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### **REPORT FROM COUNSEL FEBRUARY 2014 ISSUE**

#### **DEDUCTING THE BUSINESS USE OF YOUR HOME**

The federal income tax deduction for the business use of a home has a good dollars-and-cents upside for those who qualify. Some detailed questions have to be answered correctly to get to that point, however. Not surprisingly, the IRS publication on the subject makes use of a complex flowchart filled with “yes or no” questions to guide taxpayers to a determination of their eligibility for the deduction.

##### *Qualifying for the Deduction*

To pass the threshold for use of the home business deduction, a taxpayer must satisfy the following two basic sets of requirements: The first set concerns the nature of the business activities, while the second set relates more to the place itself.

First, the use of the business part of the home must be exclusive (with exceptions to be discussed), regular, and for the business. Second, the business part of the home must be one of the following: the principal place of business—the place where the taxpayer meets or deals with patients, clients, or customers in the normal course of business—or a separate, detached structure used for business.

The exclusive use factor means that the area is used *only* for business, not for a mixture of business and personal uses. However, the

exclusive use requirement does not have to be met when a part of the home is used for the storage of inventory or product samples or for a day-care facility. Be aware that not every activity that makes money for the taxpayer constitutes the use of the home for a trade or business: If you use a computer in your den for day-trading stocks or online gambling, do not count on taking the deduction.

As for what constitutes a “regular” use for business, that essentially means business conducted on a continuing basis, not occasionally. Even if a taxpayer has a place in the home used exclusively for business, the deduction is not available if the business activity is only sporadic.

As for the requirements relating to the place itself, the area in the home used for business is a “principal place of business” if it is used exclusively and regularly for the administrative or management activities of the business and there is no other fixed location where substantial activities of that kind are carried out. If some business is transacted at more than one location, determining whether the home location is the principal place of business requires consideration of the relative importance of the activities at each location.

If that does not provide an answer, the time spent at each site should be considered.

Remember that the deduction is available if either the home is the place for meeting with patients, clients, or customers, or a separate structure on the premises is dedicated for business.

If the taxpayer is an employee using part of his or her home for business, the deduction is available if all the requirements described above are met, plus additional tests. The business use must be for the convenience of the employer (not just appropriate or helpful). If the taxpayer rents part of his or her home to his or her employer and uses the rented part in performing services for the employer as an employee, the deduction for the business use of the home is limited.

Mortgage interest, qualified mortgage insurance premiums, real estate taxes, and personal casualty losses for the rented part are deductible, subject to any limitations. However, the taxpayer cannot deduct otherwise allowable trade or business expenses, business casualty losses, or depreciation related to the use of the home in performing services for the employer.

#### *What Is Deductible?*

Deductible expenses for a business use of the home include items such as the business portion of real estate taxes, deductible mortgage interest, rent, casualty losses, utilities, insurance, depreciation, painting, and repairs. This is not likely to be an all-or-nothing proposition, though. Generally, an expense is fully deductible if it is direct, that is, incurred only for the business part of the home.

An indirect expense, incurred for running the home as a whole, is deductible based on the percentage of the home used for business. Any reasonable method for determining that percentage is acceptable, such as dividing the square feet used for business by the total square feet or dividing the number of rooms devoted to business by the total number of rooms. If an

expense is unrelated to the business part of the home, it is not deductible at all.

If the taxpayer's gross income from the business use of the home is lower than the total business expenses, the deduction for certain expenses will be limited. But those expenses that cannot be deducted because of such a limitation can be carried forward for the next year's home business expenses.

A new development in 2013 was the IRS offering of a simplified option for figuring deductions for the business use of a home. Instead of involving the sometimes complex calculations generally required for taking the deduction, the new "safe harbor" method, starting with the 2013 return that most taxpayers will file in 2014, makes the calculation easier. It caps the deduction at \$1,500 per year, based on \$5 per square foot for up to 300 square feet of space.

Bear in mind, though, that the basic requirements for claiming the deduction still apply even if the safe harbor method is used. All in all, it would be prudent to consult your tax advisor as to whether the "old" or the "new" method of calculating the deduction is better in your particular circumstances.

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DAY!♥**