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## Business Use of Your Home

### Quick Notes...

You can deduct expenses for the business use of your home if you use part of your home exclusively and regularly for business.

IRS Form 8829 *Expenses for Business Use of Your Home* must be completed to claim a home office deduction.

Tax laws are complex, individualistic, and ever changing. You should consult your income tax professional.

This article discusses the business use of your home and deducting related expenses on Schedule C or Schedule F of your income tax return. *Day Care Facilities* are not included in this discussion since specific rules pertain to such businesses.

### Requirements For Claiming The Deduction

You can deduct expenses for the business use of your home if you use part of your home exclusively and regularly:

1. As the principal place of business for any trade or business in which you engage, or

2. As a place of business to meet or deal with patients, clients, or customers in the normal course of your trade or business.

"Exclusive use" means only for business. The business part of your home can be a room or other separately identifiable space, but it does not necessarily have to be marked off by a permanent partition. If you use part of your home as your business office and also use that part for personal purposes, you do not meet the exclusive use test.

Two exceptions to the exclusive use test are (1) the use of part of your home for the storage of inventory or product samples, and (2) the use of part of your home as a day care facility.

"Regular use" means use on a continuing basis. Occasional or incidental business use of part of your home does not meet the regular use test even if that part is used for no other purpose.

"Principal place of business" is ultimately determined by (1) the relative importance of the activities performed at each business location, and (2) the time spent at each business location. A comparison of the relative importance of the activities performed at each location depends on the characteristics of the business.

If the nature of the business requires that you meet with clients, or that you deliver goods or services to a customer, the place where that contact occurs must be given great weight in determining where the most important activities are performed. Performance of necessary or essential activities in your home office (such as planning for services or delivery of goods, or the accounting for those activities or goods) does not, in and of itself, allow you to claim a home office deduction.

In addition to comparing the relative importance of the activities performed at each business location, a comparison must be made of the time spent on business at home with the time spent on business at other locations.

The "Taxpayer Relief Act of 1997" expanded the definition of "principal place of business" so that a home office qualifies as a taxpayer's place of business if:

1. The office is used by the taxpayer to conduct administrative or management activities of the taxpayer's trade or business, and
2. There is no other fixed location where the taxpayer conducts substantial administrative or management activities of the trade or business.

The expanded definition of a principal place of business will enable many taxpayers to deduct the cost of traveling to and from their homes to other locations at which they conduct business. However, the effective date for this change begins after 31 December 1998.

### **Direct Expenses**

If you use part of your home for business and meet the requirements discussed previously, you can deduct all of your direct expenses.

Direct expenses benefit only the business part of

your home. Some examples might be office supplies, long distance telephone calls, subscriptions and books, and postage. Also included are painting or repairs made to the specified area or room used for business.

### **Indirect Expenses**

Indirect expenses are for keeping up and running your entire home. They benefit both the business and personal parts of your home. Examples of indirect expenses include real estate taxes, deductible mortgage interest, utilities, repairs, security systems, and depreciation.

To figure deductions for the business use of your home, you must first find the business percentage. You can do this by dividing the number of square feet of space used for business by the total number of square feet of space in your home. (You can use any other reasonable method to determine the business percentage).

*Real Estate Taxes:* To figure the business part of your real estate taxes, multiply the real estate taxes paid by the percentage of your home used for business.

*Deductible Mortgage Interest:* To figure the business part of your deductible mortgage interest, multiply this interest by the percentage of your home used for business. Your deduction may be limited if your mortgage debt and home equity debt exceed certain levels.

*Utilities and Services:* Expenses for utilities and services, such as electricity, gas, trash removal, and cleaning are primarily personal expenses. However, you may deduct a portion of such expenses based upon the business percentage of your home.

*Telephone:* The basic local telephone service charge, including taxes, for the first telephone line into your home is a nondeductible personal expense. However, charges for business long-distance phone calls on that line

are deductible business expenses. The cost of a second line into your home used exclusively for business may also be deducted.

*Insurance:* You can deduct the cost of insurance that covers the business part of your home. However, if your insurance premium gives you coverage for a period that extends past the end of your tax year, you can deduct only the business percentage of the part of the premium that gives you coverage for your tax year.

*Repairs:* The cost of repairs and supplies that relate to your business (not permanent improvements) is a deductible expense. Again, multiply the repair costs by the percentage of business use.

### **Casualty Losses**

If you have a casualty loss on your home that you use in business, treat the casualty loss as an unrelated expense, a direct expense, or an indirect expense, depending on the property affected.

1. If the loss is on the portion of the property you use only in your business, the entire loss is used to figure the business use of the home deduction (direct expense).
2. If the loss is on property you do not use in your business, none of the loss is used to figure the deduction (an unrelated expense).
3. If the loss is on property you use for both business and personal purposes, only the business portion is used to figure the deduction (an indirect expense).

### **Depreciation**

The cost of property that can be used for more than one year, such as a building, permanent improvement, or furniture, is a capital expenditure. You generally cannot deduct its

entire cost in one year.

Permanent improvements increase the value of the property, add to its life, or give it a new or different use. Examples are replacement of wiring or plumbing, a new roof, an addition, remodeling, or major modifications. If you make repairs as part of an extensive remodeling or restoration of your home, the entire job is an improvement.

To figure depreciation on the business part of your home, you need to know:

1. The business use percentage of your home,
2. The first month in your tax year for which you can deduct business use of your home expenses, and
3. The adjusted basis and fair market value of your home at the time you qualify for a deduction. Adjusted basis is generally the cost of the home plus the cost of any permanent improvements minus any casualty losses deducted in earlier tax years.

### **Deduction Limit**

If gross income from the business use of your home equals or exceeds total business expenses (including depreciation), you can deduct all your expenses for the business use of your home.

However, if gross income from the business use of your home is less than total business expenses, the deduction for certain expenses for the business use of your home is limited. Total deductions for otherwise nondeductible expenses (such as utilities, insurance, and depreciation) cannot be more than the gross income from the business use of your home minus the sum of (1) the business percentage of the otherwise deductible mortgage interest, real estate taxes, and casualty and theft losses, and (2) the business expenses that are

attributable to the business activity in the home, but not to the use of the home itself (for example, salaries or supplies).

You can carry forward to the next tax year deductions over the current year's limit. These deductions are subject to certain limitations.

### **Recordkeeping**

You do not have to use a particular method of recordkeeping, but you must keep records that provide the information needed to figure your deductions for the business use of your home. You should keep canceled checks, receipts, and other evidence of expenses.

You must keep your records for as long as they are important for any federal tax law. This is usually three (3) years from the date the return is filed. Records supporting the basis in your home should be kept for as long as they are needed to figure the correct basis of your original or replacement home, plus three years from the date the applicable tax return is filed.

### **IRS Form 8829**

Expenses for business use of your home are reported on IRS Form 8829. It, and the accompanying instructions, identifies the

allowable expenses that can be claimed on Schedule C of Form 1040 or carried over to preceding tax years.

### **Professional Assistance**

Tax laws are complex, individualistic, and ever changing. This article is educational in nature; thus not all issues related to specific tax laws could be discussed.

Some income tax deductions, such as home office deductions, are thought by some income tax professionals to be "red flags" for audits due to the potential for abuse by taxpayers. It is important that you contact an income tax professional regarding your ability to deduct expenses related to the business use of your home.

For additional information, please contact:

1. Publication 587, Business Use of Your Home.
2. <http://www.irs.ustreas.gov>
3. FAX (703) 487-4160

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*Notes...  
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