The Impact of Location on Net Income: A Comparison of Homebased and Non-Homebased Sole Proprietors

by

Joanne H. Pratt

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Joanne H. Pratt Associates, Dallas, TX 75219

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Using 2002 sole proprietorship data, the impact of location on net income was analyzed using a sample of 1.6 million profitable nonfarm sole proprietorships that took a home office business deduction (homebased businesses) and 1.9 million that deducted rent for other business property (non-homebased businesses). Homebased (584,000) and non-homebased (770,000) firms reporting a deficit were compared with profitable businesses.

Overall Findings

In 2002, homebased businesses (HBB) earn lower average receipts ($62,523) and net income ($22,569) than businesses operated in rented space (non-HBB) ($178,194 and $38,243, respectively). Homebased firms gain a higher return on gross revenues compared with non-HBBs (36 percent versus 21 percent).

Highlights

- Homebased businesses earn 35 percent of the receipts earned by non-homebased businesses, take 29 percent of their total deductions and have a net income of 59 percent of non-HBBs. HBBs spend 12 percent of non-HBBs' cost of labor and 26 percent for business location.
- Cost of labor is greater for firms earning a profit (12 percent versus 5 percent of total deductions). The allocation to cost of business location is roughly equivalent (26 percent versus 28 percent) for both profitable firms and those reporting a loss.
- Homebased business owners were found to work fewer hours per week and days per year, and 25 percent of HBB owners rely on their business for their total income compared with 33 percent of non-HBB owners.
- Homebased sole proprietors who take the home business deduction contribute a total of $102 billion in revenue to the economy. The 10 million "all other" firms, which appear to be largely homebased, contribute an additional $431 billion.

Data Sources

In this study the authors used federal income tax data from year 2002 sole proprietorship returns (Schedule C). The 2002 dataset is based on a sample of 49,752 returns and a population of 18,925,517 returns (13.8 million reporting net income; 5.2 million reporting a deficit) accounting for 21,020,333 non-farm businesses. Because persons who deduct home office expenses must file a Schedule C (that is, they cannot file the shorter Schedule C-EZ) the cross-tabulation tables are based on representative samples of non-farm homebased business owners who deduct home office expenses and non-homebased business owners who deduct "rent on other business property." The sample does not contain those "all other" firms that opt not to take the home office deduction nor those that deduct for both a home office and rent, so in that respect it is not representative of all homebased businesses.

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EXECUTIVE SUMMARY

The impact of location on net income was analyzed using a sample of 1.6 million profitable nonfarm sole proprietorships that took a home office business deduction (homebased businesses) and 1.9 million that deducted rent for other business property (non-homebased businesses). Homebased (584,000) and non-homebased (770,000) firms reporting a deficit were compared with profitable businesses.

Homebased businesses (HBB) earn lower average receipts ($62,523) and net income ($22,569) than businesses operated in rented space (non-HBB) ($178,194 and $38,243, respectively). However, homebased firms have an advantage compared with non-HBBs: they consistently gain a higher return on gross revenues (36 percent versus 21 percent).

The most numerous homebased businesses are professional, scientific and technical services, construction and health care and social assistance while the most profitable are those in wholesale trade, particularly durable goods and travel accommodation such as bed and breakfasts. The most numerous non-homebased firms are in retail, professional services and health care. The most profitable sectors are ambulatory health care services, insurance, real estate and consulting. Wholesale trade is the only sector in which homebased firms consistently make higher net incomes than firms operated in rented quarters. However, in sub-sectors of some industries, for example specialty trade contractors, HBBs earn incomes similar to non-HBBs because HBBs have lower costs.

Although absolute receipts, deductions and net income are much greater for non-homebased firms, allocations to various business costs as a percent of available resources are similar for many items. A notable exception is that HBBs allocate less to labor costs.

In percentage terms, profitable homebased businesses earn 35 percent of the receipts earned by non-homebased businesses, take 29 percent of their total deduction,s but have a net income of 59 percent of non-HBBs. Partly explaining the differences are the fact that HBBs spend only 12 percent of non-HBBs' cost of labor and 26 percent for business location.

For firms with a net loss, although the dollar costs are less for every expense, the ratios of homebased to non-homebased are quite similar for many costs to those for firms with net income. Examples are total deductions, cost of sales, overhead and marketing. Particularly interesting is that cost of labor is greater for firms earning a profit (12 percent versus 5 percent of total deductions) but the allocation to cost of business location is roughly equivalent (26 percent versus 28 percent) for both profitable firms and those reporting a loss. This may suggest that firms do not move to larger quarters as they begin to make a profit.

With few exceptions businesses operated outside the home show substantially higher revenues than non-HBBs. Why is that the case? This analysis of tax forms revealed allocation of expenses. But none of the factors found in this study such as percent of costs allocated to marketing, singly or together completely explains the differences in net income although the lower allocation to labor stands out. The answers may not be findable in tax returns. However, prior research suggests that motivation and goals may be a large factor. Homebased business owners were found to work fewer hours per week and days per year and only 25 percent of HBB owners rely on their business for their total income compared with 33 percent of non-HBB owners.

The findings of the study suggest that individuals choosing to enjoy a preferred lifestyle, can operate an unincorporated homebased business knowing that their return on revenues will be greater than if they rent business space. As a homebased business owner, with few or no employees, they can work the hours and seasons necessary to reach the needed level of revenues and net income. Those wanting to maximize income can hire employees, work more hours, and operate outside the home.

Homebased sole proprietors who take the home business deduction contribute a total of $102 billion in revenue to the economy. The 10 million “all other” firms, which appear to be largely homebased, contribute an additional $431 billion. Self-employment trends may rise due to demographic, technology and life-style factors.

CHAPTER 1: INTRODUCTION

The increase in homebased firms is dramatic. But is it a good choice compared with leasing outside space?

E-business has created a new impetus for policy makers to better understand homebased firms. "With advances in technology and telecommuting giving society greater flexibility, the number of people working out of their homes, including those with businesses, is increasing dramatically. Helping 10 million to 14 million [homebased] businesses coalesce into a cohesive economic segment will greatly empower the entire small business community and the nation's economy (Office of Women's Business Ownership 2004, p. 6). "Because of their general 'invisibility' (due to lack of a storefront or other facility), this is a vast, largely unserved market, not only for agencies like the U.S. Small Business Administration, but for business-to-business commerce as well" (ibid, p. 1).

This study analyzes sole proprietorship tax returns to increase our understanding of the impact of location on business performance. Because over 90 percent of businesses operated from a private residence are individual proprietorships this approach captures all but the four percent of partnerships and 4.8 percent of Subchapter S corporations that are homebased (U. S. Small Business Administration 2004). I compare the receipts, deductions and net income of businesses operating from the home with those in leased facilities.

Sole Proprietorship Tax Forms

Definition

Sole proprietors are taxpayers who file a Schedule C (Form 1040) "to report income from a business you operated or a profession you practiced as a sole proprietor…An activity qualifies as a business if your primary purpose for engaging in the activity is for income or profit and you are involved in the activity with continuity and regularity" (Internal Revenue Service 2002, p. c-1). Because hobbies and partnerships are excluded, Schedule C returns provide data with which to measure serious business intent.

The number of nonfarm sole proprietorship tax returns filed in 2002 was 18,925,518, an increase of 3.2 percent in one year (Pierce and Parisi 2002). Accurately identifying homebased businesses has been possible only since 1995 when a separate tax form was first required for reporting home office deductions.[1] In the next five-year period, up to 2000, the dollar figure deducted for home offices increased 69 percent. During the same period rent for business space increased 14 percent, utilities 13 percent and office expense 25 percent. Total deductions increased 26 percent while the total number of returns increased only 9 percent (Balkovic and Parisi 2000). Clearly the businesses taking the home office deduction have become increasingly important to understand. This study uses federal income tax data from year 2002 Sole Proprietorship returns (Schedule C).

IRS Tax Returns

Net income is based on revenue enhancement and/or cost reduction. Details of sole proprietorship returns permit a close look at the relation between revenue and net income as a function of business expense (Balkovic and Parisi 2000; Parisi and Balkovic 1999, 2001). Sole proprietorship income and expense tables for 2002 tax returns provide fine-grained detail on business receipts, cost of sales and operations, deductions by categories stipulated on the Schedule C tax form and net income. The tables are based on a representative sample of all small businesses that file Schedule C returns that have been cross-tabulated for homebased and non-homebased firms.

Self-employment Trends

Self-employment may rise due to demographic, technology and life-style factors. Operating a business from home offers particular advantages to the self-employed by providing an opportunity to earn income with a low overhead cost. Homebased businesses "offer people who are tied to the home for social or physical reasons, an opportunity to operate a business within their constraint(s). The net overall effect of home-based business is minimizing entry barriers, one of the most important conditions for stimulating an entrepreneurial society" (NFIB 2003, p. 20).

Small businesses generate more than 50 percent of the nonfarm private gross domestic product (GDP). There is some evidence that self-employment has started to increase after a prolonged slow decline. Between May 2001 and 2004, the Current Population Survey (CPS) found that the percent of total employed who usually worked at home as part of their primary job stayed about the same, at 15 percent. However the self-employed segment increased from 30.2 to 33.7 percent. The total

[1] However, not all homebased firms take the deduction. See Appendix A.

number was 14.4 million incorporated and unincorporated self-employed workers of whom 7.6 million, or 52.8 percent work at home on their primary job (CPS 2004).

People tend to switch to self-employment when the economy takes a downswing and flow out when the economy recovers (Rissman 2003). But there are fundamental changes occurring that suggest overall there will be an upward trend:

Longer-lived, aging population

Americans are becoming a longer-lived, aging population who no longer retire promptly at age 65. Of the rising baby boomers some have been self-employed. Others begin a business as a transition to full retirement, to earn supplementary income or just to keep their hand in. Avoiding the costs of leased space plus the flexibility of being able to combine work with recreation and travel make a homebased business an attractive solution for them.

"[M]iddle aged or older workers constitute a disproportionate share of the self-employed.…in 2002, workers age 45 and older represented 38 percent of the workforce in total, but they made up 54 percent" of unincorporated sole proprietors (Karoly 2004, p. 24)." Their motives are not simply to earn money. Although the self-employed may earn less than wage and salary counterparts, "the self-employed derive nonpecuniary benefits from self-employment, such as the opportunity to 'be your own boss" (Hamilton 2000, p.27).

"The aging of the workforce as the baby-boom cohort approaches retirement will almost certainly influence the size and characteristics of the self-employed workforce. Although the overall trend in self-employment rates has been downward in the past decade the fact that self-employment rates rise at older ages and that the population is aging suggests that demographics alone may halt or reverse that trend" (Karoly 2004, p. .42).

Faster growth of women-owned sole proprietorships

More women are going into business. Between 1985 and 2000, "Female-owned sole proprietorships grew much faster than their male-owned counterparts in terms of number of businesses, gross receipts, and net income" (Lowrey 2005, p. 1). Women, who have young children or for other reasons opt to work fewer total hours than men, gain the flexibility to do so with a homebased firm (Pratt 1999). Self-employed business women spend 81 percent of their 31.9 hours work time at home contrasted with homebased businessmen, who spend 49 percent of their 42.1 hour work week at home (Pratt 2002a).

Increasing use of the Internet

"Information technologies have simply made it much easier and cheaper to conduct business operations from a personal residence" (NFIB 2003, p. 30). The proportion of total sales made online is greatest for firms with fewer than 10 employees. Thus it is not surprising that use of the Internet to work at home increased from 44.6 to 67.4 percent from 2001 to 2004 (CPS 2001, 2004). Business owners generate leads and sales from web sites and gain credibility, an important benefit, particularly for HBBs (eMarketer 2005a, Pratt 2002b; U. S. Small Business Administration 2003).

As Phillips has pointed out "Home-based firms using the Internet are growing 46 percent faster and surviving longer than home-based firms not using the technology (Phillips 2002, p. 1). A 2005 market research survey confirms the earlier predictions and provides new details on ways that small firms specifically benefit from e-commerce:

- Over 70 percent of U.S. adults "believe that the Internet has made it easier to start a small business";
- Small businesses "that use the Internet to conduct e-business" rose from 22 percent to 73 percent in one year and are predicted to reach 82 percent in 2005;
- Web sites generate business leads for 81 percent;
- 77 percent believe a web site "helped to make them more competitive"; and
- 55 percent thought that having a web site "helped their company weather" economic downturns (eMarketer 2005a).

The merging of the PDA/computer/cell phone into one pocket-sized tool with broadband Internet access will give the self-employed even more flexibility to conduct their business from anywhere.

Increasing participation in the global economy

Homebased entrepreneurs have the advantage of being able to test a new business product or service without the need for outside capital. American's willingness to risk and fail underlie introduction of new ideas and innovations. Rowe, Haynes and Stafford (1999) see work at home as a form of community development offering alternative or supplemental income sources for individuals with an economic multiplier effect on a community and region. Considering the so-called flattening of the world as the global economy matures, entrepreneurship may prove an even more critical factor in keeping the U.S. competitive.

Changing life-style attitudes

Individual attitudes are changing from "live to work" to "work to live." Supporting the observation that men and women choose self-employment to support a life style they prefer is the finding that there is a "bipolar distribution of workers reporting both low and high hours " (Karoly 2004, p. 35). In 2001, 59 percent of older self-employed workers in unincorporated businesses worked 35 or more hours per week, compared with 74 percent of wage and salary workers in the same age group. Studies consistently show that men work longer hours than women. Another factor in the choice to stay small is that microbusiness owners "like what they do" and resist growing "from being a producer …toward being an administrator" (Baker 2005, p. 12). This is the group that defines success by financial criteria but considers non-financial lifestyle criteria more important (Walker and Brown 2004).

Desire to "be one's own boss"

A longitudinal study found that "lower hourly earnings among the self-employed with high levels of tenure may be explained by nonpecuniary factors of the job, such as being one's own boss" (Fairlie 2005, p.45). Sixty-five percent of the self-employed liked their job "very much" compared with only 45 percent of wage and salary workers.

Increase in incorporated businesses

Persons wanting full-time work (and presumably higher income) tend to incorporate. Non-farm, unincorporated self employment has been on a downward trend. From 1990 to 2003, it dropped from 7.5 to 6.9 percent of total employment. But concurrently incorporated self employment increased from 2.9 to 3.6 percent (Hipple 2004). From 1989 to 2002, incorporated self-employment rose from 25.6 percent to 32.0 percent of all self-employed workers (Karoly 2004). According to Hipple (2004, p. 14) "Workers will typically incorporate their business for traditional benefits of the corporate structure, including limited liability, tax considerations, and the enhanced opportunity to raise capital through the sale of stocks and bonds."

Research Questions

Based on the literature, homebased firms are viable businesses that need full support and credibility to fully realize their potential as contributors to the economy. Beale, for example, expresses the common understanding that "Home-based businesses, which make up roughly half of all U.S. businesses, are of particular interest because of their potential as a wellspring of economic activity" (Beale 2004, p. ES-1). According to the National Federation of Independent Business, "The significant factor about home-based business is that it allows the owner to cut overhead and conserve resources. Controlling costs is a critical issue for businesses of all sizes, but it is particularly significant for the new and very small…Eliminating outlays for space, duplicative office equipment (possibly), and commuting can provide an enormous advantage, at least initially" (NFIB 2003). But is that true?

This study extends our knowledge of small firms by examining the relationships between revenues and net income and the ways expenses are allocated in various industry sectors in a direct comparison between homebased and non-homebased firms. I test the hypothesis that having a homebased business with no outlay for leased space plus a home office deduction gives an apparent advantage to a homebased, compared with a non-hombased business.

Does avoiding facilities costs mean that money is reallocated to marketing or some other aspect of the business that contributes to profitability? That is, do homebased business owners gain an "edge" from lower overhead? My analysis of Characteristics of Business Owners (CBO) data showed that homebased businesses, on average, make less than those located outside the home, which is partly explained by fewer hours spent operating the firm (Pratt 1999). Another factor may be that only nine percent of homebased, compared with 32 percent of non-homebased businesses, have paid employees. The sole proprietorship returns document actual labor costs, which are critical to know due to the perception that employees of homebased firms often are underpaid family members. In the global economy will more small firms operate as virtual companies, thus giving even homebased businesses the leverage of a larger number of employees than can be accommodated in a home office? Homebased businesses can use teleworkers located anywhere in the world; they do not have to work in the proprietor's home. In any case the cost, wherever that labor is geographically located, is revealed in the salaries and wages line item of the Schedule C form. The analysis also exposes other factors that might determine profitability.

Methodology

Cross-tabulations

This study adapts Parisi and Balkovic's table design, Nonfarm Sole Proprietorships: Income Statements, by Selected Industrial Sectors Classified with the North American Industry Classification System. Cross-tabulations of Schedule C filings provided by the IRS, disaggregate the total samples of 13,750,798 Businesses with Net Income and 5,174,720 Businesses without Net Income into two groups:

- HBB - Schedule C returns filed by persons who take a “Home office business” deduction and do not take a deduction for "Rent on other business property."[2]
- Non-HBB - The opposite group: those who do take a deduction for "rent on other business property" but do not take a home office deduction.[3]

A total of 1,632,734 homebased businesses (HBB) with net income and 584,474 reporting a deficit and 1,892,626 non-homebased businesses (non-HBB) with net income and 769,949 with a deficit met the criteria. The remaining 14,045,735 businesses with and without net income that do not meet these criteria are excluded from this analysis. The Appendix provides more detail on the sample size and characteristics of the HBB, non-HBB and “All other” segments of the total sole proprietorship filed tax returns.

Organization of Report

Chapter 2 reviews sole proprietorships in the context of all businesses as an introduction to the home as a business location. Chapter 3 compares businesses by their homebased or non-homebased location. Returns, receipts, deductions and net income are compared for firms with and without net income in major industries and selected sub-sectors. Allocations of categories of deductible expenses are shown for major industries. The return of income on gross receipts is discussed. Chapter 4 discusses the findings and suggests options and choices for the small business owner with recommendations for support of sole proprietors.

Detailed characteristics of the homebased and non-homebased sample analyzed in the study, the larger sample from which it was derived and the 2002 Schedule C tax form are shown in the Appendix.

[2] Business use of your home deduction from Form 8829

[3] “…amounts paid to rent or lease other property, such as office space in a building.” 2002 Instructions for Schedule C, Profit or Loss from Business.

CHAPTER 2: SOLE PROPRIETORSHIPS

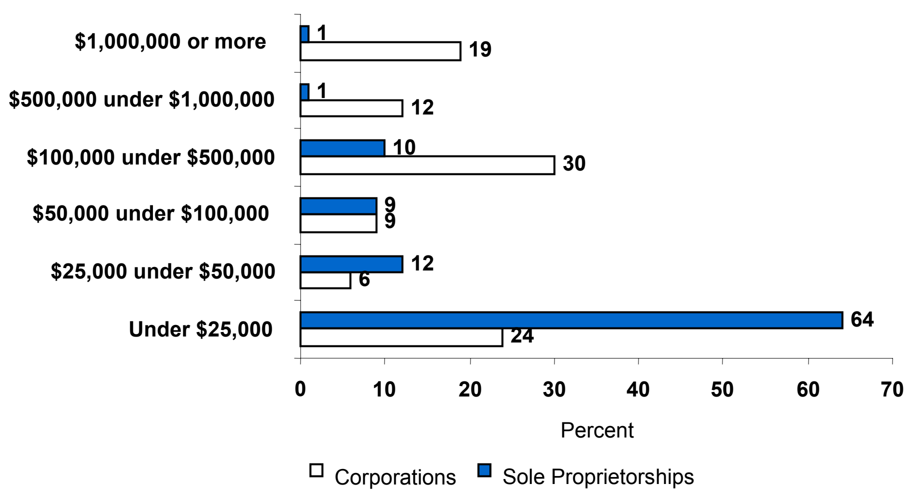
Small Business in Context

In spite of lower average receipts than corporations, small businesses drive the U.S. economy due to their greater numbers.

"Small businesses are important players in the U.S. economy" (SBA Office of Advocacy, 2004). As shown in Figure 2-1, 9 percent of both sole proprietorships and corporations earn annual receipts in the range of $50 to $100,000. Although 61 percent of corporations generate $100,000 or more while 64 percent of sole proprietorships report receipts of under $25,000, there are more than three times as many sole proprietorships as corporations: 18.3 million compared with 5.1 million. Thus, their contribution to the economy is substantial.

Figure 2-1 Sole Proprietorship and Corporate Receipts, 2004

Percent

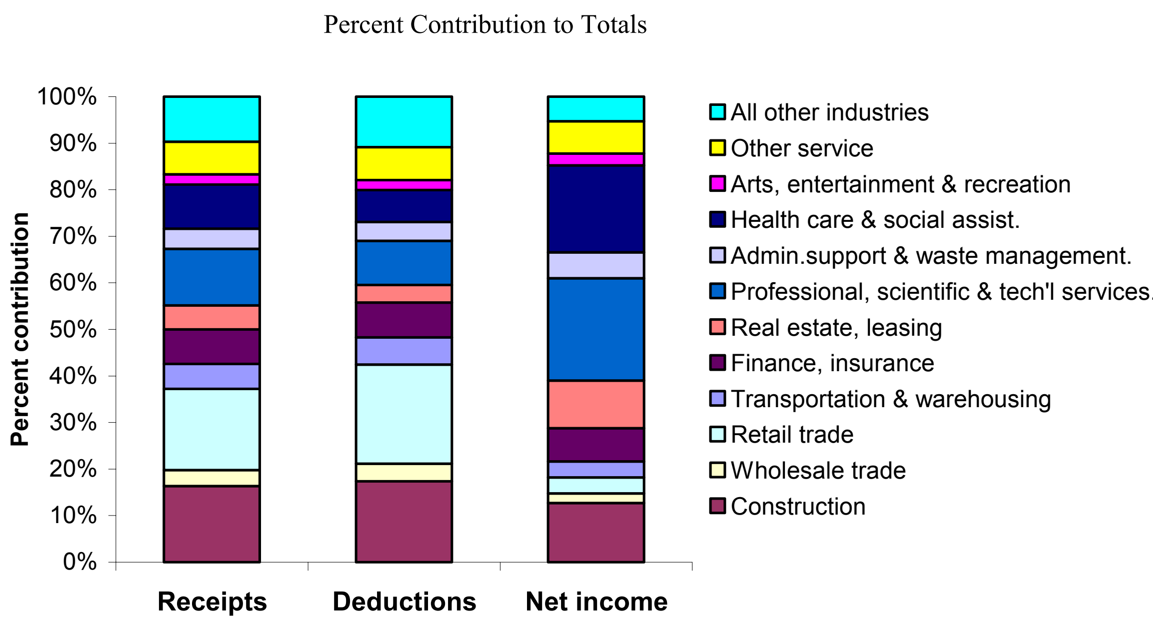


In addition, small businesses "represent about half of its output, employ about half of the private sector work force, fill niche markets, innovate, increase competition, and give individuals in all life circumstances a chance to succeed. Individual small businesses in various industries face a wide array of business conditions, and they tackle them with unique solutions using their diverse resources, with a range of outcomes. Many business owners are content to maintain a thriving business, but have no desire to expand; a few foster exceptional growth, with a large impact on the economy" (SBA Office of Advocacy, 2004).

In 2002, sole proprietorships with and without net income reported $1,029.7 billion in total business receipts, but the industrial sectors did not contribute equally (Pierce and Parisi, 2002). There are several ways to examine the contribution of these relatively small firms. First, how did the sectors contribute to the whole? As shown in Figure 2-2, construction and retail trade led in total receipts; they also accounted for the largest percentage deductions. However, the professional, scientific and technical services, and health care and social assistance as a group led in percent contribution to total net income.

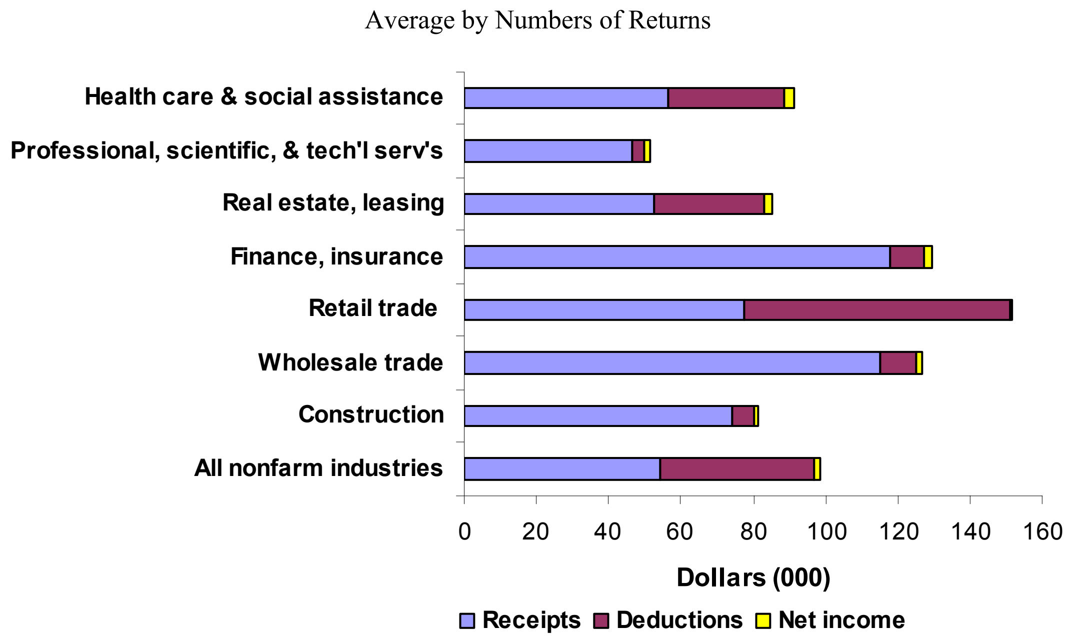
Figure 2-2 Total Receipts, Deductions and Net Income by Selected Industries

All sole proprietorships with and without net income



In 2002, the number of firms in each sector varied from 2.7 million professional, scientific and technical services to 308,000 in wholesale trade. Examining each sector individually shows that high revenues do not automatically mean high profitability. Firms with the highest average revenues were finance, wholesale trade, retail and construction (Figure 2-3). Retail trade took the highest deductions followed by health care and social assistance, real estate, renting and leasing and wholesale trade. But the sectors averaging the highest net income were finance and insurance (which reported few deductible expenses), real estate, professional, scientific, and technical services, and health care and social assistance.

Figure 2-3 Leading Sectors by Receipts, Deductions and Net Income
All sole proprietorships with and without net income



Although finance and insurance firms lead both in receipts and net income, their overall contribution to the economy is small due to their relatively small number.

The Home as a Business Location

Over half of small businesses are operated in or from homes.

Beginning with the Industrial Age, the home was viewed as a residential haven physically separated from commerce. Business was big business carried out in factories and office buildings. Business entities in the home were considered "mom and pop" operations with negligible contributions to the economy. Much has changed. Salvatore Sodano, Chairman and CEO of the American Stock Exchange, calls small businesses "the rock on which the U.S. economy is built" (Sodano, 2004). Over half of all small business owners, 52 percent, conduct a business in or from their home.[4] As of 2002, the 1.6 million businesses that took a home office deduction earned $102 billion in receipts and reported net income of just under $37 billion.

Homebased businesses occur in every industry, but the nature of the business activity limits the choice of location. In this research sample, as Table 2-1 shows, 45

[4] Includes sole proprietorships, partnerships and Subchapter S Corporations

percent of firms are homebased (they take the home office deduction). The percentage of businesses in each industry that are homebased ranges from 65 percent in administrative support and waste management-- firms doing computer work, for example-- to 13 percent in accommodation, food services places where, with the exception of bed and breakfasts, business is conducted in non-homebased locations. Looking at their relative contribution to the total homebased sector, homebased firms are concentrated in professional, scientific and technical services (478,000 or 21.8 percent of all), health care and social assistance (302,000 or 13.8 percent), construction (256,000 or 11.7 percent) and retail (244,000 or 11.1 percent). Leading sectors of businesses located in rented property, are all other services (523,000, or 19.8 percent), retail trade (471,000 or 17.8 percent), and professional, scientific and technical services (366,000 or 13.8 percent).

Table 2-1 Sample Distribution by Location and Contribution to All Industries[1]

Homebased and non-homebased businesses with and without net income

	NUMBER OF RETURNS (THOUSANDS)		% HOMEBASED LOCATION	% CONTRIBUTION TO ALL INDUSTRIES	
	HBB	NON-HBB	HBB	HBB	NON-HBB
ALL INDUSTRIES	2,195	2,648	45	100	100
AGRICULTURE	15	23	39	0.7	0.9
MINING	3	5	38	0.1	0.2
UTILITIES	--	--	--	--	--
CONSTRUCTION	256	187	58	11.7	7.1
MANUFACTURING	46	55	46	2.1	2.1
WHOLESALE TRADE	50	42	54	2.3	1.6
RETAIL TRADE	244	471	34	11.1	17.8
TRANSPORTATION & WAREHOUSING	57	75	43	2.6	2.8
INFORMATION	33	19	63	1.5	0.7
FINANCE & INSURANCE	67	143	32	3.1	5.4
REAL ESTATE & RENTAL & LEASING	122	106	54	5.6	4.0
PROFESSIONAL, SCIENTIFIC & TECH'L	478	366	57	21.8	13.8
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	177	96	65	8.1	3.6
EDUCATIONAL SERVICES	43	41	51	2.0	1.5
HEALTH CARE & SOCIAL ASSISTANCE	302	257	54	13.8	9.7
ARTS, ENTERTAINMENT & RECREATION	128	123	51	5.8	4.6
ACCOMMODATION, FOOD SVCS. PLACES	17	116	13	0.8	4.4
ALL OTHER SERVICES	157	523	23	7.2	19.8

Industries may not sum to 100 percent due to omitted sectors and rounding

[1] Unless otherwise noted, this and following tables exclude returns without a home office deduction and those taking deductions for both a home office and rent.

CHAPTER 3: HOMEBASED AND NON-HOMEBASED BUSINESSES

Firms with Net Income

Major Industries

Sector Contribution

The greatest number of all sole proprietorships is professional, scientific and technical services, firms that also gain the highest net income.

Homebased businesses are found in every sector of the economy except utilities but the sector contributions to industry as a whole differ in number of returns, gross revenues and net income. Table 3-1 compares the number of firms and total receipts and net income of profitable homebased and non-homebased businesses in each major industry.

Table 3-1 Total Returns, Receipts and Net Income by Industry

Homebased and non-homebased businesses with net income

Dollar Contribution to Totals

RETURNS IN THOUSANDS DOLLAR AMOUNTS IN MILLIONS	RETURNS		$ RECEIPTS		$ NET INCOME	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
ALL INDUSTRIES	1,616	1,882	101,530	336,025	36,614	72,107
AGRICULTURE	8	13	1,039	2,286	137	273
MINING	3	3	302	861	179	114
CONSTRUCTION	218	149	25,654	33,899	5,078	4,302
MANUFACTURING	36	33	1,823	8,155	540	1,124
WHOLESALE TRADE	35	31	3,847	13,931	1,418	1,110
RETAIL TRADE	112	261	7,049	79,554	1,795	5,777
TRANSPORTATION & WAREHOUSING	50	56	4,868	8,203	897	1,250
INFORMATION	24	15	861	1,761	413	373
FINANCE & INSURANCE	54	116	4,372	21,133	1,955	7,256
REAL ESTATE & RENTAL & LEASING	99	86	7.050	11,139	3,850	3,876
PROFESSIONAL, SCIENTIFIC & TECH'L	369	260	20,984	43,504	10,816	15,428
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	138	68	7,017	10,172	2,516	1,777
EDUCATIONAL SERVICES	31	27	775	1,293	433	420
HEALTH CARE & SOCIAL ASSISTANCE	231	221	6,850	49,770	3,023	19,693
ARTS, ENTERTAINMENT & RECREATION	87	53	3,349	4,643	1,660	1,360
ACCOMMODATION, FOOD SVCS. PLACES	12	69	1,057	16,606	113	1,442
ALL OTHER SERVICES	109	421	4,633	29,115	1,791	6.530

Industries may not sum to 100 percent due to omitted sectors and rounding

The 1.89 million profitable non-homebased firms earned three times the receipts, $336 billion, but only twice, $72 billion, in net income as HBBs (Table 3-1). Homebased businesses draw most of their receipts from two sectors, construction and professional, scientific and technical services; non-homebased firms gain primarily from retail trade. Net income is highest for HBBs in professional services and for non-HBBs, in health care and social assistance. Professional, scientific and technical services are the most numerous type of homebased business and also account for nearly one-third of total net income. But the industry is an exception. Other popular sectors such as construction and health care have much lower net incomes.

Table 3-2 and Figures 3-1 and 3-2 show the relative contributions of each industry in percentage terms. The most numerous profitable homebased firms are professional, scientific and technical services (22.8 percent), health care and social assistance (14.3 percent) and construction (13.5 percent). But construction contributes one quarter of gross receipts (25.3 percent) and professional services, 29.5 percent of net income.

Table 3-2 Total Returns, Receipts and Net Income by Industry

Homebased and non-homebased businesses with net income

Percent Contribution to Totals

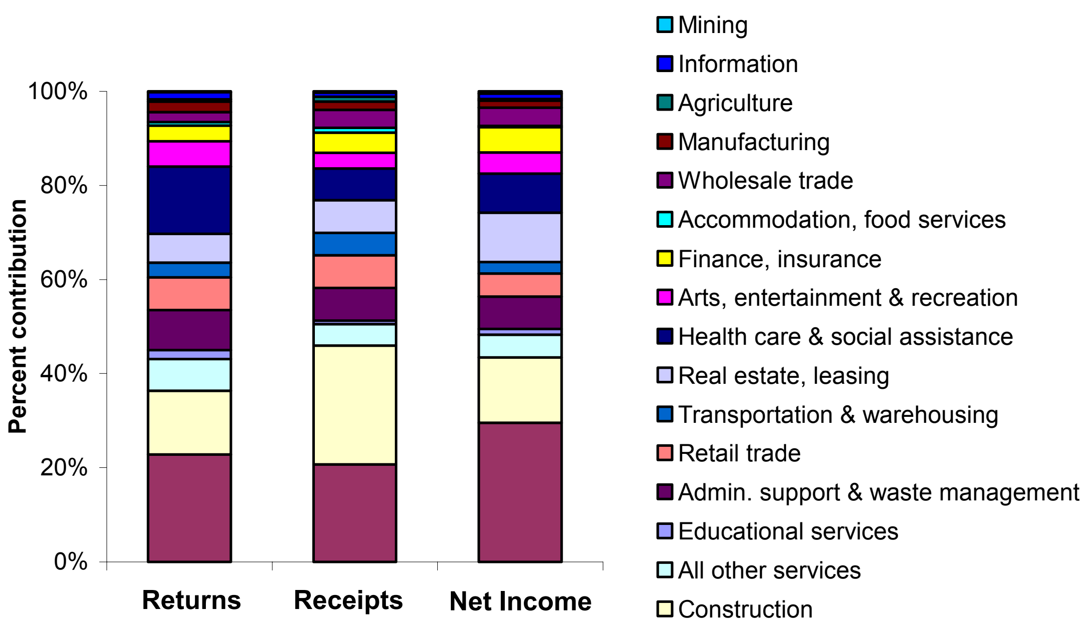
	RETURNS		RECEIPTS		NET INCOME	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
ALL INDUSTRIES	100	100	100	100	100	100
AGRICULTURE	0.5	0.7	1.0	0.7	0.4	0.4
MINING	0.2	0.2	0.3	0.3	0.5	0.2
CONSTRUCTION	13.5	7.9	25.3	10.1	13.9	6.0
MANUFACTURING	2.2	1.8	1.8	2.4	1.5	1.6
WHOLESALE TRADE	2.2	1.6	3.8	4.1	3.9	1.5
RETAIL TRADE	6.9	13.9	6.9	23.7	4.9	8.0
TRANSPORTATION & WAREHOUSING	3.1	3.0	4.8	2.4	2.5	1.7
INFORMATION	1.5	0.8	0.8	0.5	1.1	0.5
FINANCE & INSURANCE	3.3	6.2	4.3	6.3	5.3	10.1
REAL ESTATE & RENTAL & LEASING	6.1	4.6	6.9	3.3	10.5	5.4
PROFESSIONAL, SCIENTIFIC & TECH'L	22.8	13.8	20.7	12.9	29.5	21.4
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	8.5	3.6	6.9	3.0	6.9	2.5
EDUCATIONAL SERVICES	1.9	1.4	0.8	0.4	1.2	0.6
HEALTH CARE & SOCIAL ASSISTANCE	14.3	11.7	6.7	14.8	8.3	27.3
ARTS, ENTERTAINMENT & RECREATION	5.4	2.8	3.3	1.4	4.5	1.9
ACCOMMODATION, FOOD SVCS. PLACES	0.7	3.7	1.0	4.9	0.3	2.0
ALL OTHER SERVICES	6.7	22.4	4.6	8.7	4.9	9.1

Industries may not sum to 100 percent due to omitted sectors and rounding

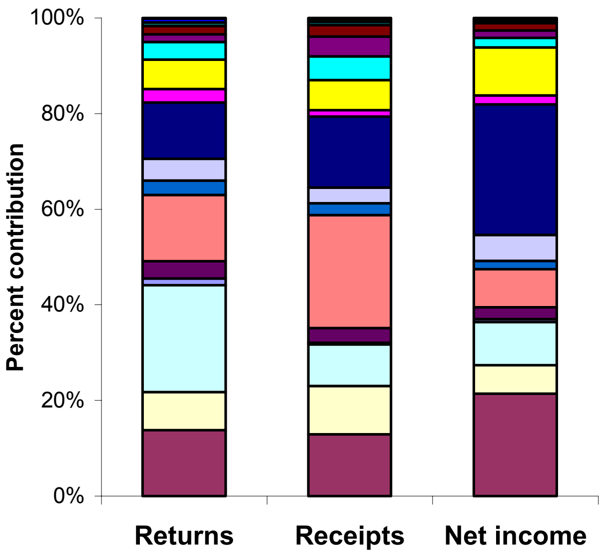
Figures 3-1 and 3-2 Returns, Receipts and Net Income by Industry

Percent Contribution to Totals

Homebased sole proprietorships with net income



Non-homebased sole proprietorships with net income



Most non-homebased firms, with the exception of all other services (22.4 percent), are evenly clustered in retail trade (13.9 percent) and professional services

(13.8 percent). Retail contributes nearly one-fourth of gross receipts (23.7 percent) while health care accounts for over one-fourth of net income (27.3 percent).

Industry Sub-Sectors

The most profitable homebased sub-sectors are those in travel accommodation such as bed and breakfasts and wholesale trade, particularly non-durable and durable goods. The most profitable non-homebased sub-sectors are in ambulatory health care services, legal services, miscellaneous manufacturing, insurance and securities.

Clearly homebased and non-homebased firms make major contributions to the economy as a whole, $871 billion in receipts, including the sample of HBB and non-HBBs and those not qualified for this study. But what are the outcomes of operating a homebased rather than a non-HBB for the average business owner? The answer is found by examining sub-sectors of the major industries, because the impact for individuals is influenced dramatically by the sub-sector in which they choose to do business.

Concentrations of homebased and non-homebased businesses in sub-sectors of each industry are shown in Table 3-3. Sub-sectors are listed by their percent contribution in number of tax returns to each industry and by their average receipts, deductions and net income. Three industries individually contribute little to either homebased or non-homebased total tax returns: agriculture, mining and education. Although, as described, there are a few homebased sole proprietorships in each, they are omitted from Table 3-3 and dropped from further analysis.

Agriculture, forestry, hunting & fishing

Homebased firms in nonfarm agriculture are found in forestry and logging (41.9 percent), fishing (34.4 percent) and support activities for the industry (19.3 percent). The majority of those operated in rented quarters involve fishing (51.3 percent).

Mining

Not surprisingly, few homebased and non-homebased businesses are found in the mining industry. What roles do these businesses play? Oil and gas extraction accounts for 69.7 percent of the homebased firms and 84.8 percent of those operated outside the home. The balance, 30.0 percent and 13.6 percent, respectively, involves support activities for mining.

Education

As expected, there are no sub-sectors within education, an industry staffed largely by employees rather than by the self-employed.

Construction

Over 13 percent of all homebased and nearly 8 percent of non-homebased businesses are found in the construction industry. As Table 3-3 shows, within the construction sector, three-quarters of both homebased and non-homebased firms are specialty trade contractors, with $99,000 and $190,000 in average receipts, respectively. Because non-HBBs have much higher deductions, $163,000 compared with $75,000, the average net income for each is comparable, $23,000 for HBBs and $27,000 for businesses operated outside the home.

Heavy and civil engineering firms have the highest average net income whether homebased or not, that is, about $35,000. Non-homebased residential builders also earn $34,000 in net income but homebased firms earn less, $23,000.

Manufacturing

The types of manufacturing that occur in homes include fabricated metal products (13 percent of homebased manufacturing) and wood products (12.0 percent). The businesses would include blacksmiths or furniture makers who have their shops on their property. Surprisingly, apparel represents only 7.5 percent of the homebased and 5.0 percent of non-homebased manufacturing.

The number of homebased cooks (under Other) also is miniscule, accounting for only one percent contribution to the sector but the average net income is relatively high, $36,000 compared with $33,000 for non-homebased food products. As shown, except for food and furniture products, non-homebased firms show substantially higher net incomes than those that are operated from home. Printing and related support activities and miscellaneous manufacturing, for example, both have high concentrations of homebased businesses but they report net incomes of $8,000 compared with $19,000 for non-homebased firms and $14,000 compared with $78,000.

Other miscellaneous manufacturing includes diverse products such as textiles, paper products, petroleum products, electrical equipment, transportation equipment and medical equipment.

Wholesale trade

As shown, 37 percent of both homebased and non-homebased businesses engaged in wholesale trade, deal in durable goods including machinery, woods, metals, etc. However, more homebased firms are agents, brokers or some other aspect of wholesaling electronics (35.1 percent) and more non-homebased firms sell nondurable goods including food fiber, chemicals, etc. (45.7 percent). Wholesale trade is the only sector in which homebased firms consistently make higher net incomes than firms operated in rented quarters. Sellers of durable goods, for example, report an average of $47,000 if they are homebased compared with $39,000 if they are not.

Retail trade

As expected, non-store retailers account for nearly half of homebased businesses in the retail industry. A few operate storefront bookstores, electronics, home furnishings and even motor vehicle and parts stores from their homes, possibly living upstairs or in other quarters on the property. Notably, the relatively few motor vehicle dealers and building material and garden dealers make twice the net income if they are homebased.

Transportation & warehousing

Homebased firms in the transportation and warehousing industry tend to be long distance (41.1 percent) and local truckers (30.3 percent). Sixteen percent are couriers and messengers and 8 percent are taxi drivers. More of the non-homebased firms perform long distance trucking (43.9 percent) rather than local trucking (18.0 percent). More offer taxi service (15.2 percent) and fewer are couriers (8 percent). The net income earned by a HBB is similar for local ($22,000) and long distance ($18,000) trucking.

Information

Despite the association of working at home being enabled by technologies of the information age, the amount of information sector work is extremely small. The 24,153 businesses represent only 1.5 percent of all homebased firms. There are even fewer non-HBBs, 15,021. This is partly because the North American Industry Classification System (NAICS) classification system limits the information sector to communication and the Internet. Even so, HBBs are surprisingly underrepresented. For example, there were only 30 sole proprietorship returns for Internet publishing and broadcasting, a sector, which appears particularly suited to homebased business.[5] Publishing industries except Internet account for nearly half of the HBBs in this industry, compared with 13 percent of non-HBB. Non-HBBs are more likely to provide motion picture & sound recording (53 percent). Within the information sector other broadcasting (except Internet) and telecommunications earns the highest receipts ($116,000), even higher than non-HBBs ($78,000) and also higher net income ($39,000 HBB versus $27,000 non-HBB). However, only 2 percent of information HBBs conduct business in this niche.

[5] The estimates should be used with caution because they are based on very small sample sizes.

Table 3-3 Returns, Receipts, Deductions and Net Income
Homebased and non-homebased businesses in selected sub-sectors

Industries may not sum to 100 percent due to omitted sectors and rounding

$ AVERAGE/TAX RETURN IN THOUSANDS	% RETURNS IN SECTOR		$ RECEIPTS		$ DEDUCTIONS		$ NET INCOME	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
ALL INDUSTRIES			63	178	38	140	23	38
CONSTRUCTION	100	100						
SPECIALTY TRADE	75	74	99	190	75	163	23	27
RESIDENTIAL	18	16	185	367	162	333	23	34
NON-RESIDENTIAL	5	6	128	277	112	246	16	32
HEAVY & CIVIL ENGINEERING	2	4	188	245	153	211	35	34
MANUFACTURING	100	100						
PRINTING	20	14	24	174	16	154	8	19
MISCELLANEOUS	17	4	47	424	34	346	14	78
FABRICATED METAL	13	10	56	352	43	308	13	43
WOOD PRODUCTS	12	10	33	78	24	65	9	13
APPAREL	8	5	53	332	35	303	18	29
FURNITURE PRODUCTS	5	11	61	258	40	218	21	40
MACHINERY	3	13	83	211	36	178	47	34
OTHER	23	34	77	150	57	123	20	27
WHOLESALE TRADE	100	100						
DURABLE GOODS	37	37	126	482	79	443	47	39
ELECTRONICS	35	17	65	242	38	226	27	16
NON-DURABLE GOODS	28	46	142	508	94	466	48	41
RETAIL TRADE	100	100						
NONSTORE RETAILERS	49	14	41	108	31	95	10	13
MISCELLANEOUS	17	27	82	162	63	143	20	19
SPORTING GOODS, HOBBY, BOOK STORES	6	8	79	170	66	151	13	20
ELECTRONICS STORES	6	3	70	369	48	341	22	27
BUILDING MAT'L & GARDEN DEALERS	5	3	94	374	53	363	42	21
HOME FURNISHINGS	5	4	66	310	48	282	19	28
CLOTHING STORES	4	11	67	233	51	208	16	25
MOTOR VEHICLE & PARTS	2	10	153	660	104	637	49	23
OTHER RETAIL	5	23	114	508	98	479	17	29
TRANSPORTATION & WAREHOUSING	100	100						
GENERAL FREIGHT, TRUCKING, LONG DISTANCE	41	44	117	168	99	146	18	22
GENERAL FREIGHT TRUCKING, LOCAL	30	18	110	179	88	153	22	27
COURIERS & MESSENGERS	16	8	59	101	42	87	17	15
TAXI & LIMO	8	15	34	43	27	29	7	13
SUPPORT ACTIVITIES	0	9	0	160	0	130	0	30
OTHER	5	5	84	208	71	170	14	38
INFORMATION	100	100						
OTHER PUBLISHING	46	13	31	320	17	278	15	42
MOVIE & SOUND RECORDING	31	53	40	102	20	76	20	26
INTERNET SERVICE PROVIDERS	21	12	30	67	14	58	16	9
OTHER BROADCASETING & TELECOM	2	15	116	78	77	51	39	27
INTERNET PUBLISHING & BROADCASTING	0	6	0	10	0	6	0	4
FINANCE & INSURANCE	100	100						

INSURANCE AGENTS, BROKERS & RELATED	56	75	69	150	32	88	36	63
CREDIT INTERMEDIATION	23	7	76	232	36	174	39	58
SECURITIES, COMMODITY	21	18	118	294	87	231	31	63
REAL ESTATE & RENTAL & LEASING	100	100						
REAL ESTATE AGENTS	86	80	70	120	32	71	38	48
OTHER REAL ESTATE	10	9	74	157	29	111	45	46
RENTAL & LEASING	3	7	93	243	56	214	38	29
REAL ESTATE LESSORS	1	4	70	69	28	57	42	13
PROFESSIONAL, SCIENTIFIC & TECH'L	100	100						
MANAGEMENT, SCI. & TECH'L CONSULTING	27	13	71	105	28	59	42	46
OTHER SERVICES	19	17	69	170	40	129	28	41
ACCOUNTING SERVICES	15	15	30	126	16	81	14	45
ARCHITECTURE & ENGINEERING	13	9	55	195	27	152	27	43
COMPUTER SYSTEMS DESIGN	10	5	41	114	20	54	21	60
SPECIALIZED DESIGN	9	5	59	131	31	101	28	30
LEGAL SERVICES	7	37	53	210	22	124	31	86
ADMINISTRATIVE SUPPORT, WASTE MAN. MANAGEMENT	100	100						
ADMINISTRATIVE SUPPORT	99	97	51	149	32	123	18	26
HEALTH CARE & SOCIAL ASSISTANCE	100	100						
CHILD DAYCARE	68	9	22	37	14	28	9	9
AMBULATORY HEALTH CARE SERVICES	22	83	54	263	25	158	29	105
RESIDENTIAL CARE, SOCIAL ASSISTANCE	10	8	28	51	18	35	10	16
ARTS, ENTERTAINMENT & RECREATION	100	100	38	87	19	62	19	25
ACCOMMODATION, FOOD SVCS. PLACES	100	100						
FOOD SERVICES & DRINKING PLACES	83	91	85	252	75	231	10	21
ROOMING & BOARDING HOUSES	8	3	121	118	113	93	8	24
RV PARKS	8	2	11	117	9	82	2	35
TRAVEL ACCOMMODATION	1	4	694	187	630	165	64	22
ALL OTHER SERVICES	100	100						
PERSONAL & LAUNDRY SERVICES.	47	78	39	49	20	35	19	14
MISCELLANEOUS REPAIRS	45	9	45	127	30	106	15	21
AUTO REPAIR	8	13	54	153	40	133	15	21

Finance & insurance

Insurance agents account for the highest participation in finance and insurance, 56 percent of HBBs and 75 percent of those operating in rented space. There is a substantial advantage in operating outside the home both in sales and net income. Non-homebased agents earn $63,000 net income compared with $36,000 HBBs.

Real estate & rental & leasing

Most of the 99,400 businesses in the Real Estate sector are offices of real estate agents, brokers, property managers and appraisers. Nearly 86,000 are homebased and together earn a net income of $3.3 billion dollars. However, the average net income is $38,000, less than the $48,000 gained by firms in rented facilities. Only the 9,000 homebased firms engaged in undefined other real estate activities showed nearly equivalent net income as the 7,800 non-homebased firms ($45,000 versus $46,000). Although homebased rental and leasing services earned higher net income ($38,000) than firms that were non-homebased ($29,000), there were only 3,000 in number. Most of those operated as general rental centers and other consumer goods rental.

Professional, scientific & technical services

Consulting services earns the highest average receipts, $71,000, of the professional, scientific and technical services industry. Net income averages $42,000. But that is still less than those businesses make operating in rented facilities which average $105,000 in receipts and $46,000 net income. Much larger differentials exist for other sub-sectors,. Legal services, for example, has only 7 percent of HBBs in the industry but 37 percent of non-HBB. Both receipts and net income are considerably lower for HBBs.

Administrative support & waste management

The administrative support and waste management industry is the fourth most popular industry in which to operate a HBB, but the inclusion of waste management is misleading. Ninety-nine percent of homebased firms and 97 percent of non-homebased businesses in this sector engage in administrative support.

Health care & social assistance

Health care and social assistance is the third most popular homebased and also non-homebased business in terms of number of returns with net income. However, 68.1 percent of businesses operated in homes and the few non-HBBs earn very low average incomes ($9,000) operating child day care services. Businesses located in rented facilities are doctors' offices including physicians, mental health specialists, dentists, chiropractors, optometrists and other health care services designed for ambulatory patients. They earn $105,000 net income, the highest of all sole proprietorships. A small amount of low income nursing and residential care and social assistance also is reported on sole proprietorship returns.

Arts, entertainment & recreation

Sole proprietorships in the arts, entertainment and recreation industry are concentrated in the performing arts, historical sites and similar institutions for 95 percent of homebased and 82.8 percent of non-homebased firms. The balance is in the amusement, gambling & recreation subsector, 4.3 percent if they are homebased; 17.2 percent if they are not. Businesses in the total sector report low receipts and net income, $38,000 and $19,000, respectively, if they are homebased and receipts and income of $87,000 and $25,000, if they are not.

Accommodation, food services & drinking places

Surprisingly homebased travel accommodation, including bed and breakfasts, represent only one percent of its parent industry. However, they report an average of $694,000 in sales and $64,000 in net income.[6] Eighty-three percent of HBBs and 91 percent of non-HBBs in this industry are food services and drinking places earning net incomes of only $10,000 and $21,000, respectively.

Other services

Homebased other services are roughly divided between personal and laundry services and miscellaneous repairs, while 78 percent of non-HBBs offer personal services. This is one of the rare subsectors in which HBBs report higher net income than do non-HBBs ($19,000 versus $14,000).

Additional sectors

Omitted from Table 3-3 are businesses classified as religious, grantmaking, civic professional and similar organizations and unclassified establishments that account for the remaining 0.2 percent of homebased and 9.8 percent of non-homebased firms.

Firms Reporting a Deficit

Firms that report net income are more likely to be operated in or from homes than firms showing a deficit. There are 584,474 homebased and 769,949 non-homebased businesses that generate $10 billion and $62 billion, respectively, in total receipts but report a net loss. One's home is used as a location for starting a business, but also as a permanent place to operate an established firm. Tax returns do not state how long the business has been in operation but we can assume at least some firms reporting a deficit are start-ups. The question is whether there are differences in the percent that are homebased, in deductions they take or other characteristics that can be identified from the tax returns.

Table 3-4 gives the percent of businesses with and without net income that take a home office deduction, that is, the share of total firms that are HBBs and not non-HBBs. Without longitudinal data we cannot say definitively that businesses move out of the home into leased space when they begin making a net income as one might predict. But unexpectedly, based on the tax data, the opposite appears to be true. Firms that report net income are more likely to be operated in or from homes than firms showing a deficit (46 versus 43 percent for all industries.). Comparing the two data columns, the percent of successful businesses that are homebased is less than those with net losses only for wholesale and retail trade, information, health care and

[6] The estimates should be used with caution because they are based on a sample of only 124 returns.

social assistance and other services. Even in those industries, some sub-sectors, for example, non-durable goods and miscellaneous repairs that show net income are more, not less apt to be homebased rather than non-homebased than those taking a loss. Table 3-4 reveals several surprises: non-store retailers are more likely to be non-homebased if they have net income and legal services that make a profit are more likely, not less, to be homebased (22 versus 15 percent).

Sector Contribution

Retail trade, which shows a small loss, and professional, scientific and technical services, which has the greatest loss, contribute the largest number of returns to all sole proprietorships without net income.

The most numerous profitable sole proprietorships are professional, scientific and technical services, firms that also gain the highest net income. In contrast, retail trade accounts for 22 percent of all sole proprietorships without net income, contributes the largest share of receipts, 21.8 percent, and is responsible for a relatively small share, 2.5 percent, of the overall loss.

Homebased firms showing highest gross receipts but a net loss, are in the finance and insurance, and transportation industries; non-homebased firms are in finance and insurance, construction and wholesale trade.

The numbers of businesses reporting a loss are too few to provide data on many of the sub-sectors shown in Table 3-3 (Firms with Net Income). The averages for all firms, including those not listed, are \$18,000 and \$80,000 in receipts for HBBs and non-HBBs, respectively. Table 3-5 shows that the homebased sub-sectors reporting the highest revenues—but still taking a loss—are found in the finance and insurance and transportation and warehousing.

Table 3-4 Homebased Businesses by Income and Industry Sub-Sectors

Homebased Firms as a Percent of Total Firms

	RETURNS WITHOUT NET INCOME PERCENT HBB	RETURNS WITH NET INCOME PERCENT HBB
ALL INDUSTRIES	**43**	**46**
CONSTRUCTION	**50**	**59**
SPECIALTY TRADE	53	60
RESIDENTIAL	47	61
MANUFACTURING	**31**	**52**
PRINTING	0	61
WHOLESALE TRADE	**58**	**53**
DURABLE GOODS	64	53
ELECTRONICS	63	47
NON-DURABLE GOODS	35	41
RETAIL TRADE	**39**	**30**
NONSTORE RETAILERS	70	60
MISCELLANEOUS RETAILERS	18	22
TRANSPORTATION & WAREHOUSING	**25**	**47**
GENERAL FREIGHT, TRUCKING, LONG DISTANCE	36	45
GENERAL FREIGHT TRUCKING, LOCAL	20	60
INFORMATION	**67**	**62**
FINANCE & INSURANCE	**32**	**32**
INSURANCE AGENTS, BROKERS & RELATED	45	26
CREDIT INTERMEDIATION	18	63
SECURITIES, COMMODITY	32	35
REAL ESTATE & RENTAL & LEASING	**54**	**54**
REAL ESTATE AGENTS	56	56
OTHER REAL ESTATE	55	55
PROFESSIONAL, SCIENTIFIC & TECHNICAL SVCS.	**51**	**59**
MANAGEMENT, SCI. & TECHN'L CONSULTING	51	75
OTHER PROFESSIONAL, SCIENTIFIC & TECHNICAL SVCS.	50	69
CERTIFIED PUBLIC ACCOUNTANTS	33	50
ARCHITECTURE & ENG'G.	45	67
COMPUTER SYSTEMS DESIGN	82	76
LEGAL SVCS.	15	22
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	**58**	**67**
HEALTH CARE & SOCIAL ASSISTANCE	66	51
CHILD DAYCARE	85	88
AMBULATORY HEALTH CARE SVCS.	40	21
ARTS, ENTERTAINMENT & RECREATION	37	62
ACCOMMODATION, FOOD SVCS. & DRINKING PLACES	**10**	**15**
FOOD SVCS & DRINKING PLACES	9	14
ALL OTHER SERVICES	**32**	**21**
PERSONAL & LAUNDRY SVCS.	31	13
MISC. REPAIRS	52	57

Similarly, the top earning non-homebased sub-sectors reporting a loss are found in finance and insurance, construction and wholesale trade. Typically, the remaining homebased industries report average receipts of under $20,000/firm and losses of $2,000 – $9,000/firm (Table 3-5). Those non-homebased businesses show receipts primarily in the $4,000 - $60,000/firm range and losses in the teens. In every case except long distance trucking the average receipts, deductions and loss are greater for non-HBBs than for HBBs.

Table 3-5 Returns, Receipts, Deductions and Net Loss
Homebased and non-homebased businesses in selected sub-sectors

$ AVERAGE/TAX RETURN IN THOUSANDS	% RETURNS IN SECTOR		$ RECEIPTS		$ DEDUCTIONS		$ NETLOSS	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
ALL INDUSTRIES			18	80	23	93	5	13
CONSTRUCTION	100	100	46	178	53	195	6	17
SPECIALTY TRADE	73	66	32	184	39	201	6	17
MANUFACTURING	100	100	7	120	12	137	5	18
OTHER	34	12	16	160	20	175	4	15
WHOLESALE TRADE	100	100	19	193	25	213	7	20
DURABLE GOODS	61	45	10	178	19	199	9	20
RETAIL TRADE	100	100	11	92	16	104	5	12
NONSTORE RETAILERS	58	16	6	38	11	47	5	9
MISCELLANEOUS	15	42	12	45	17	54	6	9
TRANSPORTATION & WAREHOUSING	100	100	120	92	133	116	14	24
GENERAL FREIGHT, TRUCKING, LONG DISTANCE	69	41	117	116	133	127	16	10
INFORMATION	100	100	10	67	18	98	7	31
FINANCE & INSURANCE	100	100	134	181	144	204	10	23
INSURANCE AGENTS, BROKERS & RELATED	52	41	15	44	18	59	3	15
SECURITIES, COMMODITY	39	39	321	421	337	439	16	38
REAL ESTATE & RENTAL & LEASING	100	100	14	65	21	87	7	22
REAL ESTATE AGENTS	77	73	15	39	21	54	6	14
PROFESSIONAL, SCIENTIFIC & TECH'L	100	100	13	53	17	66	5	13
MANAGEMENT, SCI. & TECH'L CONSULTING	28	27	17	66	22	81	5	13
OTHER SERVICES	49	51	15	62	21	78	6	14
COMPUTER SYSTEMS DESIGN	49	6	7	76	10	93	3	16
LEGAL SERVICES	24	14	34	62	37	79	3	17
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	100	100	9	58	14	67	6	9
HEALTH CARE & SOCIAL ASSISTANCE	100	100	13	58	16	70	3	12
CHILD DAYCARE	58	20	12	44	14	53	2	9
ARTS, ENTERTAINMENT & RECREATION	100	100	6	22	10	33	3	11
ACCOMMODATION, FOOD SVCS. PLACES	100	100	19	113	25	129	5	16
OTHER SERVICES	100	100	8	41	11	47	3	6

Industries may not sum to 100 percent due to omitted sectors and rounding

Allocation of Deductible Expenses

Both homebased and non-homebased businesses as a whole allocate the largest percentage of resources to cost of sales.

How do small businesses allocate their expenses? Does it differ when homebased are compared with non-homebased firms? The dollar amount per return of total deducted costs is listed for selected industries in Table 3-3. However, to understand how small business owners spend their capital and revenues—irrespective of total resource size—we look next at allocation of costs on a percentage basis. First, line item deductions are grouped to highlight costs of business for labor, facilities, travel, marketing, overhead and miscellaneous expenditures as shown in Table 3-6.

Table 3-6 Allocation Categories of Deductible Expenses[1]

COST OF SALES AND OPERATIONS
- Inventory, beginning of year (35)
- Cost of labor (37)
- Purchases (36)
- Materials and supplies (38)
- Other costs (39)
- Inventory, end of year (41)

LABOR EXPENSE
- Salaries and wages (26)
- Pensions and profit-sharing plans (19)
- Employee benefit programs (14)

COMMISSIONS (11)

FACILITY COSTS
- Expenses for business use of home (30)
- Rent on other business property (20b)
- Utilities (25)
- Mortgage interest (16a)

MARKETING EXPENSE
- Advertising expenses (8)
- Meals and entertainment deducted (24b)

TRAVEL COSTS
- Travel (24a)
- Car and truck expense (10)

OVERHEAD COSTS
- Office expenses (18)
- Insurance (15)
- Legal and professional services (17)
- Repairs and maintenance (21)
- Supplies (22)
- Taxes and licenses paid (23)

OTHER BUSINESS EXPENSES (27)

MISCELLANEOUS
- Depletion (12)
- Depreciation (13)
  - Depreciation Form 8829 (home office)
- Other interest paid on business indebtedness (16b)
- Rent of machinery and equipment (20a)

[1]Schedule C Line number for each expense is in parentheses (See Appendix.)

Classification of expenses is explained in the *2002 Instructions for Schedule C, Profit or Loss from Business* (See Appendix for copy of Schedule C (Form 1040). Cost of goods sold (Part III of Form 1040) is completed by businesses in which "the production, purchase, or sale of merchandise was an income-producing factor." Costs are given for goods produced during the year 2002, which is determined by subtracting the ending from the beginning inventory. The costs include, for example, both labor and raw materials used in a manufacturing business. Labor expense for businesses that sell services but not goods is recorded under Part II, Expenses. To understand total labor costs, not associated with production of goods, pensions and profit-sharing plans and other employee benefit programs are grouped with salaries and wages. Similarly, facility costs include expenses for business use of your home (which requires attaching Form 8829), or rent on other business property plus utilities and any mortgage interest. Office expenses, insurance, legal and professional services, etc. are grouped under overhead costs.

Firms Reporting Net Income

Figure 3-3 summarizes the allocation of deductible expenses for all industries. Both homebased and non-homebased firms spend the bulk of their resources on cost of sales and operations (COS). In comparison with HBBs, non-HBBs allocate more than twice to labor expense but surprisingly similar percentages to commissions, facility costs, overhead costs and marketing. Table 3-7 provides the breakouts for the major industries.

Figure 3-3 Allocation of Deductible Expenses for All Industries with Net Income

Percent of Homebased or Non-homebased

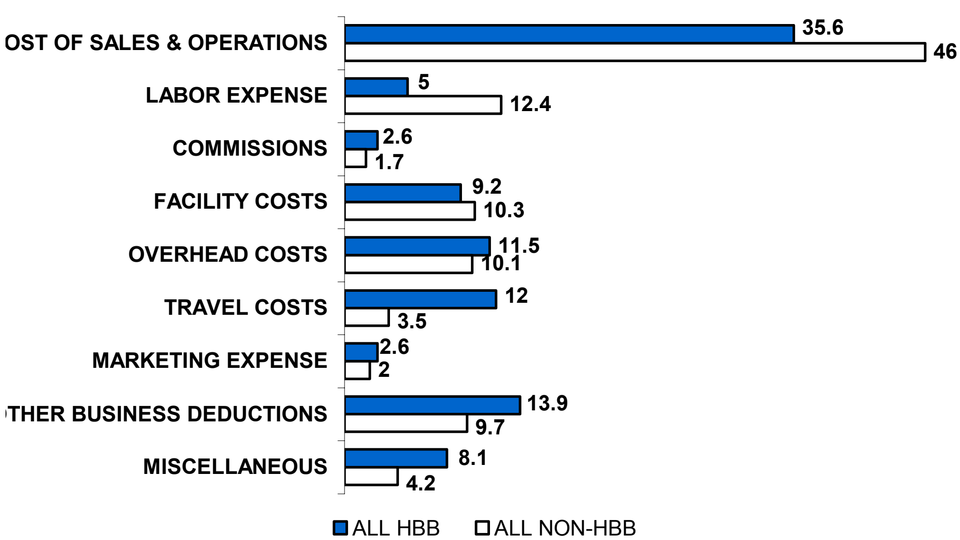


Table 3-7 Allocation of Deductible Expenses by Industry

Homebased and Non-Homebased Businesses with Net Income

Percent

	ALL		CONSTRUC-TION		MANUFAC-TURING		WHOLESALE TRADE		RETAIL TRADE		TRANSPOR-TATION		INFOR-MATION		FINANCE & INSURANCE	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
COST OF SALES & OPERATIONS	35.6	46	53.6	58.9	46.3	52.4	50.3	82.7	56.4	74.3	18.8	20.6	9.9	30.4	29.5	27.4
LABOR EXPENSE	5	12.4	6.5	8.9	*	11.5	*	3.1	2.3	5.5	2.8	9.4	19.5	13.4	3	14.9
COMMISSIONS	2.6	1.7	2.3	1	*	1.4	7	1	2	0.5	2.1	0.1	*	1.6	4.9	8.7
FACILITY COSTS	9.2	10.3	3.9	4.4	10	8.9	6.7	3	5.5	6.8	3.9	8.3	19.5	13.8	11.8	11.5
OVERHEAD COSTS	11.5	10.1	9.6	9.1	11.6	8.9	5.1	2.5	6	4.8	15.4	16	12.1	8.5	9.3	10.4
TRAVEL COSTS	12	3.5	7.2	3.7	9.9	3.2	12.2	1.9	11.1	1.4	21.7	15.2	20.6	5.8	16.1	6.6
MARKETING EXPENSE	2.6	2	0.9	0.9	1.5	1.5	3.1	0.7	2.1	1.2	2.4	1.8	3	2.1	5.7	3.7
OTHER BUSINESS DEDUCTIONS	13.9	9.7	10	8.1	7.2	7.2	8	3.3	9.3	3.6	14	15.5	13.3	13.6	14.1	12.4
MISCELLANEOUS	8.1	4.2	6	4.8	9.9	4.8	5.7	1.5	5.3	1.9	19.3	13.2	12.5	9.4	5.7	4.1

	REAL ESTATE, RENTAL		PROFESSION., SCIENTIFIC & TECH'L		ADMINI-STRATIVE - SUPPORT		HEALTH CARE & SOCIAL ASSISTANCE		ARTS, ENTERTAIN.& RECREATION		ACCOMMO-DATION & FOOD SVCS.		OTHER SERVICES	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
COST OF SALES & OPERATIONS	5.2	18.7	22.3	20.5	26.9	39.4	3.9	9.8	6.8	24.5	53.1	42.6	32.2	33.6
LABOR EXPENSE	2.4	6.5	4.1	19.1	6.5	14.9	7.6	29.1	1.8	7.7	*	17.8	4.9	11.1
COMMISSIONS	3.4	15.4	3.2	1.2	*	1.4	*	0.4	*	3.5	*	0.2	*	1.4
FACILITY COSTS	10.9	13.1	13.7	13.1	9.5	6.8	25.6	14.3	17.7	14.3	6.4	15.3	12.5	21.2
OVERHEAD COSTS	17	11.8	12.8	13.1	12.7	10.2	17.6	20.2	13.8	11.4	13.7	11	14.7	13.2
TRAVEL COSTS	20.4	7.6	14.1	5.3	14.1	5.5	9.4	2.5	16.9	6.9	4.3	1.3	14	3.7
MARKETING EXPENSE	10.5	7	3.5	3.5	2.7	1.6	2.2	2.2	4.5	3.2	1.8	1.8	2.2	1.6
OTHER BUSINESS DEDUCTIONS	20.3	13.3	19.1	19	14.8	14.6	25.2	15.6	24.6	22.2	4.1	6.3	10.6	9
MISCELLANEOUS	9.5	6.5	7.9	5.1	12.1	5.5	9.9	5.8	15	6.1	3	3.6	8.2	5.2

Columns may not sum to 100% due to rounding and omission of data based on small number of sample returns (*)

Cost of Sales and Operations

In all but a few industries the percent of all deductions allocated to the cost of sales and operations (COS) is less and in a few industries, very much less for homebased than for non-homebased businesses. In the aggregate for all industries, the COS is 35.6 percent for HBB compared with 46 percent for non-HBB (Tables 3-7). Broken out by major industries, the COS for homebased construction firms is somewhat less, 53.6 percent of total deductions compared with 58.9 percent for non-HBB, while wholesale trade is very much less, 50.3 percent compared with 82.7 percent. Information, real estate and rental and leasing and arts, entertainment and recreation, for example, also show large disparities between homebased and non-homebased firms. On the other hand, the percent allocated to COS expense is in the same range or a little higher for HBBs in transportation and warehousing, finance and insurance, professional, scientific and technical services and other services.

Facility Costs

Deductions for the space in which to operate a business are approximately the same for HBB and non-HBB firms. However, owners of homebased firms have the advantage of not having to raise or use available funds to pay rent. For all industries the deduction for facility costs is 9.2 percent of total deductions for firms that deduct a portion of the home dedicated solely to business use compared with 10.3 percent for firms that pay rent but do not take a HBB deduction (Table 3-7). The allocation of facility expenses to total deductions is even closer for construction, retail trade, finance and insurance, professional, scientific and technical services. The exceptions in which the deduction for business location represents a much larger percentage of the total deduction for HBB than non-HBBs are wholesale trade (6.7 percent versus 3 percent) and day care (31.1 percent versus 20.6 percent), which is in the health care and social assistance sector.

Labor Expense

Labor deductions are a lower percentage of total HBB compared with non-HBB costs across all industries. For all industries the difference is 5 percent HBB compared with 12.4 percent non-HBB. As shown in Table 3-7, for nearly every industry the differences in labor costs are substantial and, in fact, represent the key defining factor between homebased and non-homebased firms based on their Schedule C tax returns.

Commissions

In certain industries commissions represent a substantial portion of total labor expense. Generally, the percent of total deductions is much less for HBBs than for non-homebased firms: finance and insurance (4.9 percent HBB versus 8.7 percent non-HBB) and real estate and rental (3.4 percent HBB versus 15.4 percent non-HBB).

In most other sectors the allocation for commissions amounts at most to a few percent.

Overhead Costs

The percent of funds allocated to overhead costs such as office expense, insurance, legal and professional services, repairs, supplies and taxes, varies from 2.5 percent to 20.8 percent across industries. But overhead as a percentage of costs is surprisingly close for HBB and non-HBBs within a given sector, for example, construction, transportation, finance and insurance and most professional services. Overhead is a larger percentage deduction for homebased firms in manufacturing, wholesale trade, real estate and rental, architecture and engineering, and education. It is smaller only for the securities, health care and day care sectors.

Travel Costs

Travel costs, almost entirely due to car and truck expense, are consistently higher for homebased businesses. The far larger deduction can partly be explained by tax law that disallows costs of commuting to a non-homebased location, that is, travel to the place of business must be deducted from total miles driven. For total small businesses, travel costs are 12 percent of HBB deductions compared with only 3.5 percent of non-HBB (Table 3-7). Within sectors percentage travel costs are highest for homebased firms in transportation, 21.7 percent and real estate, 20.4 percent. Travel expense is surprisingly low for both homebased (7.2 percent) and non-HBB (3.7 percent) firms in construction.

Marketing Expense

Unexpectedly most HBB and non-HBBs write off the same percentage of total deductions for marketing costs. For all industries combined, marketing represents 2.6 percent of HBB deductibles and 2.0 percent of non-HBBs. The highest allocations are found in real estate, rental (10.5 percent versus 7 percent). Construction and manufacturing invest the least in marketing, that is, one percent or less, irrespective of business location.

Other Business Expense

Deductions under this catch-all category are consistently higher for most homebased in contrast to non-homebased firms. Exceptions of sectors that deduct the same percentages include manufacturing, professional, scientific and technical services and administrative and support services. For all industries the percent deduction is 13.9 percent for HBB and 9.7 for non-homebased but the allocation ranges from 29.5 percent for the homebased daycare subsector to 3.3 percent for non-HBB wholesale trade.

Miscellaneous Deductions

Grouped for convenience, this arbitrary category consists of deductions for depletion, depreciation and Form 8829 home office depreciation, other interest paid on business indebtedness and rent of machinery and equipment. HBBs also show higher allocations under this category than do non-HBBs, that is, 8.1 percent for all HBBs and 4.2 percent for non-HBBs. For most industries, depreciation accounts for the largest portion of miscellaneous deductions.

Firms Reporting a Deficit

Compared with homebased firms reporting net income, all firms with a deficit have slightly smaller COS, lower labor and commissions cost and higher facility and miscellaneous costs, but virtually the same deductions for overhead, travel, marketing and other deductions.

For firms reporting a deficit, obviously the total business deductions are greater than receipts. But are there differences in distribution of available funds that might suggest a start-up, rather than mature business? For example, is the percent of total deductions allocated to the costs of sales and operations different for businesses with no net income than for businesses showing a profit? Table 3-8 parallels Table 3-7 (firms with net income).

Compared with homebased firms reporting net income, all firms with a deficit have slightly smaller COS, lower labor and commissions cost and higher facility and miscellaneous costs, but virtually the same deductions for overhead, travel, marketing and other deductions.

Cost of sales and operations

Surprisingly the cost of sales and operations is quite similar for businesses that do and do not report net income. For all homebased businesses, COS is 34 percent for firms without; 35.6 percent for those with net income. Similarly, for non-HBBs, COS is 43 percent for businesses reporting a loss and 46 percent for income-generating firms.

Labor Expense

Homebased firms without net income allocate 2.1 percent of their total deductions to labor compared with 5 percent by profitable firms. Non-HBBs show a smaller difference, 10.5 percent and 12.4 percent, respectively (Tables 3-7 and 3-8). Allocations for commissions are lower for HBBs reporting deficits compared with profitable HBBs but about the same for non-HBBs.

Facility Costs

Compared with profitable firms, deductions for facility costs are surprisingly higher for both HBBs and non-HBBs with net losses, 12.7 percent (net loss) versus 9.2 percent (net income) and 11.1 percent versus 10.3 percent, respectively.

Table 3-8 Allocation of Deductible Expenses by Industry

Homebased and Non-Homebased Businesses without Net Income (Percent)

	ALL		CONSTRUC-TION		MANUFAC-TURING		WHOLESALE TRADE		RETAIL TRADE		TRANSPOR-TATION		INFOR-MATION		FINANCE & INSURANCE	
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB
COST OF SALES & OPERATIONS	34	43.0	41.7	54.6	22.3	47.9	46.3	67.8	40.5	61.4	*	9.3	*	16	*	32.3
LABOR EXPENSE	2.1	10.5	*	11.1	*	11.2	*	5.3	*	6.8	*	8.6	*	15.5	*	4.1
COMMISSIONS	1.8	1.4	*	2	*	1.4	*	2.7	1	0.6	*	0.9	*	6.6	*	2.5
FACILITY COSTS	12.7	11.1	6.2	4.3	18.1	10.5	9.7	5	11.4	10.9	2.3	8	20.7	13.5	*	4.5
OVERHEAD COSTS	11.7	9.1	12.2	9.8	*	9.6	2.3	5.6	10.5	6.6	17	15.9	7.8	8.6	2	2.9
TRAVEL COSTS	12.3	3.8	9.6	3.3	9.7	2.7	16.3	2.1	11.5	2.5	15.6	13.9	10.8	2.9	1.7	2.8
MARKETING EXPENSE	2.3	1.7	0.7	1	*	2	0,6	1.4	3.1	1.5	2.8	2.3	3.8	4.1	3.5	0.8
OTHER BUSINESS DEDUCTIONS	14.1	12.8	9.9	7.8	19.5	8	5.7	7.3	9.8	5.8	13.9	17.3	12.6	22.4	12.2	46.4
MISCELLANEOUS	9.9	6.3	11.2	5.8	*	6.3	4.8	2.7	11.6	3.8	8.6	23.8	8.4	9.6	0.5	3.6
BAD DEPTS FROM SALES, SVCS.	0.3	0.2	*	0.3	*	0.5	*	0.1	0.3	0.2	*	0.0	*	0.2	*	
	REAL ESTATE, RENTAL		PROFESSION., SCIENTIFIC & TECH'L		ADMINI-STRATIVE - SUPPORT		HEALTH CARE & SOCIAL ASSISTANCE		ARTS, ENTERTAIN.& RECREATION		ACCOMMO-DATION & FOOD SVCS.		OTHER SERVICES			
	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB	HBB	NON-HBB		
COST OF SALES & OPERATIONS	*	14.2	14	33.4	20.7	30.4	*	6.7	7.5	10.2	*	37.8	24.1	33		
LABOR EXPENSE	*	9.9	*	15.7	*	21.5	*	30	*	8.3	*	15.2	*	9.8		
COMMISSIONS	1.5	15.7	2.6	1.2	*	1.2	*	0.3	*	0.7	*	0.2	*	1		
FACILITY COSTS	12.8	17.0	18	11	14.5	9.2	26	16.5	26.8	17.2	7.2	17.4	16.5	20.5		
OVERHEAD COSTS	13.8	11.9	13.5	9.3	12.5	11.8	17.4	17.6	12.9	14.2	*	12.3	24.3	11.7		
TRAVEL COSTS	17.5	5.1	18.3	6.2	20.5	6.7	9.1	3.4	15.4	8	*	1.3	11.1	4.5		
MARKETING EXPENSE	4.9	3.7	3.4	2	2.9	2.2	1.8	2.5	5.2	3.7	*	1.8	1.5	2.1		
OTHER BUSINESS DEDUCTIONS	19.8	9.6	19.6	15	13.6	10.4	23.8	15.2	15.1	22.6	*	7.3	9.6	11		
MISCELLANEOUS	15.6	12.6	9.7	5.9	6.3	6.4	10.4	7.5	14	14	*	6.7	9.5	6.2		
BAD DEPTS FROM SALES, SVCS.	*	0.3	*	0.3	*	0.1	*	0.3	*	0.9	*	0	*	0		

Columns may not sum to 100% due to rounding and omission of data based on small number of sample returns (*).

The Bottom Line

Net Income

Homebased businesses earn higher net income than non-homebased firms in two industries, whole sale trade and other services. Across all industries, homebased firms show higher returns on gross receipts.

What factors are associated with higher net income? Tax laws are structured so that sole proprietors, unlike owners of incorporated businesses, do not pay themselves wages. Thus, net income, in effect, is proxy for the owner's salary. Economists argue over what self-employment income represents. "The major problem posed…is its allocation between its property and labor components. Some have argued that this distinction cannot be accomplished, that self-employment income is a mixture of the owner's labor, entrepreneurship and the capital employed in the business, none of which can be separated out" (Whiteman 1981). Working with tax returns, one measure of business achievement we can examine is return on receipts. What percent of return on sales does the HBB owner get to keep, compared with those in the same sector who operate in rented quarters?

As Table 3-9 shows, HBBs earn less in receipts than do non-HBBs. The differential ranges from 13 percent (health care and social assistance) to 67 percent (transportation and warehousing). For all industries, homebased businesses earn only 35 percent of non-homebased firms' gross receipts and 59 percent in net income. Although in every sector the receipts are lower, in two industries, wholesale trade and other services, HBBs report higher net income than do firms operating in rented space. In major industries the difference in net income ranges from HBBs earning 15 percent lower net income (health care and social assistance) to 111 percent more net income (wholesale trade) than non-HBBs. However, in several sub-sectors the ratio is considerably higher. For example, the ratios of HBB as a percent of non-HBB are 169 percent of wholesale electronics, 113 percent for couriers and messengers, and 136 percent for personal and laundry services.

However, the decision to operate a homebased rather than a non-HBB business becomes more rational when the relative returns on receipts are compared (data columns seven and eight). Homebased business owners retain more of what they take in from customers and clients. For HBBs the ratio of net income to receipts ranges from 11 homebased; 9 percent non-HBB (accommodation, food services) to 60 percent HBB; 44 percent non-HBB for management, science and technical consulting and 60 percent HBB versus 29 percent non-HBB for firms in other real estate. The difference is explained by non-HBBs having higher costs that appear on

Table 3-9 Net Income Return on Gross Receipts
Homebased and non-homebased businesses

$ AVERAGES/TAX RETURN IN THOUSANDS	$ RECEIPTS		RATIO HBB/ NON[1]	$ NET INCOME		RATIO HBB/ NON[1]	NET INCOME AS PERCENT OF RECEIPTS	
	HBB	NON-HBB		HBB	NON-HBB		HBB	NON-HBB
ALL	**63**	**178**	**35**	**23**	**38**	**59**	**36**	**22**
CONSTRUCTION	**117**	**226**	**52**	**23**	**29**	**79**	**20**	**13**
SPECIALTY TRADE	99	190	52	23	27	85	24	14
RESIDENTIAL	185	367	50	23	34	68	13	9
MANUFACTURING	**51**	**245**	**21**	**15**	**34**	**44**	**30**	**14**
PRINTING	24	174	14	8	19	42	33	11
WHOLESALE TRADE	**109**	**452**	**24**	**40**	**36**	**111**	**37**	**8**
DURABLE GOODS	126	482	26	47	39	121	37	8
ELECTRONICS	65	242	27	27	16	169	41	6
NON-DURABLE GOODS	142	508	28	48	41	117	34	8
RETAIL TRADE	**63**	**305**	**21**	**16**	**22**	**73**	**25**	**7**
NONSTORE RETAILERS	41	108	38	10	13	77	25	12
TRANSPORTATION & WAREHOUSING	**98**	**147**	**67**	**18**	**22**	**82**	**18**	**15**
GENERAL FREIGHT, TRUCKING, LONG DISTANCE	117	168	70	18	22	82	15	13
GENERAL FREIGHT TRUCKING, LOCAL	110	179	61	22	27	81	20	15
COURIERS & MESSANGERS	59	101	58	17	15	113	29	15
INFORMATION	**36**	**117**	**31**	**17**	**25**	**68**	**48**	**21**
OTHER PUBLISHING	31	320	10	15	42	36	46	13
FINANCE & INSURANCE	**81**	**182**	**45**	**36**	**62**	**58**	**45**	**34**
INSURANCE AGENTS, BROKERS & RELATED	69	150	46	36	63	57	53	42
CREDIT INTERMEDIATION	76	232	33	39	58	67	52	25
SECURITIES, COMMODITY	118	294	40	31	63	49	27	21
REAL ESTATE & RENTAL & LEASING	**71**	**130**	**55**	**39**	**45**	**87**	**55**	**35**
REAL ESTATE AGENTS	70	120	58	38	48	79	55	40
OTHER REAL ESTATE	74	157	47	45	46	98	60	29
PROFESSIONAL, SCIENTIFIC & TECHNICAL SVCS.	**57**	**167**	**34**	**29**	**58**	**50**	**52**	**35**
MANAGEMENT, SCI. & TECHN'L CONSULTING	71	105	68	42	46	91	60	44
OTHER PROFESSIONAL, SCIENTIFIC & TECHNICAL SVCS.	69	170	41	28	41	68	52	31
CERTIFIED PUBLIC ACCOUNTANTS	30	126	24	14	45	31	46	38
ARCHITECTURE & ENG'G.	55	195	28	27	43	63	50	22
COMPUTER SYSTEMS DESIGN	41	114	36	21	60	35	52	53
LEGAL SVCS.	53	210	25	31	86	36	58	41
ADMINISTRATIVE SUPPORT & WASTE MANAGEMENT	**51**	**151**	**34**	**18**	**26**	**69**	**36**	**17**
ADMINISTRATIVE SUPPORT	51	149	34	18	26	69	36	17
HEALTH CARE & SOCIAL ASSISTANCE	**30**	**225**	**13**	**13**	**89**	**15**	**44**	**40**
CHILD DAYCARE	22	37	59	9	9	100	38	25
AMBULATORY HEALTH CARE SVCS.	54	263	21	29	105	28	53	40
ARTS, ENTERTAINMENT & RECREATION	**38**	**87**	**44**	**19**	**25**	**76**	**50**	**29**
ACCOMMODATION, FOOD SVCS. & DRINKING PLACES	**88**	**242**	**36**	**10**	**21**	**48**	**11**	**9**
FOOD SVCS & DRINKING PLACES	85	252	34	10	21	48	11	6
OTHER SERVICES	**43**	**69**	**62**	**17**	**16**	**106**	**39**	**22**
PERSONAL & LAUNDRY SVCS.	39	49	80	19	14	136	48	29
MISC. REPAIRS	45	127	35	15	21	71	33	16
[1] HBB amount as percent ratio of Non-HBB								

the Schedule C tax form as total business deductions. But surprisingly, the difference between HBBs and non-HBBs is not found in the deductions for office space which, as was shown in Table 3-7, are remarkably similar, but largely in cost of sales and labor.

The determining reasons for the higher return on receipts for HBBs cannot be attributed to a single factor, at least as judged by tax returns. Homebased firms have the advantage of being able to deduct the cost of home office space without having to use business resources to pay for leased space. But that is not the total explanation. Earlier studies using the *Characteristics of Business Owners* 1992 data reported that within either women-owned or men-owned businesses, more of those operating non-homebased firms had profits greater than $10,000 (Pratt 1999). This finding was associated with a number of factors such as the main reason for being in business was to earn a primary rather than a secondary income, more hours were spent on the business and the business had more employees.

Comparison of Firms with and without Net Income

Most businesses showing a deficit average both lower expenses and lower receipts than firms with net income. The exceptions are construction, information, finance and insurance and real estate, which have equivalent costs but lower revenues.

Do firms without net income make lower revenues or spend more than profitable firms? Are there differences in how firms with and without net income spend their resources? As shown in Table 3-5, in the aggregate, compared with firms reporting net income, *all* businesses showing a deficit average much lower receipts ($18 versus $63,000 HBB; $80 versus $178,000 non-HBB.) They also report lower expenses ($23 versus $40,000 HBB; $93 versus $140 non-HBB. But there are remarkable exceptions in some sectors.

HBBs in information and health care and social assistance report lower revenues than profitable firms but have the same costs, resulting in a net loss. Two other industries report higher receipts than firms with net income but higher deductions result in deficits: Transportation and warehousing has higher receipts, $120 versus $98,000, and considerably higher costs, $133 versus $80,000; finance and insurance has both higher receipts, $134 versus $81,000, and deductions, $144 versus $81,000.

Generally, non-HBBs reporting a deficit show the same pattern of lower receipts and deductions but the exceptions are different from homebased firms. As shown in Table 3-10 non-HBB construction firms with a loss earn lower receipts but have equivalent deductions. Information reports lower receipts, $67 versus $117,000, and somewhat higher deductions, $98 versus $92,000. Finance and insurance reports the same receipts, about $182,000, but higher costs, $204 versus $119,000, resulting in a deficit. Finally, real estate has lower receipts $65 versus $130,000, but about equivalent costs, $85,000.

Table 3-10 also highlights percentage allocations to the major costs reported by each sector. Construction firms with net income allocate less to labor costs and somewhat more to COS than those taking a loss. Profitable information businesses allocate considerably more to COS and less to other business deductions.

Finance and insurance earns equivalent receipts but profitable businesses spend nearly four times more on labor and 2 1/2 times more on space to house employees while non-profitable firms devote close to 1/2 of costs to "other business deductions." This tax category might include, for example, business start-up costs including setting up a website and advertising. Real estate allocates somewhat more to COS, and less to labor and nearly half to unspecified miscellaneous costs.

Table 3-10 Allocation of Deductible Expenses by Selected Industries

Non-homebased businesses with and without net income[1]

Average/tax return in thousands	**Bottom Line[2]**	**Receipts**	**Deduc**	**COS**	**Labor**	**Commis**	**Facility costs**	**Over-head**	**Other business deduc**	**Misc.**
Construction	Loss	$178	$195	54.6%	11.1%		4.3%	9.8%		
	Net income	$226	$198	58.9%	8.9%		4.4%	9.1%		
Information	Loss	$67	$98	16.0%	15.5%		13.5%		22.4%	
	Net income	$117	$92	30.4%	13.4%		13.8%		13.6%	
Finance and insurance	Loss	$181	$204	32.8%	4.1%		4.5%		46.4%	
	Net income	$182	$119	27.4%	14.9%		11.5%		12.4%	
Real estate and rental & leasing	Loss	$65	$89	14.2%	9.9%	15.7%	15.7%			12.6%
	Net income	$130	$85	18.7%	6.5%	15.4%	15.4%			6.5%

1 The same detailed information is not available for HBBs taking a loss.

2 Firms reporting a loss or net income

CHAPTER 4: CONCLUSIONS

Discussion

What are the differences between homebased businesses—those operated in or from a home—and non-homebased businesses operated in rented space? Table 4-1 summarizes average receipts, costs and net income or loss for non-farm industries as a whole. Looking at businesses with net income, it is apparent that profitable homebased firms compared with non-homebased businesses, receive on average lower receipts, $62,523 versus $178,194, and report lower deductible costs, $39,958 versus $139,955, which results in lower net income, $22,569 versus $38,243. In contrast, both HBB and non-HBB firms reporting deficits have substantially lower receipts and total deductions. Non-HBBs show a deficit more than twice that of HBBs, $13,127 versus $5,011. Both labor and office space expenses are substantially less for homebased than for non-homebased firms.

Table 4-1 Average Receipts, Costs and Net Income (Loss)

	Net Income		Net Loss	
Average/tax return	**HBB**	**Non-HBB**	**HBB**	**Non-HBB**
Receipts	$62,523	$178,194	$17,558	$79,914
Net Income (loss)	$22,569	$38,243	($5,011)	($13,127)
Total deductions	$39,958	$139,955	$22,604	$93,175
Cost of sales	$14,228	$64,334	$7,694	$40,088
Salaries and wages	$2,010	$17,315	$473	$9,759
Commissions	$1,044	$2,360	$397	$1,339
Home office deduction	$3,686	---	$2,871	---
Rent deduction	---	$14,442	---	$10,363
Overhead	$4,614	$14,168	$2,644	$8,490
Travel costs	$4,797	$4,948	$2,776	$3,546
Marketing expense	$1,054	$2,757	$520	$1,598
Other business expenses	$5,539	$13,584	$3,179	$11,945
Miscellaneous expense	$3,221	$5,905	$2,240	$5,845

Table 4-2 compares profitable homebased and non-HBBs in percentage terms. HBBs show receipts that are 35 percent of non-HBB receipts, 29 percent of total deductions but have a net income of 59 percent of non-HBBs. The fact that HBBs spend only 12 percent of the amount that non-HBBs allocate to labor and 26 percent on business location partly explaining the differences. Although the dollar costs are less for every expense the ratios of homebased to non-homebased for firms with a net loss are for many costs quite similar to those for firms with net income. Examples are total deductions, cost of sales, overhead and marketing. Particularly interesting is that cost of labor is greater for firms earning a profit but the cost of business location is roughly equivalent. This may suggest that firms do not move to larger quarters as they begin to make net income.

Table 4-2 Average Receipts, Net Income (Loss) and Cost Ratios

Homebased as Percent of Non-homebased Firms

	HBB with Net Income	HBB with Net Loss
Receipts	35%	22%
Net Income	59%	-38%
Total deductions	29%	24%
Cost of sales	22%	19%
Labor	12%	5%
Commissions	44%	30%
Business location	26%	28%
Overhead	33%	31%
Travel costs	97%	78%
Marketing expense	38%	33%
Other business expense	41%	27%
Miscellaneous expense	55%	38%

Although non-HBBs earn higher gross receipts, HBBs make a higher return on their gross revenues, 36 percent versus 21 percent net income as percent of receipts (Table 4-3). Homebased firms also show lower costs including labor and facilities when compared as a percent of receipts.

Table 4-3 Average Income and Costs as Percent of Gross Receipts

Percent of Receipts

	Net Income		Net Loss	
	HBB	**Non-HBB**	**HBB**	**Non-HBB**
Net income	36%	21%	-29%	-16%
Total deductions	64%	79%	129%	117%
Salaries and wages	3%	10%	3%	12%
Home office deduction	6%	---	16%	---
Rent on other business property	---	8%	---	13%

With few exceptions businesses operated outside the home show substantially higher revenues than HBBs. Why is that the case? The power of analyzing tax forms is that allocation of expenses is revealed. But none of the factors found in this study, such as percent of costs allocated to marketing, singly or together completely explains the differences in net income although allocation to labor stands out. The answers may not be findable in tax returns. For example, we cannot determine from Schedule C tax returns whether or not the business had access to capital.

For a broader view of factors influencing business "success," defined as higher revenues and net income, we can look at the *Characteristics of Business Owners* (CBO) survey data that provides information on motivation including time spent on the business (Pratt 1999). The CBO adds information that suggests differences in motivation of homebased and non-homebased business owners (Table 4-4). HBB owners work on average 26 – 35 hours/week; non-HBB owners work as many as 33-43 hours. Non-HBB owners also work more weeks in the year. Sixty-five percent work 48 or more weeks in their business compared with just over half of all homebased owners. Finally, and most telling, only 25 percent of HBB owners rely on their business for their total income compared with 33 percent of non-HBB owners.

Gender also affects the time spent on the business. Compared to men, more women choose homebased self-employment, they work less on the business and have different goals. As of 2004, the participation rate of women in homebased incorporated businesses or sole proprietorships was 61.3 percent, compared to a rate by men of only 48.2 percent (CPS 2004). Women, particularly those with young children, work many fewer hours than men. The CBO study found that the "main reason for being in business" was primarily to earn secondary income for homebased and non-homebased businesswomen. More non-homebased men were in business to earn a primary income with a ratio of 1.5 primary to secondary income. Thus, motivation followed by effort devoted to the business may outweigh the importance of location in predicting gross revenues.

Table 4-4 Time Worked on Business

1992 *Characteristics of Business Owners*[1]

Schedule C, Partnership and Sub-chapter S Tax Filers

	Operated "from or in a home"	Non-homebased
Hours worked/week	26 – 35	33 - 43
Worked 48+ weeks in business	53%	65%
Business contributes 100% to personal income	25%	33%

1 OpCit Pratt 1999

Options and Choices for Entrepreneurs

Options

What is the sector to choose if you want to operate a homebased business that has the highest net income? As shown in this analysis, total receipts and net income vary by industry and by sub-sectors within industries. The highest annual net income, $105,000, is earned in non-homebased ambulatory health care services by physicians, mental health specialists, dentists and other medical professionals. Other sub-sectors with higher net incomes for non-HBBs include management, scientific and technical consulting ($46,000), real estate agents, brokers, property managers and appraisers ($48,000) and insurance agents, brokers, and related activities ($75,000). For a homebased business, a better option to gain higher income is to engage in wholesale trade, particularly durable goods ($47,000), travel accommodation such as bed and breakfasts ($64,000) and possibly broadcasting (except Internet and telecommunications).[7] Net incomes are the same or so close that one could choose either to operate from home or from rented facilities in the sectors special contractors ($23,000 HBB to $27,000 non-HBB), heavy and civil engineering (approximately $35,000), manufacture of food products ($36 to $33,000) and local or long distance trucking (approximately $20,000).

[7] The sample is so small that the estimate should be used with caution.

Another factor to consider is that some sectors of all sole proprietorships are growing, others not. Lowrey (2005) found that from 1985 to 2000 the growth rate of net income for all proprietors exceeded that of the number of firms and gross receipts. Businesses, with and without net income, that grew in numbers between 2001 and 2002 included finance and insurance, 12.3 percent, administrative support and waste management, 11.9 percent and professional services, 3.1 percent (Pierce and Parisi 2002). Specialty trade contractors and child day care services decreased in number of returns by 7.9 percent and 4.0 percent, respectively.

Women looking at options should be encouraged that female-owned sole proprietorships are growing much faster than male-operated firms in, not only number of businesses, but also in gross receipts and net income (Lowrey 2005).

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APPENDIX A: Data Sources, Limitations and Advantages

Sample Characteristics

In this study we use federal income tax data from year 2002 Sole Proprietorship returns (Schedule C). The 2002 dataset is based on a sample of 49,752 returns and a population of 18,925,517 returns (13.8 million reporting net income; 5.2 million reporting a deficit) accounting for 21,020,333 non-farm businesses. The two samples, businesses with and without net income, are shown in Tables A-1 and A-2.

Table A-1 Sample of All Nonfarm Sole Proprietorships with Net Income, 2002

	Total Firms	Homebased Business[1]	Non-homebased Business[2]	All Other[3]
Number	13,750,798	1,632,734	1,892,626	10,225,438
Percent of total firms	100%	12%	14%	74%
Percent of firms in sample		46%	54%	---
Total receipts	$871,015,286,000	$102,084,180,000	$337,255,436,000	$431,675,671,000
Total net income	$257,292,855,000	$36,848,573,000	$72,380,425,000	$148,063,856,000
Total deductions	$613,750,692,000	$65,240,045,000	$264,882,375,000	$283,628,272,000
Average receipts	$63,343	$62,523	$178,194	$42,216
Average net Income	$18,711	$22,569	$38,243	$14,480
Average total deductions	$44,633	$39,958	$139,955	$27,738

Table A-2 Sample of All Nonfarm Sole Proprietorships without Net Income, 2002

	Total Firms	Homebased Business[1]	Non-homebased Business[2]	All Other[3]
Number	5,174,720	584,474	769,949	3,820,297
Percent of total firms	100%	11%	15%	74%
Percent of firms in sample		43%	57%	
Total receipts	$158,676,474,000	$10,262,392,000	$61,529,981,000	$86,884,100,000
Total net income	($36,179,568,000)	($2,928,657,000)	($10,106,976,000)	($23,143,936)
Total deductions	$195,149,959,000	$13,211,550,000	$71,739,928,000	$110,198,481,000
Average receipts	$30,664	$17,558	$79,914	$22,743
Average net Income	($6,992)	($5,011)	($13,127)	($6,058)
Average total deductions	$37,712	$22,604	$93,175	$28,846

1. Firms taking home office business deductions but no deduction for “rent on other business property.”
2. Firms taking a deduction for “rent on other business property.” but no home office business deductions
3. Includes homebased businesses that do not take the home office deduction plus those that deduct both for a homebased business and for rent.

Because persons who deduct home office expenses must file a Schedule C, that is, they cannot file the shorter Schedule C-EZ, the cross-tabulation tables are based on representative samples of nonfarm homebased business owners who deduct home office expenses and non-homebased business owners who deduct "rent on other business property." The sample does not contain those "all other" firms that opt not to take the home office deduction nor those that deduct for both a home office and rent, so in that respect it is not representative of all homebased businesses. However, the level of average receipts, deductions and net incomes for the all other group suggest that they are largely homebased. As Beale and others have pointed out, fear of audits by the IRS causes people to not claim an expense to which they are entitled (Beale, 2004). There also is a slight distortion in that "more businesses may have existed than those counted" (Parisi and Balkovic, 2001). About 0.11 percent of individual tax returns are estimated to include an average of 4.59 sole proprietorships. An important limitation is that sole proprietorship tax returns do not reveal the amount or source of capital invested in the business.

Special Advantages of the Sole Proprietor Data

The sample dataset allows us to detect which businesses within an industry sector are operated primarily in or from the home. For example, the home office deduction for the construction industry as a whole is $608 million. But nearly all firms taking the deduction are *special trade contractors* (77 percent of the dollar value). Deductions by other subcategories are much smaller: *Residential construction*, 17 percent and *nonresidential construction* and *heavy construction*, each 3 percent.[8] Thus, we can directly compare the financial details of how the *residential construction* segment, for example, is operated from the two locations.

Another advantage of using 2002 tax returns rather than an older data set is that the costs of technology and communications are included although they cannot be identified as a separate line item. In addition, the Schedule C form does not include labor costs for the owner, so that any labor costs expensed indicate the presence of employee or contract labor. Finally, income tax forms are filled out directly from records of income and expenses and therefore should be more reliable than survey responses based on memory.

[8] The limitation is that after disaggregation into the homebased and non-homebased categories some cell values may be small.

APPENDIX B: IRS Schedule C: Profit or Loss From Business (2002)

SCHEDULE C (Form 1040)

Department of the Treasury
Internal Revenue Service (99)

Profit or Loss From Business

(Sole Proprietorship)

▶ Partnerships, joint ventures, etc., must file Form 1065 or 1065-B.

▶ Attach to Form 1040 or 1041. ▶ See Instructions for Schedule C (Form 1040).

OMB No. 1545-0074

2002

Attachment Sequence No. **09**

Name of proprietor | **Social security number (SSN)**

A Principal business or profession, including product or service (see page C-1 of the instructions) | **B Enter code from pages C-7, 8, & 9** ▶

C Business name. If no separate business name, leave blank. | **D Employer ID number (EIN), if any**

E Business address (including suite or room no.) ▶
City, town or post office, state, and ZIP code

F Accounting method: **(1)** ☐ Cash **(2)** ☐ Accrual **(3)** ☐ Other (specify) ▶

G Did you "materially participate" in the operation of this business during 2002? If "No," see page C-3 for limit on losses . ☐ **Yes** ☐ **No**

H If you started or acquired this business during 2002, check here . . . . . ▶ ☐

Part I Income

1	Gross receipts or sales. **Caution.** If this income was reported to you on Form W-2 and the "Statutory employee" box on that form was checked, see page C-3 and check here . . . ▶ ☐	**1**	
2	Returns and allowances	**2**	
3	Subtract line 2 from line 1	**3**	
4	Cost of goods sold (from line 42 on page 2)	**4**	
5	**Gross profit.** Subtract line 4 from line 3	**5**	
6	Other income, including Federal and state gasoline or fuel tax credit or refund (see page C-3)	**6**	
7	**Gross income.** Add lines 5 and 6 . . . ▶	**7**	

Part II Expenses. Enter expenses for business use of your home **only** on line 30.

8	Advertising	**8**		**19**	Pension and profit-sharing plans	**19**	
9	Bad debts from sales or services (see page C-3)	**9**		**20**	Rent or lease (see page C-5):		
				a	Vehicles, machinery, and equipment	**20a**	
10	Car and truck expenses (see page C-3)	**10**		**b**	Other business property	**20b**	
				21	Repairs and maintenance	**21**	
11	Commissions and fees	**11**		**22**	Supplies (not included in Part III)	**22**	
12	Depletion	**12**		**23**	Taxes and licenses	**23**	
13	Depreciation and section 179 expense deduction (not included in Part III) (see page C-4)	**13**		**24**	Travel, meals, and entertainment:		
				a	Travel	**24a**	
14	Employee benefit programs (other than on line 19)	**14**		**b**	Meals and entertainment		
15	Insurance (other than health)	**15**		**c**	Enter nondeductible amount included on line 24b (see page C-5)		
16	Interest:						
a	Mortgage (paid to banks, etc.)	**16a**		**d**	Subtract line 24c from line 24b	**24d**	
b	Other	**16b**		**25**	Utilities	**25**	
17	Legal and professional services	**17**		**26**	Wages (less employment credits)	**26**	
18	Office expense	**18**		**27**	Other expenses (from line 48 on page 2)	**27**	

28	**Total expenses** before expenses for business use of home. Add lines 8 through 27 in columns . ▶	**28**	
29	Tentative profit (loss). Subtract line 28 from line 7	**29**	
30	Expenses for business use of your home. Attach **Form 8829**	**30**	
31	**Net profit or (loss).** Subtract line 30 from line 29. • If a profit, enter on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3. • If a loss, you **must** go to line 32.	**31**	

32 If you have a loss, check the box that describes your investment in this activity (see page C-6).

• If you checked 32a, enter the loss on **Form 1040, line 12,** and **also** on **Schedule SE, line 2** (statutory employees, see page C-6). Estates and trusts, enter on Form 1041, line 3.

• If you checked 32b, you **must** attach **Form 6198.**

32a ☐ All investment is at risk.

32b ☐ Some investment is not at risk.

Part III Cost of Goods Sold (see page C-6)

33 Method(s) used to value closing inventory: a ☐ Cost b ☐ Lower of cost or market c ☐ Other (attach explanation)

34 Was there any change in determining quantities, costs, or valuations between opening and closing inventory? If "Yes," attach explanation . . . ☐ Yes ☐ No

35	Inventory at beginning of year. If different from last year's closing inventory, attach explanation	35	
36	Purchases less cost of items withdrawn for personal use	36	
37	Cost of labor. Do not include any amounts paid to yourself	37	
38	Materials and supplies	38	
39	Other costs	39	
40	Add lines 35 through 39	40	
41	Inventory at end of year	41	
42	**Cost of goods sold.** Subtract line 41 from line 40. Enter the result here and on page 1, line 4	42	

Part IV Information on Your Vehicle. Complete this part **only** if you are claiming car or truck expenses on line 10 and are not required to file Form 4562 for this business. See the instructions for line 13 on page C-4 to find out if you must file.

43 When did you place your vehicle in service for business purposes? (month, day, year) ► ____/____/____ .

44 Of the total number of miles you drove your vehicle during 2002, enter the number of miles you used your vehicle for:

a Business ____________ b Commuting ____________ c Other ____________

45 Do you (or your spouse) have another vehicle available for personal use? . . . ☐ Yes ☐ No

46 Was your vehicle available for personal use during off-duty hours? . . . ☐ Yes ☐ No

47a Do you have evidence to support your deduction? . . . ☐ Yes ☐ No

b If "Yes," is the evidence written? . . . ☐ Yes ☐ No

Part V Other Expenses. List below business expenses not included on lines 8–26 or line 30.

48	**Total other expenses.** Enter here and on page 1, line 27	48	