Avoiding T2200 Home Office Deduction Headaches

Letting employees do at least some job duties from home can create HR headaches—especially if employees want to deduct home office space expenses from their income tax. To claim such deductions, employees will need you to complete the dreaded T2200 form. This article will do 2 things to help you negotiate the T2200 and Item 10, which covers the home office deduction:

- Describe the employer's legal obligation for filling out a T2200; and
- Explain when home office space costs are deductible.

What the Law Requires

Sec. 8 of the *Income Tax Act* allows employees to deduct expenses they incur in earning employment income, including costs associated with using part of the home as office space (Sec. 8(1)(i)(ii) and (iii)). Deductibility under Sec. 8 varies depending on the expenses involved and whether certain "conditions of employment" are present during the tax year.

Employees must complete paperwork to claim these expenses as deductions on their individual tax returns. Section 8(10) requires the employee to get their employers to fill out and sign a document certifying that the conditions of employment required for the deduction have been met. The "Declaration of Conditions of Employment," or T2200, is the form used for that purpose.

Why Employers Hate the T2200

There are 3 reasons to dislike the T2200:

1. It's an Administrative Burden: The T2200 runs only 2 pages. Part B, the section employers fill out, contains 14 items asking about the employee's working conditions. Some of these items, particularly items 4 (motor vehicle allowance), 5 (repayment of expenses paid to earn employment income) and 9 (employment contract terms) can be time-consuming and labour-intensive to complete. It's often necessary to collect and review the employee's contract and payment records.

2. Some Questions Are Hard to Answer: One example: Item 10 asks if the home office space for which an employee is claiming a deduction is the place where the employee "mainly," i.e., more than 50% of the time, does his or her work. But how are you

supposed to know what part of the house employees does their work in?!

3. You Must Certify Accuracy: Perhaps the biggest reason the T2200 is dreaded by HR and payroll managers is that somebody in a high position at the company must certify the accuracy of the information in the "employer declaration" at the end of the form in which employers state that the information provided is "to the best of my knowledge, correct and complete."

Certifying to the accuracy of a tax document is enough to make any company nervous, especially if you're the person whose signature is on the document. Although understandable, within the context of the T2200 this fear is somewhat overblown. Explanation: T2200 certification just certifies that the information you provide on the form about the employee's employment during the year is true, *not* that the employee is actually entitled to the deduction.

The T2200's Real Impact on the Employer

Although it's not the employer's burden to determine if employees are entitled to deductions, being asked to complete a T2200 still puts you in a ticklish position. For example, what if you can't honestly answer "yes" to the questions in Items 1 or 10 for an employee seeking to deduct home office space? If you answer "no"—or refuse to fill out the T2200 altogether—you might alienate the employee; but certifying to the accuracy of a "yes" that you don't know is yes is even worse.

And there's no guarantee the employee will receive the deduction even if you *do* answer "yes." Signing a T2200 certifying that the conditions of employment are in place may lead to adverse consequences for both sides if the deduction turns out to be unwarranted. The best thing that can happen is that CRA will deny the deduction and the time and effort you spent to complete the T2200 will have been in vain.

The worst thing that can happen is that the CRA will allow the deduction and discover the error later. That could lead to an audit against the employee. And while you may not be the target, the audit is likely to involve you because you completed the T2200 the employee used to support his claim.

Defusing the T2200 Dilemma

One possible way around the situation is to refuse to complete the T2200. This option, although not great for employee relations, may make sense when you know that the conditions of employment necessary to support the deduction aren't in place and that the deduction will be denied anyway.

It gets trickier if the conditions of employment for the deduction *are* in place but you know or suspect that the employee won't be entitled to the deduction for some other reason, e.g., the employee is claiming mortgage interest in connection with the space, which isn't a permissible deduction.

The optimal solution is to ensure that employees won't come to you with a T2200 unless and until they make an informed determination that they're entitled to a deduction. How? By creating and distribute educational materials that explain to your employees the rules on the deduction of work-related expenses under Sec. 8.

HOME OFFICE DEDUCTION RULES

The home office deduction rules are set out in Secs. 8(1)(f), 8(1)(i)(ii) and (iii), and 8(13) of the *Act;* and they're explained in 2 CRA documents: Guide T4404(E) (Employment Expenses); and Interpretation Bulletin IT-352R (Vehicle, Travel and Sales

Expenses of Employees).

1. Conditions of Employment

The employment conditions for a home office deduction vary depending on whether the employee is on salary or commission.

Salaried employees: The employer must require the salaried employee to incur the costs as a condition of employment. The clearest indication of this requirement is where the employment contract spells it out. The obligation to set aside a portion of the home for employment use must also be at the employee's own expense. But even if the contract doesn't say that the employee must pay the expenses out of his own pocket, courts are willing to imply such an obligation as a matter of "common sense." (See, for example, a case called *Schnurr v. Canada*, [2004] T.C.J. No. 565. If the employer reimburses the employee for his out-of-pocket expenses, the deduction doesn't apply.

Commissioned employees: Employees paid in whole or in part by commission or similar amounts based on sales or contracts negotiated are entitled to a deduction only if all 3 of the following conditions are met:

- The employment contract requires the employee to pay his own expenses;
- The employee is "normally required" to work away from the employer's place of business; and
- The employee hasn't received a non-taxable allowance for travel expenses during the tax year.

2. Space Must Be Part of the Home

The space must be part of "a self-contained domestic establishment where the individual resides," according to Sec. 8(13)(a). IT-352R clarifies that this means a "home," including a "dwelling-house, apartment or other similar place of residence in which a person as a general rule sleeps and eats." Some employees claim home office deductions if they do a lot of work out of their cars. Such deductions would not be permissible.

3. Space Must Be Used for Performing Employment-Related Duties

The most important and frequently misunderstood requirement involves use of the space. To claim the home office deduction, employees must meet one of the following 2 conditions:

- The work space is where they "mainly," (i.e., more than 50% of the time) do their work; or
- They use the work space only to earn their employment income and use it on "a regular and continuing basis" to meet clients or customers.

To counteract a common misperception, you need to make it clear to employees that they're not entitled to a home office deduction simply because they do a couple of hours a work at home at night or on weekends.

4. Costs Must Be for Rent or Maintenance

The deduction covers costs the employee incurs to use the space to earn income from the employment. This includes 2 kinds of costs:

Rent: Under Sec. 8(i)(ii), taxpayers can deduct "office rent." IT-352R makes it clear

that rent is deductible only if the employee is actually renting the space. In other words, employees who own their home can't deduct the rental *value* of the space.

Maintenance: Under Sec. 8(i)(iii), a deduction applies to the "cost of supplies that were consumed directly" in the performance of the employment. IT-352R specifies that "cost of supplies" covers maintenance costs such as electricity, heating, light bulbs, cleaning materials and minor repairs.

What's Not Covered: The home office deduction does not include mortgage interest, property taxes, home insurance or capital cost allowance.

5. Costs Must Be Attributable to the Work Space

The home office deduction doesn't apply to 100% of the rent cheque or maintenance supplies used in the whole home. The employee must use a "reasonable basis" to attribute a percentage of the deducted expense to the part of the home used as a work space. The Guide T4404E lists examples of methods the CRA considers acceptable:

- Dividing the area of the work space by total area of the home to calculate rent attributable to work space; and
- Determining how much of each claimed maintenance expense was actually used to maintain the work space. So, for example, 0% of the cost of a light bulb would be deductible if the light bulb was used in the kitchen (if cooking isn't part of the job); but the employee could deduct 100% of the cost of a bulb used to light the desk lamp in the office.

6. Deduction Can't Create or Enlarge a Loss

Finally, the deduction applies only to employment income left over after the employee deducts all other employment-related expenses from the employment. In other words, the home office deduction can't create or increase a loss from employment for the year. If the employee has a net loss, he can't apply the deduction to income earned from another employer. He has to carry forward the deduction and apply it to employment income he earned from the employer in the next taxable year.