

New Tax Choice on Home Office Deductions

Comparing Deductions under Two Methods

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For a qualified small-business owner, a home office deduction can result in significant annual tax savings. But there's a new twist on 2013 returns: A taxpayer may use a simplified method for deducting home office expenses, although this is not always the best choice.

Background

To qualify, you must use the office regularly and exclusively as your principal place of business or a place where you meet or deal with customers, clients or patients in the normal course of business. If you are an employee of a company, you must use the home office for the convenience of your employer.

For instance, if you are self-employed and you run your business from home, you will generally qualify for home office deductions. But if you merely bring work home from your office on weekends, you are not likely to realize any tax benefits.

Traditional Method

Normally, a home office deduction includes direct expenses attributable to the office, plus a proportionate share of indirect expenses such as mortgage interest, property taxes, utilities, repairs and insurance. Mortgage interest and property taxes are generally tax-deductible anyway. The deduction available for indirect expenses is based on the percentage of your home used for business purposes. Also, you may be entitled to a depreciation deduction for the part of the home used as an office.

However, this method requires you to keep detailed records of expenses. Beginning with the 2013 tax return, the IRS is offering a streamlined option.

Simplified Method

All you have to do is figure out the square footage of your home used as an office. Then, you can deduct \$5 per square foot, up to a maximum of \$1,500.

Nevertheless, when you compare these two methods, the traditional method may produce a bigger deduction. If you have the necessary records, you might bypass the simplified method.

Hypothetical Example

Gina, a self-employed taxpayer, uses a home office as the principal place of her business. The home is 3,000 square feet and the home office is 300 square feet, or 10% of the home. Let's say that Gina has \$2,000 in direct home office expenses plus indirect expenses—including utilities, insurance and repairs—of \$10,000 for the year (disregarding mortgage interest and property taxes that would otherwise be deductible). Under the IRS table, Gina is also entitled to a \$400 depreciation allowance.

On these facts, Gina can deduct \$2,000 in direct expenses, \$1,000 in indirect expenses and \$400 in depreciation, for a total of \$3,400. With the simplified method, her deduction is limited to \$1,500, less than half of the total with the traditional method.

Be aware that you may switch between the traditional and simplified methods year-to-year. You are not locked into either method.

Do not make any costly assumptions or rash decisions. Compare the deduction available with each method to see which way you come out ahead. Note that a taxpayer cannot switch methods on an amended return.

For questions on home office deductions contact your Henry & Horne, LLP professional tax adviser.

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