

PASARI CONSULTING LLC

Simplifying Tax, Payroll, and Accounting

AUGUST 2026 NEWSLETTER

The Home Office Deduction: What Actually Works

Why This Matters Right Now

With remote work and home-based consulting remaining standard for many small business owners and contractors, the home office deduction is one of the most valuable—and misunderstood—tax breaks available. This month, we're covering how to claim it correctly across all three areas: taxation (IRS rules), bookkeeping (documentation), and payroll (employee considerations). Whether you're a consultant, contractor, therapist, or small business owner working from home, this guide will show you exactly what the IRS allows and how to document it properly.



SEGMENT A: TAXATION FOCUS

IRS Publication 587: Understanding the Home Office Deduction

The home office deduction allows self-employed individuals, freelancers, and small business owners to deduct expenses for a dedicated workspace. According to **IRS Publication 587 (Business Use of Your Home)**, you qualify if your home office is your principal place of business, you regularly meet clients/customers there, or you use a separate structure (like a garage) exclusively for business.

Two Methods: Simplified vs. Actual Expense

METHOD 1: SIMPLIFIED METHOD

- \$5 per square foot (up to 300 sq ft)
- Maximum deduction: \$1,500/year
- Example: 200 sq ft office × \$5 = \$1,000 annual deduction
- Best for: Quick setup, minimal record-keeping

METHOD 2: ACTUAL EXPENSE METHOD

- Deduct actual costs: mortgage interest/rent, utilities, insurance, repairs, depreciation
- Requires precise records and percentage allocation
- Example: If office is 10% of home and utilities cost \$2,400/year, deduct \$240
- Best for: Large offices or high utility bills

MYTH: "Filing a home office deduction triggers an IRS audit."

REALITY: The deduction itself does NOT increase audit risk. What triggers review is improper documentation—claiming 50% of your home when you use 5%, or deducting expenses for rooms not used exclusively for business. **IRS Publication 587 is clear:** the deduction is legitimate IF you meet the tests.

Our Take: Accurate documentation beats aggressive claims every time. If unsure your space qualifies, the conservative approach protects you.



SEGMENT B: BOOKKEEPING & ACCOUNTING REQUIREMENTS

Record-Keeping & Documentation Standards

To claim the home office deduction, you must maintain detailed records that prove business use. **IRS Publication 587** requires documentation of:

✓ **Square Footage:** Measure your dedicated office space. The IRS defines 'regular and exclusive' use as the space being used **ONLY** for business, not as a guest room or multipurpose space.

✓ **Expense Documentation:** Keep receipts for mortgage interest (if claiming actual expense method), property taxes, utility bills, insurance statements, and repair/maintenance invoices.

✓ **Utility Allocation:** Calculate the percentage of home used for office (office sq ft ÷ total home sq ft). Apply this percentage to utilities to determine deductible amount.

✓ **Repair & Maintenance:** Separate office repairs (deductible) from home repairs (not deductible). Example: Painting office walls = deductible; replacing roof on entire home = not deductible.

Record Retention & Timeline

Keep all home office documentation for **at least 3-7 years** per IRS standards (3 years minimum for routine audits, 6-7 years for complex situations). Organize by expense category: utilities, repairs, insurance, property taxes. Store digital copies and backup physical receipts.

Common Bookkeeping Mistakes to Avoid

1. **Mixing personal and business expenses:** Keep home office expenses separate from personal household expenses in your accounting system.
2. **Overestimating office space:** Be honest about square footage. The IRS knows average home sizes. Claiming 50% when you live in a 2,000 sq ft home with a 100 sq ft office raises red flags.
3. **Failing to maintain utility records:** Don't estimate utility deductions. Keep actual bills and apply the office percentage. Estimated numbers trigger audits.
4. **Deducting non-office expenses:** Home insurance for the entire house is not fully deductible—only the portion covering the office space.



SEGMENT C: PAYROLL & COMPLIANCE ALERTS

August Payroll Filing Deadlines

Q3 Semiweekly Payroll Tax Deposits (Aug 2026):

If you deposit payroll taxes semiweekly, deposits are due on the following schedule in August. Reference: **IRS Publication 505** and **Form 941-X** guidance.

Q2 941 Reconciliation (if applicable): If quarterly reconciliation is needed, ensure Q2 941 filings are complete and accurate before moving to Q3.

Q3 Estimated Tax Payment (Sept 15, 2026): Self-employed individuals and business owners must file Q3 estimated taxes by Sept 15. This is critical for those operating home-based businesses.

Employee Work-From-Home Tax Implications

If you **have employees working from your home office**, tax and payroll compliance matters:

- **W-2 vs. 1099 Classification:** Ensure employees are properly classified. Home-based employees should be on payroll (W-2) unless they're independent contractors meeting IRS tests.
- **Home Office Expenses for Employees:** Employees generally cannot deduct unreimbursed home office expenses (Tax Cuts and Jobs Act). If you reimburse employee home office expenses, document it as an accountable plan under **IRC Section 162**.
- **State Payroll Compliance:** Some states require home office workers to be registered with state labor departments. Check your state's requirements.

Year-End W-2 & 1099 Planning

August is an ideal time to begin planning for year-end tax filings. If you work with contractors or have complex payroll, coordinate home office deduction strategy with W-2 and 1099 reporting. Ensure contractor invoices and payments are documented separately from employee payroll.



■ UNIFIED FILING DEADLINE ALERT

Q3 ESTIMATED TAX PAYMENT: SEPTEMBER 15, 2026

Self-employed individuals and business owners must file quarterly estimated taxes. Reference: **IRS Publication 505**. Underpayment penalty applies if missed.

WHO IT AFFECTS: Self-employed consultants, contractors, home-based business owners with net profit exceeding \$1,000.

PAYROLL DEPOSITS: Employers with semiweekly schedules must continue regular deposits. Federal Payroll Tax Payment: Due on semiweekly schedule per Form 941.

■ COMPLIANCE SPOTLIGHT: Mileage Tracking for Home Office Owners

If you claim a home office deduction AND drive to client meetings, you can deduct vehicle mileage. **IRS Publication 463** is strict about documentation.

What the IRS Requires: You must maintain a **contemporaneous mileage log** with:

- Date of trip
- Destination
- Business purpose
- Miles driven
- Total business mileage for the year

The Audit Reality: Mileage is the most audited Schedule C deduction. If audited, you must show your log. Estimated mileage ('I probably drove 15,000 business miles') can result in complete deduction denial.

Solution: Use a mileage tracking app (MileIQ, Stride, etc.) or maintain a notebook in your car. Log entries immediately, not months later. This simple step protects \$5,000+ in deductions from audit risk.

Questions? Let's Talk

Fairfax, VA 22033

■ nikita@pasariconsulting.com | ■ (571) 201-7166

www.pasariconsulting.com

Services: Tax Preparation | Payroll Management | Bookkeeping & Accounting

IMPORTANT NOTICE

Tax laws, payroll regulations, and accounting requirements are updated regularly. This newsletter provides factual guidance based on current IRS publications and Department of Labor guidance (as of August 2026). However, your individual situation—including business structure, employee count, and state location—requires professional evaluation to ensure full compliance and optimization. We recommend reviewing your specific circumstances with a qualified tax professional or consulting with Pasari Consulting.

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