

Business or Hobby

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The sad truth is that most businesses fail to make money. This in and of itself, does not mean that the IRS will view your business as a hobby nor does it mean that you will not be able to deduct your business expenses.

The rules for determining whether or not an activity is a business or a hobby are quite complex and you should seek the advise of a qualified tax professional to see how your activities should be classified. In general, the IRS uses the following 9-Point Test to determine if your activity is a business or a hobby:

1. The manner in which the activity is conducted
2. The expertise of the taxpayer
3. The time expended on the activity
4. The expectation of profit
5. The success in other similar or dissimilar activities
6. The history of income and losses
7. The amount of "occasional" profits
8. The financial status of the taxpayer
9. How personal pleasure or recreation contribute to the business

If you intended to make a profit and a tax professional (and the IRS) concurs that your activity is a business, you can claim all your applicable business expenses. If your business expenses exceed your income for the tax year, you can claim a loss for the year, up to the amount of your taxable income from other activities. Any remaining losses may be carried over into other years.

If your tax professional (or the IRS at a later date) believes that your business never intended to make a profit your activity will be classified as a "hobby" and your losses will be limited to the amount of income generated by the activity.

"Hobby Income" is reported as "other income" on your Form 1040, Individual Income Tax Return. "Hobby Expenses" are only deductible if you itemize deductions on your tax return. They are considered "miscellaneous itemized deductions" and you may only deduct the portion of them that, along with any other miscellaneous deductions, exceeds 2 percent of your adjusted gross income.

Depending on your particular tax circumstances this can result in all income from the hobby being taxable income with no offsetting deduction for hobby expenses.

The IRS does not put a limit on the number of businesses a person can own or hobbies that a person wishes to engage in.

Gina L. Gwozdz is a CPA who has chosen to specialize in taxes. Visit her website at <http://GLGcpa.com> to view more Tax Tip Articles.