

The Business Versus Hobby Test

Why does it matter? If your activity is a business, your income can be reduced by all your qualified business expenses, even if it results in a loss. If your activity is deemed a hobby, no losses are allowed on your tax return. By keeping proper records and proactively knowing the pitfalls, you can avoid most problems.

Business

VS.

Hobby

You have a reasonable expectation of making a profit.

PROFIT MOTIVE

You may sell occasionally, but making money is not your main goal.

You invest significant personal time and effort. You depend on the resulting income.

EFFORT & INCOME

It's something you do in your free time; you make the bulk of your money elsewhere.

Your expenses are ordinary and necessary to run your business.

REASONABLE EXPENSES

Your expenses are driven by your personal preferences and not strictly necessary.

You have a track record in this industry, and/or a history of making profits.

BACKGROUND

You don't have professional training in the field and have rarely or never turned a profit.

You have multiple customers or professional clients.

CUSTOMERS

You have few customers, mainly relatives and friends.

You keep professional records, including a separate checkbook and balance sheet; you have business cards, stationery and a branded business website.

PROFESSIONAL

You don't keep strict professional records of your activities; you don't have a formal business website or business cards.