

THE TAX BENEFITS TO SELF-EMPLOYMENT

With the downturn in the economy and the difficult job market, many people are turning to self-employment in their respective fields. Self-employment can take several forms, either as a sole proprietor, a single-member LLC, or a multi-member LLC. Being self-employed can have many income tax deductions that are either not available for employees or very difficult to employees to qualify for, some of which can be sizable and have a significant impact come tax time.

One of these deductions is the home office deduction, which is available to taxpayers operating businesses out of their homes. The home office deduction allows you to deduct the expenses associated with using that part of the home for business purposes. This deduction is also available to taxpayers who are W-2 employees (rather than self-employed individuals), but only if your employer requires you to have a home office for the employer's convenience. (Different home office rules apply to owner/employees of S-Corporations, which will not be discussed in this article.)

It is very important to be aware of the rules and requirements governing the home office deduction so that the IRS does not reject your deduction. First, and most importantly, the area used for the home office must be used exclusively for business purposes. For example, if you have a room or defined area in your house that you use solely for business purposes, then you have satisfied the exclusive use rule. If, on the other hand, you work at your dining room table, but also still use the room for family meals, it does not satisfy the exclusive-use rule.

Another requirement is that the area is used regularly or continuously for business purposes. If you only use the area occasionally or sporadically for business purposes, then the space does not meet the regular-use rule. If the home office area is used exclusively and regularly for business, then the next question is how to calculate the expenses for the use of that room to deduct on your income taxes.

Many expenses are calculated on a pro-rata basis, based on the size of the home office in relation to the size of your entire home. For example, if your entire home is 1500 square feet, and your home office is 30 square feet, your home office accounts for 2% of the costs of "operating" your home. Expenses that are calculated on a pro-rata basis typically include your mortgage or rent, real estate taxes, homeowner's/renter's insurance, and utilities, to name a few. Other expenses can be charged solely to the home office. These include a second phone line and internet service used exclusively in the home office and office supplies.

As with all deductions and information used to prepare your income tax returns, keeping records of these expenses is very important. Not only do they assist you and/or your tax preparer in calculating the deductions you are entitled to on your income taxes, but they also help you prove your deduction if it is ever questioned by a taxing authority, such as the IRS or Pennsylvania Department of Revenue.

For more information regarding this and tax issues affecting self-employed taxpayers, or

if you would like me to prepare your tax returns, please do not hesitate to contact me to schedule a consultation at 717-657-7770.

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