HOBBY LOSSES

Losses incurred by individuals that are attributable to an activity not engaged in for profit – so-called hobby losses – are generally deductible only to the extent of income produced by the activity. The itemized deduction for hobby losses is subject to the 2% floor on miscellaneous itemized deductions.

If you do not carry on your business or investment activity with the intent of making a profit, you cannot use a loss from the activity to offset other income.

In determining whether you are carrying on an activity for profit, several factors are taken into account. No one factor alone is decisive. Among the factors to consider are whether:

- You carry on the activity in a businesslike manner,
- The time and effort you put into the activity indicate you intend to make it profitable,
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- You depend on the income for your livelihood,
- Your losses are due to circumstances beyond your control (or are normal in the start-up phase of your type of business),
- You change your methods of operation in an attempt to improve profitability,
- You (or your advisors) have the knowledge needed to carry on the activity as a successful business,
- You were successful in making a profit in similar activities in the past,
- The activity makes a profit in some years , and
- You can expect to make a future profit from the appreciation of the assets used in the activity.

In addition to the above factors the IRS also takes the stand that an activity is presumed carried on for profit if it produces a profit in at least 3 of the last 5 tax years, including the current year. Activities that consist primarily of breeding, training, showing, or racing horses are presumed carried on for profit if they produce a profit in at least 2 of the last 7 tax years, including the current year.

The IRS puts heavy emphasis on the presumption of profit factor.

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