Tax Advantages of Home Office

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To Whom It May Concern,

There are unique tax benefits to operating a business from home. Home-based business owners generate what I call “phantom” expenses that other business owners do not experience and from which they cannot benefit. Due to these unique, “phantom” expenses, home-based businesses often generate positive cash flow yet report a loss on the tax return.

First, for most home-based businesses, there is no additional cost incurred in having an office, because all the usual costs of procuring and retaining an office, such as rent, utilities, insurance, and maintenance are already being incurred by the homeowner. In other words, the homeowner would already be spending the money for these expenses regardless of whether or not they had an office in their home.

However, from a tax standpoint, now that they have an office in their home, they get to deduct expenses for operating an office in their home for which heretofore they were not allowed to deduct on their tax return, such as rent, insurance, utilities, repairs, maintenance, and depreciation in cases where they own the home. So while the taxpayer is not spending any additional money to operate an office from their home, they are getting to claim additional expenses on their tax return, which reduces their reportable net income from business. In other words, it is a reportable expense without any corresponding cash outlay.

In a similar way, a home-based business owner is now in the unique position of not having any commuting mileage that would be non-deductible, because since they are already at their principal place of business, all business mileage originates from their home, and any mileage back to their home is mileage back to their office, and thus is deductible.

Therefore, generally, home-based business owners claim considerably more business miles than those who operate from an office outside their home. More importantly, because they are not driving additional miles to commute to an office outside their home, the home-based business owner puts less wear and tear on their car, causing their vehicles to last longer and be less costly overall. Moreover, insurance premiums are less for drivers who operate a home-based business because the insurance company does not have to insure the vehicle while commuting, since there is no commute.

But most importantly, sole proprietors get to claim a tax deduction for business vehicle expense - known as the standard mileage rate - that usually exceeds the actual cost of operating and depreciating the vehicle. Consequently, as with the office in home, they are reporting an expense on paper for which there is no corresponding cash outlay.

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Finally, a home-based business owner often times takes advantage of placing into business assets that were originally intended for personal use. As a result, assets that heretofore were not deductible on their tax return, via depreciation, because they were used for personal purposes, are now deductible on their tax return, via depreciation, because they are used for business purposes. Examples of personal assets being converted into business assets include computers, printers, copiers, audio/video and other equipment, bookcases, file cabinets, and other furniture.

Once again, the home-based business owner is allowed to deduct an expense (depreciation), and thereby report lower income, on their tax return, simply by using in (converting to) business **what they already had (and paid for), <u>without the outlay of any additional capital</u>**.

Hopefully you can understand that the home-based business owner actually experiences a higher level of income than what is shown on their tax return. (And isn't that the whole objective?) In fact, I used this analysis to show my own mortgage loan officer how we could afford a $950 monthly house payment (in 1995), although on paper it looked like we could only afford an $800 payment.

When analyzing their tax return to determine the ability of the taxpayer to repay a loan, be sure to make the appropriate adjustments to their income in these areas to compensate for these "phantom" expenses. As always, thank you for allowing us to help you "Pay **<u>Yourself</u>**, Not the IRS."

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