shown below (see highlighted entries):

18	Freight and trucking	18			32	Other expenses (specify):			
19	Gasoline, fuel, and oil	19			a	Business use of home	32a	1,000	
20	Insurance (other than health)	20			b		32b		
21	Interest:				c		32c		
a	Mortgage (paid to banks, etc.)	21a			d		32d		
b	Other	21b			e		32e		
22	Labor hired (less employment credits	22			f		32f		

Expenses Deductible only when Home is used for Business

While the deductible expenses already discussed are deductible by a taxpayer whether or not the taxpayer's home is used for business, certain other expenses are generally deductible only when the taxpayer's home is used for business purposes. Those expenses that are deductible by a taxpayer using the actual expense method only to the extent related to the business use of the taxpayer's home include:

- Insurance;
- Maintenance;
- Utilities; and
- Depreciation of the home.

Accordingly, the personal portion of any of these expenses remains nondeductible. If the taxpayer uses the simplified method of determining the home-office deduction, these expenses do not figure into the deduction allowed for business use of the taxpayer's home.

Where the taxpayer using the actual expense method deducts the business portion of the above expenses depends on the method used by the taxpayer to figure the deduction for business use of the home.

Actual Expense Method

A taxpayer who files Schedule C and claims a home-office deduction using the actual expense method should report the home expenses that would not be allowable if the home were not used for business on the appropriate lines of Form 8829. If these expenses exceed the deduction limit, the taxpayer should carry over the excess to the next year in which the actual expense method is used, and the carryover will be subject to the following year's deduction limit.

If the taxpayer files Schedule F, the otherwise nondeductible expenses for insurance, maintenance, utilities, depreciation, etc. should be included with the taxpayer's total business use of the home expenses on Schedule F, line 32, and the notation "business use of home" should be entered on the adjacent dotted line.

Business Expenses Not for Use of Home

Irrespective of how the taxpayer figures the home-office deduction, the taxpayer should deduct business expenses that are not for the use of the taxpayer's home on the appropriate lines of Schedule C or Schedule F in full. Since these expenses are not for the use of the taxpayer's home, they are not subject to the deduction limit for business use of the home expenses.

Partners' Deduction of Home-Office Expenses

A partner incurring unreimbursed ordinary and necessary expenses paid on behalf of the partnership, including qualified expenses for the business use of the taxpayer's home, may deduct such expenses if he or she was required under the partnership agreement to pay them. If using actual expenses to figure the home-office deduction, the taxpayer should use the **Worksheet To Figure the Deduction For Business Use of Your Home**, contained in Publication 587 and shown below:

Worksheet To Figure the Deduction for Business Use of Your Home

Use this worksheet if you file Schedule F (Form 1040) or you are a partner, and you are using actual expenses to figure your deduction for business use of the home. Use a separate worksheet for each qualified business use of your home.

Part 1 Part of Your Home Used for Business

1)	Area of home used for business			1)
2)	Total area of home			2)
3)	Percentage of home used for business (divide line 1 by line 2 and show result as a percentage)			3) %

Part 2 Figure Your Allowable Deduction

		(a) Direct expenses	(b) Indirect Expenses	
4)	Gross income from business.(see instructions)			4)
5)	Casualty losses	5)		
6)	Deductible mortgage interest	6)		
7)	Real estate taxes	7)		
8)	Total of lines 5 through 7	8)		
9)	Multiply line 8, column (b) by line 3		9)	
10)	Add line 8, column (a) and line 9		10)	
11)	Business expenses not from business use of home (see instructions)		11)	
12)	Add lines 10 and 11			12)
13)	Deduction limit. Subtract line 12 from line 4			13)
14)	Excess mortgage interest	14)		
15)	Excess real estate taxes	15)		
16)	Insurance	16)		
17)	Rent	17)		
18)	Repairs and maintenance	18)		
19)	Utilities	19)		
20)	Other expenses	20)		
21)	Add lines 14 through 20	21)		
22)	Multiply line 21, column (b) by line 3			
23)	Carryover of operating expenses from prior year (see instructions)			
24)	Add line 21, column (a), line 22, and line 23			24)
25)	Allowable operating expenses. Enter the **smaller** of line 13 or line 24			25)
26)	Limit on excess casualty losses and depreciation. Subtract line 25 from line 13			26)
27)	Excess casualty losses (see instructions)		27)	
28)	Depreciation of your home from line 40 below		28)	
29)	Carryover of excess casualty losses and depreciation from prior year (see instructions)		29)	
30)	Add lines 27 through 29			30)
31)	Allowable excess casualty losses and depreciation. Enter the **smaller** of line 26 or line 30			31)
32)	Add lines 10, 25, and 31			32)
33)	Casualty losses included on lines 10 and 31 (see instructions)			33)
34)	Allowable expenses for business use of your home. (Subtract line 33 from line 32.) See instructions for where to enter on your return.			34)

Part 3 Depreciation of Your Home

35)	Smaller of adjusted basis or fair market value of home (see instructions)	35)
36)	Basis of land	36)
37)	Basis of building (subtract line 36 from line 35)	37)
38)	Business basis of building (multiply line 37 by line 3)	38)
39)	Depreciation percentage (from applicable table or method)	39) %
40)	Depreciation allowable (multiply line 38 by line 39)	40)

Part 4 Carryover of Unallowed Expenses to Next Year

41)	Operating expenses. Subtract line 25 from line 24. If less than zero, enter 0-	41)
42)	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42)

Recordkeeping Requirements

Taxpayers are required to keep records that provide information needed to figure the deduction for business use of the taxpayer's home. Thus, a taxpayer should keep canceled checks, receipts, and other evidence of expenses he or she paid. In connection with the home-office deduction, the taxpayer's records must show the following information:

- The part of the taxpayer's home used for business purposes;
- That the taxpayer used part of the home exclusively (unless its use constituted an exception from the exclusive use requirement) and regularly for business as –
    a) The taxpayer's principal place of business, or

b) The place where the taxpayer meets or deals with clients or customers in the normal course of business.

In addition, the taxpayer must keep records to prove the home's depreciable basis, including records evidencing:

- When and how the taxpayer acquired the home;
- The home's original purchase price;
- Any improvements made to the home; and
- Any depreciation the taxpayer is allowed because of maintaining an office in the home.

Taxpayers must keep the records required to support their deduction for business use of a home for as long as they are important for any tax law. Accordingly, applicable records should normally be kept until the later of:

- Three years from the tax return due date or the date filed; or
- Two years after the tax was paid.

Summary

A taxpayer's deduction for business use of a home is taken on IRS Form 1040. If a self-employed taxpayer or statutory employee uses his or her home in a trade or business and files Schedule C, the entire deduction for business use of the taxpayer's home should be reported on Schedule C, line 30. If the taxpayer who files Schedule C uses the actual expense method of determining the home office deduction, Form 8829 should be attached to Schedule C. If the taxpayer uses a home in his or her farming business and files Schedule F, the entire deduction for business use of the home should be reported on line 32 of Schedule F. The words "business use of home" should be entered on the adjacent dotted line.

If the taxpayer uses the simplified method of determining the home-office deduction, expenses that are deductible irrespective of whether a business is involved are treated as personal expenses and do not figure into the deduction allowed for business use of the taxpayer's home. However, if the taxpayer uses the actual expense method of figuring the home-office deduction, the tax return preparer should deduct the business portion of these expenses on Schedule C or Schedule F, as appropriate. If the taxpayer itemizes deductions, he or she will deduct the personal portion of these expenses on Schedule A.

Certain other expenses—other than those deductible whether or not a business is involved—are generally deductible only when the taxpayer's home is used for business purposes. Those expenses that are deductible by a taxpayer using the actual expense method only to the extent related to the business use of the taxpayer's home include insurance, maintenance, utilities and depreciation of the home. The personal portion of any of these expenses remains nondeductible. If the taxpayer uses the simplified method of determining the home-office deduction, these expenses do not figure into the deduction allowed for business use of the taxpayer's home.

Taxpayers must keep records that provide information needed to figure the deduction for business use of their home, including canceled checks, receipts, and other evidence of paid expenses. When such records are retained to show how the home-office deduction was determined, they must show a) the part of the taxpayer's home used for business purposes, b) that the taxpayer used part of the home exclusively (unless its use constituted an exception from the exclusive use requirement) and regularly for business as the taxpayer's principal place of business, or the place where the taxpayer meets or deals with clients or customers in the normal course of business.

In addition, the taxpayer must keep records to prove the home's depreciable basis, including records evidencing a) when and how the taxpayer acquired the home, b) the home's original purchase price, c) any improvements made to the home, and d) any depreciation the taxpayer is allowed because of maintaining an office in the home. The required records must be kept for as long as they are important for any tax law, generally the later of a) three years from the tax return due date or the date filed, or b) two years after the tax was paid.

Chapter Review

1. Arthur is a full-time insurance agent who works solely for MegaMutual and is considered a statutory employee. Where should his home-office expenses be reported?
   A. On Schedule A, line 6
   B. On Schedule A as unreimbursed employee expenses
   C. On Schedule F, line 32
   D. On Schedule C, line 30
2. Shirley is a self-employed attorney whose business home office percentage is 25%. If she pays $10,000 in real estate taxes for her home, how much of that amount, if any, would be deductible for purposes of her home office deduction?
   A. $0
   B. $2,500
   C. $5,000
   D. $10,000
3. For how long are taxpayers generally required to keep records needed to support their deduction for business use of their home?
   A. Until they file a federal income tax return for the following year
   B. For two years from the tax return due date
   C. For the longer of two years following payment of the tax or three years from the tax return due date or date filed
   D. Seven years following the date of any tax paid

Answers to Chapter Review Questions

Chapter 1

Question 1 Answer

A. Your answer is incorrect. The mere fact that Philip is an employee does not preclude his home-office deduction with respect to his self-employed activities. Please try again.

B. Your answer is correct. With certain specified exceptions, the taxpayer must use the office *only* for the business to qualify for a home-office deduction. Since the taxpayer uses it for business and also uses it for personal purposes the taxpayer does not qualify for a home-office deduction.

C. Your answer is incorrect. Although under tax law prior to the Tax Cuts and Jobs Act, Philip's use of the office must have been for the convenience of his employer to enable him to obtain a tax deduction when used to perform work for his employer, that deduction is no longer available. Please try again.

D. Your answer is incorrect. Philip's failure to meet with clients in his home does not disqualify him from taking a home-office deduction in this case. Please try again.

Question 2 Answer

A. Your answer is correct. A daycare facility is an exception to the exclusive use requirement. Thus, Sally may operate a daycare facility in part of her home and use the space at other times for personal purposes without forgoing the home-office deduction.

B. Your answer is incorrect. Although the use of a home office as a place to meet clients allows a professional to take a deduction despite not being the principal place of business, it is not an exception to the exclusive use requirement. Please try again.

C. Your answer is incorrect. Bob's separate structure must be used exclusively for his business. Its use for personal purposes will disqualify the taxpayer from taking a home-office deduction for the expenses associated with it. Please try again.

D. Your answer is incorrect. Bill must meet all the applicable requirements including exclusive use of the home office for business. Please try again.

Chapter 2

Question 1 Answer

A. Your answer is incorrect. Although a taxpayer using the actual expense method cannot deduct expenses for home use when the home was not being used for business, Helen's expense was incurred when the home was being used for business. Please try again.

B. Your answer is incorrect. Helen's expenses are part direct costs and part indirect costs, some of which are fully deductible and others subject to her 20% business percentage. Please try again.

C. Your answer is correct. Helen's $3,120 deduction is comprised of her indirect costs for homeowners insurance adjusted for her 20% business percentage and 6-month use of the office and her direct costs to paint the office.

D. Your answer is incorrect. Although some expenses are direct expenses incurred after Helen put the office in use, part of her expenses are indirect costs subject to adjustment for a partial year and the applicable business percentage. Please try again.

Question 2 Answer

A. Your answer is correct. Harry's deduction, exclusive of depreciation, is $60. Installation costs are depreciated but the expense to maintain the system is deductible, subject to the applicable business percentage. ($600 x .10 = $60)

B. Your answer is incorrect. The costs for installing the home security system are depreciated while the cost for system maintenance is deductible subject to the applicable business percentage. Please try again.

C. Your answer is incorrect. Installation costs of a home security system are depreciable because the system is deemed to add value to the property. Please try again.

D. Your answer is incorrect. The costs paid by the taxpayer for maintaining and monitoring the home security system are deductible, subject to the percentage of the home used for business purposes. The installation costs are depreciable. Please try again.

Question 3 Answer

A. Your answer is incorrect. Although the home-office deduction is limited to no more than $1,500, George's business expenses not related to the business use of his home continue to be deductible. Please try again.

B. Your answer is incorrect. Since George's costs for business telephone and internet apply solely to the business, they are not subject to the business percentage use of the house. Please try again.

C. Your answer is incorrect. The simplified method limits George's home-office deduction to the prescribed rate times no more than 300 square feet, and his business telephone and internet service expenses are deductible. Please try again.

D. Your answer is correct. George's business deduction is $2,700, comprised of a $1,500 home-office deduction and business expenses not related to his home of $1,200.

Question 4 Answer

A. Your answer is incorrect. Harry's use of his home office in September must be counted in the average because it is at least 15 days of use. Please try again.

B. Your answer is correct. Harry's home-office deduction is $500, calculated by multiplying the office area by four months, dividing by 12 and multiplying the result by the $5 prescribed rate. (300 x 4 = 1,200; 1,200 ÷ 12 = 100; 100 x $5 = $500)

C. Your answer is incorrect. Although the answer selected shows that the proper number of months was used—four months, in this case—the maximum square footage used for any month is 300. Please try again.

D. Your answer is incorrect. The maximum amount of square footage that may be used to determine the average is 300. In addition, any month in which the office is used for fewer than 15 days is considered unused for the entire month. Please try again.

Question 5 Answer

A. Your answer is incorrect. Daycare providers are permitted to deduct a portion of the meals provided to certain staff members who are not part of the provider's family. Please try again.

B. Your answer is correct. If a daycare provider provides food for customers, the expense is claimed as a separate deduction on Schedule C and is limited to the total of the cost of food eaten by customers and half the cost of food eaten by employees.

C. Your answer is incorrect. A daycare provider may be able to deduct 0%, 50% or 100% of the food consumed, depending on who eats it. Please try again.

D. Your answer is incorrect. The entire cost of food consumed is deductible only when that food is eaten by daycare recipients. Please try again.

Chapter 3

Question 1 Answer

A. Your answer is incorrect. Only if the taxpayer itemizes deductions and pays certain "other taxes" would the taxpayer utilize Schedule A, line 6. Please try again.

B. Your answer is incorrect. Prior to passage of the Tax Cuts and Jobs Act, regular employees who incurred business expenses in the performance of their employer's business had limited ability to deduct the expenses they incurred; following passage of TCJA, that ability ended. However, Arthur is a *statutory* employee. Please try again.

C. Your answer is incorrect. Schedule F is reserved for reporting the profit or loss from farming activities. In this case, the taxpayer is an insurance agent. Please try again.

D. Your answer is correct. As a statutory employee, Arthur should report his home office expenses on Schedule C, line 30. Since he is a statutory employee, the entire deduction for business use of the home should be reported.

Question 2 Answer

A. Your answer is incorrect. Although Shirley's real estate taxes are deductible within certain limits, the deduction is apportioned between her business use and non-business use. Please try again.

B. Your answer is correct. Only the portion of the real estate taxes equal to the taxpayer's home office use percentage is deductible for purposes of the home office deduction. The balance of the real estate taxes would be deductible, within limits, by an itemizing taxpayer.

C. Your answer is incorrect. While only the part of the real estate taxes attributable to home office use would be deductible for purposes of the home office deduction, the amount is not $5,000. Please try again.

D. Your answer is incorrect. Even though Shirley's real estate taxes may be deductible within limits, only part of her real estate tax payment is deductible as a home office deduction. Please try again.

Question 3 Answer

A. Your answer is incorrect. The records supporting the business use of a home must be kept for as long as important for any tax law. Meeting that standard requires they be kept for longer than one year. Please try again.

B. Your answer is incorrect. A taxpayer may be required to produce documents supporting his or her home office deduction for a period longer than two years. Please try again.

C. Your answer is correct. Applicable records should normally be kept until the later of a) three years from the tax return due date or the date filed, or b) two years after the tax was paid.

D. Your answer is incorrect. Although maintaining home office deduction records for seven years would meet the general record maintenance requirements, such records do not normally need to be maintained for that long. Please try again.

Glossary

Actual expense method	The actual expense method of figuring a home-office deduction uses the actual expenses incurred by the taxpayer as the basis for determining the deduction allowable for business use of the taxpayer's home.
Adjusted basis	The adjusted basis of the taxpayer's home is equal to its cost, plus the cost of any permanent improvements made by the taxpayer to the home before the taxpayer began using the home for business, minus any casualty losses or depreciation deducted in earlier tax years.
Carryover	If the taxpayer's home-office deduction in any year is reduced by the deduction limit, the taxpayer may carry over the excess to the next year in which he or she uses the actual expense method in claiming a home-office deduction.
Daycare facility	A business engaged in providing supervision and other services to children, adults age 65 and over, and persons who are physically or mentally unable to care for themselves and which is operated by a taxpayer exempt from or possessing certain specified credentials.
Depreciation	Depreciation is a tax deduction designed to reflect the wear and tear on the portion of the taxpayer's home used for business.
Direct expenses	Direct expenses are expenses applicable to and affecting only the business part of the taxpayer's home.
Exclusive use requirement	The general rule that applies to qualifying for a home-office deduction requires that the taxpayer use a specific area of the home ***only*** for the trade or business.
Expenses deductible by all homeowners	Expenses deductible by all homeowners are expenses that are deductible by the taxpayer whether or not the home is used for business purposes.
Fair market value	The fair market value of a taxpayer's home is the price at which the property would change hands between a buyer and a seller, assuming neither is under a compulsion to buy or sell, and both possess reasonable knowledge of all necessary facts concerning the transaction.
Gross income limitation (simplified method)	Under the gross income limitation applicable to the simplified method, a taxpayer's home-office deduction is limited to an amount equal to the taxpayer's gross income derived from the qualified business use of the home reduced by the business deductions that are unrelated to the use of the taxpayer's home.
Home-office deduction	An income tax deduction for use of a taxpayer's home for business purposes.
Indirect expenses	Indirect expenses are those expenses the taxpayer incurs for keeping up and running his or her entire home.
Percentage used for business	The percentage of the home used for business is the decimal derived by dividing the square footage of the space in the home used for business purposes by the total square footage of the home.

Permanent improvement	A permanent improvement is one that increases the value of the property, extends the life of the property or gives the property a new or different use.
Recapture	A taxpayer who claims depreciation as part of the home office deduction is required to recapture the total amount of depreciation taken, or which could have been taken, at the time the property is sold.
Simplified method	An alternative to the actual expense method of figuring the home-office deduction in which the deduction is equal to the square footage of the space used for business purposes, not exceeding 300 square feet, multiplied by the prescribed rate.
Standard meal and snack rates	If the taxpayer qualifies as a family daycare provider, the standard meal and snack rates may be used instead of actual food costs to compute the deduction for the cost of meals and snacks provided to eligible children.
Unrelated expenses	Unrelated expenses are expenses incurred by the taxpayer that are neither direct nor indirect expenses; such expenses are not deductible for purposes of the home-office deduction.

Index

Final Exam

Home Office Deduction

The following exam is attached only for your convenience. To access the official exam for this self-study course, please log into your account online and take the Final Exam from the course details page. A passing score of 70 percent or better will receive course credit and a Certificate of Completion.

1. Which of the following taxpayers may qualify for a home-office deduction for business use of the taxpayer's home even though the use of the space is NOT exclusive to the business?

A. Shirley, who uses part of her home in her beauty shop

B. Bob, a self-employed chiropractor, who uses a room in his home to see patients

C. Audrey, who operates a daycare facility

D. Arthur, a statutory employee, who uses a room in his home to schedule appointments with clients

2. An activity for which a home-office deduction may be allowed must be

A. profitable

B. a trade or business

C. charitable

D. professional

3. Which of the following is NOT a requirement under the general rule permitting a self-employed taxpayer to take a deduction for business use of his or her home?

A. It must be used exclusively for the business activity

B. It must be used regularly for the business activity

C. It must be the principal place of business for the taxpayer

D. It must be used as a place in which the taxpayer sees customers, patients or clients

4. Which of the following will normally cause a taxpayer to lose a tax deduction for use of part of a home for business purposes?

A. Using the home office for non-business activities

B. Using the home office to engage in more than one business

C. Using the home office to store samples or inventory used in a business

D. Sharing the home office with another taxpayer also engaged in a business activity

5. Which of the following taxpayers may qualify for a home-office deduction even though the home office is not the taxpayer's principal place of business?

A. Arthur, a salesman, who uses his home office to schedule sales appointments

B. Shirley, a psychologist, who uses her home office as a place to see patients

C. Helen, a business owner, who uses her home office to plan her business activities

D. George, a retired lawyer, who uses his home office to manage his investment portfolio

6. **What requirement must be satisfied in addition to providing daycare services to specified daycare recipients in order for a daycare facility to qualify for an exception to the exclusive use rule?**

   A. The taxpayer must have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group day care home under state law

   B. The taxpayer must be self-employed

   C. The facility must be a member of the National Association of Daycare Providers

   D. The facility must provide meals and snacks to daycare recipients

7. **In connection with the actual expense method of figuring the deduction for business use of a home, a taxpayer's expenses applicable to and affecting only the business part of the taxpayer's home are referred to as which of the following?**

   A. Direct expenses

   B. Qualified expenses

   C. Indirect expenses

   D. Unrelated expenses

8. **For purposes of figuring the home-office deduction, the term __________ refers to an expense a taxpayer incurs for keeping up and running his or her entire home.**

   A. direct expense

   B. unrelated expense

   C. qualified expense

   D. indirect expense

9. **Which of the following expenses are deductible under the home-office deduction only in an amount equal to the total of such expenses multiplied by the percentage of the home used for business?**

   A. Indirect expenses

   B. Direct expenses

   C. Unrelated expenses

   D. Qualified expenses

10. **Harry began using part of his home for business purposes this year. Over what period must he figure depreciation for purposes of his home-office deduction?**

    A. 5 years

    B. 7 years

    C. 25 years

    D. 39 years

11. **Ellen uses 10% of her home for business purposes and qualifies for a home-office deduction. If the space she used for business for the entire year was 400 square feet and she uses the simplified method, for what home-office deduction would she qualify?**

    A. $1,500

    B. $2,000

    C. $2,500

    D. $3,000

12. Which of the following expenses is NOT deductible when a taxpayer uses the simplified method of calculating the home-office deduction?

A. Business telephone expenses

B. The cost of repairs to the office

C. The cost of cleaning carpeting in the office

D. Depreciation

13. John used part of his home for business purposes during the year and qualifies for a home-office deduction. If he used his 300 square foot office for 15 days in May, the entire months of June through September and 14 days in October, what is his home-office deduction under the simplified method?

A. $500

B. $625

C. $750

D. $1,000

14. **Peter operates a daycare facility and provides meals and snacks to eligible children and staff. How much of the actual cost of food consumed by non-related staff may Peter deduct**?

A. 0%

B. 25%

C. 50%

D. 100%

15. Harriet, a self-employed beautician, qualifies for a home-office deduction for use of part of her home as a beauty shop. She uses the simplified method. Where should she enter that deduction?

A. On Schedule A

B. On Schedule F

C. On Schedule C

D. On Form 8829