



Deducting Home Expenses

The decision to use part of your home as a place of business is usually based on an individual's needs and preferences. The decision may be financial, so that the overhead of rent for example, will not be burdensome. Or the decision may reflect personal attitudes about commuting, or working flexible hours. When an individual establishes his business in his home, he may be entitled to deduct home expenses. This discussion of the deduction of home expenses **does not apply** to situations where you are an **employee of a business**. The deduction of home expenses by an employee is a topic outside the scope of this discussion.

If you wish to make any claim for home expenses you are required by Canada Revenue Agency to meet one of the two tests;

1. the work space in your home is your principal place of business, or
2. the work space in your home is used exclusively for earning income from business and is used on a regular and continuous basis for meeting customers, clients or patients.

In addition to the above qualifications, you are subject to a limitation on the amount of home expenses you may claim. Basically, the amount of expenses you are permitted to claim is limited to your net income from the business before deducting any amount for work space in your home. In other words, you cannot create a loss from business by claiming home expenses. Also there are special rules that enable you to carry forward unused home expenses to a subsequent year.

What Items Qualify as Expenses?

Subject to the limitations above, you may deduct expenses applicable to the part of your residence used solely for business. Examples of these expenses might be rent, heat, light, insurance, water, property taxes and interest on your



mortgage. These expenses are most easily accounted for when they are apportioned between business and personal use. The two most common methods of apportioning these expenses are on the square footage basis and on the number of rooms basis. If your business occupies 25% of the total square footage of the home,

then you should be able to deduct 25% of the expenses. Similarly, if your business occupied one out of five rooms, then you should be able to deduct 1/5 of the expenses.

In addition to the above, you will want to claim expenses relating directly to the space used for business. Examples of this might include repairs or maintenance required to spruce up an office that has wear associated with use by the public. Or, you may be required to redecorate an area where you may have your work on display. You must take care not to claim a repair expense for an item or items that are considered to be additions or enhancements to the home.

Can You Claim a Business Expense for Depreciation or Capital Cost Allowance on Your Home?

The simple answer to this question is yes! However, it is not considered to be a wise decision. The reason is that the eventual sale of your home will result in the disqualification of the principal residence exemption on the business portion of the home. In other words, you will probably have to pay tax on the recaptured depreciation and a portion of the capital gain resulting from the sale.

Some Other Considerations

Any decision by Canada Revenue Agency to allow or disallow a claim for home expenses may be influenced by an indication of your serious pursuit of the business. For example, do you have a business license, or was the



home partially assessed for business purposes? Do you have a separate business telephone? Do you have a sign on the

home announcing the business? Is the business space entirely separate from the family living area?

In addition to the above, there may be rules relating to specific businesses such as daycare where all of the home is used for business purposes for 8 hours per day. Each circumstance may warrant special considerations or interpretations of the deduction of home expenses. You should consult your advisor before making a claim for home expenses.

If you wish to discuss these items in more detail or have any questions call your advisor at MacKay LLP.

This document is general in nature and should not be relied upon to replace specific professional advice.