

**BUSINESS VS. HOBBY**  
**Factors in Establishing a Profit Motive**  
**(Not an all-inclusive list)**

Although an activity must be engaged in for profit to avoid the hobby loss rules, a predictable or highly probable expectation of profit is not required. For example, a taxpayer may well have a profit motive for investing in a very risky venture (e.g., wildcat oil and gas drilling or providing capital to start-up businesses). The circumstances should indicate that the taxpayer entered into or continued the activity with the honest objective of making a profit, but even risky investments can be considered made for a profit motive.

The following factors should be considered in establishing the existence of a profit motive [Reg. 1.183-2(b)]. The courts consistently rely on these factors to determine a profit motive. “Yes” answers to the questions tend to indicate the existence of a profit motive. Lack of a profit motive can result in your business being reclassified by the Internal Revenue Service, as a hobby. This can have negative tax results.

1. Manner in which activity is conducted:
  - a. Is there a legitimate profit or gain motive?
  - b. Are complete and accurate books and records maintained?
2. Taxpayer’s or adviser’s expertise:
  - a. Does taxpayer have prior expertise in the business?
  - b. Does taxpayer seek advice from qualified advisers?
  - c. If adviser’s advice is not followed, are reasons documented?
3. Time and effort:
  - a. Does taxpayer devote substantial time to the activity?
  - b. Are others employed to carry on the activity?
4. Is there a reasonable expectation of asset appreciation (in lieu of operating profits)? Actual appreciation is not necessary; only an honest expectation of appreciation [Holmes, Robert E., 85 AFTR 2d 99-287, 99-2 USTC 50, 642 (6th Cir. 1999)].
5. Has the taxpayer previously turned a similar unsuccessful business into a profitable one?
6. Has the activity previously generated significant profits?
7. Are profits substantial in relation to any losses and the taxpayer’s investment?
8. Is the activity a meaningful part of the taxpayer’s overall sources of income?
9. Do profit motives outweigh any elements of personal pleasure or recreation associated with the activity?