

IT514 Work space in home expenses

INTERPRETATION BULLETIN

SUBJECT: INCOME TAX ACT WORK SPACE IN HOME EXPENSES

NO.: IT-514 DATE: FEBRUARY 3, 1989

REFERENCE: SUBSECTION 18(12)

TAX REFORM

This bulletin comments on amendments to the Act resulting from Tax Reform.

APPLICATION

The provisions of subsection 18(12) discussed in this bulletin are applicable to fiscal periods commencing after 1987.

SUMMARY

Expenses incurred in earning income from a business are normally deductible in computing income to the extent they are reasonable. This bulletin deals with the conditions and restrictions placed on the deductibility of such expenses when they relate to an office or other work space in the home of an individual. The work space must be used for specified purposes and the expenses relating thereto cannot exceed the individual's income from the business for a taxation year. The bulletin also deals with the carry forward of any excess to the immediately following taxation year.

DISCUSSION AND INTERPRETATION

1. Subsection 18(12) provides that a self-employed individual, in computing income from a business for a taxation year, is not entitled to any deduction for expenses otherwise deductible under the Act related to any part (hereinafter referred to as "work space") of a self-contained domestic establishment in which the individual resides, except where the work space is either (a) the principal place of the business of the individual, or (b) used exclusively to earn business income and on a regular and continuous basis for meeting clients, customers or patients of the individual in respect of the business.

The expression "self-contained domestic establishment" is defined in subsection 248(1) as a dwelling house, apartment or other similar place of residence in which place a person as a general rule sleeps and eats. Where an individual's income for a taxation year includes income from a business the fiscal period of which does not coincide with the calendar year, a reference in this bulletin to a taxation year should be read as a reference to a fiscal period of the business ending in the taxation year.

PRINCIPAL PLACE OF BUSINESS

2. Where an individual has two or more places of business in respect of the same business, the work space must be the principal place of business in order to meet the requirement in 1(a) above. The word "principal" is not defined in the Act but it is considered that the words "chief" and "main" are synonymous to it. Where, for example, a room in a contractor's residence is used to accomplish the functions relating to a contracting business, such as, receiving work orders, bookkeeping, purchasing and preparing payrolls while the remaining activities of the business, the performance of the contracts, are carried out at the customer's location, the room would be considered as the contractor's principal place of business. Similarly, the work space in a farmer's home utilized to operate the farming business would normally be the farmer's principal place of business. The room used by the contractor and the farmer's work space could also be used for personal purposes since they need not be used exclusively for the business in order to meet the 1(a) requirement.

REGULAR AND CONTINUOUS BASIS

3. The first requirement of 1(b) above is that the work space must be used exclusively to earn business income. This requirement is met if a segregated area, such as a room or rooms, is used in a business and for no other purpose. The second requirement is that the work space must be used for meeting clients, customers or patients on a regular and continuous basis. The regularity and frequency of meetings in a work space to meet the requirement of being on a regular and continuous basis will depend on the nature of the business activity and is determined on the facts of each situation. However, a work space in respect of a business which normally requires infrequent meetings or frequent meetings at irregular intervals would not meet the requirement. A home office used by a doctor to meet one or two patients a week is an example of a work space which would not be considered used on a regular and continuous basis for meeting patients. On the other hand, a work space used to meet an average of 5 patients a day for 5 days each week would clearly be used for that purpose on a regular and continuous basis. Unless 1(a) above applies, both requirements in 1(b) above must be met in order to deduct expenses relating to a work space.

RESTRICTION ON DEDUCTION

4. An individual who carries on a business in a work space, and has met the test in either 1(a) or (b) above, will be able to deduct only the expenses related to the work space to the extent they are otherwise deductible and do not exceed the income from the business for the taxation year, carried on in the home or elsewhere, determined prior to deducting the expenses related to the work space. Thus, such expenses for a taxation year cannot create or increase a loss for income tax purposes from the business for which the work space is used. The expenses related to the work space could include, for example, the prorated portion of rent, capital cost allowance, property insurance, property taxes, mortgage interest or operating costs such as heating and lighting. The expenses should be apportioned between business and non-business use on a reasonable basis, such as, square metres of floor space used. However, the reasonable basis should also take into consideration the personal use, if any, of a work space that is an individual's principal place of business as described in 2 above. The principal residence protection from capital gains does not apply to a work space for which capital cost allowance has been claimed (see the current issue of IT-120). Although telephone, consumed supplies and other similar expenses may relate to the business, they do not relate to the work space and, accordingly, are not subject to the conditions and restrictions of subsection 18(12).

CARRY FORWARD OF UNDEDUCTED EXPENSES

5. The portion of the otherwise deductible expenses related to a work space that cannot be deducted in a taxation year by reason only of 4 above will be considered an expense related to the work space in the immediately subsequent taxation year. Where in that immediately subsequent taxation year the test in 1(a) or (b) above is met, the portion of the expenses carried forward and any further actual expenses incurred in that year may be deducted to the extent permitted by 4 above, and any excess is carried forward to the next year. Thus an indefinite carry forward is provided as long as either 1(a) or (b) above is met on a continuous basis.

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