The tax benefits of working from home

A number of circumstances and developments have come together over the past few years to make working from a home office, once almost unknown, a common fact of business life. First and foremost, of course, is the technology, particularly communications technology, which enables the home-based worker to have access to all of the information and services available to his or her in-office counterpart. Given the right technology, it's nearly as easy for an employee working from home to send and receive e-mails through the employer's communications network and access the people, information, and services needed to do his or her job in the same way as it would be if he or she was at the office.

While technology has made it possible to work from home on a regular basis, other developments have made the daily commute to the office, and the maintenance of large offices in major urban centres, less and less appealing. The continuing increase in fuel costs has made the cost of that daily commute prohibitively expensive in some cases. As well, there is an increased awareness of the environmental cost of having most major highways clogged each morning and evening with hundreds of thousands of cars sitting in traffic gridlock. And finally, the cost of renting office space in most major Canadian cities means that most employers are at least willing to consider the cost savings which might be realized from work-at-home or telecommuting arrangements for their employees.

Along with the greater availability of work-from-home arrangements for employees, there has been a significant increase in the number of self-employed Canadians. Statistics Canada has reported that, between October 2008 and October 2009, self-employment in Canada increased by more than 100,000. And while not all of the self-employed work from home, it's fairly common for those venturing into the world of self-employment for the first time to save costs by operating their business, at least initially, out of a home office.

One of the things which make a telecommuting or work-from-home arrangement attractive, aside from avoiding the daily commute, is the tax deductions which can be claimed. While those benefits, especially for employees, are not necessarily as generous as is popularly believed, it is the case that working from home can make costs which would be incurred in any event deductible for tax purposes.

As is usually the case in tax matters, the rules differ for employed taxpayers and for the self-employed, as the latter 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 (defined by the Canada Revenue Agency as more than 50% of the time) performs the duties of employment or must be the taxpayer's principal place of business: or*
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> *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 15% of available floor space and who incurs $2,000 each year in qualifying expenses would be entitled to deduct $300 ($2,000 times 15%) 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.

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 must have been used directly in the employee's work at home.

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 and maintenance costs. An employee is not, however, entitled to claim any portion of mortgage interest, property taxes, or home insurance costs paid, and cannot claim capital cost allowance (see paragraph on capital cost allowance, below).

Employees working on commission, who usually occupy the tax territory somewhere in between employees and the self-employed, have slightly more latitude in claiming deductions with respect to the use of their own homes for work purposes. 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.

One of the tax 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 a short-term benefit with long-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, in monetary and tax terms, than any CCA claim which might have been made.

Being able to claim home office expenses doesn't result in the huge tax benefits that some popular tax myths claim. However, it can and does permit qualifying taxpayers to claim a portion of home ownership (or rental) expenses which would have been incurred in any case while also avoiding the dreaded daily commute, making it a win-win scenario.