

# Tax Advantages Of A Home Based Business

Operating a home based **business** has a number of **income tax** advantages that entrepreneurs may be **unaware of**, and consequently miss out on.

So rather than guess and risk paying too much in taxes, or worse, enduring an IRS audit for being too sticky fingered, I made a list of the most common tax questions and sought out the advice of a tax professional, the eminent Richard Streitfeld, a Certified Public Accountant and Certified Fraud Examiner and a partner in the accounting firm of Aaronson, Lavoie, Streitfeld and Diaz & Co., PC.

Our candid Q & A discussion on how to prepare for and safely, legally take advantage of the most common home business income tax deductions is presented here for your benefit.

**Q:** How should I calculate the percentage or ratio of the area of my home, apartment and home business expenses that I can legally deduct and use as a tax deduction and write off?

**A:** Use a tape measure... Literally! Measure the square footage of the interior of your home or apartment and then calculate the space of your home office in square footage, and you'll determine the percentage of your entire home or apartment that it represents.

**Example:** Divide the little number by the big number. For example: 108 sq. ft. office (9x12ft. room) / 400 sq. ft. home equals .27 or 27%. That 27 % is the number your accountant will need.

**Q:** My business is Incorporated (S Corp., C Corp.). Does that matter?

**A:** Yes, it does. You can't do a tax write-off for a "home-office", per se, but you may benefit from charging your "home based business" "rent" in your home. This will be income to you personally. Check with your accountant for more details.

**Q:** Can I declare a portion (using the percentage calculated from your measurements) of my home mortgage interest, my property taxes or my rent as a home business tax deduction?

**A:** Yes, you can. Whether or not you're self-employed, property taxes and mortgage interest are always deductible on Schedule A of your tax return if you itemize deductions. However, if you are a self-employed "sole proprietor" (DBA or LLC, the most common), you can further reduce your self-employment tax burden (usually 15.3% in addition to your **income tax** woes) if you have a legitimate home based business office.

**Q:** Can I declare a portion of my home owner's or renter's insurance as an income tax deduction? And what about utilities like heat and electricity?

**A:** Insurance: Yes you can, by the same percentage as your calculated home office space. But unless you live in a McMansion or the Palace at Versailles or have an enormous insurance policy, it may not net you much savings. But hey, every little bit helps, right?

**A:** Utilities: Yes! Heat, electricity and water for your household is all partially deductible as a home office tax deduction.

**A:** Landscaping: No. I know you didn't ask. And no, you may not. And the same usually goes for things such as snow plowing, trash collection and the tip for the paper boy.

**Q:** Can I declare office equipment like a desk, a computer or software, and what about office supplies like paper and printer ink? Can I deduct those as an income tax write off?

**A:** You can fully deduct the cost of any items that are considered "reasonable and necessary" to operate your business. So absolutely. But things such as equipment, which has a multi-year span of use is handled differently from immediately consumable supplies like paper and printer ink. Equipment is "depreciated" over time, something you will need to discuss with your accountant.

**Q:** What about my home Telephone and my Internet service? And what about my Cell Phone?

**A:** Those are a bit trickier. With home business offices these are often considered "indirect expenses". So unless you use your cell and land line telephones and your internet service exclusively for business, you will need to estimate your business usage as a percentage.

**Q:** What else might I appreciate about home office deductions?

**A:** Appreciate that you can depreciate the cost of your home and your office equipment! That's the mysterious process I mentioned above where your humble accountant consults the Dark Gods of the Taxation Oracle for guidance to receive the proper rate of depreciation on your business equipment and even your home to get you the maximum tax relief. Your accountant can 'splain this to you to help make sense of this mysterious process.

If you're not seeing much benefit from this 'Depreciation' thingy I'm talking about, there could be many reasons: The size of the home office; the fact that Depreciation is spread out over many years; and the fact that there is a limitation on home business office deductions that is tied to the net profit of your business. As I mentioned above, this is a secret formula understood only by accountants, and

they're sworn to secrecy under pain of IRS audit of our travel and annual holiday party expenses.

**Q:** Can I hire my spouse or children to work for my business and can I deduct what I pay them each year?

**A:** Absolutely. You can hire Attila the Hun and write it off (whether he is related or not). Remember, you're creating taxable wage income for the recipient. Another upside of this is that your child is in a much lower income tax bracket than you are and if you do not ridiculously overpay her, she may ultimately have no income tax liability at all. There's also payroll tax savings related to the hiring of a spouse or child for your (unincorporated) business.

**Q:** Can I deduct the cost of my **Health Insurance Coverage** from my home based business income?

**A: Yes!** You can and you should. The policy premiums of your health and dental policies for your **entire family** are 100% deductible. In fact, for 2010 these costs are also deductible from your self-employment earnings – so you save that ghastly 15%. This is **huge**. There are (surprise) caveats connected to your net business earnings, and FYI, domestic partners are not considered “family” by federal income tax guidelines.

**Q:** What if I have a few employees? I keep hearing about new health insurance credits.

**A:** The cost of any premiums you pay for employees is of course deductible as a business expense. And there **are** new credits designed to lower your health insurance costs and incentivize you to provide coverage. The calculation of the credit involves full-time equivalents, average annual wages, state thresholds, phase-outs, and your ability to do cartwheels with a paper bag covering your head. You should not drink and drive while reading these regulations. Actually you should just drink.

**Q:** Can I declare a portion of home business related Automobile and Travel expenses as a business tax deduction?

**A:** Yes, you can. However be particularly careful when it comes to deducting automobile expenses. Keep an accurate log of your activity while on business trips and save your receipts showing your car's cumulative mileage at the beginning and end of the year. The IRS is hip to taxpayers' proclivity to exaggerate in this area and you may well be asked for such documentation if you are audited. There are numerous sources for log books and software to track these expenses, too.

**Q:** What would you consider “best practices” in regard to home business record keeping?

**A:** Maintain a completely separate business bank account, even if you are unincorporated. Reconcile your bank account. Use a software program or at minimum

a spreadsheet to record your income and expenses... And don't do your tax return from memory! (Yes, I have clients that have tried this!)

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