

My Home Loan



Mortgage Insight: Home Business Tax Breaks

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If you are among the millions of homeowners and renters who operate a profitable part-time or full-time business from your home, don't forget to claim your home business tax deductions to reduce your income taxes. It doesn't matter if you're self-employed or you're an employee working from home, such as an outside salesperson or a telemarketer.

However, if your employer provides suitable workspace, but you prefer working at home, then you don't qualify for Uncle Sam's generous work-at-home tax deductions. For example, if you are a computer programmer who prefers to work from home so you can supervise your pre-school child, you don't qualify for home business deductions if your employer provides suitable office workspace.

MUST PASS PRIMARY BUSINESS LOCATION TEST

If you are self-employed, such as an independent contractor, to qualify for the Internal Revenue Code 280A home-business tax deductions, your residence must be used either (1) to meet with clients, customers or patients or (2) as your primary business location for administrative activity if you have no other fixed business location.

In 1999, Congress changed

the tax law to allow the self-employed working from home to deduct business expenses if their residence is their "primary business location." Examples include a self-employed bookkeeper who travels to offices of her clients, a handyman who works at various job sites, and a computer repairman who works at many business offices during the week.

WORK-AT-HOME EMPLOYEES HAVE A SPECIAL TEST

If you are a salaried employee working at home, the IRS imposes a special rule called "the convenience of the employer test." You probably meet this test if your employer doesn't provide suitable workspace, or expects you to work from home. Examples include outside salespeople, computer entry clerks and telephone order takers.

PART-TIME BUSINESSES CAN ALSO QUALIFY

If you operate a part-time business from your residence and you can meet the "primary business location" or "convenience of the employer" tests above, then part of your home operating costs are tax-deductible.

For example, suppose you operate a profitable part-time home business selling books on the Internet, or perhaps you sell Avon, Amway or Mary Kay products from your home where you have an office and store inventory and supplies. Then you can qualify for the home business tax deduction.

THE "EXCLUSIVE BUSINESS AREA" RULE

If your full-time or part-time home business meets the rules explained above, the next test requires an "exclusive business area," which is not also used for personal or family purposes.

The exclusive business area need not be a separate room. Part of a room can qualify, but it cannot be shared use. For example, if you have your desk, filing cabinet and business supplies in one part of the family room, that area can qualify. However, using your kitchen table to operate your part-time bookkeeping business, or occasionally entertaining business clients in the living room clearly doesn't qualify.

SQUARE FOOTAGE IS BASIS FOR DEDUCTIONS

Your home business tax deductions are determined by the percentage of your home's square footage that is used for the exclusive business area.

For example, suppose you own or rent a 1,500-square-foot house or condo. One-third, or 500 square feet, is the "business area" where you keep your business supplies and have your office.

The result is 33 percent of applicable household expenses qualify as business tax deductions. If you are a renter, one-third of your rent is deductible on your business tax return. If you are a homeowner, one-third of applicable home expenses such as utilities, repairs,

insurance, mortgage interest and property taxes will be deductible on your business tax return, in this example.

However, 100 percent of some expenses are fully deductible, such as your business telephone line (if you also have a personal telephone line,) business computer broadband fees, and painting or improvement costs for the business area.

REMEMBER TO DEDUCT 100 PERCENT OF BUSINESS EQUIPMENT.

If you purchased business equipment and placed it in service in 2006, such as a new business computer and software, 100 percent of that equipment cost is deductible up to a maximum \$108,000 deduction, with a maximum \$25,000 deduction for an SUV vehicle used in your business.

Higher equipment expense limits apply in an "enterprise zone" such as \$208,000 in the Gulf Opportunity Zone. However, no deduction is available for personal assets converted to business use, such as a home computer bought in 2004 but converted to business use in 2006.

DEPRECIATE YOUR HOME

BUSINESS AREA

If you own your house or condo, the exclusive business area is depreciable. Using the example above, if your home-business area occupies 33 percent of your home's square footage, then you can depreciate one-third of your residence's cost basis (excluding non-depreciable land value) on a 39-year, commercial property, straight-line basis.

IRS Regulation 2002-142 says business use of your home won't affect using the Internal Revenue Code 121 principal-residence-sale exclusion up to \$250,000 (\$500,000 for a married couple filing jointly.) However, the total "business area" depreciation deducted must be "recaptured" and taxed when the home is sold using the special 25 percent federal recapture tax rate.

HOME-BUSINESS USERS GET SPECIAL AUTO EXPENSE TAX BREAK

If you qualify for the home business-use tax deduction, and you start your work day from your home office, when you use your automobile or truck to visit customers or work locations, your business mileage becomes tax deductible the minute

you drive away from home.

For 2006, the business deduction is 44.5 cents per mile. But you must keep a daily log of business miles.

HOME-BUSINESS DEDUCTIONS CANNOT CREATE A TAX LOSS

Your home business expense deductions cannot create a tax loss.

That means your home business deductions, when subtracted from your home-business profit, cannot create a tax loss against your other ordinary taxable income. But, unused home-business losses can be carried forward to future tax years.

For example, if your business operating from your home produced a \$2,500 profit in 2006, but your tax deductions for your home-business area are \$3,200, only \$2,500 can be deducted and the remaining \$700 is carried over to a future tax year.

CONCLUSION:

Whether you operate a full-time or part-time business from your residence, and whether you are a home owner or a renter, you can deduct applicable expenses to reduce your income taxes. Both the self-employed and employees alike can qualify. **For full details, please consult your tax adviser.**

Claudio D. Varga is President of My Home Loan. The firm provides a wide variety of lending solutions for residential and commercial real estate. Claudio has been a licensed mortgage broker and consultant since 1998 and his clientele ranges from first time home buyers to professional multi-property real estate investors.

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