

The murky waters of home office expenses: three methods for claiming tax deductions

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With the ongoing COVID-19 related restrictions, Australia's workforce has seen a dramatic shift to working from home on a more permanent basis. There are a number of benefits to this

arrangement for both the employer and employee, but what does it mean for the employee and what they can claim as a tax deduction?

General Rules

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Home office expenses and tax deductions – general rules

Like any other employment related expenses, tax deductions can only be claimed for home office expenses to the extent that the following principles have been satisfied:

- The expenses must have been incurred by you;
- The expenses have not been reimbursed by your employer;
- The expenses must be in relation to your income earning activity; and
- You must have a record as evidence.

What expenses can be claimed

Examples of running costs that can be claimed as a tax deduction include:

- Additional electricity costs in relation to heating, cooling, lighting and cleaning your home as a result of working from home;
- Work related phone and internet expenses;
- Ink, printer paper and stationery used for work; and
- Decline in value of home office equipment such as computers, printers, phones, furniture and furnishings.

You cannot claim a tax deduction occupancy expenses such as interest on mortgages, rent and council rates. The exception to this general principle is if you have a dedicated area for a workplace. For example, a hairdressing business that is run at home where there is a dedicated area to perform the services, such as cutting and washing hair or a doctor that maintains a consulting room in their home. Extra care should be taken if you are considering claiming occupancy costs as these can limit the ability to apply any main residence exemption to the ultimate sale of your home.

1. Actual cost method

The actual cost method allows individuals to claim the actual running costs of their home office provided they can evidence the deductible proportion of the total expense incurred. This evidence generally needs to be in the form of itemised invoices specifying the deductible proportion of a taxpayer's usage for each period to support the annual deduction. As this can be difficult to ascertain, particularly in relation to the allocation of utility expenses, the ATO allows taxpayers to estimate these costs provided that the estimate is based upon a representative four week period and that the usage is constant throughout the entire year, e.g. if an individual works from home one day every week they will be eligible to claim $1/7^{\text{th}}$ of their actual utility usage costs. If a taxpayer is seeking to utilise this method, it should be noted that no claim can be made if the taxpayer does not have an appropriate representative period.

Interestingly, due to the significant time that employees have now been working from home, and that this time has spanned multiple income years, employees may now have a representative period. The key to this lies in the consistency of working from home; if the employee has been returning to the office regularly and only working from home on an ad-hoc basis, then there will be no representative period.

To further muddy the waters, how are factors such as home schooling children or having non-working spouses remain at home during these same working periods meant to be factored in, if the representative period now lies at or near $5/7^{\text{th}}$ (as close to 100% as you can get!)? As this has continued throughout this 2021 financial year, are employees still eligible to deduct $5/7^{\text{th}}$ of their utility usage notwithstanding that these same utilities have been used for non-work related purposes during those same days?

In addition to utility expenses, deductions are also allowable for the depreciation related to the purchase of computers, desks, chairs, monitors, computer accessories, telephones, etc. It is easier to support the actual usage of such costs; however, any use of these items by other members of the household can limit a taxpayer claim.

Where the cost of these assets is less than \$300, the taxable use percentage can be claimed in the year in which it was acquired. If the asset cost is more than \$300 it must be depreciated over its useful life and only the taxable use percentage of the depreciation expense can be claimed.

2. Fixed-rate method

As the actual cost method is difficult for most taxpayers to manage (and many taxpayers do not work from home on a consistent or regular basis and do not have a representative period), the ATO have provided a fixed rate method to assist them in claiming deductions for running their home office.

The fixed-rate method allows taxpayers to claim deductions for the following:

- Rate of 52 cents per hour on running expenses, such as heating, cooling, lighting cleaning and decline in value of office *furniture* (e.g. office chair & desk).
- Actual work-related usage costs related to phone, internet, ink, printer paper, and stationery; and
- Actual work-related costs of the purchase and/or decline in value of home office *equipment* (e.g. computer, monitor, printer and phone).

To support taxpayers that might not wish to make a claim for the actual usage of their phone or internet, the ATO allow a fixed amount of \$50 as a deduction with no substantiation required.

3. Shortcut method (extended to 30 June 2021)

Originally announced to apply from 1 March 2020 to 30 June 2020, the ATO have provided a shortcut rate of 80 cents per hour on *additional* running expenses incurred. This shortcut method has been extended for the full 2021 financial year. As this rate is intended to cover **all** work related home office costs including phone, internet, ink, printer paper, and decline in value home office furniture and equipment, no further deduction can be claimed for any of these items in addition to the per hour allowance if the shortcut method is used from 1 March 2020. Importantly, this method only applies to those who:

- Are working from home or running their business. However, this does not include those who are on leave or have been stood down, or in the case of running a business, have stopped operating permanently. Note: Working from home does not include minimal tasks such as checking emails or taking calls; and
- Have incurred additional expenses as a result of working from home due to COVID-19.

Deductions can only be claimed under the shortcut method for the period 1 March 2020 through 30 June 2021, a period that spans the entire 2021 financial year, and taxpayers must keep a record of the hours that they have worked from home. Taxpayers wishing to claim a deduction using this shortcut method must include a specific '*COVID-hourly rate*' narration next to the deduction in their tax return.

Case study example

Jane Smith, a Chartered Accountant, resides in St Kilda and ordinarily works from her office in the CBD of Melbourne. During the 2020 financial year, as a result of the initial impacts of the COVID-19 pandemic, Jane setup her home office with the purchase of a desk, chair and monitor for exclusive work use and these items were claimed as a tax deduction at that time.

Due to the ongoing lockdowns in Melbourne throughout the 2021 financial year, Jane has been working from home the entire year with only sporadic visits into the office. As Jane is a fastidious accountant, she has maintained comprehensive timesheet records which specify that she worked from home for 1,725 hours during the 2021 financial year (being 37.5 hours every week less 6 weeks of leave). As Jane has been working from home, she has also kept comprehensive diary records of her work use of items such as her phone and other utilities and determined the following representative figures:

Item	4-week representative period	
	Cost	Business Use
Phone and Internet	\$65	75%
Electricity and Gas	\$450	33%
Water	\$80	33%
Office Consumables	\$20	100%

* While this appears low, Jane is both working and living in the same premises and therefore must adjust the business use accordingly. If there are 24 hours in a day, less 8 hours for sleeping, there are 112 hours in a week that household utilities are actively used for which Jane has required 37.5 hours for business use.

For Jane to be able to determine her deduction, she must apply the business use of the 4-week period across all available 4-week periods and there are 13 of these in a year. Given that Jane has taken six weeks of leave during the 2021 financial year she is not eligible to claim 1.5 periods meaning the deduction is only available for 11.5 periods.

As Jane has maintained comprehensive records, she is able to claim costs associated with working from home using the actual method if she chooses, but to ensure she is obtaining the best possible deduction she has also calculated the costs of maintaining her home office using the fixed-rate and shortcut methods:

- **Under the fixed-rate method**, Jane can claim a deduction of \$0.52 for the 1,725hrs worked at home, plus \$560.63 for phone and internet usage as she has maintained the appropriate records (i.e. $\$65 \times 11.5 \text{ periods} \times 75\%$). In addition, as the fixed-rate method does not include an allowance for the office consumables, she is able to claim the business use of these of \$230 (i.e. $\$20 \times 13 \text{ periods}$).
- **Under the shortcut method**, Jane can claim \$0.80 for the 1,725 hours worked at home during the 2021 financial year. As the shortcut method allows for the cost of utility

consumption, the use of phone and internet, as well as the decline in value of all assets, she is unable to claim additional expenses for these costs.

Based on the above information, Jane's potential income tax deductions under each method are set out below:

	Actual Cost	Fixed Rate	Shortcut
Fixed-rate amount	N/A	\$897	\$1,380
Utilities (Electricity, Gas and Water)	\$2,011.35	N/A	N/A
Consumables	\$230	\$230	N/A
Phone and internet	\$560.63	\$560.63	N/A
Decline in value of office furniture	\$nil	N/A	N/A
Decline in value of office equipment	\$nil	N/A	N/A
Total	\$2,8011.98	\$1,687.63	\$1,380

As can be seen above, whilst the Shortcut method is the easiest to apply, the Actual Cost and Fixed Rate methods would yield a higher tax deduction for Jane.

In summary

While individual taxpayers can choose from three methods to claim deductions for expenses incurred while working from home, particular care should be taken in determining the appropriate method based upon the level of documentation they hold. Individuals should also ensure that they "run the numbers" to see if the new shortcut rate announced by the ATO is indeed as tax effective as it has been promoted to be.

Conclusion

For a confidential discussion related to your available personal income tax deductions, please reach out to one of our [Fordham Partners](#).

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