The Home Office Deduction and the Pandemic: Can It Help You in 2020?

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In addition to the social and economic impact of the pandemic, you may be wondering what effects the pandemic has on you from a tax perspective. Since early March, we have seen a massive migration of office workers to their homes, whereby millions of Americans were forced to set up remote working space inside of their homes in order to meet their job requirements. By mid-February, 46% of American businesses implemented remote work policies. Under the circumstances, the necessity to work at home became prominent and widespread throughout the United States. Currently, 62% of the employed workforce work in their abode compared to just 25% one year ago.

This shift in paradigm creates a potential opportunity for these remote workers to claim expenses for the business use of their home to reduce their taxable income – and you get to wear pajama pants while you work!

However, taking this deduction properly requires a bit of planning and documentation.

Are You an Employee?

The Home Office Deduction has been around for many years, but the Tax Cuts and Jobs Act (TCJA) of 2017 added a limitation that prevents many from accessing this benefit. The TCJA eliminated miscellaneous itemized deductions for individual taxpayers. Unfortunately, home office deductions are considered miscellaneous itemized deductions. This effectively requires that a taxpayer have self-employment income in order to take the Home Office Deduction.

Individuals will need to consider their home state of residence for a state deduction. Certain states, like New York, allow for the use of itemized deductions and did not couple the TCJA changes with their own tax rules. So, in certain situations, employees who cannot take the deduction on their federal returns may qualify for the deduction on their state returns.

Do You Have a Home Office for Tax Purposes?

Self-employed individuals remain eligible for the Home Office Deduction because they typically report the results of their operations on a Form Schedule C as part of their Form 1040 tax filing, or are partners in a business that files a Form 1065. For small business owners who are members of partnerships, IRS guidelines state that your operating agreement should clearly reference that home office expenses are not reimbursable to member partners.

But just because you've been working from home doesn't necessarily mean you're eligible for the deduction.

For part of your home to qualify for the Home Office Deduction, it must be used *regularly* and *exclusively* for business purposes, and it must be your *principal place of business*. While those working remotely are certainly now using their home workspaces regularly, the questions of exclusive use and qualifying as a principal place of business require more analysis.

Exclusive use does not necessarily require that the "home office" be a dedicated room in the house. After all, many working from home find themselves working at a table in the living room, bedroom or somewhere in the basement. As long it is a dedicated space, it should qualify. Whether a home office is a separate room or part of a larger space, however, it does not qualify for the deduction if it is used for anything other than the worker's own business. If you're working at a table in the living room that you also use to eat dinner or in a basement that doubles as your home gym – that space probably won't qualify. This is obviously a subjective question, though – taking some personal calls at your desk would not doom the deduction.

What Is Your Principal Place of Business?

A home office only qualifies for the deduction if it is a principal place of business. To pass the "principal place of business" test, you must use it exclusively for "administrative or management activities," and you must not have any other location where you also conduct a substantial amount of "administrative or management activities." What happens in 2020 when your office has been closed since the middle of March? There's no specific IRS guidance on this issue. Thus, taxpayers will need to consult with their advisors and use their judgment on this issue.

Note: a person may have multiple principal places of business if they use the second one to meet clients, patients or customers. Does video conferencing qualify? That's another issue we lack guidance on.

How Do You Calculate the Deduction?

There are two options for determining the amount of the Home Office Deduction.

Simplified Option: Qualifying taxpayers can use a prescribed rate of $5 per square foot of the portion of the home used for business (up to a maximum of 300 square feet). Thus, under this method, the maximum deduction that can be taken against Schedule C or Schedule E Business income is $1,500.

Regular Method: Under this method, eligible expenses relating to the home need to be apportioned between personal and business use, based on the percentage of the home floor space used for business. This includes real estate taxes, mortgage interest, rent, utilities, insurance, repairs and maintenance. To compute and file for the deduction, taxpayers must use Form 8829, Expenses for Business Use of Your Home. Records should be maintained showing how the amount is determined.

If your business expenses related to the use of your home are greater than your gross income from the business use of your home, then you'll be limited to the amount you can deduct, as it is capped at your gross income amount.

Caution

As one can surmise, the Home Office Deduction is not available for everyone. Those employed who receive a Form W-2 simply cannot take the deduction. If you are self-employed or a member of a partnership, the deduction may be available, but the facts and circumstances must be consistent with requirements stated above.

Thus, you should discuss the Home Office Deduction with a tax professional to ensure you meet the necessary requirements to qualify for the deduction and calculate the deduction correctly as the tax law is complex and specific. And of course, it is not too late. Many of us will be working at home through the rest of 2020, and you might as well get a tax benefit while still in your pajamas.

Contact Us

As always, for further assistance and guidance on the Home Office Deduction or any other tax matter, please reach out to your PKF O'Connor Davies' engagement team members or:

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