

The logo for SBW & Associates, P.C. features the letters "SBW" in a white, serif font inside a dark red square with a white border.

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CERTIFIED PUBLIC ACCOUNTANTS

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SCHEDULE F FARMING & RANCHING - 9 FACTORS TO DETERMINE IF A HOBBY

1. Is the activity carried on in a businesslike manner? If the producer keeps businesslike books and records, changes methods of operation that are not working, tries to use profit-making techniques to increase efficiency and profitability, or even abandons a business venture that is going nowhere, the profit motive may be indicated. Is there a business plan? Does the producer have a separate bank account for activity?

2. What is the expertise of the producer or his or her advisors? The producer should be able to show that he or she has studied the accepted practices of the venture engaged in and/or has sought advice from experts in the field. In other words, the producer has read books, taken classes, paid advisors, and taken their advice. If the producer has gotten advice and information and has operated in a completely different manner, he or she should be prepared to show that an attempt has been made to develop new practices which could result in profit.

3. How much time and effort are being expended by the producer in this business? If the producer is spending significant personal time and effort on the activity, it can indicate a profit motive. Employing competent persons to run the activity for the producer may also indicate a profit motive.

4. Are the assets expected to appreciate in value? Overall profit could be reasonably expected from an increase in business assets such as land value, livestock, or other assets. This can be true even if operations of the business are not showing a current profit. Does the income generated from the activity cover the variable costs of carrying the assets?

5. Has the producer done this before? Has the producer been successful in carrying on similar activities for a profit? If the producer has carried on similar activities in the past and turned them from unprofitable to profitable, a profit motive could be assumed.

6. What's been happening here? What is the history of income or loss? Are losses mainly a start-up situation or have they been sustained beyond a reasonable length of time? If there have been unforeseen circumstances beyond the producer's control—such as drought, flood, fire, theft, war, depressed market conditions, etc.—the reasonable length of time for loss could be extended. Again, good records would help support this type of claim.

7. Has the producer made any money? What profits, if any, have been earned? The occasional small profit from a venture offset by persistent high losses would probably indicate that there is no profit motive. A solid profit, though infrequent, or a reasonable opportunity to achieve an eventual profit might support the producer's profit motive.

8. Is the producer making money doing anything else? What is the financial status of the producer? If there is no substantial income from other sources, it is a good bet the activity is meant to generate a profit. Substantial income from other sources may suggest the producer can "afford to support the hobby." However, the presence of other income, especially during the start-up period of a venture, shows good planning and would not negate the profit motive.

9. Is the producer having fun? The presence of personal pleasure or recreation in an activity has often been used by the IRS to claim an activity as a hobby. However, the other factors mentioned in this article are also taken into consideration by the courts. The fact that a person enjoys a business is not sufficient to disallow the profit-making motive.

*** The law presumes that an activity is not a hobby if profits occur in any three of five consecutive years or two of seven consecutive years for equine activities.**

***The failure to meet the profit test does not automatically make the activity a hobby; it only allows the IRS to look deeper into the venture.**

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