

DEDUCTING THE COST OF YOUR NEW COMPUTER

Like many individuals, in 1995, you may have replaced your obsolete two or three year old personal computer with a new, more muscular machine. No doubt, the expense and the time that you have devoted to learning how to operate your new computer have been painful. Assuming that you paid for the computer in 1995, this pain may be eased a bit through an income tax deduction. Whether you are able to take the deduction depends on the purpose for which you will use the computer and the location in which you use it. This article is written from the perspective of a business owner. (The rules governing deductions for employees are different than those discussed below.)

Personal Use. You may not take any deduction to the extent that you use your new computer for personal use. This includes entertainment, hobbies, education (except as discussed below), and other personal purposes (such as balancing your personal checkbook or keeping track of your social engagements.)

Investment Or Income-Producing Use. You may take a deduction to the extent that you use your new computer for investment purposes. This includes managing and keeping track of investments, such as stocks and bonds. This would also include income-producing activities that are not your principal business, such as managing rental properties that you may own. If your deduction is based on investment or income production, it will be available only to the extent that the cost of the computer exceeds two percent of your adjusted gross income. In addition, you will only be able amortize the deduction over a period of six years (or sooner if the computer becomes obsolete in less than six years).

Business Education. Normally, the cost of education is not deductible. However, you are allowed business expense deduction for education that you take to maintain or improve skills required in your present trade or business or to meet any express legal or professional licensing requirements. Therefore, your use of your new computer equipment in connection with such education should be deductible. For example, you should be able to deduct the cost of a new CD ROM reader or modem that you had to purchase in order to read course assignments.

Your Trade Or Business. You will be able to take a deduction for the cost of your new computer that you use in your trade or business. Generally, you will be required to amortize the deduction over the same period as must be used for investment or income-producing activity. However, under certain circumstances, you may be able to deduct the entire cost of your new computer in the year in which you first start using it.

Under Internal Code Section 179, business owners may deduct up to \$17,500 for the cost of new business equipment. This can include computers used in your business, provided that the computers are located in a "regular business establishment".

If you are operating your business out of a standard office, you should have no problem meeting the "regular business establishment" test. However, meeting this test becomes more difficult if you are operating your business out of your home.

Your home-based office will qualify as a "regular business establishment" only if it meets one of the following three tests: (1) you must use the space that you have set aside for your home-based office exclusively and regularly as the principal place of your business; (2) your home-based office must be used by your clients or customers in meeting or dealing with you in the normal course of your business; or (3) if your home-based office is in a separate structure that is not attached to your house (such as a garage), then you must use that space in connection with your business.

Remember, you will be entitled to a deduction for your new business computer even if your home-based office does not qualify as a "regular business establishment." In that case, you will have to spread out the deduction over several years, rather than taking it in one year.

In order to take any deduction for your home computer, you will also be required to maintain strict records substantiating your use of your new computer. These include the receipt or invoice that you received when you purchased the computer along with a contemporaneously maintained log recording the hours of business and personal use.