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Lock in the Home-Office Deduction for Your S Corporation

Question

I used to operate my business as a single-member LLC, but recently made an S corporation election. I never had an issue deducting my home-office expenses on my proprietorship tax return, but now that I'm operating as a corporation, I want to make sure I get the same benefit with my S corporation.

How can I make sure the IRS doesn't "take away" the home-office tax deduction from me?

Answer

Welcome to your new S corporation world of tax strategy, where you encounter additional rules that you need to know and follow to ensure that home-office deduction.

Reimbursement—The One Right Way

There's one right way to get the benefit of the home-office deduction for your corporation, and that's by using the reimbursement method. The reason the reimbursement method is the one right way is simple—it's the only way that works!

Let's take a quick look at two other methods.

1. Why Rent Fails

One method some taxpayers mistakenly use is renting the office to the corporation. This will provide you a tax benefit of exactly zero dollars.

The S corporation deducts the rent paid to you. You include the rent in your taxable income on your personal tax return. But the tax code does not allow you to claim tax deductions against this rental income.¹



Result. You simply moved the money from one hand to the other, and that results in no tax benefit whatsoever!

2. Why Form 2106 Fails

Update: The TCJA forbids Form 2106 deductions for years 2018-2025.

Another method that fails is claiming the home office on your personal tax return as unreimbursed employee expenses on IRS Form 2106. This is a mistake because here you suffer under one or more of three strikes:

- **Strike 1.** To benefit from employee expenses on IRS Form 2106, you have to itemize deductions. If you don't itemize deductions, you get no benefit from the home-office deduction.
- **Strike 2.** You claim your 2106 expenses as miscellaneous itemized deductions that you deduct to the extent they exceed 2 percent of your adjusted gross income.² This is a likely goodbye to some or all of your home-office deductions.
- **Strike 3.** The alternative minimum tax (AMT) does not allow any miscellaneous itemized deductions. If you are paying the AMT, deducting the home office on your personal tax return produces zero tax benefits.³

Back to the One Right Way for Deductions

The one and only way to get your rightful home-office deduction is with the reimbursement method. Here's how this works:

1. As an employee of your corporation, you submit expense reports to your corporation for the expenses of your home office.
2. The corporation reimburses you for the home office and claims 100 percent of the home-office deduction as office space.
3. You receive the reimbursement as reimbursed employee business expenses. Such employee reimbursements are not taxable to you.

Why Reimbursement Works



The reason the reimbursement method works is simple—the IRS gives you a road map!

IRS Regulation Section 1.62-2(c) allows your S corporation employer to reimburse you (the employee) under an accountable plan for certain expenses.⁴ You, the employee, exclude from income all amounts reimbursed by your S corporation employer under an accountable plan, and the corporate employer gets a tax deduction for the full amount.⁵

The same IRS regulation further states that expenses that qualify for reimbursement under an accountable plan include those listed in part VI, subchapter B, chapter 1 of the code, as long as the employee pays or incurs the expense in connection with the performance of services as an employee for the employer.⁶

The tax code sections in part VI, subchapter B, chapter 1 include all the deductions that apply to the home office, such as depreciation, repairs, interest, utilities, and taxes.

Doing the Reimbursement Right (Audit-Proofing)

When you submit your expenses to the S corporation, you need to ensure that the expenses comply with tax law. For the home office, you have the following requirements:⁷

1. Proof of the expense (e.g., photocopy of the utility bill)
2. Proof of exclusive use (e.g., attesting to exclusive use; photo of exclusive use setup)
3. Proof of regular use (e.g., attesting to regular use; submitting a document with hours of use)
4. Proof of business use (e.g., adding the type of business use to the hours of use document)
5. Proof that your employee use of the home office is for the convenience of your S corporation employer

Your employee use of a home office is for the convenience of your S corporation employer when your facts and circumstances satisfy any one of the following:⁸

- You must maintain the home office as a condition of employment.
- Your home office is necessary for the functioning of the S corporation's business.



The home office is necessary to allow you to perform your duties properly.

We recommend that you create a statement that satisfies the requirements above, submit it at least annually with your expense reports, and update it annually.

The home office must not be “purely a matter of personal convenience, comfort, or economy with respect to the employee.”⁹

For some thoughts on what makes for convenience, see Answer 5 in [Six Answers to the Home-Office Deduction for the S Corporation Owner](#).

Tax Return Preparation Tip

On the S corporation tax return, report the total reimbursement of the home office in the other deductions category in a line item labeled “office space” or something similar.

On your personal tax return, reduce your itemized deductions by the dollar amounts you received as reimbursements from the S corporation for the home-office mortgage interest and property taxes.

In the permanent file that you maintain for your personal taxes, make sure to track the straight-line depreciation that the corporation reimburses to you for the home office. You need to treat this depreciation as if you claimed it personally. This means the depreciation reduces your basis in the home. This also means that at the time of sale, the straight-line depreciation reimbursed to you is subject to taxation of up to 25 percent as unrecaptured Section 1250 gain.¹⁰

Takeaways

If you operate your business as an S corporation and you also want to benefit from the home-office deduction, you need to follow the accountable plan rules to accumulate your proper benefits.

The accountable plan is basically a fancy way of describing an expense report. To obtain your rightful home-office deduction benefits, you (the owner-employee) need to submit properly prepared expense reports to your S corporation.

The expense-report method is the only right way to achieve a full deduction for the home office.

Using the rent strategy produces a zero deduction. And claiming the home office as an employee expense on IRS Form 2106 almost always costs you at least some deductions, and in many cases eliminates the home-office deduction altogether.



Solution—the one right way: reimbursement!

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- 1 IRC Section 280A(c)(6).
- 2 IRC Section 67(a); 67(b).
- 3 IRC Section 56(b)(1)(A).
- 4 Reg. Section 1.62-2(c).
- 5 Reg. Section 1.62-2(d)(1).
- 7 IRC Section 280A(c)(1).
- 8 Hamacher v Commr., 94 T.C. 348.
- 9 Ibid.
- 10 Six Answers to the Home-Office Deduction for the S Corporation Owner.

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