



Hobby vs. Business

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Hobby or Business?

If an individual, partnership, estate, trust, or an S corporation engages in an activity that is not conducted as a for-profit business, expenses (other than cost of goods sold) are not deductible. This rule does not apply to corporations other than S corporations. If an activity is considered a for-profit business, deductions can exceed income, allowing the resulting loss to offset other income.

Determination

In determining whether an activity is a hobby or a business, all facts and circumstances are taken into account. No one factor can make the determination. The following list is not intended to be all inclusive.

- 1) **The manner in which the taxpayer carries on the activity.** Factors that may indicate a business include maintaining complete and accurate books and records, carrying on the activity substantially similar to other profitable activities of the same nature, and changing operating methods and techniques to improve profitability.
- 2) **The expertise of the taxpayer or his or her advisors.** Factors that may indicate a business include knowledge of the taxpayer, or consultation with those who are knowledgeable about a particular industry, then using that knowledge to try to make a profit.
- 3) **The time and effort expended by the taxpayer in carrying on the activity.** Factors that may indicate a business include spending a lot of time and effort in the activity, particularly if the activity does not have substantial personal or recreational aspects.

Taking time away from another occupation may also indicate a profit motive. Spending little time will not be counted against the taxpayer if qualified employees are hired to carry on the activity.

- 4) **The expectation that assets used in the activity may appreciate in value.** Even if no profit is made from operations, if the value of land or other assets in the activity appreciate so that an overall profit is made from a sale, the activity may be considered a business.
- 5) **The success of the taxpayer in carrying on other similar or dissimilar activities.** If the taxpayer was successful in the past turning an unprofitable venture into a profitable venture, the current activity may be a business even if it has not yet made a profit.
- 6) **The taxpayer's history of income or losses with respect to the activity.** Early losses during start-up will not count against the taxpayer, but continued losses after the customary start-up stage that are not explainable may indicate a hobby. Losses sustained due to unforeseen circumstances, such as casualty or thefts beyond the taxpayer's control, will not count against the taxpayer. Any series of profitable years are strong evidence the activity is a business.
- 7) **The amount of occasional profits, if any, which are earned.** The amount of profits in relation to the amount of losses, and in relation to the taxpayer's investment in the activity, may indicate intent. An occasional small profit one year, mixed with large losses in other years or large taxpayer investments, may indicate the activity is a hobby. Substantial occasional profits mixed with frequent small losses or investment may indicate a business. An opportunity to earn substantial ultimate profits in a highly speculative venture also indicates a profit motive.