PERSPECTIVE

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Lawyers beware home office deductions

By Robert W. Wood

You may work at home sometimes, but should you claim a home office tax deduction? People have worried for decades that home office deductions flag their tax returns for audit. Yet more than half of working Americans work for small businesses. Many work at home, some even exclusively.

Lawyers are certainly part of this trend. With improved technology, some lawyers are going virtual and doing just about everything — including some court appearances — from home. While saving office rent is great, there's wear and tear on your home, not to mention added utilities, phone and Internet charges. If partners, associates, co-counsel or clients ever come over, you even have to clean up.

Does that mean you can deduct all that on your taxes? It depends, but you may be able to tweak your operation to fit within the tax law. After all, not claiming legitimate tax deductions can feel like lemon juice in a paper cut. And as the economy and workplace change, you may be leaving more on the table every year.

But no matter how much you work at home, do you qualify? The home office tax deduction rules are set out in Section 280A(c) of the tax code. They aren't simple.

What qualifies?

Much of the discussion is about whether you qualify, not about what you can deduct if you do qualify. Generally, your deduction depends on the percentage of your home used for business. If you qualify, you can deduct the ratable portion of utilities, as well as direct costs such as special phone lines, Internet, etc.

You can also depreciate the percentage of your home used for business just like if it were commercial property. If you are meeting with clients there and need the grounds to look right, some people even succeed at deducting a share of gardening expenses. But most of the home office tax disputes are about whether the taxpayer meets the qualification rules.

To qualify, a home office must be used "regularly and exclusively" for business. These are terms of art, but "exclusively" really means it. You can't use your home office as a family room and you shouldn't have a TV or chess table in the corner. This may sound silly, but some taxpayers have lost their cases over such details.

In addition, the deduction is limited to income from the business. That means if you run a home-based eBay business from the spare room off your garage — and you don't use that room for anything else — you could deduct the cost of utilities attributable to that space. You could even depreciate that portion of your home. But what if you lose money on your eBay venture before you even get to your home office deduction? You don't qualify.

Consider cost-benefit too. Claiming a home office deduction involves filling out a 43-line form (IRS Form 8829) with complex calculations of allocated expenses, depreciation and carryovers of unused deductions. Many taxpayers will find it easier next year, since a streamlined form will be used for a simplified home office deduction on 2013 returns that will be filed in 2014. For now, though, we are stuck with the old tough rules.

There are several avenues to claiming a deduction for using a part of your home exclusively and regularly for business. Here are the ways you can qualify.

Your home office is your principal place of business. Obviously, if you work at home two days a week and at the office three days a week, your office is your principal place of business. In other words, this category works only if you have one place of business — your home.

You use your home office to meet or deal with patients, clients or customers in the normal course of your business. This category is used frequently by professional people. If you have a primary office in the city but keep an office at home in the suburbs where you regularly meet your suburban clients, you qualify.

Employees beware. If you are an employee, there is an additional hurdle. The regular and exclusive business use must be for the convenience of your employer. That usually means the employer must *require* you to work at home.

If you work for a firm but are in a management capacity, can you require yourself to maintain a home office for the firm's convenience? There is no rule that says you can't. Of course, this is self-serving, so don't count on it working. If you try it, attempt to make it as independent as possible.

Separate structures are easier. If the business portion of your home is a separate structure not attached to your home, then you only have to use it "in connection with your trade or business" (a more watered-down standard).

Using partitions. Using a room exclusively for business really means it, so don't allow any nonbusiness use. Technically, though, your exclusive business area can be a portion of a room if it is clearly partitioned and you can show that personal activities are excluded from the business portion. As you might imagine, the tax cases on this topic are messy, so avoid this issue if you can.

Storage use. Other deduction possibilities include certain storage, rental or daycare-facility use of your home. In these cases, you must use the property regularly for business, but it doesn't have to be exclusively for business.

If you want an example of how literally the IRS takes the exclusive use of home offices, read *Bulas v. Commissioner*, T.C. Memo. 2011-201. An accountant kept a home office and worked there extensively preparing tax returns. His home office was allowed, but could he claim the square footage associated with the adjacent hallway and adjoining bathroom?

The question was whether the hallway and bathroom were exclusively for business. Clients used the hallway and bathroom, so you'd think they were all for business. However, the Tax Court found that his children and other nonbusiness guests occasionally used the bathroom too. That meant the hallway and bathroom were not exclusively used for business and so didn't qualify.

Conclusion

There's nothing wrong with home office deductions. However, many people who fight the IRS on home office deductions have poor cases and poor records. If you have a legitimate case and good records, there's no reason you shouldn't claim them.

However, be realistic about your facts. Be careful how you measure business versus nonbusiness use. Consider how you stand up to the rigorous regular and exclusive use requirements.

Perhaps you just occasionally work at home in your study or family room. If you have a primary office elsewhere, and don't meet with clients at your home, you probably don't qualify. Even if you have better facts than this, remember that when the IRS says "exclusively" it means it.

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