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Selling a Home with a Home Office can be a Tax Trap

These days, more individuals are working from home offices and availing themselves of the "Home Office Deduction." For tax purposes, this deduction essentially divides your home into two separate pieces of property, your home and business property. Those taking the deduction using the actual expense method will be able to deduct a portion of the home operating expenses including interest, taxes, insurance, utilities, upkeep and office depreciation. Since taxes and interest are generally deductible and any depreciation taken is added back to income when the house is sold and taxed at 25%, the real net benefit of taking a home office deduction lies with deducting the business portion of the utilities, insurance and upkeep.

If the home office deduction is figured by using the simplified method ($5 per square foot, up to 300 square feet of office area), interest and taxes paid are deducted as usual as part of itemized deductions but none of the other operating or depreciation expenses are deductible for the home office.

- **For Employees** - the home office is deducted as a miscellaneous itemized deduction, which means an individual must itemize their deductions in order to benefit from the deduction. In addition, the total of all the taxpayer's miscellaneous itemized deductions is reduced by 2% of his or her adjusted gross income, so depending upon the income amount, some or all of the home-office expenses may not be deductible at all.

- **For Self-Employed Individuals** - the benefits of a home office deduction are more substantial since the home office deduction is taken on the Schedule C and not subject to the limitations of itemizing deductions. In addition to offsetting income tax, a home office deduction can also reduce self-employment tax for individuals whose net income is subject to self-employment tax. The deduction may be limited by the business' gross income and when that occurs any unused expenses are carried over to a future year. This carryover is not available if the home office deduction is figured using the simplified method.

The tax trap occurs when you sell your home. If the office is an integral part of your home, the entire gain from the home and the business portion qualifies for the exclusion of gain except for the business depreciation taken after 5/6/97. If the business portion is separate, the gain from that portion would not qualify for the exclusion and would be taxable. See Sale of Home Used for Business for additional details.

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