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## Claim Tax Deductions from your Hobby (part 1)

Can you claim deductible expenses from your hobby? You can if you make your hobby become your business. If you are spending a substantial amount of money on your hobby, you might as well turn it into a business. Look at it this way – suppose you spend \$20,000 a year in your hobby, then you can report that loss on a Schedule C and write it off against your salary on your Form 1040. Assuming your combined state and federal income tax rate is 40%, maintaining your hobby will really only cost you \$12,000, and the federal and state governments would have subsidized your hobby. Doesn't that sound appealing?

However, this is only possible if you turn your hobby into a business. If you don't, you are not allowed to claim a loss from it. But you must still report any income from any sales, but you can only deduct your expenses from your hobby to the extent of those sales. Moreover those expenses must be claimed as miscellaneous itemized deductions, provided they exceed 2% of your adjusted gross income.

So it does make sense to turn your hobby into a business. Here's how to do it.

1. Keep accurate records As in any business, record-keeping is a must. So you must make sure you keep accurate records of all your transactions (sales, expenses etc) relating to your hobby. This is a standard requirement whether or not you are making a profit.
2. Three in five profit ratio The golden standard in the eyes of the government is making profit 3 years out of every 5 (if your hobby is horse breeding, the ratio falls to 2 out of 7 years). This gives your hobby the credibility to be considered a legitimate business. If you achieve this, then even if the IRS argues that your hobby is not a business, the onus is on them to prove otherwise.

3. Plan when you spend and get paid To achieve the three in five profit ratio, you should make wise choices in how and when you spend money on your hobby/business. You can increase the expenses by lumping together similar expenses (for example by buying all your equipment in one year); likewise you can decrease your expenses by spreading them out over different years. Similarly, you can control your income to some extent (although this is more difficult than controlling your expenses). You could bill your customers at certain times to time your income just the way you want it. All these go towards achieving that 3 years profit out of 5 that the government wants to see.

4. Draw up a business plan Make your hobby look business-like by coming up with a simple business plan. It does not matter if you stick to it, just have it available so that you can produce it to IRS agents if they come calling. Periodically revise your business plan so that it looks legit.

In the second part of this article, I will share more ways you can turn your hobby into a tax deductible business.