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Five Tips To Make Your Hobby Tax Deductible

Will the IRS pay for your hobby? The short answer is no. The more nuanced answer is sometimes, provided that you make it enough of a *real* business. If you want to avoid any IRS hassles [my standard advice](#) is to keep your business and personal pursuits separate. But most of us like two-fers, and current economics make multipurposing even more compelling.



The whippets chase the lure at Cheltenham racecourse in Cheltenham, England. (Image credit: Getty Images via @daylife)

Say you lose \$20,000 a year in the “business” of breeding, training and caring for whippets. You can report the loss on Schedule C to your Form 1040 and write it off against your salary. Assuming your combined state and federal tax rate is 40%, your whippet breeding really only costs you \$12,000. See [In Pictures: Convincing Uncle Sam To Subsidize Your Hobby](#).

If your whippets are a hobby, you can't claim a loss. But before you decide to turn your nondeductible hobby into a deductible business, be careful. This is an area of intense IRS scrutiny. The IRS [issued a new manual](#) to help agents ferret out taxpayers improperly writing off hobbies. Here are five tips for getting business tax treatment for a pursuit you enjoy.

1. Match income and loss. The IRS is less likely to question whether you're engaged in a **business** if your income from the activity exceeds your expenses. See [The ABCs of Hobby Losses and Profit Motive](#).

2. Keep good records. It matters whether you conduct yourself in a businesslike manner. If you keep good records and hold yourself out as running a business, it will help. See [Tax Return Filed? Now Consider Your Records](#).

3. Show a profit three years in five. If you can manage to eke out a profit three years out of every five (or two years out of seven, if your activity is horse breeding), the IRS will **presume** you're in business to make a profit. That presumption is worth a lot since you probably won't have to mud wrestle with the IRS over a more amorphous facts and circumstances test.

4. Plan income and expenses. Our tax system is annual and so are profit-and-loss determinations. You may have more control than you think over when you receive income and especially when you incur expenses. That control can help you make a profit three years out of five. See [When You Have Income But No Cash](#).

5. Delay a profits determination. You can elect to defer the determination of profit motive until the fourth year of your "business," or your sixth year in the case of an activity involving horses. To make this election you file a [Form 5213](#), postponing the determination of whether you've met the three-out-of-five-years profit presumption. The idea of the election is to give you time to ramp up and achieve a profit.

Warning: Most advisers don't recommend this election since it could flag the profit-motive issue. Plus, it has the effect of extending the IRS statute of limitations beyond the normal three years. The IRS can examine all the years in question after the deferral period has passed. For more about the IRS statute of limitations, click [here](#).

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