

Administrative and Management Activities Test

Tax Relief Act of 1997 liberalizes home office use by retaining all of the pre-established conditions (e.g. regular and exclusive use, storage of inventory and samples, separate structure, a place to meet patients, clients, or customers) but adds that a home office also qualifies as a principal place of business if:

- The office is used on an exclusive and regular basis for the administration or management activities of any trade or business and,
- There is no fixed location of the trade or business where you conduct substantial administrative or management activities of the trade or business

Therefore, a home office deduction is allowed if a portion of the home is exclusively and regularly used to conduct administrative and management activities as long as you don't perform these duties at another location even though some administrative and management activities may be conducted by someone else at another location.

This home office deduction is allowable even if you perform administrative or management activities outside the home in a non-fixed location (e.g. auto or hotel room) or if in another fixed location, the administrative or management activities are not substantial. This liberalization of home office deductibility benefits:

- Doctors and nurses whose job performance primarily occurs in the hospital
- Sales people when most of their time spent in customers' offices
- Authors and writers whose time is mostly spent with publishers, on publicity tours or doing research outside the home
- Teachers who perform their duties at schools and universities
- Contractors, painters, plumbers and similar trades people who spend most of their time on job sites
- Employees who work out of their home for the convenience of their employer also qualify

Tip: Previously nondeductible commuting costs may now become deductible business travel costs as the principal place of business will now include your home office.

IF YOU ARE AN EMPLOYEE

A home office deduction may be possible if:

- The business use of your home is for the convenience of your employer.
- Convenience of the employer is defined as a business necessity on which employment is based.
- Use for personal convenience is not an adequate qualification.

FIGURING THE BUSINESS DEDUCTION

- Divide the area used for business by the total area in your home to determine the pro-rate share of rent, utilities, and other expenses.
- Capture depreciation based on the lower of either the adjusted basis or fair market value of your home at the time business use begins.

Caution: If the business is active less than a full year consider the time period in business for which the deduction is allowed.

- Costs incurred in repairing and painting directly in the business rooms are totally deductible. These same costs in the rooms which don't benefit the business room are not deductible but you may allocate business and non-business portions of these costs if the benefit is to both.
- Expenses of lawn care and landscaping are not deductible.
- Telephone costs:
 - The basic costs for the main first line into your residence are not deductible.
 - Long distance business charges are deductible.
 - Deduct the business portion of additional line costs and rental equipment.
- Deductions are limited to the gross income from business use of the home office (except for mortgage interest & property taxes).
- Deductions in excess of the current year's limitation may be carried forward.
- When sale of residence occurs, all depreciation for home office must be recaptured in sale of residence gain or loss calculations. So save those home improvement receipts.

HOME OFFICE

Keeping track of deductible expenses



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HOME OFFICE

Today, more and more people are working from their homes. This is readily made possible due to technological advances such as the computer, cell phones, internet and e-mail. If you are running a business out of your home or thinking about starting an in-home business, the information in this brochure should be helpful in detailing when and how you can claim the tax deductions available to you.

HOME OFFICE GUIDELINES

Under liberalized guidelines for Home Office Deductions more people will be eligible to deduct home office expenses. The rules allow workers such as plumbers, contractors and consultants, who primarily perform services away from home, to deduct their home office expenses. Prior to 1997 it was very difficult for home-based workers whose jobs routinely took them out of their homes to qualify for home office expense deductions.

While more details will follow, generally:

- Specific tests must be passed to take advantage of home office deductions
- There is a limitation on the amount of otherwise non-deductible expenses
- The term “home” includes a house, apartment, condominium, mobile home or boat. It includes structures on the property, such as an unattached garage, studio, barn or greenhouse
- The term “home” does not include any part of the property used as a hotel or inn

On-going Trade or Business Test

If the space is used in a trade or business on a regular and continuing basis:

- To provide daycare services
- As a place to meet with patients, clients or customers
- To store inventory for a wholesale or retail sales business and your home is the business’ only fixed location

- In a separate structure which is not attached to your residence and is used exclusively for business
- As the principal place of business for your trade or business

Importantly, you must present sufficient evidence to convince the IRS that business was conducted on a regular basis.

Note: Management by an individual of his/her investment portfolio is not considered a trade or business.

Exclusive Use Test

- There can be no personal use (other than minimal personal use) of the home office portion of the residence at any time during the taxable year.
- The use of only a portion of a room is acceptable as long as you can prove a particular portion of the room was used exclusively for business.
- There are exceptions to the exclusive use condition if:
 - inventory is kept for use in selling products at whole sale or retail.
 - the residence is the only fixed location of your trade or business; and the space is separately identifiable (a portion of a room regularly used is acceptable).

Tip: If the space must be used to store inventory, the cost of storage space for books, files or equipment cannot be deducted unless you qualify under one of the following tests:

- The space is used for storage of product samples, thus you need not attempt to distinguish between inventory and product samples
- The space is used as a Daycare Facility, provided you comply with all state approval requirements and you are in the business of providing day care for children, persons 65 or older or persons who are physically or mentally unable to care for themselves.

Separate Structures Test

- You can deduct expenses for a separate and free-standing structure, such as a studio, barn or garage if

you use the structure exclusively and regularly in your business. The structure does not have to be your principal place of business or the place you meet patients, clients, or customers.

Place to Meet Patients, Clients or Customers

- The patients, clients, or customers must be physically present on the premises.
- Conversations with you by telephone do not constitute use of the premises by patients, clients, or customers.
- The use of the dwelling unit by patients, clients, or customers must be substantial and integral to the conduct of your business.

Principal Place Of Business Test

- A taxpayer is deemed to have a principal place of business for each trade or business in which you engage.
- When you engage in a single trade or business at more than one location, the principal place of business is determined in light of the specific facts and circumstances of running the business.

Note: The Supreme Court has held that the principal place of business is a subjective process that must be made on the facts of each case by comparing two primary factors:

- A. The relative importance of the business activities performed at each location; and,
- B. The time spent working at each place

One’s best bet to insure the home office deduction without IRS challenge is to:

- Work in a separate structure or portion of your home
- Meet with customers at home
- Show that the most important activities are performed at home

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This publication provides only summary information regarding the subject matter. Please call with any questions on how this information may impact your situation.