

When Does a Hobby Become a Business?



There are numerous success stories of inventions or businesses that originated from hobbies. As the passion and enjoyment for the hobby grows, the attention may shift to growing the hobby into a business. Hobbyists who make money regularly and take the limited deductions allowed on Schedule A, might consider the tax advantages of turning their hobby into a business. The IRS looks at the following factors in determining when a hobby is considered a business for tax purposes:

- Is the activity carried on in a businesslike manner?
- Does the owner (and his advisors) have the expertise to run the business?
- Does the owner spend the time and effort to make the business successful, including partial or total withdrawal from another occupation?
- Is there an expectation that the business assets will appreciate in value over time?
- Has the owner had success with other activities?
- Is there a history of income or loss? (Does the owner continue with the activity despite many years of losses?)
- How do occasional profits compare in relation to the amount of investment?
- Is this the owner's only source of income?
- To what degree does the business activity possess elements of personal pleasure or recreation?

The Internal Revenue Service is stepping up efforts to prevent taxpayers from deducting losses on business activities not intending to make a profit. So a business plan illustrating profitability and cash flow along with attention towards immaculate record-keeping are prerequisite to the decision to develop your hobby into a business.

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