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in every issue YOUR MONEY

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Home Sweet Home Office

The rules have been revised. Are you taking full advantage of them?

Do you have a home office? So many people do these days. And while more people are taking advantage of the logistic and cost benefits, many have been afraid to take a home office deduction because they worry that it would raise their taxes when they eventually sell their home. Also, many think the deduction would be a "red flag" for an IRS audit. But recent tax law changes eliminate the tax cost of having an office in a home that is sold and also make it easier to support a deduction for a home office.

The new rules indicate that, even though a home office is treated as a business property when taking a business deduction, it still qualifies as a residential property at the time the home is sold. In effect, if you use part of your home for business, you can treat the entire dwelling as your residence for purpose of taking the capital gain exclusion at the time of sale, provided the home was used as your primary residence for at least two of the prior five years before the sale. Under prior regulations, the gain attributable to the home office would be treated as taxable gain on business property and not qualify for the exclusion. The new rules still require recapture of depreciation claimed on a home office after May 6, 1997, which is taxed at a 25 percent rate.

Bear in mind that taxpayers are not entitled to deduct any expenses for using their home for business purposes unless the expenses are attributable to a portion of their home used exclusively on a regular basis:

1. as the principal place of business carried on by the taxpayer;
2. as a place of business that is used by customers, clients or patients in meeting or dealing with the taxpayer in the normal course of business, or
3. in connection with the taxpayer's business if the taxpayer is using a separate structure that is proximate to but not actually attached to the home.

Another change in the regulations made it easier to qualify for a home office deduction. Under prior regulations, the IRS said that, in order to qualify for the deduction, the home office had to be the principal place of business. For example, if a doctor worked at a hospital but had no office there, and had to keep his or her records at home, the home office was not deductible. Under the newer rules, the necessity of having to have a home office justifies its deduction even if most of one's work is done elsewhere. The current rules indicate that a deductible home office can be used for record keeping (if no other office is available for this purpose); holding sensitive records and valuable business items (if another office is not secure); and storing inventory, even if selling takes place elsewhere.

Once a taxpayer qualifies for a home office, previously non-deductible home ownership expenses, such as home insurance, maintenance and repairs, utilities, private mortgage insurance, and mortgage interest in excess of normal limits for a personal residence become deductible. Also, establishment of a home office may also convert nondeductible commuting to a deductible business driving expense because the drive from the home office to another work site would be treated as a drive between two work locations.

The rules are quite complicated, but the amount of the home office deduction can result in considerable tax savings. It's a subject homeowners should be discussing at length with their professional tax advisors. ❖

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