

A tax deduction for the business use of your home can be taken if the home is used:

1. As the principal place of business for your trade or business.
2. As a place of business that you use for meeting patients, clients, or customers, or
3. In the case of a separate structure which is not attached to your home, in connection with your trade or business.

Also, if there is no other fixed business location where you are able to conduct your required administrative or management activities, you may be entitled to deductions for the use of your home for those purposes.

In determining whether the office in your home is your principal place of business, the "relative importance" test is applied first. The "relative importance" test compares the activities performed at each business location. If this test provides no definitive answer, the "time" test is then applied. The "time" test looks at the amount of time spent on business at home versus the time spent on business at other locations.

All expenses pertaining to your home must be allocated between business and personal use. For purposes of allocation, expenses pertaining to the residence may be divided into three categories:

1. Expenses that are unrelated to the business use of the residence.
2. those that are directly related, and
3. those that are indirectly related.

Unrelated expenses are those that benefit only the parts of the taxpayer's residence that are not used for business, such as expenses for repairs to personal areas of the residence and lawn care. Unrelated expenses are not deductible as home office expenses.

Direct expenses are expenses that benefit only the business part of the taxpayer's home. For example, painting or repairs made to the specific area or room used for business are direct expenses. Expenses that are directly related to the qualifying business use of the taxpayer's residence are deductible, subject only to the gross income limitation.

Indirect expenses are those that benefit both the business and personal use portions of the taxpayer's residence. The business portion of indirect expenses may be determined by the taxpayer by any method that is reasonable under the circumstances. If the rooms in the unit are approximately of equal size, the general expenses of the unit may ordinarily be allocated according to the number of rooms in the dwelling unit. Alternatively, general expenses may be allocated according to the percentage of the total floor space in the unit that is used for business purposes. Indirect expenses would include utilities,

homeowners insurance, and property taxes.

Deductions for home office expenses allocated to the business use portion of the residence are limited to the gross income derived from the qualifying business use for the taxable year. Note that the gross income limitation does not disallow any deductions permanently, rather it limits the amounts that may be deducted in the current taxable year. To the extent deductions exceed the gross income limitation for the current taxable year, such excess is taken into account as a deduction in the succeeding taxable year. However, in the succeeding taxable year the excess remains subject to the gross income limitation irrespective of whether the dwelling unit qualifies as a residence.

No portion of otherwise deductible personal expenses (i.e., real estate taxes, mortgage interest, and casualty losses) is disallowed in the current taxable year under the gross income limitation. Except in the case of employees, the portion of such expenses allocated to the qualifying business use portion of the residence is allowed as a business deduction and the balance is allowed as an itemized deduction irrespective of the gross income limitation. Although deductible personal expenses are not limited under the gross income limitation, such expenses play an important role in determining the gross income limitation on other expenses allocated to the qualifying business use portion of the residence, as discussed above.