

Business or Hobby? Answer Has Implications for Deductions

The Internal Revenue Service reminds taxpayers to follow appropriate guidelines when determining whether an activity is a business or a hobby, an activity not engaged in for profit.

In order to educate taxpayers regarding their filing obligations, this fact sheet explains the rules for determining if an activity qualifies as a business and what limitations apply if the activity is not a business. Incorrect deduction of hobby expenses account for a portion of the overstated adjustments, deductions, exemptions and credits that add up to \$30 billion per year in unpaid taxes, according to IRS estimates.

In general, taxpayers may deduct ordinary and necessary expenses for conducting a trade or business. An ordinary expense is an expense that is common and accepted in the taxpayer's trade or business. A necessary expense is one that is appropriate for the business. Generally, an activity qualifies as a business if it is carried on with the reasonable expectation of earning a profit.

In order to make this determination, taxpayers should consider the following factors:

- Would you continue to do this activity whether you made a profit or not?
- Does the time and effort put into the activity indicate an intention to make a profit?
- Does the taxpayer depend on income from the activity?
- If there are losses, are they due to circumstances beyond the taxpayer's control or did they occur in the start-up phase of the business?
- Has the taxpayer changed methods of operation to improve profitability?
- Does the taxpayer or his/her advisors have the knowledge needed to carry on the activity as a successful business?
- Has the taxpayer made a profit in similar activities in the past?
- Does the activity make a profit in some years?
- Can the taxpayer expect to make a profit in the future from the appreciation of assets used in the activity?

The IRS presumes that an activity is carried on for profit if it makes a profit during at least three of the last five tax years, including the current year.

If an activity is not for profit, losses from that activity may not be used to offset other income. An activity produces a loss when related expenses exceed income. Deductions for hobby activities are claimed as itemized deductions on Schedule A (Form 1040) if you itemize and the income is all taxable.

Link: Further information is available in [IRS Publication 535, Business Expenses](#)

I have read the above and verify that my activity is a business and not a hobby.

Name: _____

Date: _____