Forbes

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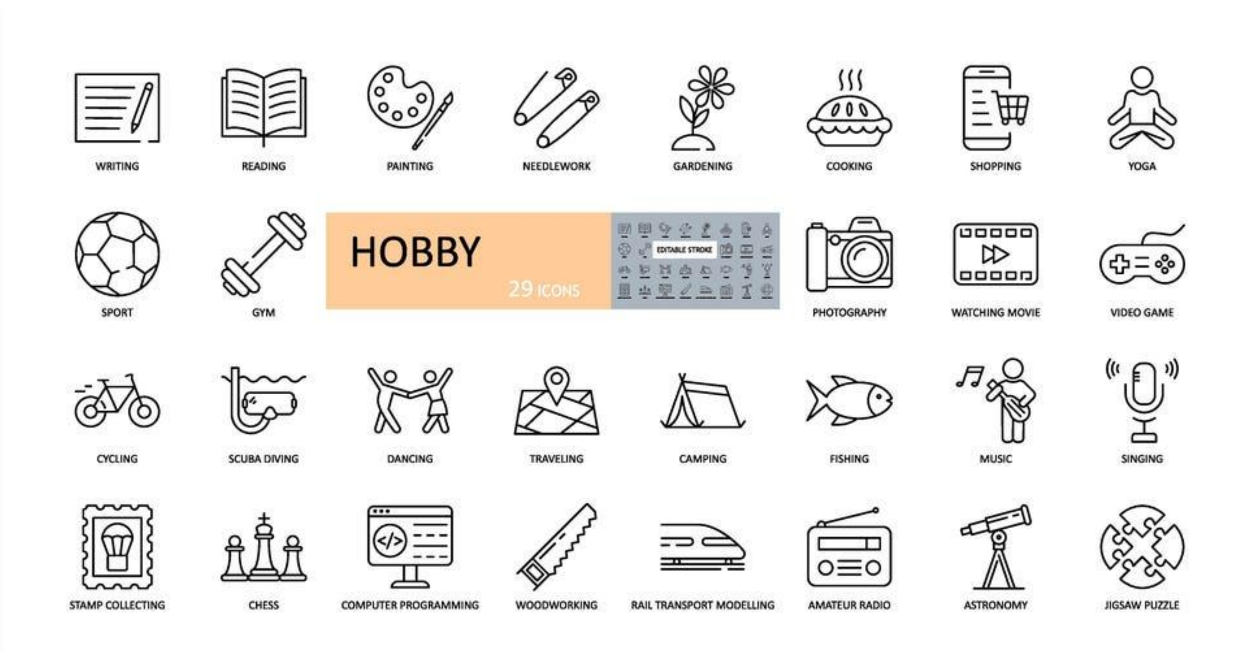
July 13, 2026

Tips For Making Your Hobby Tax Deductible With IRS



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, keep your business and personal pursuits separate. But some people say the best business is personal, and loving what you do can sometime mean that avocations become vocations. The stakes can be alluring.

Say you lose $40,000 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 if off against your salary. Assuming your combined state and federal tax rate is 40%, your whippet breeding really only costs you $24,000.

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. The IRS monitors [differences between a hobby and a business]() and likes to audit people who are improperly writing off hobbies. Here are tips for getting business tax treatment.

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]().

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.

Show a Profit 3 Years Out of 5

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.

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.

Delaying Profit 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 an IRS Form 5213 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.

Some advisers don’t recommend this election since it may flag the profit-motive issue. It also 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. This is one of many IRS statute of limitation rules on audit.

Full Time, Have a Business Plan

The IRS is more likely to query writing off a "hobby" against income from your regular job. If you work 40 hours a week in an office and raise chinchillas on the side, does that mean the chinchillas are just a hobby? No, but the IRS is more likely to consider it a business if you do it full-time.

The IRS looks for businesslike activity. One of the auditors' checklist items is a business plan. Write one up and try to look businesslike in all things.

Hire Experts, Become One.

The more expert you become and the more you engage others the more businesslike you'll look. If you have advanced degrees or hire consultants to help you grow prize orchids, raise toucans, or race mopeds, it may be easier to convince the IRS. And don't enjoy it too much. Do what you love? Maybe, but the IRS thinks personal pleasure is an indication your "business" is a hobby, so you may want to curb your enthusiasm.

Combine Activities

A stand-alone activity with losses might be combined with a profitable activity. What you call a single activity should be accepted by the IRS unless it's artificial. You can't combine profits from working as a tech consultant with losses from breeding whippets as a single business activity. But a profitable sideline selling handcrafted dog collars and an unprofitable sideline boarding dogs might be combined on a single Schedule C to your Form 1040. It could make it easier to show a profit three years out of five.

Bottom line?

It's good to keep your business and personal life separate, but if you generate income from a pastime consider becoming more businesslike, as long as the activity you love doesn't feel like a daily grind.