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How Corporations Reduce IRS Audits of Home-Office Deductions

If you filed your business income and expenses as a proprietor in 2017 and reported \$100,000 or more in gross receipts, your chances of IRS audit were 2.4 percent (2017 returns are still open for audit, so the percentage could increase).¹

Had you reported this income as an S corporation, your chances of audit were only 0.20 percent.²

You have probably read that the home-office deduction increases your chances of IRS audit. We've read that, too, but we don't believe it.

Paranoid about Audits

Regardless, let's assume that you're a little paranoid about audits, and you want to claim the home-office deduction in a way that doesn't attract the attention of the IRS.

If you operate as a corporation, your home-office deduction does not show on either your personal return or your corporate return if you have the corporation reimburse the office as an employee business expense.

With reimbursement, the corporation claims the deduction for the expenses it reimburses to you. The corporation probably puts the reimbursement into a category called "office expenses" or something similar. Thus, the home-office deduction as a name or title does not appear in the corporate return.

You receive the reimbursement from the corporation as a reimbursed employee expense. You do not report employee-expense reimbursements as taxable income on your personal return. Thus, you do not identify the home office on your personal return.

Got it? The home-office deduction does not appear under a home-office label on either the corporate or personal tax return as a tax deduction.

Easy Method

The first step to getting the dollar amount for the corporate reimbursement is to complete IRS Form 8829 as if you were going to claim the deduction personally (which you are not doing).

You are going to use IRS Form 8829 as backup to the expense report that you will submit to the corporation for reimbursement.

With this form, the corporate reimbursement to you includes the home-office percentage of amounts you spend for mortgage interest and property taxes. Because the amounts are reimbursed to you by the corporation, you do not deduct them on your personal return.

Example. Your mortgage interest for the year is \$10,000, and 10 percent of your home is office. Your corporation reimburses \$1,000 (10 percent times \$10,000), so your personal net mortgage interest expense for the year is \$9,000 (\$10,000 minus \$1,000).

If you itemize deductions, which is less likely because of the Tax Cuts and Jobs Act (TCJA), you deduct the \$9,000 as an itemized deduction on Schedule A of your Form 1040.

When you sell your home, you treat it as though you had taken the home office as a personal deduction. Your corporation reimbursed you for depreciation, and since depreciation is subject to the recapture tax, you must consider the depreciation recapture problem in your home-selling strategy.

Expense Report Rules

The corporation may reimburse expenses only if it has adequate proof of the expenses. Therefore, make your corporation demand proof that substantiates your administrative use, regular use, and exclusive use of the home office.

Think of your corporation as an IRS auditor who's making sure that the expenses meet the requirements of the law. If you fail the adequate-proof part, your corporation will have to include the expense reimbursements in your W-2 income.³ You do not want that.

With proper proof, your corporation gets the tax deduction and you, the employee, get an employee reimbursement that is not taxable income to you.⁴ A win-win situation!

To help you with this proof, here's an Excel spreadsheet that you can use for your reimbursement request ([click here](#)).

Takeaways

If you want the home-office deduction but are paranoid about claiming it, consider the corporate form of business. It does a fantastic job of hiding the deduction.

But—remember—we do not consider the home office to be an audit flag at all. Thus, we would not incorporate just to remove the home office from our tax returns.

We also understand and appreciate a certain amount of IRS-induced paranoia.

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1 Internal Revenue Service, Data Book 2005, Publication 55B, Washington, DC (May 2019), Table 9a, p. 23.

2 Ibid.

3 Reg. Section 1.62-2(c)(5).

4 Reg. Section 1.62-2(c)(4).