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Business Use of Your Home

(Including Use by Daycare Providers)

For use in preparing

2004 Returns



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What's New

Standard mileage rate for 2004. The standard mileage rate for the cost of operating your car, van, pickup, or panel truck for 2004 is 37.5 cents a mile for all business miles.

Standard mileage rate available for small fleets. Beginning in 2004, the business standard mileage rate may be used for as many as four vehicles that you own or lease and use simultaneously.

Reminder

Photographs of missing children. The Internal Revenue Service is a proud partner with the National Center for Missing and Exploited Children. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

Introduction

The purpose of this publication is to provide information on figuring and claiming the deduction for business use of your home. The term “home” includes a house, apartment, condominium, mobile home, boat, or similar property, which provides basic living accommodations. It also includes structures on the property, such as an unattached garage, studio, barn, or greenhouse. However, it does not include any part of your property used exclusively as a hotel or inn.

This publication includes information on the following.

- The requirements for qualifying to deduct expenses for the business use of your home (including special rules for storing inventory or product samples).
- Types of expenses you can deduct.
- How to figure the deduction (including depreciation of your home).
- Special rules for daycare providers.
- Selling a home that was used partly for business.
- Deducting expenses for furniture and equipment used in your business.
- Records you should keep.
- Where to deduct your expenses.

If you are an employee or a partner, or you file Schedule F (Form 1040), Profit or Loss From Farming, use the worksheet on page 24 and its instructions, which begin on page 25, to help figure your deduction. If you file Schedule C (Form 1040), Profit or Loss From Business, you must generally use Form 8829, Expenses for Business Use of Your Home. The *Schedule C Example* on pages 19 through 23 shows how to report the deduction on Form 8829.

The rules in this publication apply to individuals.

If you need information on deductions for renting out your property, see Publication 527, Residential Rental Property.

Comments and suggestions. We welcome your comments about this publication and your suggestions for future editions.

You can write to us at the following address:

Internal Revenue Service
Individual Forms and Publications Branch
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We respond to many letters by telephone. Therefore, it would be helpful if you would include your daytime phone number, including the area code, in your correspondence.

You can email us at *taxforms@irs.gov. (The asterisk must be included in the address.) Please put “Publications Comment” on the subject line. Although we cannot respond individually to each email, we do appreciate your

feedback and will consider your comments as we revise our tax products.

Tax questions. If you have a tax question, visit www.irs.gov or call 1-800-829-1040. We cannot answer tax questions at either of the addresses listed above.

Ordering forms and publications. Visit www.irs.gov/formspubs to download forms and publications, call 1-800-829-3676, or write to one of the three addresses shown under *How To Get Tax Help* in the back of this publication.

Useful Items

You may want to see:

Publications

- 523** Selling Your Home
- 551** Basis of Assets
- 583** Starting a Business and Keeping Records
- 946** How To Depreciate Property

Forms (and Instructions)

- Schedule C (Form 1040)** Profit or Loss from Business
- 2106** Employee Business Expenses
- 2106-EZ** Unreimbursed Employee Business Expenses
- 4562** Depreciation and Amortization
- 8829** Expenses for Business Use of Your Home

See *How To Get Tax Help* near the end of this publication for information about getting publications and forms.

Qualifying for a Deduction

Generally, you cannot claim expenses such as mortgage interest and real estate taxes as business expenses. However, you may be able to deduct expenses related to the business use of part of your home if you meet specific requirements. Even then, your deduction may be limited. Use this section and Figure A, later, to decide if you can deduct expenses for the business use of your home.

To qualify to claim expenses for business use of your home, you must use part of your home:

1. Exclusively and regularly as your principal place of business (defined later),
2. Exclusively and regularly as a place where you meet or deal with patients, clients, or customers in the normal course of your trade or business,
3. In the case of a separate structure which is not attached to your home, in connection with your trade or business,

4. On a regular basis for certain storage use (see *Storage of inventory or product samples*, later),
5. For rental use (see Publication 527), or
6. As a daycare facility (see *Daycare Facility*, later).

Additional tests for employee use. If you are an employee and you use a part of your home for business, you may qualify for a deduction for its business use. You must meet the tests discussed above plus:

1. Your business use must be for the convenience of your employer, and
2. You must not rent any part of your home to your employer and use the rented portion to perform services as an employee for that employer.

Exclusive Use

To qualify under the exclusive use test, you must use a specific area of your home only for your trade or business. The area used for business can be a room or other separately identifiable space. The space does not need to be marked off by a permanent partition.

You do not meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.

Example. You are an attorney and use a den in your home to write legal briefs and prepare clients' tax returns. Your family also uses the den for recreation. The den is not used exclusively in your profession, so you cannot claim a business deduction for its use.

Exceptions to Exclusive Use

You do not have to meet the exclusive use test if either of the following applies.

- You use part of your home for the storage of inventory or product samples (discussed next).
- You use part of your home as a daycare facility, discussed later under *Daycare Facility*.

Storage of inventory or product samples. If you use part of your home for storage of inventory or product samples, you can claim expenses for the business use of your home without meeting the exclusive use test. However, you must meet all the following tests.

- You sell products at wholesale or retail as your trade or business.
- You keep the inventory or product samples in your home for use in your trade or business.
- Your home is the only fixed location of your trade or business.
- You use the storage space on a regular basis.

- The space you use is a separately identifiable space suitable for storage.

Example. Your home is the only fixed location of your business of selling mechanics' tools at retail. You regularly use half of your basement for storage of inventory and product samples. You sometimes use the area for personal purposes. The expenses for the storage space are deductible even though you do not use this part of your basement exclusively for business.

Regular Use

To qualify under the regular use test, you must use a specific area of your home for business on a regular basis. Incidental or occasional business use is not regular use. You must consider all facts and circumstances in determining whether your use is on a regular basis.

Trade or Business Use

To qualify under the trade-or-business-use-test, you must use part of your home in connection with a trade or business. If you use your home for a profit-seeking activity that is not a trade or business, you cannot take a deduction for its business use.

Example. You use part of your home exclusively and regularly to read financial periodicals and reports, clip bond coupons, and carry out similar activities related to your own investments. You do not make investments as a broker or dealer. So, your activities are not part of a trade or business and you cannot take a deduction for the business use of your home.

Principal Place of Business

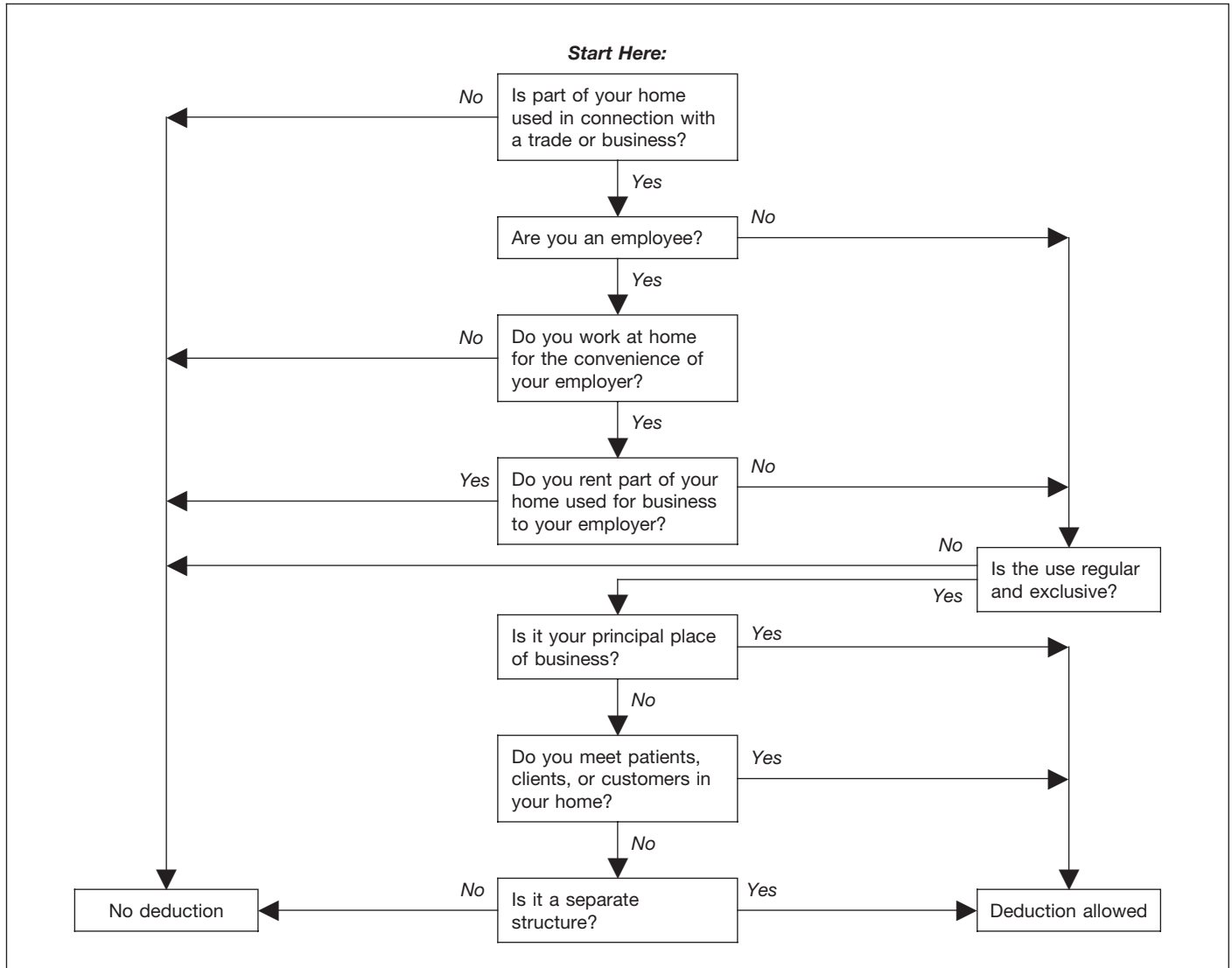
You can have more than one business location, including your home, for a single trade or business. To qualify to deduct the expenses for the business use of your home under the principal place of business test, your home must be your principal place of business for that trade or business. To determine whether your home is your principal place of business, you must consider:

- The relative importance of the activities performed at each place where you conduct business, and
- The amount of time spent at each place where you conduct business.

Your home office will qualify as your principal place of business if you meet the following requirements.

- You use it exclusively and regularly for administrative or management activities of your trade or business.
- You have no other fixed location where you conduct substantial administrative or management activities of your trade or business.

Figure A. **Can You Deduct Business Use of the Home Expenses?** Do not use this chart if you use your home for the storage of inventory or product samples, or to operate a daycare facility. See *Exceptions to Exclusive Use*, earlier, and *Daycare Facility*, later.



If, after considering your business locations, your home cannot be identified as your principal place of business, you cannot deduct home office expenses. However, see the later discussions under *Place To Meet Patients, Clients, or Customers* or *Separate Structure* for other ways to qualify to deduct home office expenses.

Administrative or management activities. There are many activities that are administrative or managerial in nature. The following are a few examples.

- Billing customers, clients, or patients.
- Keeping books and records.
- Ordering supplies.
- Setting up appointments.
- Forwarding orders or writing reports.

Administrative or management activities performed at other locations. The following activities performed by

you or others will not disqualify your home office from being your principal place of business.

- You have others conduct your administrative or management activities at locations other than your home. (For example, another company does your billing from its place of business.)
- You conduct administrative or management activities at places that are not fixed locations of your business, such as in a car or a hotel room.
- You occasionally conduct minimal administrative or management activities at a fixed location outside your home.
- You conduct substantial nonadministrative or non-management business activities at a fixed location outside your home. (For example, you meet with or provide services to customers, clients, or patients at a fixed location of the business outside your home.)

- You have suitable space to conduct administrative or management activities outside your home, but choose to use your home office for those activities instead.

Example 1. John is a self-employed plumber. Most of John's time is spent at customers' homes and offices installing and repairing plumbing. He has a small office in his home that he uses exclusively and regularly for the administrative or management activities of his business, such as phoning customers, ordering supplies, and keeping his books.

John writes up estimates and records of work completed at his customers' premises. He does not conduct any substantial administrative or management activities at any fixed location other than his home office. John does not do his own billing. He uses a local bookkeeping service to bill his customers.

John's home office qualifies as his principal place of business for deducting expenses for its use. He uses the home office for the administrative or managerial activities of his plumbing business and he has no other fixed location where he conducts these administrative or managerial activities. His choice to have his billing done by another company does not disqualify his home office from being his principal place of business. He meets all the qualifications, including principal place of business, so he can deduct expenses (to the extent of the deduction limit, explained later) for the business use of his home.

Example 2. Pamela is a self-employed sales representative for several different product lines. She has an office in her home that she uses exclusively and regularly to set up appointments and write up orders and other reports for the companies whose products she sells. She occasionally writes up orders and sets up appointments from her hotel room when she is away on business overnight.

Pamela's business is selling products to customers at various locations throughout her territory. To make these sales, she regularly visits customers to explain the available products and take orders.

Pamela's home office qualifies as her principal place of business for deducting expenses for its use. She conducts administrative or management activities there and she has no other fixed location where she conducts substantial administrative or management activities. The fact that she conducts some administrative or management activities in her hotel room (not a fixed location) does not disqualify her home office from being her principal place of business. She meets all the qualifications, including principal place of business, so she can deduct expenses (to the extent of the deduction limit, explained later) for the business use of her home.

Example 3. Paul is a self-employed anesthesiologist. He spends the majority of his time administering anesthesia and postoperative care in three local hospitals. One of the hospitals provides him with a small shared office where he could conduct administrative or management activities.

Paul very rarely uses the office the hospital provides. He uses a room in his home that he has converted to an office.

He uses this room exclusively and regularly to conduct all the following activities.

- Contacting patients, surgeons, and hospitals regarding scheduling.
- Preparing for treatments and presentations.
- Maintaining billing records and patient logs.
- Satisfying continuing medical education requirements.
- Reading medical journals and books.

Paul's home office qualifies as his principal place of business for deducting expenses for its use. He conducts administrative or management activities for his business as an anesthesiologist there and he has no other fixed location where he conducts substantial administrative or management activities for this business. His choice to use his home office instead of the one provided by the hospital does not disqualify his home office from being his principal place of business. His performance of substantial nonadministrative or nonmanagement activities at fixed locations outside his home also does not disqualify his home office from being his principal place of business. He meets all the qualifications, including principal place of business, so he can deduct expenses (to the extent of the deduction limit, explained later) for the business use of his home.

Example 4. Kathleen is employed as a teacher. She is required to teach and meet with students at the school and to grade papers and tests. The school provides her with a small office where she can work on her lesson plans, grade papers and tests, and meet with parents and students. The school does not require her to work at home.

Kathleen prefers to use the office she has set up in her home and does not use the one provided by the school. She uses this home office exclusively and regularly for the administrative duties of her teaching job.

Kathleen must meet the convenience-of-the-employer test, even if her home qualifies as her principal place of business for deducting expenses for its use. Her employer provides her with an office and does not require her to work at home, so she does not meet the convenience-of-the-employer test and cannot claim a deduction for the business use of her home.

More Than One Trade or Business

The same home office can be the principal place of business for two or more separate business activities. Whether your home office is the principal place of business must be determined separately for each of your trade or business activities. You must use the home office exclusively and regularly for one or more of the following purposes.

- As the principal place of business for one or more of your trades or businesses.
- As a place to meet or deal with patients, clients, or customers in the normal course of one or more of your trades or businesses.

- If your home office is a separate structure, in connection with one or more of your trades or businesses.

If you are an employee, any use of the home office in connection with your employment must be for the convenience of your employer. See *Rental to employer*, later if you rent part of your home to your employer.

Example. Tracy White is employed as a teacher. Her principal place of work is the school, which provides her office space to do her school work. She also has a mail order jewelry business. All her work in the jewelry business is done in her home office and the office is used exclusively for that business. If she meets all the other tests, she can deduct expenses for business use of her home for the jewelry business.

If Tracy also uses the office for work related to her teaching, she must meet the exclusive use test for both businesses to qualify for the deduction. As an employee, Tracy must also meet the convenience-of-the-employer test to qualify for the deduction. She does not meet this test for her work as a teacher, so she cannot claim a deduction for the business use of her home for either activity.

Place To Meet Patients, Clients, or Customers

If you meet or deal with patients, clients, or customers in your home in the normal course of your business, even though you also carry on business at another location, you can deduct your expenses for the part of your home used exclusively and regularly for business if you meet both the following tests.

- You physically meet with patients, clients, or customers on your premises.
- Their use of your home is substantial and integral to the conduct of your business.

Doctors, dentists, attorneys, and other professionals who maintain offices in their homes generally will meet this requirement.

Using your home for occasional meetings and telephone calls will not qualify you to deduct expenses for the business use of your home.

The part of your home you use exclusively and regularly to meet patients, clients, or customers does not have to be your principal place of business.

Example. June Quill, a self-employed attorney, works 3 days a week in her city office. She works 2 days a week in her home office used only for business. She regularly

meets clients there. Her home office qualifies for a business deduction because she meets clients there in the normal course of her business.

Separate Structure

You can deduct expenses for a separate free-standing structure, such as a studio, garage, or barn, if you use it exclusively and regularly for your business. The structure does not have to be your principal place of business or a place where you meet patients, clients, or customers.

Example. John Berry operates a floral shop in town. He grows the plants for his shop in a greenhouse behind his home. He uses the greenhouse exclusively and regularly in his business, so he can deduct the expenses for its use, subject to the deduction limit, explained later.

Figuring the Deduction

After you determine that you meet the tests under *Qualifying for a Deduction*, you can begin to figure how much you can deduct. You will need to figure the percentage of your home used for business and the limit on the deduction.

Business Percentage

To find the business percentage, compare the size of the part of your home that you use for business to your whole house. Use the resulting percentage to figure the business part of the expenses for operating your entire home.

You can use any reasonable method to determine the business percentage. The following are two commonly used methods for figuring the percentage.

1. Divide the area (length multiplied by the width) used for business by the total area of your home.
2. If the rooms in your home are all about the same size, you can divide the number of rooms used for business by the total number of rooms in your home.

Example 1.

- Your office is 240 square feet (12 feet × 20 feet).
- Your home is 1,200 square feet.
- Your office is 20% ($240 \div 1,200$) of the total area of your home.
- Your business percentage is 20%.

Example 2.

- You use one room in your home for business.
- Your home has four rooms, all about equal size.
- Your office is 25% (1 ÷ 4) of the total area of your home.
- Your business percentage is 25%.



Use lines 1–7 of Form 8829, or lines 1–3 on the worksheet near the end of this publication, to figure your business percentage.

Part-Year Use

You cannot deduct expenses for the business use of your home incurred during any part of the year you did not use your home for business purposes. For example, if you begin using part of your home for business on July 1, and you meet all the tests from that date until the end of the year, consider only your expenses for the last half of the year in figuring your allowable deduction.

Deduction Limit

If your gross income from the business use of your home equals or exceeds your total business expenses (including depreciation), you can deduct all your business expenses related to the use of your home.

If your gross income from the business use of your home is less than your total business expenses, your deduction for certain expenses for the business use of your home is limited.

Your deduction of otherwise nondeductible expenses, such as insurance, utilities, and depreciation (with depreciation taken last), that are allocable to the business, is limited to the gross income from the business use of your home minus the sum of the following.

1. The business part of expenses you could deduct even if you did not use your home for business (such as mortgage interest, real estate taxes, and casualty and theft losses that are allowable as itemized deductions on Schedule A (Form 1040)). These expenses are discussed in detail under *Deducting Expenses*, later.
2. The business expenses that relate to the business activity in the home (for example, business phone, supplies, and depreciation on equipment), but not to the use of the home itself.

If you are self-employed, do not include in (2) above your deduction for half of your self-employment tax.

Carryover of unallowed expenses. If your deductions are greater than the current year's limit, you can carry over

the excess to the next year. They are subject to the deduction limit for that year, whether or not you live in the same home during that year.

Figuring the deduction limit and carryover. If you are an employee or a partner, or you file Schedule F (Form 1040), use the worksheet on page 24 to figure your deduction limit and carryover. If you file Schedule C (Form 1040), figure your deduction limit and carryover on Form 8829.

Example. You meet the requirements for deducting expenses for the business use of your home. You use 20% of your home for business. In 2004, your business expenses and the expenses for the business use of your home are deducted from your gross income in the following order.

Gross income from business	\$6,000
Minus:	
Deductible mortgage interest and real estate taxes (20%)	3,000
Business expenses not related to the use of your home (100%) (business phone, supplies, and depreciation on equipment)	2,000
Deduction limit	<u>\$1,000</u>
Minus other expenses allocable to business use of home:	
Maintenance, insurance, and utilities (20%)	800
Depreciation allowed (20% = \$1,600 allowable, but subject to balance of deduction limit)	200
Other expenses up to the deduction limit	<u>\$1,000</u>
Depreciation carryover to 2005 (\$1,600 – \$200) (subject to deduction limit in 2005)	<u>\$1,400</u>

You can deduct all of the business part of your deductible mortgage interest and real estate taxes (\$3,000). You also can deduct all of your business expenses not related to the use of your home (\$2,000). Additionally, you can deduct all of the business part of your expenses for maintenance, insurance, and utilities, because the total (\$800) is less than the \$1,000 deduction limit. Your deduction for depreciation for the business use of your home is limited to \$200 (\$1,000 minus \$800) because of the deduction limit. You can carry over the \$1,400 balance and add it to your depreciation for 2005, subject to your deduction limit in 2005.

More than one place of business. If part of the gross income from your trade or business is from the business use of part of your home and part is from a place other than your home, you must determine the part of your gross income from the business use of your home before you figure the deduction limit. In making this determination, consider the time you spend at each location, the business investment in each location, and any other relevant facts and circumstances.



If your home office qualifies as your principal place of business, you can deduct your daily transportation costs between your home and another work location in the same trade or business. For more information on transportation costs, see Publication 463, *Travel, Entertainment, Gift, and Car Expenses*.

Deducting Expenses

If you qualify to deduct expenses for the business use of your home, you must divide the expenses of operating your home between personal and business use. This section discusses the types of expenses you may have and gives examples and brief explanations of these expenses.

Types of Expenses


The part of a home operating expense you can use to figure your deduction depends on both of the following.

- Whether the expense is direct, indirect, or unrelated.
- The percentage of your home used for business.

The following table describes the types of expenses you may have and the extent to which they are deductible.

Expense	Description	Deductibility
Direct	Expenses only for the business part of your home. Examples: Painting or repairs only in the area used for business.	Deductible in full.* Exception: May be only partially deductible in a daycare facility. See <i>Daycare Facility</i> , later.
Indirect	Expenses for keeping up and running your entire home. Examples: Insurance, utilities, and general repairs.	Deductible based on the percentage of your home used for business.*
Unrelated	Expenses only for the parts of your home not used for business. Examples: Lawn care or painting a room not used for business.	Not deductible.

*Subject to the deduction limit, discussed earlier.

 **TIP** *Form 8829 and the deduction worksheet (both illustrated near the end of this publication) have separate columns for direct and indirect expenses.*

Expenses related to tax exempt income. Generally, you cannot deduct expenses that are related to tax exempt allowances. However, if you receive a tax exempt parsonage allowance or a tax exempt military allowance, your expenses for mortgage interest and real estate taxes are deductible under the normal rules. No deduction is allowed for other expenses related to the tax exempt allowance.

If your housing is provided free of charge and the value of the housing is tax exempt, you cannot deduct the rental value of any portion of the housing.

Examples of Expenses

Certain expenses are deductible whether or not you use your home for business. If you qualify to claim business use of the home expenses, use the business percentage of these expenses to figure your total business use of the home deduction. These expenses include the following.

- Real estate taxes.
- Deductible mortgage interest.
- Casualty losses.

Other expenses are deductible only if you use your home for business. You can use the business percentage of these expenses to figure your total business use of the home deduction. These expenses generally include (but are not limited to) the following.

- Depreciation (covered under *Depreciating Your Home*, later).
- Insurance.
- Rent.
- Repairs.
- Security system.
- Utilities and services.

Real Estate Taxes

To figure the business part of your real estate taxes, multiply the real estate taxes paid by the percentage of your home used for business.

For more information on the deduction for real estate taxes, see Publication 530, Tax Information for First-Time Homeowners.

Deductible Mortgage Interest

To figure the business part of your deductible mortgage interest, multiply this interest by the percentage of your home used for business. You can include interest on a second mortgage in this computation. If your total mortgage debt is more than \$1,000,000 or your home equity debt is more than \$100,000, your deduction may be limited. For more information on what interest is deductible, see Publication 936, Home Mortgage Interest Deduction.

Casualty Losses

If you have a casualty loss on your home that you use for business, treat the casualty loss as a direct expense, an indirect expense, or an unrelated expense, depending on the property affected.

- A direct expense is the loss on the portion of the property you use only in your business. Use the entire loss to figure the business use of the home deduction.

- An indirect expense is the loss on property you use for both business and personal purposes. Use only the business portion to figure the deduction.
- An unrelated expense is the loss on property you do not use in your business. Do not use any of the loss to figure the deduction.

If you are filing Schedule C (Form 1040), get Form 8829 and follow the instructions for casualty losses. If you are an employee or a partner, or you file Schedule F (Form 1040), use the worksheet on page 24. You will also need to get Form 4684, Casualties and Thefts.

For more information on casualty losses, see Publication 547, Casualties, Disasters, and Thefts.

Insurance

You can deduct the cost of insurance that covers the business part of your home. However, if your insurance premium gives you coverage for a period that extends past the end of your tax year, you can deduct only the business percentage of the part of the premium that gives you coverage for your tax year. You can deduct the business percentage of the part that applies to the following year in that year.

Rent

If you rent the home you occupy and meet the requirements for business use of the home, you can deduct part of the rent you pay. To figure your deduction, multiply your rent payments by the percentage of your home used for business.

If you own your home, you cannot deduct the fair rental value of your home. However, see *Depreciating Your Home*, later.

Repairs

The cost of repairs that relate to your business, including labor (other than your own labor), is a deductible expense. For example, a furnace repair benefits the entire home. If you use 10% of your home for business, you can deduct 10% of the cost of the furnace repair.

Repairs keep your home in good working order over its useful life. Examples of common repairs are patching walls and floors, painting, wallpapering, repairing roofs and gutters, and mending leaks. However, repairs are sometimes treated as a permanent improvement. See *Permanent improvements*, later, under *Depreciating Your Home*.

Security System

If you install a security system that protects all the doors and windows in your home, you can deduct the business part of the expenses you incur to maintain and monitor the system. You also can take a depreciation deduction for the part of the cost of the security system relating to the business use of your home.

Utilities and Services

Expenses for utilities and services, such as electricity, gas, trash removal, and cleaning services, are primarily personal expenses. However, if you use part of your home for business, you can deduct the business part of these expenses. Generally, the business percentage for utilities is the same as the percentage of your home used for business.

Telephone. The basic local telephone service charge, including taxes, for the first telephone line into your home is a nondeductible personal expense. However, charges for business long-distance phone calls on that line, as well as the cost of a second line into your home used exclusively for business, are deductible business expenses. Do not include these expenses as a cost of using your home for business. Deduct these charges separately on the appropriate form or schedule. For example, if you file Schedule C (Form 1040), deduct these expenses on line 25 (instead of line 30).

Depreciating Your Home

If you own your home and qualify to deduct expenses for its business use, you can claim a deduction for depreciation. Depreciation is an allowance for the wear and tear on the part of your home used for business. You cannot depreciate the cost or value of the land. You recover its cost when you sell or otherwise dispose of the property.

Before you figure your depreciation deduction, you need to know the following information.

- The month and year you started using your home for business.
- The adjusted basis and fair market value of your home (excluding land) at the time you began using it for business.
- The cost of any improvements before and after you began using the property for business.
- The percentage of your home used for business. See *Business Percentage*, earlier.

Adjusted basis defined. The adjusted basis of your home is generally its cost, plus the cost of any permanent improvements you made to it, minus any casualty losses or depreciation deducted in earlier tax years. For a discussion of adjusted basis, see Publication 551.

Permanent improvements. A permanent improvement increases the value of property, adds to its life, or gives it a new or different use. Examples of improvements are replacing electric wiring or plumbing, adding a new roof or addition, paneling, or remodeling.

You must carefully distinguish between repairs and improvements. See *Repairs*, earlier. You also must keep accurate records of these expenses. These records will help you decide whether an expense is a deductible or capital (added to the basis) expense. However, if you

make repairs as part of an extensive remodeling or restoration of your home, the entire job is an improvement.

Example. You buy an older home and fix up two rooms as a beauty salon. You patch the plaster on the ceilings and walls, paint, repair the floor, install an outside door, and install new wiring, plumbing, and other equipment. Normally, the patching, painting, and floor work are repairs and the other expenses are permanent improvements. However, because the work gives your property a new use, the entire remodeling job is a permanent improvement and its cost is added to the basis of the property. You cannot deduct any portion of it as a repair expense.

Adjusting for depreciation deducted in earlier years. Decrease the basis of your property by the depreciation you deducted, or could have deducted, on your tax returns under the method of depreciation you properly selected. If you took less depreciation than you could have under the method you selected, decrease the basis by the amount you could have taken under that method. If you did not take a depreciation deduction, decrease the basis by the amount you could have deducted.

If you deducted more depreciation than you should have, decrease your basis by the amount you should have deducted, plus the part of the excess depreciation you deducted that actually decreased your tax liability for any year.

If you deducted the incorrect amount of depreciation, see *How Do You Correct Depreciation Deductions* in chapter 1 of Publication 946.

Fair market value defined. The fair market value of your home is the price at which the property would change hands between a buyer and a seller, neither having to buy or sell, and both having reasonable knowledge of all necessary facts. Sales of similar property, on or about the date you begin using your home for business, may be helpful in figuring the property's fair market value.

Figuring the Depreciation Deduction for the Current Year

If you began using your home for business before 2004, continue to use the same depreciation method you used in past tax years.

If you began using your home for business in 2004, depreciate the business part as nonresidential real property under the modified accelerated cost recovery system (MACRS). Under MACRS, nonresidential real property is depreciated using the straight line method over 39 years. For more information on MACRS and other methods of depreciation, see Publication 946.

To figure the depreciation deduction, you must first figure the part of the cost of your home that can be depreciated (depreciable basis). The depreciable basis is figured by multiplying the percentage of your home used for business by the smaller of the following.

- The adjusted basis of your home (excluding land) on the date you began using your home for business.

- The fair market value of your home (excluding land) on the date you began using your home for business.

Depreciation table. If 2004 was the first year you used your home for business, you can figure your 2004 depreciation for the business part of your home by using the appropriate percentage from the following table.

Table 1. MACRS Percentage Table for 39-Year Nonresidential Real Property

Month First Used for Business	Percentage To Use
1	2.461%
2	2.247%
3	2.033%
4	1.819%
5	1.605%
6	1.391%
7	1.177%
8	0.963%
9	0.749%
10	0.535%
11	0.321%
12	0.107%

Multiply the depreciable basis of the business part of your home by the percentage from the table for the first month you use your home for business. See Table A-7a in Appendix A of Publication 946 for the percentages for the remaining tax years of the recovery period.

Example. In May, George Miller began to use one room in his home exclusively and regularly to meet clients. This room is 8% of the square footage of his home. He bought the home in 1994 for \$125,000. He determined from his property tax records that his adjusted basis in the house (exclusive of land) is \$115,000. In May, the house had a fair market value of \$165,000. He multiplies his adjusted basis (which is less than the fair market value) by 8%. The result is \$9,200, his depreciable basis for the business part of the house.

George files his return based on the calendar year. May is the 5th month of his tax year. He multiplies his depreciable basis of \$9,200 by 1.605% (.01605), the percentage from the table for the 5th month. His depreciation deduction is \$147.66.

Depreciating Permanent Improvements

Add the costs of permanent improvements made before you began using your home for business to the basis of your property. Depreciate these costs as part of the cost of the house as explained earlier. The costs of improvements made after you begin using your home for business (that affect the business part of your home, such as a new roof) are depreciated separately. Multiply the cost of the im-

provement by the business-use percentage and depreciate the result over the recovery period that would apply to your home if you began using it for business at the same time as the improvement. For improvements made this year, the recovery period is 39 years. For the percentage to use for the first year, see Table 1, earlier. For more information on recovery periods, see *Which Recovery Period Applies* in chapter 4 of Publication 946.

Daycare Facility

If you use space in your home on a regular basis for providing daycare, you may be able to deduct the business expenses for that part of your home even though you use the same space for nonbusiness purposes. To qualify for this exception to the exclusive use rule, you must meet both the following requirements.

- You must be in the trade or business of providing daycare for children, persons age 65 or older, or persons who are physically or mentally unable to care for themselves.
- You must have applied for, been granted, or be exempt from having a license, certification, registration, or approval as a daycare center or as a family or group daycare home under state law. You do not meet this requirement if your application was rejected or your license or other authorization was revoked.

Figuring the deduction. If you regularly use part of your home for daycare, figure what part is used for daycare, as explained earlier under *Business Percentage*. If you use that part exclusively for daycare, deduct all the allocable expenses, subject to the deduction limit, as explained earlier.

If the use of part of your home as a daycare facility is regular, but not exclusive, you must figure what part of available time you actually use it for business. A room that is available for use throughout each business day and that you regularly use in your business is considered to be used for daycare throughout each business day. You do not have to keep records to show the specific hours the area was used for business. You may use the area occasionally for personal reasons. However, a room you use only occasionally for business does not qualify for the deduction.



To find what part of the available time you actually use your home for business, compare the total time used for business to the total time that part of your home can be used for all purposes. You can compare the hours of business use in a week with the number of hours in a week (168). Or you can compare the hours of business use for the year with the number of hours in the year (8,784 in 2004).

Example 1. Mary Lake uses her basement to operate a daycare business for children. She figures the business percentage of the basement as follows.

$$\frac{\text{Square footage of the basement}}{\text{Square footage of her home}} = \frac{1,600}{3,200} = 50\%$$

She uses the basement for daycare an average of 12 hours a day, 5 days a week, for 50 weeks a year. During the other 12 hours a day, the family can use the basement. She figures the percentage of time the basement is available for use as follows.

$$\frac{\text{Number of hours available for use } (12 \times 5 \times 50)}{\text{Total number of hours in the year } (24 \times 366)} = \frac{3,000}{8,784} = 34.15\%$$

Mary can deduct 34.15% of any direct expenses for the basement. However, because her indirect expenses are for the entire house, she can deduct only 17.08% of the indirect expenses. She figures the percentage for her indirect expenses as follows.

Business percentage of the basement	50%
Multiplied by: Percentage of time used	$\times 34.15\%$
Percentage for indirect expenses	<u>17.08%</u>

Mary completes Form 8829 as shown in Figure B, later. In Part I, she figures the percentage of her home used for business, including the percentage of time the basement is used.

In Part II, Mary figures her deductible expenses. She uses the following information to complete Part II.

Gross income from her daycare business	\$50,000
Expenses not related to the business use of the home	<u>\$25,000</u>
Tentative profit	<u>\$25,000</u>
Rent	\$8,400
Utilities	\$850
Painting the basement	\$500

Mary enters her tentative profit, \$25,000, on line 8. (This figure is the same as the amount on line 29 of her Schedule C.)

The expenses she paid for rent and utilities relate to her entire home. Therefore, she enters them in column (b) on the appropriate lines. She adds these two expenses (line 21) and multiplies the total by the percentage on line 7 and enters the result, \$1,580, on line 22.

Mary paid \$500 to have the basement painted. The painting is a direct expense. However, because she does not use the basement exclusively for daycare, she must multiply \$500 by the percentage of time the basement is used for daycare (34.15% — line 6). She enters \$171 (34.15% \times \$500) on line 18, column (a). She adds line 21, column (a), and line 22 and enters \$1,751 (\$171 + \$1,580) on line 24. This is less than her deduction limit (line 15), so she can deduct the entire amount. She completes the rest of Part II by entering \$1,751 on lines 32 and 34. She then carries the \$1,751 to line 30 of her Schedule C (not shown).

Example 2. Assume the same facts as in Example 1 except that Mary also has another room that is available each business day for children to take naps in. Although she did not keep a record of the number of hours the room was actually used for naps, it was used for part of each business day. Since the room was available during regular operating hours each business day and was used regularly in the business, it is considered to be used for daycare throughout each business day. The basement and room

Expenses for Business Use of Your Home
 ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.
 ▶ See separate instructions.

Name(s) of proprietor(s) Mary Lake Your social security number 412 : 00 : 1234

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples (see instructions)	1	1,600
2	Total area of home	2	3,200
3	Divide line 1 by line 2. Enter the result as a percentage	3	50 %
● For day-care facilities not used exclusively for business, also complete lines 4–6. ● All others, skip lines 4–6 and enter the amount from line 3 on line 7.			
4	Multiply days used for day care during year by hours used per day	4	3,000 hr.
5	Total hours available for use during the year (366 days × 24 hours) (see instructions)	5	8,784 hr.
6	Divide line 4 by line 5. Enter the result as a decimal amount	6	.3415
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3	7	17.08%

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9–20.	8	25,000
		(a) Direct expenses	(b) Indirect expenses
9	Casualty losses (see instructions)	9	
10	Deductible mortgage interest (see instructions)	10	
11	Real estate taxes (see instructions)	11	
12	Add lines 9, 10, and 11	12	
13	Multiply line 12, column (b) by line 7	13	
14	Add line 12, column (a) and line 13	14	-0-
15	Subtract line 14 from line 8. If zero or less, enter -0-	15	25,000
16	Excess mortgage interest (see instructions)	16	
17	Insurance	17	
18	Repairs and maintenance	18	171
19	Utilities	19	850
20	Other expenses (see instructions)	20	8,400
21	Add lines 16 through 20	21	9,250
22	Multiply line 21, column (b) by line 7	22	1,580
23	Carryover of operating expenses from 2003 Form 8829, line 41	23	
24	Add line 21 in column (a), line 22, and line 23	24	1,751
25	Allowable operating expenses. Enter the smaller of line 15 or line 24	25	1,751
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15	26	23,249
27	Excess casualty losses (see instructions)	27	
28	Depreciation of your home from Part III below	28	
29	Carryover of excess casualty losses and depreciation from 2003 Form 8829, line 42	29	
30	Add lines 27 through 29	30	-0-
31	Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30	31	-0-
32	Add lines 14, 25, and 31	32	1,751
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B	33	-0-
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions	34	1,751

Part III Depreciation of Your Home

35	Enter the smaller of your home's adjusted basis or its fair market value (see instructions)	35	
36	Value of land included on line 35	36	
37	Basis of building. Subtract line 36 from line 35	37	
38	Business basis of building. Multiply line 37 by line 7	38	
39	Depreciation percentage (see instructions)	39	%
40	Depreciation allowable (see instructions). Multiply line 38 by line 39. Enter here and on line 28 above	40	

Part IV Carryover of Unallowed Expenses to 2005

41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42	

are 60% of the total area of her home. In figuring her expenses, 34.15% of any direct expenses for the basement and room are deductible. In addition, 20.49% (34.15% × 60%) of her indirect expenses are deductible.

Meals. If you provide food for your daycare recipients, do not include the expense as a cost of using your home for business. Claim it as a separate deduction on your Schedule C (Form 1040). You can never deduct the cost of food consumed by you or your family. You can deduct as a business expense 100% of the actual cost of food consumed by your daycare recipients (see *Standard meal and snack rates*, later, for an optional method for eligible children) and generally only 50% of the cost of food consumed by your employees. However, you can deduct 100% of the cost of food consumed by your employees if its value can be excluded from their wages as a *de minimis* fringe benefit. For more information on meals that meet these requirements, see *Meals* in Publication 15-B, Employer's Tax Guide to Fringe Benefits.

If you deduct the actual cost of food for your daycare business, keep a separate record (with receipts) of your family's food costs.

Reimbursements you receive from a sponsor under the Child and Adult Food Care Program of the Department of Agriculture are taxable only to the extent they exceed your expenses for food for eligible children. If your reimbursements are more than your expenses for food, show the difference as income in Part I of Schedule C. If your food expenses are greater than the reimbursements, show the difference as an expense in Part V of Schedule C. Do not include payments or expenses for your own children if they are eligible for the program. Follow this procedure even if you receive a Form 1099 reporting a payment from the sponsor.

Standard meal and snack rates. If you qualify as a family daycare provider, you can use the standard meal and snack rates, instead of actual costs, to compute the deductible cost of meals and snacks provided to eligible children. For these purposes:

- A family daycare provider is a person engaged in the business of providing family daycare.
- Family daycare is childcare provided to eligible children in the home of the family daycare provider. The care must be non-medical, not involve a transfer of legal custody, and generally last less than 24 hours each day.
- Eligible children are minor children receiving family daycare in the home of the family daycare provider. Eligible children do not include children who are full-time or part-time residents in the home where the childcare is provided or children whose parents or guardians are residents of the same home. Eligible children do not include children who receive daycare services for personal reasons of the provider. For example, if a provider provides daycare services for a relative as a favor to that relative, that child is not an eligible child.

You can compute the deductible cost of each meal and snack you actually purchased and served to an eligible child during the time period you provided family daycare using the standard meal and snack rates shown in Table 2, later. You can use the standard meal and snack rates for a maximum of one breakfast, one lunch, one dinner, and three snacks per eligible child per day. If you receive reimbursement for a particular meal or snack, you can deduct only the portion of the applicable standard meal or snack rate that exceeds the amount of the reimbursement.

You can use either the standard meal and snack rates or actual costs to calculate the deductible cost of food provided to eligible children in the family daycare for any particular tax year. If you choose to use the standard meal and snack rates for a particular tax year, you must use the rates for all your deductible food costs for eligible children during that tax year. However, if you use the standard meal and snack rates in any tax year, you can use actual costs to compute the deductible cost of food in any other tax year.

If you use the standard meal and snack rates, you must maintain records to substantiate the computation of the total amount deducted for the cost of food provided to eligible children. The records kept should include the name of each child, dates and hours of attendance in the daycare, and the type and quantity of meals and snacks served. This information can be recorded in a log similar to the one shown in Exhibit A, later.

The standard meal and snack rates include beverages, but do not include non-food supplies used for food preparation, service, or storage, such as containers, paper products, or utensils. These expenses can be claimed as a separate deduction on your Schedule C (Form 1040).

Table 2. 2004 Standard Meal and Snack Rates

Location of Family Daycare Provider	Breakfast	Lunch and Dinner	Snack
States other than Alaska and Hawaii	\$0.98	\$1.80	\$0.53
Alaska	\$1.55	\$2.93	\$0.87
Hawaii	\$1.13	\$2.11	\$0.63

Sale or Exchange of Your Home

If you sell or exchange your home, you may be able to exclude up to \$250,000 (\$500,000 for certain married persons filing a joint return) of the gain on the sale or exchange if you meet the ownership and use tests.

Ownership and use tests. To claim the exclusion, you must meet the ownership and use tests. This means that

during the 5-year period ending on the date of the sale, you met both the following tests.

1. You owned the home for at least 2 years (ownership test).
2. You lived in the home as your main home for at least 2 years (use test).

Business use of your home. The rules for computing the exclusion for business use of your home vary depending on the facts and circumstances involved. See *Business use or rental of home*, in Publication 523 for details.

Depreciation. If you were entitled to take depreciation deductions because you used your home for business, you cannot exclude the part of your gain equal to any depreciation allowed or allowable as a deduction for periods after May 6, 1997. If you can show by adequate records or other evidence that the depreciation deduction allowed was less than the amount allowable, the amount you cannot exclude is the amount allowed.

Basis adjustment. If you used any part of your home for business, you must adjust the basis of your home for any depreciation that was allowable for its business use, even if you did not claim it. If you took less depreciation than you could have under the method you properly selected, you must decrease the basis by the amount you could have taken under that method. If you took more depreciation than you should have under the method you properly selected, you must decrease the basis by the amount you should have deducted, plus the part of the excess deducted that actually decreased your tax liability for any year. For more information on reducing the basis of your property for depreciation, see Publication 551.

More information. This section covers only the basic rules for the sale or exchange of your home. For more information, see Publication 523.

Business Furniture and Equipment

This section discusses the depreciation and section 179 deductions you may be entitled to take for furniture and equipment you use in your home for business or work as an employee. These deductions are available whether or not you qualify to deduct expenses for the business use of your home.

This section explains the different rules for each of the following.

1. Listed property.
2. Property bought for business use.
3. Personal property converted to business use.

Listed Property

If you use certain types of property, called listed property, in your home, special rules apply. Listed property includes computers and related equipment and any property of a type generally used for entertainment, recreation, and amusement (including photographic, phonographic, communication, and video recording equipment).

Exception for certain use of computers. Computers and related equipment used exclusively in a qualifying office in your home are not listed property. If you qualify to deduct expenses for the business use of your home (see *Qualifying for a Deduction*, earlier) and you use your computer exclusively in your qualifying office in the home, do not use the listed property rules discussed below. Instead, follow the rules discussed under *Property Bought for Business Use*, later.

More-than-50%-use test. If you bought listed property and placed it in service during the year, you must use it more than 50% for business (including work as an employee) to claim a section 179 deduction or an accelerated depreciation deduction.

If your business use of listed property is 50% or less, you cannot take a section 179 deduction and you must depreciate the property using the Alternative Depreciation System (ADS) (straight line method). For more information on ADS, see chapter 4 in Publication 946.

Listed property meets the more-than-50%-use test for any year if its qualified business use is more than 50% of its total use. You must allocate the use of any item of listed property used for more than one purpose during the year among its various uses. You cannot use the percentage of investment use as part of the percentage of qualified business use to meet the more-than-50%-use test. However, you do use the combined total of business and investment use to figure your depreciation deduction for the property.

Example 1. Sarah does not qualify to claim a deduction for the business use of her home, but she uses her home computer 40% of the time for a business she operates out of her home. She also uses the computer 50% of the time to manage her investments. Sarah's home computer is listed property because it is not used in a qualified office in her home. She does not use the computer more than 50% for business, so she cannot elect a section 179 deduction. She can use her combined business/investment use (90%) to figure her depreciation deduction using ADS.

Example 2. If Sarah uses her computer 60% of the time for her business and 30% for managing her investments, her computer meets the more-than-50%-use test. She can elect a section 179 deduction. She can use her combined business/investment use (90%) to figure her depreciation deduction using the General Depreciation System (GDS).

Employee. If you use your own listed property (or listed property you rent) in your work as an employee, the property is business-use property only if you meet the following requirements.

- The use is for your employer's convenience.

- The use is required as a condition of your employment.

The use of property as a condition of your employment means that it is necessary for you to properly perform your work. Whether the use of the property is required for this purpose depends on all the facts and circumstances. Your employer does not have to tell you specifically to use the property. Nor is a statement by your employer to that effect sufficient.

Years following the year placed in service. If, in a year after you place an item of listed property in service, you fail to meet the more-than-50%-use test for that item of property, you may be required to do the following.

1. Figure depreciation, beginning with the year you no longer use the property more than 50% for business, using the straight line method.
2. Figure any excess depreciation (include any section 179 deduction on the property in figuring excess depreciation) and add it to:
 - a. Your gross income, and
 - b. The adjusted basis of your property.

For more information, see *Recapture of Excess Depreciation* under *What Is the Business-Use Requirement* in Publication 946.

Reporting and recordkeeping requirements. If you use listed property in your business, you must file Form 4562 to claim a depreciation or section 179 deduction. Begin with Part V, Section A, of that form.



You cannot take any depreciation or section 179 deduction for the use of listed property unless you can prove your business/investment use with adequate records or sufficient evidence to support your own statements.

To meet the adequate records requirement, you must maintain an account book, diary, log, statement of expense, trip sheet, or similar record or other documentary evidence that is sufficient to establish business/investment use. For more information on what records to keep, see *What Records Must Be Kept* in chapter 5 of Publication 946.

Property Bought for Business Use

If you bought certain property during 2004 to use in your business, you can do any one of the following (subject to the limits discussed later).

- Elect a section 179 deduction for the full cost of the property.
- Depreciate the full cost of the property.
- Take part of the cost as a section 179 deduction and depreciate the balance.

Section 179 Deduction

You can claim the section 179 deduction for the cost of depreciable tangible personal property bought for use in your trade or business. You can choose how much (subject to the limit) of the cost you want to deduct under section 179 and how much you want to depreciate. You can spread the section 179 deduction over several items of property in any way you choose as long as the total does not exceed the maximum allowable. You cannot take a section 179 deduction for the basis of the business part of your home.

You elect the section 179 deduction by completing Part I of Form 4562.

More information. For more information on the section 179 deduction, qualifying property, the dollar limit, and the business income limit, see chapter 2 in Publication 946.

Depreciation



You can take a special depreciation allowance or Liberty Zone depreciation allowance to recover part of the cost of qualified property or qualified Liberty Zone property placed in service during the tax year. The allowance applies for the first year you place the property in service. For qualified property acquired before May 6, 2003, or for qualified Liberty Zone property, you can take an additional 30% allowance. For qualified property acquired after May 5, 2003, you can take an additional 50% allowance. The allowance is an additional deduction you can take after any section 179 deduction and before you figure regular depreciation under MACRS for the year you place the property in service. For more information, see chapter 3, Claiming the Special Depreciation Allowance (or Liberty Zone Depreciation Allowance), in Publication 946.

Use Parts II and III of Form 4562 to claim your deduction for depreciation on property placed in service during the year. Do not include any costs deducted in Part I (section 179 deduction).

Most business property used in a home office is either 5-year or 7-year property under MACRS.

- 5-year property includes computers and peripheral equipment, typewriters, calculators, adding machines, and copiers.
- 7-year property includes office furniture and fixtures such as desks, files, and safes.

Under MACRS, you generally use the half-year convention, which allows you to deduct a half year of depreciation in the first year you use the property in your business. If you place more than 40% of your depreciable property in service during the last 3 months of your tax year, you must use the mid-quarter convention instead of the half-year convention.

After you have determined the cost of the depreciable property (minus any section 179 deduction and special depreciation allowance taken on the property) and whether

it is 5-year or 7-year property, use the table, shown next, to figure your depreciation if the half-year convention applies.

Table 3. MACRS Percentage Table for 5- and 7-Year Property Using Half-Year Convention

Recovery Year	5-Year Property	7-Year Property
1	20.00%	14.29%
2	32.00%	24.49%
3	19.20%	17.49%
4	11.52%	12.49%
5	11.52%	8.93%
6	5.76%	8.92%
7		8.93%
8		4.46%

See Publication 946 for a discussion of the mid-quarter convention and for complete MACRS percentage tables.

Example. In June 2004, Donald Kent bought a desk and three chairs for use in his office. His total bill for the furniture was \$1,975. His taxable business income for the year was \$3,000 without any deduction for the office furniture. Donald can elect to do one of the following.

- Take a section 179 deduction for the full cost of the office furniture.
- Take part of the cost of the furniture as a section 179 deduction and depreciate the balance.
- Depreciate the full cost of the office furniture.

The furniture is qualified property for purposes of the 50% special depreciation allowance and 7-year property under MACRS. Donald does not take a section 179 deduction. He multiplies \$1,975, the cost of the furniture, by 50% to figure his special depreciation allowance of \$988. His depreciable basis after the special allowance is \$987 (\$1,975 – \$988). He then multiplies \$987 by 14.29% (.1429) to get his MACRS depreciation deduction of \$141.04.

Personal Property Converted to Business Use

If you use property in your home office that was used previously for personal purposes, you cannot take a section 179 deduction for the property. You also cannot take a special depreciation allowance for the property. You can depreciate it, however. The method of depreciation you use depends on when you first used the property for personal purposes.

If you began using the property for personal purposes after 1986 and change it to business use in 2004, depreciate the property under MACRS.

The basis for depreciation of property changed from personal to business use is the lesser of the following.

1. The adjusted basis of the property on the date of change.
2. The fair market value of the property on the date of change.

If you began using the property for personal purposes after 1980 and before 1987 and change it to business use in 2004, you generally depreciate the property under the accelerated cost recovery system (ACRS). However, if the depreciation under ACRS is greater in the first year than the depreciation under MACRS, you must depreciate it under MACRS. For information on ACRS, see Publication 534, *Depreciating Property Placed in Service Before 1987*.

If you began using the property for personal purposes before 1981 and change it to business use in 2004, depreciate the property by the straight line or declining balance method based on salvage value and useful life.

Recordkeeping



You do not have to use a particular method of recordkeeping, but you must keep records that provide the information needed to figure your deductions for the business use of your home. You should keep canceled checks, receipts, and other evidence of expenses you paid.

Your records must show the following information.

- The part of your home you use for business.
- That you use part of your home exclusively and regularly for business as either your principal place of business or as the place where you meet or deal with clients or customers in the normal course of your business. (However, see the earlier discussion, *Exceptions to Exclusive Use*.)
- The depreciation and expenses for the business part.

You must keep your records for as long as they are important for any tax law. This is usually the later of the following dates.

1. 3 years from the return due date or the date filed.
2. 2 years after the tax was paid.

Keep records to prove your home's depreciable basis. This includes records of when and how you acquired your home, your original purchase price, any improvements to your home, and any depreciation you are allowed because you maintained an office in your home. You can keep copies of Forms 8829 or the Publication 587 worksheets as records of depreciation.

For more information on recordkeeping, see Publication 583.

Where To Deduct

Deduct expenses for the business use of your home on Form 1040. Where you deduct these expenses on the form depends on whether you are:

- A self-employed person, or
- An employee.

If you are a partner, see *Partners*, later, for information on where to deduct expenses for the business use of your home.

Self-Employed Persons

If you are self-employed and file Schedule C (Form 1040), complete and attach Form 8829 to your return.

If you file Schedule F (Form 1040), report your entire deduction for business use of the home (line 32 of the worksheet), up to the deduction limit discussed under *Figuring the Deduction*, earlier, on line 34 of Schedule F. Write "Business Use of Home" on the dotted line beside the entry.

Deductible mortgage interest. If you file Schedule C (Form 1040), enter all your deductible mortgage interest on line 10 of Form 8829. After you have figured the business part of the mortgage interest on lines 12 and 13, subtract that amount from the total mortgage interest on line 10. The remainder is deductible on Schedule A (Form 1040), line 10 or 11. If the interest you deduct on Schedule A for your home mortgage is limited, enter the excess on line 16 of Form 8829.

If you file Schedule F (Form 1040), include the business part of your deductible home mortgage interest with your total business use of the home expenses on line 34. You can use the worksheet on page 24 to figure the deductible part of mortgage interest. Enter the nonbusiness part of the deductible mortgage interest on Schedule A, line 10 or 11.

To determine if the limits on qualified home mortgage interest apply to you, see the instructions for Schedule A or Publication 936.

Real estate taxes. If you file Schedule C (Form 1040), enter all your deductible real estate taxes on Form 8829, line 11. After you have figured the business part of your taxes on lines 12 and 13, subtract that amount from your total real estate taxes on line 11. The remainder is deductible on Schedule A, line 6.

If you file Schedule F (Form 1040), include the business part of real estate taxes with your total business use of the home expenses on line 34. Enter the nonbusiness part of your real estate taxes on line 6 of Schedule A.



If you itemize your deductions, be sure to claim only the personal part of your deductible mortgage interest and real estate taxes on Schedule A (Form 1040). Do not deduct any of the business part on Schedule A. For example, if your business percentage on Form 8829, line 7, or line 3 of the worksheet on page 24 is 30%, you can claim only 70% of your deductible mortgage interest and real estate taxes as personal expenses on Schedule A.

Casualty losses. If you are using Form 8829, refer to the specific instructions for lines 9 and 27 and enter the amount from line 33 on line 27 of Form 4684, Section B. Write "See Form 8829" above line 27.

If you file Schedule F (Form 1040), enter the business part of casualty losses (line 31 of the worksheet) on line 27 of Form 4684, Section B. Write "See attached statement" above line 27.

Other expenses. If you file Schedule C (Form 1040), report the other home expenses that would not be allowable if you did not use your home for business (insurance, maintenance, utilities, depreciation, etc.) on the appropriate lines of your Form 8829. If you rent rather than own your home, include the rent you paid on line 20. If these expenses exceed the deduction limit, carry the excess over to next year. The carryover will be subject to next year's deduction limit.

If you file Schedule F (Form 1040), include your otherwise nondeductible expenses (insurance, maintenance, utilities, depreciation, etc.) with your total business use of the home expenses on Schedule F, line 34. If these expenses exceed the deduction limit, carry the excess over to the next year. The carryover will be subject to next year's deduction limit.

Business expenses not for the use of your home. Deduct in full your business expenses that are not for the use of your home itself (dues, salaries, supplies, certain telephone expenses, etc.) on the appropriate lines of Schedule C (Form 1040) or Schedule F (Form 1040). These expenses are not for the use of your home, so they are not subject to the deduction limit for business use of the home expenses.

Employees

As an employee, you must itemize deductions on Schedule A (Form 1040) to claim expenses for the business use of your home and any other employee business expenses. This generally applies to all employees, including outside salespersons. If you are a statutory employee, use Schedule C (Form 1040) to claim the expenses. Follow the instructions given earlier under *Self-Employed Persons*. The statutory employee box within box 13 on your Form W-2 will be checked if you are a statutory employee.

If you have employee expenses for which you were not reimbursed, report them on Schedule A, line 20. You also generally must complete Form 2106 if either of the following apply.

- You claim any job-related vehicle, travel, transportation, meal, or entertainment expenses.
- Your employer paid you for any of your job expenses reportable on line 20. (Amounts your employer included in box 1 of your Form W-2 are not considered paid by your employer.)

However, you can use the simpler Form 2106-EZ, instead of Form 2106, if you meet the following requirements.

- You were not reimbursed for your expenses by your employer, or if you were reimbursed, the reimbursement was included in box 1 of your Form W-2.
- If you claim car expenses, you use the standard mileage rate.

When your employer pays for your expenses using a reimbursement or allowance arrangement, the payments

generally should not be on your Form W-2 if all the following rules for an accountable plan are met.

1. You adequately account to your employer for the expenses within a reasonable period of time.
2. You return any payments not spent for business expenses (excess reimbursements) within a reasonable period of time.
3. You must have paid or incurred deductible expenses while performing services as an employee.

If you meet the accountable plan rules and your business expenses equal your reimbursement, do not report the reimbursement as income and do not deduct the expenses.

Adequately accounting to employer. You adequately account to your employer when you give your employer documentary evidence of your travel, mileage, and other employee business expenses, such as receipts, along with an account book, diary, or similar record in which you entered each expense at or near the time you had it.

You also may be treated as adequately accounting to your employer if your employer gives you a per diem or car allowance similar in form to, and not more than, the federal rate and you verify the time, place, and business purpose of each expense. For more information, see the instructions for Form 2106 and Publication 463.

Rental to employer. If you rent part of your home to your employer and you use the rented part in performing services for your employer as an employee, your deduction for the business use of your home is limited. You can deduct mortgage interest, real estate taxes, and personal casualty losses for the rented part, subject to any limitations. However, you cannot deduct otherwise allowable trade or business expenses, business casualty losses, or depreciation related to the use of your home in performing services for your employer.

Deductible mortgage interest. Although you generally deduct expenses for the business use of your home on Schedule A (Form 1040), line 20, do not include any deductible home mortgage interest on that line. Instead, deduct both the business and nonbusiness parts of this interest on line 10 or 11 of Schedule A.

If the home mortgage interest you can deduct on lines 10 or 11 is limited by the home mortgage interest rules, you cannot deduct the excess as an employee business expense on Schedule A, line 20, even though you use part of your home for business. To determine if the limits on home mortgage interest apply to you, see the instructions for Schedule A or Publication 936.

Real estate taxes. Deduct both the business and non-business parts of your real estate taxes on line 6 of Schedule A. For more information on amounts allowable as a deduction for real estate taxes, see Publication 530, Tax Information for First-Time Homeowners.

Casualty losses. Enter the business part of casualty losses (line 31 of the worksheet) on Form 4684, Section B, line 27. Write "See attached statement" above line 27.

Other expenses. If you file Form 2106 or Form 2106-EZ, report on line 4 the following expenses.

- The business part of your otherwise nondeductible expenses (utilities, maintenance, insurance, depreciation, etc.) that do not exceed the deduction limit.
- The employee business expenses not related to the use of your home, such as advertising.

Add these to your other employee business expenses and complete the rest of the form. Enter the total from Form 2106, or Form 2106-EZ, on Schedule A, line 20, where it is subject to the 2%-of-adjusted-gross-income limit. If you do not have to file Form 2106 or Form 2106-EZ, enter your total expenses directly on Schedule A, line 20.

Example. You are an employee who works at home for the convenience of your employer. You meet all the requirements to deduct expenses for the business use of your home. Your employer does not reimburse you for any of your business expenses and you are not otherwise required to file Form 2106 or Form 2106-EZ.

As an employee, you do not have gross receipts, cost of goods sold, etc. You begin with gross income from the business use of your home, which you determine to be \$6,000.

The percentage of expenses due to the business use of your home is 20%. You have the following expenses.

Deductible mortgage interest (20%)	\$1,500	
Real estate taxes (20%)	1,000	
Total		<u>\$2,500</u>
Expenses not related to business use of the home (100%):		
Supplies	\$500	
Advertising	1,300	
Telephone	200	
Total		<u>\$2,000</u>
Otherwise nondeductible expenses:		
Maintenance (20%)	\$200	
Utilities (20%)	350	
Insurance (20%)	250	
Total		<u>\$800</u>
Depreciation (20%)	\$1,600	

Based on the above expenses, you figure your deduction limit as follows.

Gross income		\$6,000
Less:		
Deductible mortgage interest (20%)	\$1,500	
Real estate taxes (20%)	1,000	
Expenses not related to business use of the home (100%)	<u>2,000</u>	4,500
Deduction limit		<u>\$1,500</u>

Your deduction for otherwise nondeductible expenses and depreciation is limited to \$1,500. You can deduct all your otherwise nondeductible expenses (\$800) and \$700 (\$1,500 – \$800) of your depreciation.

You deduct your expenses for business use of your home on Schedule A (Form 1040) as shown in the following table.

Expense	Amount	Schedule A
Deductible mortgage interest	\$1,500	Line 10 or 11*
Real estate taxes	\$1,000	Line 6*
Expenses not related to the business use of the home	\$2,000	Line 20**
Otherwise nondeductible expenses	\$800	Line 20**
Depreciation	\$700	Line 20**

*In addition to the 80% nonbusiness part of the expense.

**Subject to the 2%-of-adjusted-gross-income limit.

You can carry over the \$900 of depreciation that exceeds the deduction limit to next year, subject to the deduction limit for that year.

Partners

You may be allowed to deduct unreimbursed ordinary and necessary expenses you paid on behalf of the partnership (including qualified expenses for the business use of your home) if you were required to pay these expenses under the partnership agreement.

Use the worksheet on page 24 to figure the deduction for the business use of your home.

Deducting unreimbursed partnership expenses. See the following forms and related instructions for information about deducting unreimbursed partnership expenses.

- Schedule E (Form 1040), Supplemental Income and Loss.
- Schedule SE (Form 1040), Self-Employment Tax.
- Schedule K-1 (Form 1065), Partner's Share of Income, Credits, Deductions, etc.

More information. For more information about partners and partnerships, see Publication 541, Partnerships.

Schedule C Example

The filled-in forms for John Stephens that follow show how to report deductions for the business use of your home if you file Schedule C (Form 1040).

Form 4562. Based on the following facts, John completes Form 4562 as follows:

Part I, lines 1–13. John began using his home for business in January of this year. He purchased a new computer and filing cabinet to use in his business. The computer, used 100% for business, cost \$3,200. The filing cabinet cost \$600. John elects to take the section 179 deduction for both items.

John completes Part I of Form 4562. He enters the cost of both the computer and filing cabinet, \$3,800, on line 2 and completes lines 4 and 5. On line 6, he enters a description of each item, its cost, and the cost he elects to expense. Line 11 is the smaller of line 5 (\$102,000) or the taxable income from all trades and businesses without regard to the section 179 deduction. Since he has no other business income, he adds line 31 of Schedule C and the

amount of the section 179 deduction (\$3,800) for a total business income of \$27,871. This amount goes on line 11 since it is smaller than \$102,000. He enters \$3,800 on line 12.

Part III, line 19c. John converted to business use a desk and chair (furniture) he had purchased in 1997 for personal purposes. In 1997, he paid \$1,500 for them. The total fair market value in 2004 is \$550. The fair market value is less than the cost, so his depreciable basis is \$550.

Because the furniture is 7-year property under MACRS, John enters \$550 in Part III, line 19c, column (c). He completes columns (d) through (f). He uses the MACRS Percentage Table for 5- and 7-Year Property Using Half-Year Convention in this publication or Table A-1 in Publication 946 to find the rate of 14.29% for property placed in service during the first month of the year. He multiplies \$550 by 14.29% (.1429) and enters \$79 in column (g).

Part III, line 19i. This is the first year John used his home for business, so he must figure the depreciation on line 19i. On line 19i, column (c), he enters \$11,000, the depreciable basis of the business part of his home. He began using his home for business in January. (For a discussion on how he figures his depreciation deduction, see *Step 3* under *Form 8829, Part II*, later.) He enters \$271 in column (g).

Part IV, line 22. John totals the amounts on line 12 and line 19 in column (g) and enters the total on line 22. He enters both the section 179 deduction (\$3,800) and the depreciation on the furniture (\$79) on line 13 of Schedule C. He enters the depreciation on his home (\$271) on Form 8829, line 28.

Schedule C. John completes Schedule C as follows:

Line 13. As discussed previously, John enters the amount from Form 4562 for his section 179 deduction (\$3,800) and the depreciation deduction for his office furniture (\$79) for a total of \$3,879.

Line 16b. This amount is the interest on installment payments for the business assets John uses in his home office.

Line 25. John had a separate telephone line in his home office that he used only for business. He can deduct \$347 for the line.

Lines 28–30. On line 28, he totals all his expenses other than those for the business use of his home, and then subtracts that total from his gross income. He uses the result on line 29 to figure the deduction limit on his expenses for the business use of his home. He enters that amount on Form 8829, line 8, and then completes the form. He enters the amount of his home office deduction from Form 8829, line 34, on Schedule C, line 30.

Form 8829, Part I. John uses one room of his home exclusively and regularly to meet clients. In Part I of Form 8829 he shows that, based on the square footage, the room is 10% of the total area of his home.

Form 8829, Part II. John uses Part II of Form 8829 to figure his allowable home office deduction.

Step 1. First, he figures the business part of expenses that would be deductible even if he did not use part of his home for business. These expenses (\$4,500 deductible mortgage interest and \$1,000 real estate taxes) relate to his entire home, so he enters them in column (b) on lines 10 and 11. He then subtracts the \$550 business part of these expenses (line 14) from his tentative business profit (line 8). The result, \$25,002 on line 15, is the most he can deduct for his other home office expenses.

Step 2. Next, he figures his deduction for operating expenses. He paid \$300 to have his office repainted. He enters this amount on line 18, column (a) because it is a direct expense. All his other expenses (\$400 homeowner's insurance, \$1,400 roof repairs, and \$1,800 gas and electric) relate to his entire home. Therefore, he enters them in column (b) on the appropriate lines. He adds the \$300 direct expenses (line 21, column (a)) to the \$360 total for indirect expenses (line 22) and enters the total, \$660, on line 24. This amount is less than his deduction limit, so he can deduct it in full. The \$24,342 balance of his deduction limit (line 26) is the most he can deduct for depreciation.

Step 3. Next, he figures his allowable depreciation deduction for the business use of his home in Part III of Form

8829. The adjusted basis of his home is \$130,000, which is less than the fair market value of \$160,000. He figures the value of the land to be \$20,000. He subtracts the land value from the adjusted basis. He multiplies the result (\$110,000) by the percentage on line 7 to get the depreciable basis of the business part of his home (\$11,000).

He began using the office in January of this year, so he uses the MACRS Percentage Table for 39-Year Nonresidential Real Property in this publication or Table A-7a in Appendix A of Publication 946. The depreciation percentage for the first year of the recovery period for assets placed in service in the first month is 2.461%. His depreciation deduction for 2004 (line 40) is \$271 ($.02461 \times \$11,000$). He enters that amount in Part II on lines 28 and 30. This is less than the available balance of his deduction limit (line 26), so he can deduct the full amount as depreciation. John also must complete Form 4562 for 2004, so he enters \$271 on line 19i, column (g). See *Form 4562*, earlier.

Step 4. Finally, he figures his total deduction for his home office by adding together his otherwise deductible expenses (line 14), his operating expenses (line 25), and depreciation (line 31). He enters the result, \$1,481, on lines 32 and 34, and on Schedule C, line 30.

**SCHEDULE C
(Form 1040)**

Profit or Loss From Business
(Sole Proprietorship)

OMB No. 1545-0074

2004

Attachment
Sequence No. **09**

Department of the Treasury
Internal Revenue Service

▶ **Partnerships, joint ventures, etc., must file Form 1065 or 1065-B.**
▶ **Attach to Form 1040 or 1041.** ▶ **See Instructions for Schedule C (Form 1040).**

Name of proprietor: *John Stephens* Social security number (SSN): *465 : 00 : 0001*

A Principal business or profession, including product or service (see page C-2 of the instructions): *Tax Preparation Services* **B** Enter code from pages C-7, 8, & 9: *5 | 4 | 1 | 2 | 1 | 3*

C Business name. If no separate business name, leave blank. *Stephens Tax Service* **D** Employer ID number (EIN), if any: _____

E Business address (including suite or room no.) ▶ *821 Union Street*
City, town or post office, state, and ZIP code *Hometown, IA 52761*

F Accounting method: (1) Cash (2) Accrual (3) Other (specify) ▶ _____

G Did you "materially participate" in the operation of this business during 2004? If "No," see page C-3 for limit on losses Yes No

H If you started or acquired this business during 2004, check here

Part I Income

1	Gross receipts or sales. Caution. If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-3 and check here	<input type="checkbox"/>	1	34,280
2	Returns and allowances		2	
3	Subtract line 2 from line 1		3	34,280
4	Cost of goods sold (from line 42 on page 2)		4	
5	Gross profit. Subtract line 4 from line 3.		5	34,280
6	Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-3)		6	
7	Gross income. Add lines 5 and 6		7	34,280

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	8	250	19	Pension and profit-sharing plans	19	
9	Car and truck expenses (see page C-3)	9	1,266	20a	Rent or lease (see page C-5): a Vehicles, machinery, and equipment	20a	
10	Commissions and fees	10		20b	b Other business property	20b	
11	Contract labor (see page C-4)	11		21	Repairs and maintenance	21	
12	Depletion	12		22	Supplies (not included in Part III)	22	253
13	Depreciation and section 179 expense deduction (not included in Part III) (see page C-4)	13	3,879	23	Taxes and licenses	23	
14	Employee benefit programs (other than on line 19)	14		24	Travel, meals, and entertainment: a Travel	24a	310
15	Insurance (other than health)	15	750		b Meals and entertainment		512
16	Interest: a Mortgage (paid to banks, etc.) b Other	16a			c Enter nondeductible amount included on line 24b (see page C-5)		256
17	Legal and professional services	17	350	24d	d Subtract line 24c from line 24b	24d	256
18	Office expense	18	600	25	Utilities	25	347
28	Total expenses before expenses for business use of home. Add lines 8 through 27 in columns	28		26	Wages (less employment credits)	26	
29	Tentative profit (loss). Subtract line 28 from line 7	29		27	Other expenses (from line 48 on page 2)	27	267
30	Expenses for business use of your home. Attach Form 8829	30		28		28	8,728
31	Net profit or (loss). Subtract line 30 from line 29. • If a profit, enter on Form 1040, line 12 , and also on Schedule SE, line 2 (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3. • If a loss, you must go to line 32.	31		29		29	25,552
32	If you have a loss, check the box that describes your investment in this activity (see page C-6). • If you checked 32a, enter the loss on Form 1040, line 12 , and also on Schedule SE, line 2 (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3. • If you checked 32b, you must attach Form 6198 .	32a		30		30	1,481
		32b		31		31	24,071

Expenses for Business Use of Your Home
 ▶ File only with Schedule C (Form 1040). Use a separate Form 8829 for each home you used for business during the year.
 ▶ See separate instructions.

Name(s) of proprietor(s) John Stephens Your social security number 465 : 00 : 0001

Part I Part of Your Home Used for Business

1	Area used regularly and exclusively for business, regularly for day care, or for storage of inventory or product samples (see instructions)	1	200
2	Total area of home	2	2,000
3	Divide line 1 by line 2. Enter the result as a percentage	3	10 %
● For day-care facilities not used exclusively for business, also complete lines 4–6. ● All others, skip lines 4–6 and enter the amount from line 3 on line 7.			
4	Multiply days used for day care during year by hours used per day	4	hr.
5	Total hours available for use during the year (366 days × 24 hours) (see instructions)	5	8,784 hr.
6	Divide line 4 by line 5. Enter the result as a decimal amount	6	.
7	Business percentage. For day-care facilities not used exclusively for business, multiply line 6 by line 3 (enter the result as a percentage). All others, enter the amount from line 3	7	10 %

Part II Figure Your Allowable Deduction

8	Enter the amount from Schedule C, line 29, plus any net gain or (loss) derived from the business use of your home and shown on Schedule D or Form 4797. If more than one place of business, see instructions. See instructions for columns (a) and (b) before completing lines 9–20.	8	25,552
		(a) Direct expenses	(b) Indirect expenses
9	Casualty losses (see instructions)	9	
10	Deductible mortgage interest (see instructions)	10	4,500
11	Real estate taxes (see instructions)	11	1,000
12	Add lines 9, 10, and 11	12	5,500
13	Multiply line 12, column (b) by line 7	13	550
14	Add line 12, column (a) and line 13	14	550
15	Subtract line 14 from line 8. If zero or less, enter -0-	15	25,002
16	Excess mortgage interest (see instructions)	16	
17	Insurance	17	400
18	Repairs and maintenance	18	300
19	Utilities	19	1,800
20	Other expenses (see instructions)	20	
21	Add lines 16 through 20	21	300
22	Multiply line 21, column (b) by line 7	22	360
23	Carryover of operating expenses from 2003 Form 8829, line 41	23	- 0 -
24	Add line 21 in column (a), line 22, and line 23	24	660
25	Allowable operating expenses. Enter the smaller of line 15 or line 24	25	660
26	Limit on excess casualty losses and depreciation. Subtract line 25 from line 15	26	24,342
27	Excess casualty losses (see instructions)	27	
28	Depreciation of your home from Part III below	28	271
29	Carryover of excess casualty losses and depreciation from 2003 Form 8829, line 42	29	
30	Add lines 27 through 29	30	271
31	Allowable excess casualty losses and depreciation. Enter the smaller of line 26 or line 30	31	271
32	Add lines 14, 25, and 31	32	1,481
33	Casualty loss portion, if any, from lines 14 and 31. Carry amount to Form 4684, Section B	33	
34	Allowable expenses for business use of your home. Subtract line 33 from line 32. Enter here and on Schedule C, line 30. If your home was used for more than one business, see instructions	34	1,481

Part III Depreciation of Your Home

35	Enter the smaller of your home's adjusted basis or its fair market value (see instructions)	35	130,000
36	Value of land included on line 35	36	20,000
37	Basis of building. Subtract line 36 from line 35	37	110,000
38	Business basis of building. Multiply line 37 by line 7	38	11,000
39	Depreciation percentage (see instructions)	39	2.461 %
40	Depreciation allowable (see instructions). Multiply line 38 by line 39. Enter here and on line 28 above	40	271

Part IV Carryover of Unallowed Expenses to 2005

41	Operating expenses. Subtract line 25 from line 24. If less than zero, enter -0-	41	
42	Excess casualty losses and depreciation. Subtract line 31 from line 30. If less than zero, enter -0-	42	

Worksheet To Figure the Deduction for Business Use of Your Home

Use this worksheet if you file Schedule F (Form 1040) or you are an employee or a partner.

PART 1—Part of Your Home Used for Business:			
1) Area of home used for business			1) _____
2) Total area of home			2) _____
3) Percentage of home used for business (divide line 1 by line 2 and show result as percentage)			3) _____ %
PART 2—Figure Your Allowable Deduction			
4) Gross income from business (see instructions)			4) _____
	(a) Direct Expenses	(b) Indirect Expenses	
5) Casualty losses	5) _____	_____	
6) Deductible mortgage interest	6) _____	_____	
7) Real estate taxes	7) _____	_____	
8) Total of lines 5 through 7	8) _____	_____	
9) Multiply line 8, column (b), by line 3		9) _____	
10) Add line 8, column (a), and line 9		10) _____	
11) Business expenses not from business use of home (see instructions)		11) _____	
12) Add lines 10 and 11			12) _____
13) Deduction limit. Subtract line 12 from line 4			13) _____
14) Excess mortgage interest	14) _____	_____	
15) Insurance	15) _____	_____	
16) Repairs and maintenance	16) _____	_____	
17) Utilities	17) _____	_____	
18) Other expenses	18) _____	_____	
19) Add lines 14 through 18	19) _____	_____	
20) Multiply line 19, column (b) by line 3		20) _____	
21) Carryover of operating expenses from prior year (see instructions)		21) _____	
22) Add line 19, column (a), line 20, and line 21			22) _____
23) Allowable operating expenses. Enter the smaller of line 13 or line 22			23) _____
24) Limit on excess casualty losses and depreciation. Subtract line 23 from line 13			24) _____
25) Excess casualty losses (see instructions)		25) _____	
26) Depreciation of your home from line 38 below		26) _____	
27) Carryover of excess casualty losses and depreciation from prior year (see instructions)		27) _____	
28) Add lines 25 through 27			28) _____
29) Allowable excess casualty losses and depreciation. Enter the smaller of line 24 or line 28			29) _____
30) Add lines 10, 23, and 29			30) _____
31) Casualty losses included on lines 10 and 29 (see instructions)			31) _____
32) Allowable expenses for business use of your home. (Subtract line 31 from line 30.) See instructions for where to enter on your return			32) _____
PART 3—Depreciation of Your Home			
33) Smaller of adjusted basis or fair market value of home (see instructions)			33) _____
34) Basis of land			34) _____
35) Basis of building (subtract line 34 from line 33)			35) _____
36) Business basis of building (multiply line 35 by line 3)			36) _____
37) Depreciation percentage (from applicable table or method)			37) _____ %
38) Depreciation allowable (multiply line 36 by line 37)			38) _____
PART 4—Carryover of Unallowed Expenses to Next Year			
39) Operating expenses. Subtract line 23 from line 22. If less than zero, enter -0-			39) _____
40) Excess casualty losses and depreciation. Subtract line 29 from line 28. If less than zero, enter -0-			40) _____

Instructions for the Worksheet

If you are an employee or a partner, or you file Schedule F (Form 1040), Profit or Loss From Farming, use the preceding worksheet to figure your deduction for the business use of your home. The following instructions explain how to complete each part.

Partners. See *Partners*, under *Where to Deduct*, earlier, before completing the worksheet.



If you file Schedule C (Form 1040), use Form 8829 to figure the deductions and attach the form to your return.

Part 1—Part of Your Home Used for Business

Lines 1–3.

If you figure the percentage based on area, use lines 1 through 3 to figure the business-use percentage. Enter the percentage on line 3.

You can use any other reasonable method that accurately reflects your business-use percentage. If you operate a daycare facility and you meet the exception to the exclusive use test for part or all of the area you use for business, you must figure the business-use percentage for that area as explained under *Daycare Facility*, earlier. If you use another method to figure your business percentage, skip lines 1 and 2 and enter the percentage on line 3.

Part 2—Figure Your Allowable Deduction

Line 4.

If you file Schedule F, enter your total gross income that is related to the business use of your home. This generally would be the amount on line 11 of Schedule F.

If you are an employee, enter your total wages that are related to the business use of your home.

Lines 5–7.

Enter only the amounts that would be deductible whether or not you used your home for business. In other words, enter only the amounts that would be allowable as itemized deductions on Schedule A (Form 1040).

Include only the part of a casualty loss that exceeds \$100 plus 10% of adjusted gross income.

Under column (a), *Direct Expenses*, enter expenses that benefit only the business part of your home. Under column (b), *Indirect Expenses*, enter expenses that benefit the entire home. You generally enter 100% of the expense. However, if the business percentage of an indirect expense is different from the percentage on line 3, enter only the business part of the expense on the appropriate line in column (a), and leave that line in column (b) blank.

Lines 9–10.

Multiply your total indirect expenses (line 8, column (b)) by the business percentage from line 3. Enter the result on line 9. Add this amount to the total direct expenses (line 8, column (a)) and enter the total on line 10.

Lines 11–13.

Enter any other business expenses that are not attributable to business use of the home on line 11. For employees, examples include travel, supplies, and business telephone expenses. Farmers generally should enter their total farm expenses before deducting office in the home expenses. Do not enter the deduction for one-half of your self-employment tax. Add the amounts on lines 10 and 11, and enter the total on line 12. Subtract line 12 from line 4, and enter the result on line 13. This is your deduction limit. You use it to determine whether you can deduct any of your other expenses for business use of the home this year. If you cannot, you will carry them over to next year.

If line 13 is zero or less, enter zero. Deduct your expenses for deductible home mortgage interest, real estate taxes, casualty losses, and any business expenses not attributable to use of your home on the appropriate lines of the schedule(s) for Form 1040 as explained earlier under *Where To Deduct*.

Lines 14–21.

On lines 14 through 18, enter your otherwise nondeductible expenses for the business use of your home. These include utilities, insurance, repairs, and maintenance. If you rent, include the amount paid on line 18. If you file Schedule F, include any part of your home mortgage interest that is more than the limits given in Publication 936. (If you are an employee, do not enter any excess home mortgage interest.) In column (a), enter the expenses that benefit only the business part of your home (direct expenses). In column (b), enter the expenses that benefit the entire home (indirect expenses). Multiply line 19, column (b) by the business-use percentage (line 3) and enter this amount on line 20.

If you claimed a deduction for business use of your home on your 2003 tax return, enter the amount from line 39 of your 2003 worksheet on line 21.

Lines 24–29.

On lines 24 through 29, figure your limit on deductions for excess casualty losses and depreciation.

On line 25, figure the excess casualty loss by multiplying the business use percentage from line 3 by the part of casualty losses that would not be allowable if you did not use your home for business (i.e., the casualty losses in excess of the amount on line 5).

On line 26, enter the depreciation deduction from Part 3.

If you claimed a deduction for business use of your home on your 2003 tax return, enter on line 27 the amount from line 40 of your 2003 worksheet.

On lines 28 and 29, figure your allowable excess casualty losses and depreciation.

Lines 30–32.

On line 30, total all allowable business use of the home deductions.

On line 31, enter the total of the casualty losses shown on lines 10 and 29. Enter the amount from line 31 on line 27 of Form 4684, Section B. See the instructions for Form 4684 for more information on completing that form.

Line 32 is the total (other than casualty losses) allowable as a deduction for business use of your home. If you file Schedule F (Form 1040), enter this amount on line 34 of Schedule F and write "Business Use of Home" on the line beside the entry. Do not add the specific expenses into other line totals of Part II of Schedule F.

If you are an employee or partner, see *Where To Deduct*, earlier, for information on how to claim the deduction.

Part 3—Depreciation of Your Home

Figure your depreciation deduction on lines 33 through 38. On line 33, enter the smaller of the adjusted basis or the fair market value of the property at the time you first used it

for business. Do not adjust this amount for changes in basis or value after that date. Allocate the basis between the land and the building on lines 34 and 35. You cannot depreciate any part of the land. On line 37, enter the correct percentage for the current year from the tables in Publication 946. Multiply this percentage by the business basis to get the depreciation deduction. Enter this figure on lines 38 and 26. Complete and attach Form 4562 to your return if this is the first year you used your home, or an improvement or addition to your home, in business.

Part 4—Carryover of Unallowed Expenses to Next Year

Complete these lines to figure the expenses that must be carried forward to next year.

How to Get Tax Help

You can get help with unresolved tax issues, order free publications and forms, ask tax questions, and get more information from the IRS in several ways. By selecting the method that is best for you, you will have quick and easy access to tax help.

Contacting your Taxpayer Advocate. If you have attempted to deal with an IRS problem unsuccessfully, you should contact your Taxpayer Advocate.

The Taxpayer Advocate independently represents your interests and concerns within the IRS by protecting your rights and resolving problems that have not been fixed through normal channels. While Taxpayer Advocates cannot change the tax law or make a technical tax decision, they can clear up problems that resulted from previous contacts and ensure that your case is given a complete and impartial review.

To contact your Taxpayer Advocate:

- Call the Taxpayer Advocate toll free at 1-877-777-4778.
- Call, write, or fax the Taxpayer Advocate office in your area.
- Call 1-800-829-4059 if you are a TTY/TDD user.
- Visit www.irs.gov/advocate.

For more information, see Publication 1546, The Taxpayer Advocate Service of the IRS—How To Get Help With Unresolved Tax Problems.

Free tax services. To find out what services are available, get Publication 910, IRS Guide to Free Tax Services. It contains a list of free tax publications and an index of tax topics. It also describes other free tax information services, including tax education and assistance programs and a list of TeleTax topics.



Internet. You can access the IRS website 24 hours a day, 7 days a week, at www.irs.gov:

- *E-file* your return. Find out about commercial tax preparation and *e-file* services available free to eligible taxpayers.
- Check the status of your 2004 refund. Click on *Where's My Refund*. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2004 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.
- Download forms, instructions, and publications.
- Order IRS products online.
- Research your tax questions online.
- Search publications online by topic or keyword.
- View Internal Revenue Bulletins (IRBs) published in the last few years.

- Figure your withholding allowances using our Form W-4 calculator.
- Sign up to receive local and national tax news by email.
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Fax. You can get over 100 of the most requested forms and instructions 24 hours a day, 7 days a week, by fax. Just call 703-368-9694 from the telephone connected to your fax machine. When you call, you will hear instructions on how to use the service. The items you request will be faxed to you.

For help with transmission problems, call 703-487-4608.

Long-distance charges may apply.



Phone. Many services are available by phone.

- *Ordering forms, instructions, and publications.* Call 1-800-829-3676 to order current-year forms, instructions, and publications and prior-year forms and instructions. You should receive your order within 10 days.
- *Asking tax questions.* Call the IRS with your tax questions at 1-800-829-1040.
- *Solving problems.* You can get face-to-face help solving tax problems every business day in IRS Taxpayer Assistance Centers. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. Call your local Taxpayer Assistance Center for an appointment. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.
- *TTY/TDD equipment.* If you have access to TTY/TDD equipment, call 1-800-829-4059 to ask tax questions or to order forms and publications.
- *TeleTax topics.* Call 1-800-829-4477 and press 2 to listen to pre-recorded messages covering various tax topics.
- *Refund information.* If you would like to check the status of your 2004 refund, call 1-800-829-4477 and press 1 for automated refund information or call 1-800-829-1954. Be sure to wait at least 6 weeks from the date you filed your return (3 weeks if you filed electronically). Have your 2004 tax return available because you will need to know your filing status and the exact whole dollar amount of your refund.

Evaluating the quality of our telephone services. To ensure that IRS representatives give accurate, courteous, and professional answers, we use several methods to evaluate the quality of our telephone services. One method is for a second IRS representative to sometimes listen in

on or record telephone calls. Another is to ask some callers to complete a short survey at the end of the call.



Walk-in. Many products and services are available on a walk-in basis.

- **Products.** You can walk in to many post offices, libraries, and IRS offices to pick up certain forms, instructions, and publications. Some IRS offices, libraries, grocery stores, copy centers, city and county government offices, credit unions, and office supply stores have a collection of products available to print from a CD-ROM or photocopy from reproducible proofs. Also, some IRS offices and libraries have the Internal Revenue Code, regulations, Internal Revenue Bulletins, and Cumulative Bulletins available for research purposes.
- **Services.** You can walk in to your local Taxpayer Assistance Center every business day to ask tax questions or get help with a tax problem. An employee can explain IRS letters, request adjustments to your account, or help you set up a payment plan. You can set up an appointment by calling your local Center and, at the prompt, leaving a message requesting Everyday Tax Solutions help. A representative will call you back within 2 business days to schedule an in-person appointment at your convenience. To find the number, go to www.irs.gov/localcontacts or look in the phone book under *United States Government, Internal Revenue Service*.



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- **Central part of U.S.:**
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- **Eastern part of U.S. and foreign addresses:**
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Richmond, VA 23261-5074



CD-ROM for tax products. You can order Publication 1796, IRS Federal Tax Products CD-ROM, and obtain:

- Current-year forms, instructions, and publications.
- Prior-year forms and instructions.
- Frequently requested tax forms that may be filled in electronically, printed out for submission, or saved for recordkeeping.
- Internal Revenue Bulletins.

Buy the CD-ROM from National Technical Information Service (NTIS) at www.irs.gov/cdorders for \$22 (no handling fee) or call 1-877-233-6767 toll free to buy the CD-ROM for \$22 (plus a \$5 handling fee). The first release is available in early January and the final release is available in late February.



CD-ROM for small businesses. Publication 3207, The Small Business Resource Guide, CD-ROM 2004, is a must for every small business owner or any taxpayer about to start a business. This handy, interactive CD contains all the business tax forms, instructions, and publications needed to successfully manage a business. In addition, the CD provides other helpful information, such as how to prepare a business plan, finding financing for your business, and much more. The design of the CD makes finding information easy and quick and incorporates file formats and browsers that can be run on virtually any desktop or laptop computer.

It is available in early April. You can get a free copy by calling 1-800-829-3676 or by visiting www.irs.gov/smallbiz.

Exhibit A Family Daycare Provider Meal and Snack Log

Name of Provider _____ TIN/SSN _____

Week of _____

Keep For Your Records

Child's Name	Monday	Tuesday	Wednesday	Thursday	Friday	Saturday	Sunday	Totals
	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Number served: Breakfasts: _____ Lunches: _____ Dinners: _____ Snacks: _____
	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Snack <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Hours of attendance: _____ <input type="checkbox"/> Bkfst <input type="checkbox"/> Snack <input type="checkbox"/> Lunch <input type="checkbox"/> Dinner <input type="checkbox"/> Snack	Number served: Breakfasts: _____ Lunches: _____ Dinners: _____ Snacks: _____
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