

Many sign makers use a home office to handle administrative work, or as a base for their business

Can you write off your home office expense?

by Howard Scott

The biggest change in the tax code for the upcoming year is the expansion of the home office deduction. For sign shop owners who utilize a home office, this means that now you may be able to take advantage of this savings. As home office deductions could easily run \$3,000 per year, this change might mean a significant reduction of paper profits and a lowering of tax liability.

A home office deduction can be used by the sign maker if he uses a portion of his house or garage for his business under certain conditions. Under the old rules, to qualify, it had to be one's principal place of business. In addition, the space had to be used exclusively and regularly for business, and there had to be no other place where one could do these chores. In other words, if the home space was a second office away from the regular place of business, one couldn't use a home office deduction.

In a famous court case, an anesthesiologist named Soliman who worked at three hospitals and conducted his administrative business at home (billing clients, reviewing client records, etc.), couldn't take a home office deduction because the three hospitals could have given him office space to do his work, even though they didn't.

Tax law changes allow you to deduct the costs of having an office at home.

It's exactly this situation to which the expanded rules will apply.

What the new law says

Under the new rules, a home office qualifies as a principal place of business "if (1) the space is used by the owner to conduct substantial administrative activities, and (2) there is no other fixed location where the owner conducts substantial administrative activities." In addition, the space must be used exclusively and regularly for business. The critical word is substantial. If an owner does most of his administrative work in a home office, regardless of whether he has an office at his place of business or not, this is a sufficient requirement.

This is a looser interpretation. Now any sign maker who has a home office and does substantial administrative work there quali-

fies. The owner qualifies even if the business is several miles away and he or she goes there every day. Interestingly, the tax code does not specify what "substantial" means. Does the owner have to do 50% of his administrative work at home to qualify? Seventy percent? Ninety percent? That is left to individual judgment.

Here's the test

To determine if you qualify, you must answer the following statements affirmatively:

- I have a home office where I do substantial administrative work.
- I do much more work there than I do at my office in my place of business.
- The designated space is used exclusively for business.
- I work there regularly and frequently.

If you can say yes to all of these, you probably qualify for the home office deduction. Check with your accountant. If there is some area where he has doubts, you might be able to change how you do things before the end of the tax season so that you clearly qualify.

For instance, if you were using the kitchen table for doing paperwork, you might be able to create a permanent office space in a day room and use that exclusively for business. Or, if you were in the habit of going to your shop in the evening to handle paperwork, you might set up a space at home to do these administrative chores. Or, you might pick out several tasks which can be done at home, and arrange to do them there each day.

How much will you save?

Here's how you will benefit from a home office deduction. All relevant expenses and proportionate expenses are fully deductible to your business. Say you use 20% of your home space for your home office. Then 20% of all house costs, including mortgage interest, repairs, taxes, utilities (excluding water), insurance, and depreciation are fully deductible. Moreover, if you make repairs to your home office, they are 100% deductible. So, if your total house

expenses are \$30,000, you'll get a \$6,000 home office deduction. Even if your home office occupies only 10% of the house, you'll get a \$3,000 home office deduction. Remodeling of the home office is a depreciable expense.

Many individuals fear taking depreciation because they have heard that such use will have impact when you sell your home. However, if you have stopped taking depreciation two years before the sale of your home, it will not have any effect.

In fact, depreciation is an excellent tax reduction because no cash outflow occurs. It is simply normal wear and tear on the house. With today's valuations—houses not including land often run \$200,000—annual depreciation is significant. In the case of the \$200,000 home, the annual depreciation would be \$5,000. At 20% business use, you would get another \$1,000 of depreciation expense annually.

Moreover, every home expense can be part of your deduction. Even lawn care is an expense if you can show that it in some way helps your business. For instance, if clients or salespeople sometimes come to your home office, you can justify this expense as necessary to keep up appearances. If you suffer a casualty loss, such as

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fire or flood, this expense can be part of your home office expense.

The only obstacle in taking a full home office expense is the limitation of profit. If your company doesn't make a profit, you cannot take a home office deduction—nor can you carry a home office deduction forward to the next year. If, in the above example, your company made \$20,000, it would now make \$14,000 (\$20,000 minus \$6,000). Your taxes would be reduced by about \$1,500 depending on your state.

That's a \$1,500 reduction without spending a cent, because the expenditure is normally incurred in maintaining your house. Your personal taxes will be marginally affected, because on Schedule A only the portion of mortgage interest and property taxes not allocated to home office will be used. But, on balance, you'll come out far ahead.

If you are a renter, you are also

entitled to take a home office deduction if you qualify. In that case, the proportion of rent that covers your business space is the home office deduction, plus any appropriate utilities, insurance, and tax escalation payments.

And it's okay by the IRS

In the old days, it was said that a home office deduction signaled a red flag to the IRS. But now things have changed. Know your situation. If you're confident that you comply with the above terms, take your full home office deduction off business profit.

If your accountant is conservative, point out that the new rules permit you to take full advantage of home office deductions. If he is still doubtful, ask him to study the new rules, and explain why you are not eligible. If he still hesitates, get a second opinion.

You want your sign business to succeed. Every dollar you can put into your company's coffers—rather than in Uncle Sam's—gets you there quicker. □

Howard Scott is a business writer who has published 2,000 magazine articles and two books. During tax time, he is an H & R Block tax preparer specializing in small businesses.