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Claim Tax Deductions from your Hobby (part 2)

Are you a hobbyist? In my previous article I shared some ways you can turn your hobby into a tax-deductible business. The four ways were:

1. Keep accurate records 2. Three in five profit ratio 3. Plan when you spend and get paid 4. Draw up a business plan.

Here are some other things you ought to do:

5. Carry out your hobby/business full-time The IRS flags anyone who claims expense deductions from a hobby against his or her 40-hour a week day job income. Here is a fact – the IRS considers what you do full-time as your vocation, so if you want to silence all questions from the IRS, consider carrying out your hobby as a full-time business.

6. Claim your deductions against business income Remember the 3 in 5 profit ratio? If you can generate more income than expenses and offset those expenses from your income, then the IRS would more likely see your hobby as a business even though you carry it out part-time. So the key to achieving this is to make a net profit so that you do not claim expense deductions against your day job taxable salary.

7. Delay a profits determination In order to show a profit, you can avail yourself to the special tax rule that allows you to defer the determination of profit motive until the fourth year of your business (or sixth year in the case of horse breeding). This will postpone the determination of whether you have met the three in five years profit presumption. The idea of the election is to give you time to ramp up and achieve a profit.

However, this may invite an audit by the IRS and may extend the statute of limitations beyond the normal three years so the IRS has a right to examine all the years in question after the deferral period has passed.

8. Hire expert help If you can hire experts to help you in your hobby/business, it gives it a more business-like character. Alternatively, you could do extensive research yourself and keep good records of it so that you can show the IRS the amount of work you have done in becoming competent in your hobby/business.

9. Combine related activities If you are involved in activities that are related to your hobby/business, you can combine their profits or losses together on a single Schedule C and make it more likely to show a combined profit three years out of five. For example, if you are a betta fish hobbyist who sells pet betta and you start another part-time business providing aquarium pumps, then you can legitimately combine these two activities and consider them one single business.

These are 9 ways to make your part-time hobby into a business that would satisfy the IRS and allow you to make expense related expense deductions when you file your taxes.