Hobby Loss Factors

Business versus Hobby. An activity is considered engaged in for profit if it is of the kind that would support a deduction for a business expense, for an expense for the production or collection of income, or the management, conservation, or maintenance of income-producing property (Section 183(c)).

Relevant factors. In determining if an activity is carried on for profit, all the relevant facts are considered. No one factor alone is decisive (Reg. Section 1.183-2(b)). Among the factors to be considered are the following:

1. The activity is carried on in a businesslike way. The taxpayer:

(a) Keeps and maintains a complete and accurate set of books for the activity. (b) Changes operating methods, adopting new techniques to increase business. (c)Engaged in similar activities in the past and converted them from unprofitable to profitable enterprises; it may indicate that there is profit intent for the current activity.
The courts have generally weighed these criteria heavily in their determinations.

2. The expertise of the taxpayer or his advisors. The taxpayer has consulted with experts in the field if he is not one himself. The taxpayer should be following the advice of advisers or using best business practices for the activity.

3. The time and effort to turn profit. The taxpayer spends enough time on the activity to demonstrate the intent to make it profitable.

4. The expectation of assets used in the business to appreciate. While a taxpayer's day-to-day activities may not be profitable, he expects to profit when proceeds from selling the assets exceed current losses.

5. The history of income and losses with respect to the activity. Many activities suffer losses in the early years of a business. However, longer, sustained losses may be questioned. Unexpected losses, such as those from unforeseen circumstances beyond the control of the taxpayer, would also be taken into consideration.

6. The amounts of profits earned. Occasional small profits from an activity that otherwise generates large losses could indicate that the taxpayer does not have a profit intent. Occasional substantial profits or, in the case of a highly speculative venture, the opportunity to earn a substantial ultimate profit would typically suffice to indicate that the activity is engaged in for profit even though it currently generates losses.

7. The financial status of the taxpayer. The activity that is generating losses when the taxpayer has substantial income or capital from other sources, especially if there are *personal or recreational* elements involved.

8. Elements of personal pleasure or recreation. The fact that the taxpayer derives personal pleasure from engaging in the activity does not disqualify the activity from being carried on with a profit intent. Obviously, most people don't do things they don't like to do. The courts do consider this factor, but generally give it a low weighting in decision.