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Marmer Penner Inc. Newsletter

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Home Office Expenses

The *Child Support Guidelines* ("the *Guidelines*") use total income per an individual's personal income tax return as a starting point. To this amount may be added all or a portion of the pre-tax income earned by a controlled corporation. While the *Guidelines* state that taxable income is a starting point for both personal and corporate income, the reasonableness of any expense deduction is not solely governed by whether the deduction is permitted under the *Income Tax Act* [subsection 19(2) of the *Guidelines*].

The *Income Tax Act* permits certain employees to deduct expenses related to a workspace in the home [subsection 8(13) of the *Income Tax Act*] and also permits an individual reporting business income to do the same [subsection 18(12) of the *Income Tax Act*].

In order to be deductible as either an employment expense or a business expense, the workspace in the home must be either:

(a) the individual's principal place of business; or
(b) used exclusively for the purpose of earning income <u>and</u> used on a regular and continuous basis to meet clients, customers or patients.

Where an individual has an office provided to him elsewhere by an employer or has a principal place of business elsewhere, it may be difficult to meet either of the two tests above to qualify for deductibility of the workspace in the home. Where an individual, named Penelope, has inappropriately deducted expenses relating to a home office for income tax purposes, it may be appropriate to add the home office expenses in determining Penelope's *Guidelines* income. It may also be appropriate to calculate an income tax gross-up for the additional income tax savings for which Penelope was not entitled.

What if the individual is entitled to deduct home office expenses for income tax purposes? Should his/her *Guidelines* income include this deduction? Consider two individuals – Tom and Jerry. Both Tom and Jerry own businesses which earn $100,000 per annum. Both live in identical houses with identical mortgage interest, property tax, utilities, insurance and maintenance expenses totalling $24,000 annually. Tom stores all his accounting records in one room in his home while Jerry leaves them at his work premises. Tom does not incur any additional home expenses as a result of keeping his records at home. If Tom's home office occupies one-sixth of his home, he may deduct $4,000 (1/6 of $24,000) annually from his business income. As a result, Tom pays less income tax than Jerry and may report lower income for the *Guidelines,* too. All this despite not incurring any incremental expenses.

This leaves the two questions:

(a) should the home office expenses properly deducted by Tom for income tax purposes be added to his *Guidelines* income because there was no actual incremental cost to him? and
(b) should any add-back, if appropriate, be subject to an income tax gross-up?

This is a legal issue beyond the scope of this newsletter. However, it may not be appropriate to add the income tax gross-up as it would equate Tom's position with that of Penelope who obtained an income tax advantage unfairly while Tom has not contravened any tax rules.

We look forward to guidance from the courts as home office expenses are a common deduction among those earning business income and is also claimed as a deduction on occasion by those earning employment income.