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Small Business Research Summary

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

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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.

This report was peer-reviewed consistent with Advocacy's data quality guidelines. More information on this process can be obtained by contacting the director of economic research by email at *advocacy@sba.gov* or by phone at (202) 205-6533.

Ordering Information

The full text of this report and summaries of other studies performed under contract with the U.S. Small Business Administration's Office of Advocacy are available on the Internet at ***www.sba.gov/advo/research***. Copies are available for purchase from:

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