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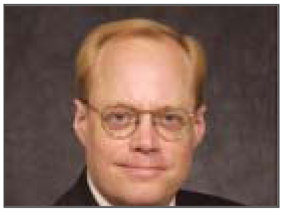

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Claiming This Deduction Invites IRS Audit

Don't you wish you knew which deductions trigger audits? You could bypass them and avoid all the trouble. Although there's no obvious contender for what to avoid, many people worry that a home office deduction is a big red flag. Actually, there's nothing wrong with claiming it but the rules are tricky and good substantiation is a must.

Home office deductions involve filling out a 43-line form (Form 8829) with complex allocations of expenses, depreciation and carryovers of unused deductions. More than half of working Americans work for a small business. Many are home-based or have home offices, while some virtual businesses actively recruit home-based employees. Moreover, the IRS is easing some home office deductions starting with 2013 returns filed in 2014. See IRS simplifies home-office deduction, for 2013.

In the meantime, under Section 280A(c) of the tax code, a home office must be used regularly and exclusively for business. You generally must use part of your home exclusively and regularly:

- As your principal place of business;
- As a place to meet or deal with patients, clients or customers in the normal course of your business; or

- If the business portion of your home is a separate structure not attached to your home, then "in connection with your trade or business" (a more watered-down standard).

Other deduction possibilities include certain storage use, rental use, or daycare-facility use. In these cases, you must use the property regularly for business, but not exclusively for business. For an employee, the regular and exclusive business use must be for the convenience of the employer. That usually means the employer must require you to work at home (get it in writing).

Although usually you don't want to treat only one corner of a room as business, a section of a room can qualify if it is clearly partitioned and you can show that personal activities are excluded from the business portion. Still, these rules are unforgiving and the IRS tends to interpret them strictly. For example, in *Bulas v. Commissioner*, an accountant claimed one room—plus an adjacent hallway and bathroom—was exclusively for business. But because his children occasionally used the bathroom, it wasn't exclusively for business.

Home office deductions are limited to income from the business. Suppose you run a home-based business from the spare room off your garage. You don't use that room for anything else, so you can deduct the utilities attributable to that space. You could even depreciate that portion of your home. But if you lose money on your eBay venture before you get to your home office deduction you don't qualify. See IRS Tax Tip 2011-53.

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