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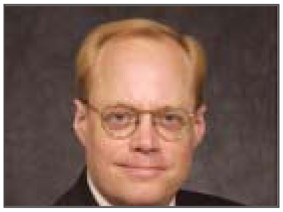

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Will Writing Off Your 'Hobby' Pass IRS Muster?

In There's Still Time To Turn Your Hobby Into A Tax Write-off, I covered five tax tips for deducting your hobby. If you can do it legitimately, transitioning from hobby to business lets taxes subsidize it. But fair warning: it can be tough to convince the IRS. You may even have to go to court. But if you're committed, here are five more tips to help smooth out that bumpy uphill road:

Do it full-time. 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.

Write a business plan. The IRS looks for businesslike activity. One of the auditors' checklist items is a business plan. Write one up and try to look businesslike as you walk through the ABCs of hobby losses and profit motive.

Consider combining 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. It could make it easier to show a profit three years out of five.

Hire experts and 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.

Don't enjoy it too much. The IRS thinks personal pleasure is an indication your "business" is a hobby. In *Lowe v. Commissioner*, Janice Lowe was the primary breadwinner, working full time as controller for a steel company for 38 years. Her husband Steve worked on home improvements from 1986 to 1999. And he fished.

When he attended a fishing tournament with a prize of $6,000, it spawned his interest in tournament fishing. Believing it would be like shooting fish in a barrel, Steve took to tournaments like a fish to water. Steve competed in 26 tournaments and eked out gross income of $4,241 in 2005. He entered 15 tournaments in 2006, and his gross income swelled to $10,932.

That may sound like a pretty full creel. But Steve racked up nearly $100,000 in expenses between 2005 and 2006, losing almost $50,000 in 2005 and $40,000 in 2006. But was he trying to land a profit? Steve's wife always went along and he deducted all her entry fees, but she never fished. This gave him a built-in handicap in the tournaments. By registering as a team, but with only Steve fishing, he had to catch *twice* as many fish!

This conduct was inconsistent with intending to make a profit. The Tax Court concluded that Steve's fishing activity was not for profit. That meant no deductions.

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. Just don't turn an activity you love into a daily grind!

For alerts to future tax articles, follow me on Forbes. You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.