

Shavano

April 2019

A publication exclusively for the residents of Shavano Park

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Debbie Weber Photography

HOW HOBBIES GET TAXED



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Hobbies are a great distraction from the hustle and bustle of work. If you're retired, they can be equally fulfilling. Over time, some of us become so good at our hobbies that they start providing income for us. How many gardeners, crafters, bakers, woodworkers, photographers, and other hobbyists do you know who have found an extra source of income doing what they love? Are you among them?

If you make money from your hobby, though, that income is taxable. If the activity becomes an actual trade or business, it's likely time to form an entity that limits your liability and allows tax advantages (an LLC or Corporation, for example).

This is critically important now because, in the past year, tax changes under the Tax Cuts and Jobs Act (TCJA) have disallowed the deduction of hobby expenses due to the suspension of miscellaneous itemized deductions. Before, hobby expenses were personally deductible under certain definitions like the expense of carrying on a trade or business or the expense incurred for the production or collection of income or the management, conservation, or maintenance of property held for income. While you may have been able to offset hobby income in the past for those

activities, the option is currently unavailable. Simply put: **Hobbies cannot claim tax losses, but businesses can.**

How do you determine a hobby should be considered a business? It all has to do with profit. If the hobby has been profitable for the past three out of five years and you expect to continue to make a profit, you've likely got a good business case. That general rule is called safe harbor under Section 183(d) of the tax code.

Additionally, the IRS uses a nine-factor test to determine whether your hobby is really a business. The following questions are based on those factors:

- Do you carry on the activity in a businesslike manner, maintaining complete and accurate books?
- Are the time and effort you put into the activity an indication you intend to make a profit?
- Do you depend on income from the activity for your livelihood?
- Are your losses due to circumstances beyond your control (or are they normal in the startup phase of your type of business)?
- If you answered yes to the previous question, have you changed your methods of operation to improve profitability?
- Do you have the knowledge needed to carry on the activity as a successful business?
- Have you been successful in making a profit in similar activities in the past?
- Does the activity make a measurable annual profit more often than not?
- Do you expect to make a future profit from the appreciation of the assets used in the activity?

If you answer "yes" to most of these questions, then you'll likely benefit from turning your hobby into a business without much fuss from the IRS. If your hobby is a passion project that makes the world a better place more than to make a profit, you may want to consider forming a nonprofit instead in order to receive tax-exempt status.

Turning a profit from a hobby is a great way to supplement your income, but the rules have changed when it comes to protecting that profit from unnecessary taxes. If your hobby is paying off — and has for a while — ask a tax professional whether they think you're ready to go into business.

Steven Bankler has more than 40 years of experience in the accounting industry. Steven's expertise lies in consulting, planning, tax, and asset protection as well as exit strategy services for closely held businesses. He also provides litigation support (both as a testifying expert witness and a consulting expert), business negotiations and estate planning. For past Shavano Living tax tips and to learn more about Steven Bankler, CPA, Ltd., visit www.bankler.com

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