Home-Based Businesses Toolkit

If you use a designated area of your home to earn self-employed income, there are some specific things you should know. This toolkit will help you understand what you can do to be ready for tax season and stay organized all year round.

Frequently Asked Questions

What are my most important responsibilities as someone who earns self-employed income out of my home?

1. Track Home-Based Businesses Income and Expenses

The most important thing to remember is to track your income and expenses and keep accurate records. If you do this accurately, it will be much easier to calculate your deductions at the end of the year.

In addition to tracking general income and expenses related to your business, you should also have some key details about your home ready when you meet with a tax professional or use E-filing software. You should know how much you paid last year in:

- Rent
- Mortgage interest
- Renter's or homeowner's insurance payments
- Repairs and maintenance
- Utilities (water, phone, electricity, internet)
- Other expenses associated with your home

You will only be able to deduct these if they meet the exclusive use test. See the Deductions section for more information.

2. Pay Quarterly Estimated Taxes

If you are self-employed and operate a business out of your home, you may have to pay estimated quarterly taxes set by the IRS, because you don't have an employer that takes taxes out of your paychecks during the year. Quarterly taxes are based on the amount of money you expect to earn this year or how much you made the previous year. When you file your return at the end of the year, the government will pay you back if you overpaid or tell you how much you still owe if you underpaid. If you don't pay throughout the year, you may owe a large sum during tax filing season and will have to pay a penalty.

Speak to one of our NYC Free Tax Prep providers or attend a free workshop to ask questions about how to pay your estimated quarterly taxes.

3. Filing a Year-end Return

When you file an annual tax return, you may be able to deduct some costs related to operating your business from your home. As a home-based business, some home-related expenses will be entered on [Form 8829](). This form is for identifying the allowable expenses for business use of your home on Schedule C (Form 1040). If you keep good records and track everything, your tax professional or E-filing software will make this easy.

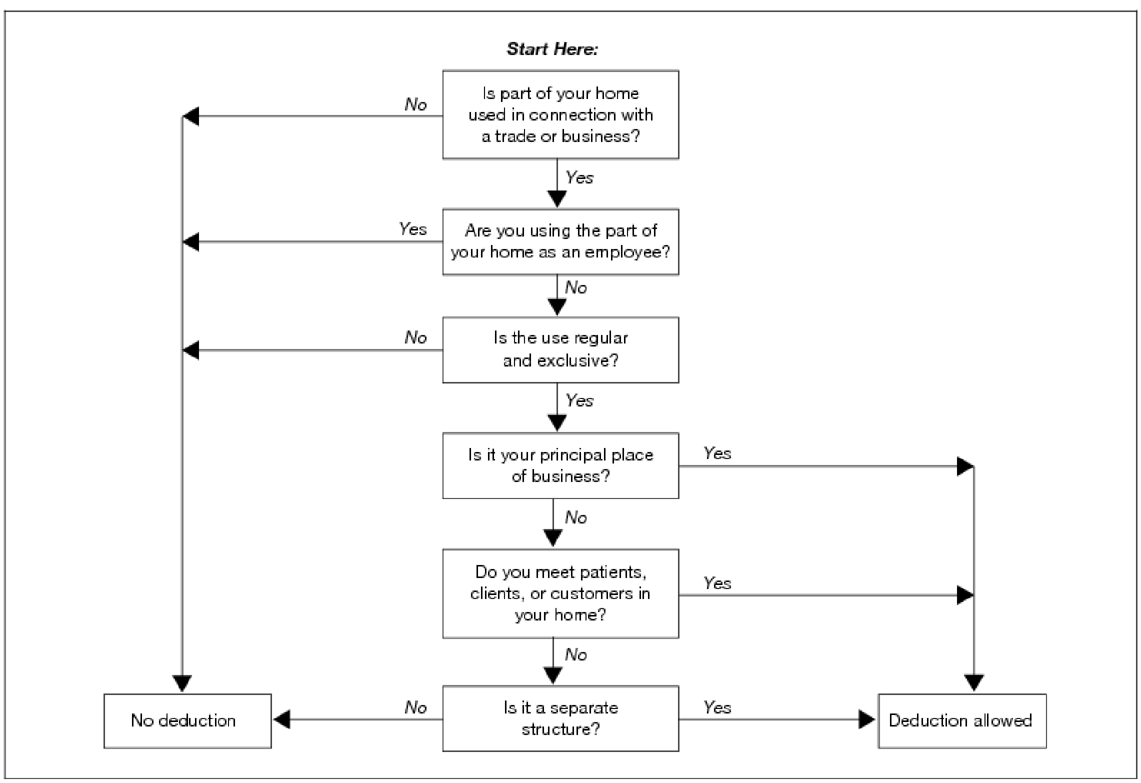
What are deductions related to my home I can claim?

To claim deductions for business use of your home, there are some requirements you must meet. The area of your home you use to earn self-employment income *must* be one of the following:

- Used exclusively and regularly as your main place of self-employment business
- Used as a place where you regularly meet with customers or clients
- Used to store products or samples
- Used for a childcare or daycare space

This is called the exclusive use test. See the below chart for guidance.

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.



Direct vs. Indirect Expenses
All your expenses related to running a business out of your home will fall into two categories: direct expenses and indirect expenses.

- Direct expenses are related *only* to the area of your home you use for business. These are fully deductible. For example, if you have a room that you use *exclusively* as an office for your self-employed business, paying to paint the walls or replace a lightbulb in that room would be a *direct expense.*
- Indirect expenses have to do with your *entire* home, not just the part you use for business. Some examples are rent, utilities, and general repairs. Indirect costs are only deductible according to what is called the *business use percentage.* This is the square footage of the space you use for business divided by the total square footage of your home. Make sure you know these numbers when you meet with a tax professional or use E-filing software.

Example: Home-Based Daycare
Let's say you run a small daycare business out of your living room. Some of your costs are direct business costs, like providing lunch and snacks for the children and buying special toys and educational supplies as enrichment activities. These expenses are fully deductible. Make sure you are tracking how much you spend on things like:

- Food
- Educational materials (including books and art supplies)
- Technology
- First aid supplies

For other expenses related to the space you use for your daycare, the IRS has some unique rules that only apply to home-based daycare businesses. You need to know how many hours the space is used *specifically* for daycare. You would then divide the total hours your space is used for daycare by the total hours in the year (8,760), then multiply that by the business use percentage.

Visit the IRS's webpage on home-based daycare for a collection of examples. If this seems complicated, an NYC Free Tax Prep provider or E-filing software can help you. If you are a daycare provider, you should be ready to share the square footage of the space you use for your daycare, the total square footage of your home, and the amount of hours yearly you provide care.

Make sure any cost related to your home-based business is being tracked throughout the year and speak to one of our NYC Free Self-Employed Tax Prep providers for more advice.