

Business Use of Home



LET'S START A CONVERSATION

We'd love to meet you, talk about your financial goals, and see if we're the right fit to help you get there.

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Business Use of Home Expenses

Some expenses are deductible whether or not you use your home for business. Others are deductible only if the home is used for business.

Deductible Regardless	Deductible Only If for Business**
<ul style="list-style-type: none"> • Real estate taxes.* • Mortgage interest.* • Casualty losses.* • Qualified mortgage insurance premiums, if available. 	<ul style="list-style-type: none"> • Homeowner's insurance. • Rent. • Repairs and maintenance. • Security system. • Utilities and services. • Depreciation (deductible after applying deduction limitation to above expenses).

* Deductible as an itemized deduction, subject to limitation.

** Deductible as a business expense pro-rated for the amount of the business use of the home

Direct Expenses

Expenses that benefit only the area exclusively used for business, such as painting or repairs in the home office, are direct expenses that are fully deductible.

Indirect Expenses

Expenses for keeping up and running the entire home, such as insurance, utilities, and general repairs, are indirect expenses that are deductible based on the percentage of the home used for business.

Unrelated Expenses

Expenses for the part of the home not used for business, such as lawn care or painting a room not used for business, are unrelated expenses that are not deductible.

Telephone

The basic local telephone service for the first telephone line is nondeductible even if it is used for business. Any additional charges for long distance or a second line into the home used for business are deductible. Any deductible telephone costs are not included as business use of home cost.

Depreciation

A qualified home office is considered nonresidential real property depreciable over 39 years. For home office depreciation, the basis in the home is the smaller of:

- The fair market value (FMV) of the home minus the FMV of land on the date the home was first used for business, or
- The home's cost plus permanent improvements minus casualty losses minus the cost of land on the date the home was first used for business.

Home Improvements

Permanent improvements prior to using the home for business are added to the basis of the home and depreciated as part of the adjusted basis of the home. The cost of improvements made after using the home for business that affect the area of the home used for business are depreciated separately.

Example: Rita had a new roof put on her home in 2004. She first used her home for business in 2008. She also replaced her furnace in 2020. The cost of the new roof from 2004 is added to the basis of her home, and the business portion is depreciated over 39 years, starting in 2008. The business portion of the furnace cost is depreciated as a separate asset over 39 years, starting in 2020.



Business Use of Home

Calculating Business Use of Home Deduction

Business Percentage

The business percentage equals the area of the part of the home used for business divided by the area of the whole house. Any reasonable method may be used to determine the business percentage.

The following are two common methods.

- Divide square footage of area used for business by total square footage of home.
- If all rooms are about the same size, divide the number of rooms used for business by total number of rooms in the home.

Part-Year Use

Do not include home expenses in the business use equation for any period during the year where the home was not used for business.

Day Care Facility

The business percentage of an area exclusively used for business in a day care facility is calculated under the business percentage method above. For the portion of the home regularly used, but not exclusively used for the day care business, multiply that portion by the business percentage of time.

Example: Jane uses her 1,600 square foot basement for her daycare business. The total area of her home is 3,200 square feet so her business-use percentage is 50% ($1,600 \div 3,200$). Her daycare used the basement for a total of 3,000 hours during the year. The total number of hours for the year was 8,760 (24 hours \times 365 days) so her daycare time percentage is 34.25% ($3,000 \div 8,760$). Any direct expenses, such as repainting the basement, are multiplied by 34.25% to determine the deductible business portion of the expense. Any indirect expenses, such as utilities, are multiplied by 17.13% ($50\% \times 34.25\%$) to determine the deductible business portion of the expense.

Did You Know? In many cases, the basement and garage may be included in the total square footage of a day care provider's home when calculating the business use percentage. In addition to regularly used rooms, the business use area can include:

- Entryways, halls, food preparation areas, and bathrooms.
- Basement with laundry or tool rooms, storage or furnace area, etc.
- Garage where business car is parked or where household tools, trash cans, or stored day care items are kept.

Calculating Time Spent on Day Care

You should keep a log reflecting time spent conducting the day care business, including dates and hours each person was in your care, and additional time spent organizing, preparing meals, and cleaning up.

Deduction Limitation

The business use of home deduction is limited to net income from the business.

Carryover of Unallowed Expenses

Deductions not allowed due to the net income limitation are carried over to the following year. They are added to current expenses from each category and subject to the deduction limit for that year for that category, whether or not you live in the same home during that year.

Simplified Option for Home Office Deduction

The simplified option for the home office deduction may be calculated as follows:

- A standard deduction is allowed of \$5 per square foot of home used for business, limited to 300 square feet.
- Allowable home-related itemized deductions such as mortgage interest and real estate taxes are claimed in full on Schedule A, instead of apportioned between the business form and Schedule A.
- No home depreciation deduction is claimed and no later recapture of depreciation is required for the years the simplified method is used.

Note: Although recordkeeping is simplified, this option does not change the criteria for who may claim a home office deduction.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 72.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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