HOBBY LOSS RULES AND GUIDELINES

Generally speaking, IRS rules provide that deductions for activities are only allowable to the extent of income received. There is a presumption that an activity is engaged in for profit if the activity is profitable in 3 out of any 5 consecutive years. For activities involving horses, the rules are more liberal in that it is 2 years out of 7. In either case, the presumption may be rebutted by the government if it can be established (by the IRS) that there is a clear lack of profit intent. Regulations provide criteria for evaluating whether or not an activity is engaged in for profit. There are nine factors that are looked at in evaluating the activity.
These are as follows:

1.) Businesslike manner in which the activity is operated
2.) Expertise of the taxpayer in the activity or expert consultation obtained.
3.) Time and effort put into the activity.
4.) Appreciation (or lack thereof) in value of the assets used in the activity.
5.) Success in prior activities.
6.) History of profits or losses, or trend towards profitability.
7.) Occasional profits. This applies to long standing activities.
8.) Taxpayers financial situation.
9.) Recreation or personal pleasure.

In any situation where a taxpayer claims deductions that may be considered questionable, there are two things to keep in mind. First, IRS rules generally require full disclosure. In other words, lay everything out for them, don't try and "sneak" stuff thru. By disclosing, penalties are easier to avoid if deductions are ultimately disallowed. The second thing to remember is that the IRS always has the benefit of hindsight. For instance, if one wants to claim deductions for a temporary job situation, and it turns out to be permanent, the IRS will see that because they will be looking at things a year or two after the return is prepared.

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