Self-employed: Home office deductions, reimbursements, and expenses

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If you are an employee of your own one-man business, you may have several choices for handling the costs of a qualifying home office:

1. **You can deduct the costs of a home office if you are filing a Schedule C.** Under the Tax Cuts and Jobs Act (TCJA), employees working remotely can no longer deduct home office expenses on their tax returns to the extent they exceeded 2% of adjusted gross income (AGI). However, business owners may qualify to claim the home office deduction if they have their own business and use a portion of their home as their principle place of business.
2. **The S corporation can pay you rent** for the home office.
3. **The S corporation can pay you for the costs of a home office** under an "accountable" plan for employee business expense reimbursement. This article will take a closer look at this option.

Accountable plan for s-corporation deductions and reimbursements. The third option above, being reimbursed under an accountable plan, often provides the greatest tax savings. It is an excellent way to get money out of your closely-held corporation tax-free. The corporation can deduct the amount of the reimbursement, and you do not have to report the payment on your personal income taxes.

This option is often better than having the corporation pay you rent for the home office. While your corporation can deduct the rent paid to you, you must report the rent as income on Schedule E.

To qualify as a home office, the space, which does not have to be an entire room, must be used regularly (on a continuous, ongoing or recurring basis) and exclusively (there can be no personal use) for your trade or business, and it must be your principal place of business or a place where you physically meet with patients, clients or customers on a regular basis. The space will be considered your principal place of business if it is used for performing administrative or management activities, such as billing, bookkeeping, ordering supplies, setting up appointments and writing reports, and there is no other fixed location where you regularly perform these activities.

As an employee, the home office must be for the convenience of your employer. This means the home office is required as a condition of employment, it is necessary for the business to function, or it is necessary for you to properly perform your duties as an employee. If you do not have any other place of business, such as a rented office or storefront, your home office should qualify.

For an expense reimbursement plan to be considered "accountable," the expenses that are reimbursed must be for actual job-related expenses (you cannot reimburse personal expenses), and you, as the employee, must substantiate the expenses by providing your employer with receipts or other documentation. Under TCJA, this is only available for independent contractors and not employees.

You should create a monthly "Employee Expense Report" form for your corporation. This is a good idea whether or not you have a home office. Start out with lines for business mileage and other out-of-pocket business expenses, such as postage, office supplies, parking and tolls, meals and entertainment, etc. Staple receipts for these items to the report.

Include a Home Office section in the report. Calculate the "business use percentage" of your home office by dividing the square footage of the office area by the total square footage of the home. List each item of expense paid during the month, such as:

- real estate taxes
- homeowner's insurance
- oil heat, gas and electric
- water and sewer
- alarm or security service
- garbage disposal
- general repairs and maintenance
- mortgage interest (taken from the monthly mortgage billing statement or a loan amortization statement you can create online)

Multiply the total of these expenses by the business use percentage to determine the amount to be reimbursed. Total all the business expenses listed on the form, including the home office amount, and write a check from the corporation to yourself for this amount. To be clear, this only applies if you claim the home office deduction if you have your own business and use a portion of your home for your business. It is no longer allowed for employees under TCJA.

You must reduce the amount of your itemized deduction for real estate taxes and mortgage interest by the amount of reimbursement you receive from your corporation during the year for these items. If your real estate taxes for the year are $10,000, but in the course of the year you were reimbursed $2,000 by the corporation, you can only deduct $8,000 in real estate taxes on Schedule A.

General guidelines for s-corp home office deductions or reimbursements.
Deducting, or being reimbursed for, a home office today will no longer turn around and bite you when you sell your personal residence, as had been the case in the past. If the

home office is within the same "dwelling unit" as the residential portion of your home, you are treated as using the entire home as a principal residence.

If the office space was 10% of the total area of your home, you **do not** have to pay income tax on 10% of the gain from the sale. You will be able to exclude the entire gain, up to the $250,000 or $500,000 limits, if you qualify, less any "post-May 6, 1997" depreciation. You must report any depreciation you deducted on the home office after May 6, 1997 as "unrecaptured Section 1250 gain," which will be taxed at the capital gains rates up to a maximum of 25%.

For an example, Lisa is married and sells her personal residence, which she owned and lived in for the past four years and in which she had a qualified home office that was 15% of the total area, for a net gain of $300,000. During the four years she lived in the home, she was able to deduct $5,000 in depreciation on the home office portion. She can exclude $295,000 of the gain, and will pay tax on only $5,000. If she was not able to deduct depreciation on her home office or was not reimbursed by her corporation for depreciation, there is no income to report and 100% of the gain, up to the limits, will be tax-free.