Claiming Home Office Expenses

While the majority of Canadian employees still travel to the office at the beginning of each working day, there has been a huge increase over the past decade or so in the number of Canadian who work, on a part-time or a full-time basis, from a home office. Such an arrangement can work to everyone's benefit: the worker is spared the cost and aggravation of the daily commute and, where a significant number of employees work at least part-time from home, the employer's costs of maintaining office space, usually in expensive urban markets, can go down.

As working from a home office has become more common, a certain degree of mythology has also grown up around the tax treatment of expenses related to maintaining a home office. In the most optimistic (and unrealistic) of such scenarios, virtually all household expenses, including the mortgage, are transformed into tax deductions, reducing one's tax liability to miniscule amounts. It goes almost without saying that such is not the case. Deductions are certainly available, but the tax rules governing what's deductible and when are specific and detailed.

It's important, when dealing with the question of the deductibility of home office expenses, to distinguish between deductions claimed by employees and those claimed by the self-employed. As is almost always the case in such matters, the self-employed enjoy a greater degree of latitude in the deductions which may be claimed. That said, both the employed and the self-employed must meet the same basic two-part test in order to be eligible to deduct home office expenses, and that test is as follows:

- the home office must be the place at which the taxpayer principally performs the duties of employment or must be the taxpayer's principal place of business: **or**
- the home office must be both used *exclusively* for the purpose of earning income from employment or from the business and must be used on a regular and continuing basis for meeting customers or clients of the employer or the business.

A self-employed taxpayer who meets these criteria is entitled to claim (on Form T2124(E) (Statement of Business Activities)) expenses such as property taxes, rent or mortgage interest (but not mortgage principal amounts), insurance, utilities costs etc. However, such expenses are not deductible in their entirety: rather, the taxpayer must apportion the expenses based on the percentage of the total space which is used as a home office. For example, a self-employed taxpayer whose home office takes up 20% of available floor space and who incurs $1000 each year in qualifying expenses would be entitled to deduct $200 ($1,000 times 20%) in home office expenses for that year. There is one further caveat, in that the amount of home office expenses claimed in a year cannot be greater than the amount of income from the business. It's not, in other words, possible to run a business which produces $5,000 in income for the year and to then claim $10,000 in home office expenses relating to that business. However, where home office expenses exceed business income in any given year, the excess expenses can be carried over and claimed in a subsequent year in which there is sufficient business income to offset those expenses.

One of the benefits which is commonly supposed to exist for home office workers is the right to claim depreciation (or capital cost allowance (CCA), in tax parlance) on one's home for tax purposes. For employees, however, such a claim is simply not allowed. And , while the self-employed may be entitled to claim CCA on a home, making such a claim can create short-term benefits with longer term costs. Making a CCA claim on one's home is likely to erode the principal residence exemption from capital gains tax which is claimable when a home is sold, and that exemption is almost always more valuable than any CCA claim which might have been made.

Employed taxpayers who meet the two-part test set out above must meet a further condition before being eligible to claim home office expenses, as follows:

- the employer must provide the employee with a form T2200, which indicates that the employee

is required by his or her contract of employment to provide and pay for the expenses related to the home office;
- the employee must not have been reimbursed by the employer for such expenses; and
- the expenses incurred are incurred solely for the purpose of earning income from an office or employment.

Once the T2200 has been issued, and the other conditions are met, an employee who is a tenant can claim a proportionate part of his or her rent. An employee who owns his or her own home can claim a proportionate percentage of utilities, cleaning costs and minor repairs (but not improvements). An employee is not entitled to claim any portion of property taxes, insurance or mortgage interest paid. Slightly more latitude is provided to commission employees who work from home and own their home. Such employees may claim, in addition to the costs outlined above for employees, a portion of property taxes and insurance paid on the home. Mortgage interest and capital cost allowance remain non-deductible.

As is the case with self-employed taxpayers, an employee's deduction for home office expenses cannot be greater than the income from employment income for the year to which the expenses relate. And, once again, carryover to a subsequent taxation year is allowed.

While the deduction of home office expenses isn't the huge tax benefit that popular tax mythology would sometimes suggest it is, it can, assuming that the legal requirements are met and proper records kept, provide some tax relief on expenditures which would likely have to be incurred in any case by the taxpayer.

Any questions not answered by this article, feel free to contact us at 416-783-8156 or by email at info@taxtogo.ca