



# **Activities Not Engaged in for Profit Audit Technique Guide**

## Internal Revenue Code Section 183

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The taxpayer names and addresses shown in this publication are hypothetical.

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## **I. Overview**

### **A. Purpose**

- (1) This guide is not designed to provide guidance for every conceivable administrative, procedural, and technical aspects of an IRC 183 examination. Its purpose is to provide guidance to examiners on how to conduct a quality examination of an “activity not engaged for profit” issue under IRC 183.
- (2) This guide also provides information to taxpayers, tax return preparers, tax representatives, tax accountants, and tax attorneys.
- (3) Users should augment the contents of this guide by researching their specific tax situations and any new tax laws that may have been enacted after issuance of this guide.

### **B. History**

- (1) The “hobby loss” rules were originally included in IRC 270 of the Internal Revenue Code of 1954 until it was repealed by the Tax Reform Act of 1969 and Congress concurrently enacted IRC 183.
- (2) Passage was based on Congress's desire to create objective standards to determine whether a taxpayer was engaged in an activity for the purpose of making a profit or just attempting to create and utilize losses to offset other unrelated income. Congress was requiring that the taxpayer have an “honest objective” of making a profit rather than a “reasonable expectation” of making a profit. The factors in the regulations were issued to comply with the congressional purpose of establishing objective tests to determine subjective intentions.
- (3) IRC 183 was part of the Tax Reform Act of 1969 and the regulations were issued in 1972. And both have remained substantially unchanged since then. So, the entire body of case law of nearly fifty years remains relevant today.
- (4) The “hobby loss” rules, as they are commonly referred to, have also been used to disallow deductions from many activities that are not hobbies including various tax shelter activities. So, a more accurate description is “activity not engaged in for profit”.

### **C. Non-Compliance**

- (1) An activity not engaged in for profit examination is both extensive and challenging because of the infinite variations of fact patterns and regulations which are quite often vague. Even for tax scholars, it can often prove highly difficult to figure out the difference between a legitimate business that is devoted to making a profit and an activity that is not.
- (2) The question of determining the taxpayer's intent is unavoidably very subjective. The answer to this question depends on the intent of a particular individual.

- (3) The determination of a particular person's profit objective intent is based on the application of all nine objective factors listed in the regulations.
- (4) While IRC 183 non-compliance probably accounts for a sizable portion of the estimated \$30 billion a year tax gap, it is difficult to precisely gauge the extent of the problem or effectively target compliance efforts.
- (5) In its September 27, 2007 report, TIGTA estimated that about 1.5 million taxpayers claimed net losses on Schedule C's that reduced their income from other sources in each of four consecutive years between 2002 and 2005. And 73 percent of those taxpayers were assisted by tax practitioners.
- (6) On April 12, 2016, TITGA issued its follow-up audit report and found that opportunities still exist for the IRS to identify and examine individual taxpayers who deduct losses from an activity not engaged in for profit to offset other income.
- (7) Its review of a statistically valid sample of 100 returns determined that 88 percent reflected indications that Schedule C businesses may not have been engaging in the activity for the primary purpose of making a profit. Consequently, TIGTA estimated that 7,511 returns in the total sample population of taxpayers may have inappropriately used losses from an activity not engaged in for profit to reduce taxes by as much as \$70.9 million for tax year 2013 alone.
- (8) TIGTA recommended that the IRS: (1) use its research capabilities to identify high-income individual returns with multiyear Schedule C losses and other factors that indicate the taxpayer may not have a profit objective for the activity; (2) emphasize the importance of conducting the required filing checks during the preliminary evaluation stage when examiners are determining whether to pursue an activity not engaged in for profit loss issue; and (3) to provide tools to assist examiners in documenting their activity not engaged in for profit issue conclusions.
- (9) It is important to note that the TIGTA audits limited the scope of these reviews to a specific segment of individuals filing Schedule C's. They did not include individual filing Schedule F's, partnerships, S corporations, estates, or trusts.

## **D. Terms and Definitions**

- (1) Profit Motive: Expenditures may only be deducted under IRC 162 if the facts and circumstances indicate that the taxpayer made them primarily in a furtherance of a bona fide profit motive activity independent of tax consequences. *Green v. Commissioner*, 507 F.3d 857, 871 (5th Cir. 2007).
- (2) Trade or Business: The Supreme Court interpreted "trade or business" for purposes of IRC 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit. *Commissioner v. Groetzinger*, 480 U.S. 23, 35 (1987).



- (3) Ordinary and Necessary: For payments to qualify as ordinary and necessary business expenses for income tax purposes, they must be appropriate, helpful, and of common or frequent occurrence in the type of business carried on by a taxpayer. *Tulia Feedlot, Inc. v. United States*, 513 F.2d 800, 804-05 (5th Cir. 1975).
- (4) Activity not Engaged in for Profit: An activity other than one with respect to which deductions are allowable for the taxable year under IRC 162 (trade or business) or under paragraph (1) or (2) of IRC 212 (production of income).” IRC 183(d).

## **II. Preliminary Examination Procedures**

### **A. Pre-Contact Procedures**

#### **A.1. Pre-Contact Analysis**

- (1) Examiners assume responsibility for certain procedural aspects of the case that includes performing an initial return screening to identify potential issues before contacting the taxpayer. This is important because it allows examiners to decide on the merits of the case. It also helps to reduce taxpayer burden and utilize resources effectively. See IRM 4.10.2 on Pre-Contact Responsibilities.

#### **A.2. Mandatory Filing Checks**

- (1) Examiners should use internal sources of information, including IDRS and CFOL to complete the required filing checks and determine if prior, subsequent, or other known related returns have been filed.

#### **A.3. Conducting an In-Depth Analysis**

- (1) After completing the initial return screening, examiners are responsible for determining the scope of the examination beginning with the issues on the classification check sheet.
- (2) When determining the scope and depth of the examination, examiners should perform a thorough review of the case file to identify any large, unusual, or questionable (LUQ) items beyond those issues identified on the classification check sheet. Examiners should also be alert for any missing schedules or inconsistencies between years.
- (3) The definition of a LUQ item depends on the examiner’s perception of the return as a whole and the separate items that are included on or missing from the return.
- (4) Although examiners are expected to identify and consider all LUQ items, not every issue should be examined. For instance, it is not proper to examine an issue unless the potential adjustment will materially affect the tax liability or will be important from a compliance viewpoint. In addition, examiners should

explain and document the items which are examined and the LUQ items which are accepted without examination.

- (5) Usually, a potential activity not engaged in for profit issue cannot be identified by simply looking at the return. Nonetheless, examiners should be alert for the “red flags” like those listed below.
  - The nature of the business or activity.
  - Multiple several years with little or no income and large losses.
  - Minimal income and large expenses for several years and those losses are offsetting other income.
  - The business or activity includes elements of recreation and/or personal pleasure.
- (6) Examiners should review the complete tax return including line items, credits, the balance sheet, elections and schedules, and any other items attached to the return. Examiners should review internal and external data such as:
  - IDRS: Integrated Data Retrieval System
  - CFOL: Corporate Files On-Line
  - CDE: Compliance Data Environment
  - MeF: Modernized e-File System
  - IRPTR: Information Returns Processing Transcript Request
  - Asset or People Locator Service
  - Internet Research
  - yK1 (if applicable)
- (7) Examiners should also become familiar with the issues by conducting preliminary research. Such as, a review of applicable code sections, treasury regulations, court cases, revenue rulings and revenue procedures, Audit Technique Guides (ATG), Knowledge Base (KB), and/or internal web pages.

## **B. Analysis of Income, Expenses, and Profit or (Loss)**

- (1) Examiners should prepare an Analysis of Income, Expenses, and Profit or (Loss) to evaluate the tax potential of the tax year under examination including any prior and subsequent years that may be involved. Examiners should document that this analysis was prepared, and such documentation should include the observations and conclusions the examiner made.
  - [Exhibit 1: Analysis of Income, Expenses, and Profit or \(Loss\).](#)

## **C. Initial Information Document Request**

- (1) The Initial Information Document Request (IDR) is issued at the beginning of an examination to request basic books and records and to obtain general information about a taxpayer's business. And examiners may not be aware that an activity not engaged in for profit examination is warranted until the initial interview with the taxpayer has begun.
- (2) As a result, the initial IDR usually does not include a request for information and/or documents relating to the potential activity not engaged in for profit issue.
- (3) However, if the examiner subsequently determines that an issue involving an activity not engaged in for profit warrants examination, the examiner can request the information and/or documents in a subsequent IDR. And, if needed, the examiner may also determine that another interview is necessary to specifically address the activity not engaged in for profit issue. This is especially appropriate in situations where the taxpayer did not participate in the initial interview.

#### **D. Initial Interview**

- (1) The authority to conduct interviews and request information is authorized by IRC 7602. There are different types of interviews. They include, initial, subsequent, third party, and closing interviews. The initial interview should always be held with the taxpayer and/or person(s) having the most knowledge concerning the total financial picture and history of the person or entity being examined.
- (2) The initial interview is conducted at the beginning of an examination to request general information about the taxpayer's business, its books and records, and the tax issues under examination. If an activity not engaged in for profit issue was not identified as a tax issue prior to the initial interview, examiners most likely would not have prepared for conducting a taxpayer interview to address an activity not engaged in for profit issue.
- (3) An interview involving an activity not engaged in for profit can be extensive and is not something an examiner can do without proper preparation. Such an interview also needs to be tailored to the nature of the activity and the taxpayer's circumstances, which may not be known until after the initial interview has begun.
- (4) However, if the examiner later determines that an issue involving an activity not engaged in for profit warrants examination, the examiner can request a subsequent interview with the taxpayer to specifically address the activity not engaged in for profit issue. This is especially appropriate in situations where the taxpayer, for whatever reason, was neither present nor participated in the initial interview.
- (5) Due to the nature of an activity not engaged in for profit issue, it is imperative that the taxpayer be interviewed in person and not by telephone, video

conferencing, or by submitting the questions to the taxpayer or representative in writing. The in-person interview is necessary so that the examiner can ask follow-up questions and visually observe the taxpayer's demeanor and/or body language.

- (6) Examiners are trying to assess a taxpayer's subjective intentions and/or personal motivations for starting and continuing to engage in the activity. The answers to which a taxpayer may be reluctant to provide.
- (7) In addition, a taxpayer may provide incomplete and unresponsive answers that have little or no probative value. Any reply, relative to a pertinent matter, that is not complete and to the point should be followed up by questioning the taxpayer about all knowledge they have concerning every facet of the topic. The examiner should follow through on every pertinent lead or incomplete answer and continue asking questions until all information which can reasonably be expected has been secured.
- (8) The following suggestions will help the examiner obtain answers that are complete and accurate:
  - Use short questions confined to one topic that can be clearly and easily understood.
  - Ask questions that require narrative answers, avoiding " yes" and "no" answers, whenever possible.
  - Whenever possible, avoid questions that suggest part of the answer, i.e., leading questions.
  - Ask how the taxpayer learned what he/she states to be fact. The taxpayer should also be required to provide a factual basis for any conclusions stated. Important Note: Remember that for purposes of IRC 183, more weight is given to objective facts than to the taxpayer's subjective statement of his/her intent.
  - Be alert to instances where the taxpayer starts wandering or going off topic and redirect the taxpayer's attention to the current talking point. Where possible, ask questions that require a direct response.
  - Concentrate on the answers the taxpayer is providing, not the next question.
  - To ensure the accurate collection of facts, the examiner should clearly understand each reply provided and ensure that any lack of clarity is eliminated before continuing.
  - When all important points have been resolved, terminate the interview. If possible, leave the door open for further meetings with the taxpayer.
- (9) The Report Generation Software (RGS) contains various Lead Sheets for use by examiners. Revenue Agents should use Lead Sheet 125-2, Initial Interview Questions.

- (10) An IRC 183 examination interview is usually extensive. Its purpose is to inquire into the subjective intentions of the taxpayer and use objective factors to determine whether the taxpayer has the requisite profit motive.
- (11) Examiners should consider preparing a memorandum of interview (MOI) immediately following the meeting or shortly thereafter, to fully document the statements and replies made by the taxpayer. The MOI and the handwritten interview notes will serve to document statements made by the taxpayer, refute subsequent contradictory statements, and support examination positions taken.
- (12) Examiners should consider providing the taxpayer with an opportunity to review and confirm the accuracy of the MOI to avoid any misunderstanding or misinterpretation as to the taxpayer's statements.
- (13) Although IRC 7521(c) states that an examiner cannot require a taxpayer to accompany an authorized representative to an examination interview in the absence of an administrative summons, the taxpayer's voluntary presence at the interview can be requested through the representative as a means of expediting the examination process.
- (14) If the representative indicates the taxpayer will not be present for the initial interview, examiners should confirm with the representative that they have first-hand knowledge of the taxpayer's intention to make a profit, business, business practices, bookkeeping methods, accounting practices, and daily operations.
- (15) Examiners should not conduct the examination with someone who will only serve as a courier, shuffling back and forth between the examiner and the taxpayer with IRS submitting questions and the taxpayer responding with answers to those questions.
- (16) A representative may claim to have firsthand knowledge, but when questions are asked it may become clear that he/she is unable to give adequate answers. If an examiner determines that the representative does not have sufficient knowledge of the taxpayer's intentions and/or business operations, examiners should request a subsequent interview with the taxpayer or other individual who does possess such knowledge and/or information.
- (17) In some situations, examiners may need to consider pursuing third party contacts in order to obtain corroborating information.
- (18) If the taxpayer's representative does not comply with the request to interview someone more knowledgeable, including the taxpayer, examiners should consider management involvement, issuing an administrative summons to the taxpayer pursuant to IRC 7521(c) and/or by-passing the representative. More information can be found in IRM 4.10.2 and IRM 4.11.55.2.
- (19) Examiners can also find additional guidance on interviews in IRM 4.10.3.3.

## **E. Place of Examination**

- (1) To the extent possible, field examinations should be conducted at the taxpayer's residence, place of business, or where the taxpayer's original books and records are maintained. In the case of a sole proprietorship or business entity, this will usually be the taxpayer's principal place of business. See IRM 4.10.2.9.2, Place and Time of Examination.

## **F. Tour of Business**

- (1) The physical observation of the taxpayer's operation, or tour of business site, is an integral part of the examination process. Viewing the taxpayer's facilities and observing business activities is an opportunity to acquire an overview of the business operation; establish that the books and records accurately reflect actual business operations; observe and test internal controls; clarify information obtained through interviews; and identify potential examination issues.
- (2) Treas. Reg. 301.7605-1 provides that regardless of where an examination takes place, the IRS may visit the taxpayer's place of business or residence to establish facts that can only be established by direct visit, such as inventory or asset verification.
- (3) Tours should be conducted after the initial interview and early in the examination process. Examiners should be alert to the physical surroundings to confirm that assets identified on the tax return are physically present and to identify assets that are not represented on the return. When necessary, examiners should ask questions to confirm an understanding of what is observed.
- (4) Examiners may not always be able to perform a physical tour of the taxpayer's activity. So, examiners may consider alternatives such as photographs, videos, satellite mapping, internet websites, or social media, or other methods. If alternative methods are utilized, the examiner should verify their authenticity and that they are in fact those belonging the taxpayer's activity.

## **G. Report Generation Software (RGS) Lead Sheet – Activity Not Engaged in for Profit**

- (1) An RGS Lead Sheet is available for an "Activity Not Engaged in for Profit" issue. It provides suggested issue-specific audit steps, code section(s), relevant law, IMF/SAIN, codes, and other guidance (if applicable) for select issues.
- (2) Examiners should customize the examination steps for their specific case as needed by:
  - Adding appropriate examination steps and techniques that are specific to the issue.
  - Modifying examination steps as necessary to clearly indicate the steps taken.

- Adding additional examination steps from other resources, when necessary.
- (3) The Activity Not Engaged in for Profit (IRC 183) Lead Sheet can be viewed by clicking the links below:
- [Exhibit 2: RGS IRC 183 Lead Sheet \(Page 1\)](#)
  - [Exhibit 3: RGS IRC 183 Lead Sheet \(Page 2\)](#)

### III. IRC 183

#### A. Introduction

- (1) An "activity not engaged in for profit" means any activity other than one with respect to which deductions are allowable for the taxable year under IRC 162 (trade or business) or under paragraph (1) or (2) of IRC 212 (production of income or investment). See IRC 183(c).
- (2) The term "trade or business" is not defined in the Code or the Treasury Regulations. But, in *Commissioner v. Groetzinger*, the Supreme Court interpreted "trade or business" for purposes of IRC 162 to mean an activity conducted with "continuity and regularity" and with the primary purpose of earning income or making profit.
- (3) The expenses can only be deducted if the facts and circumstances indicate that the taxpayer made them primarily in furtherance of a bona fide profit motive activity independent of tax consequences. *Curcio v. Commissioner*, 689 F.3d 217, 223-26 (2d Cir. 2012).
- (4) Deductions allowed under IRC 162 or IRC 212 may offset income from other sources, but the deductions allowed under IRC 183 cannot.
- (5) The absence of the requisite profit objective under IRC 162 or IRC 212, may trigger the application of IRC 183. Consequently, the deductions will generally be limited to the extent of gross income from the activity during the tax year. In addition, any excess deductions cannot offset income from other unrelated sources. See IRC 183(b).

#### B. General Rule

- (1) IRC 183(a) – "General Rule - In the case of an activity engaged in by an individual or an S corporation, if such activity is not engaged in for profit, no deduction attributable to such activity shall be allowed under this chapter except as provided in this."
- (2) Comments:
- (3) IRC 183 applies to the following:
  - The statute explicitly identifies individuals and S corporations.

- It applies to partnerships pursuant to Rev. Rul. 77-320 which holds that IRC 183 applies to the activities of a partnership. The provisions are applied at the partnership level and reflected in the partners' distributive shares. Also, IRC 703(a) generally provides that the taxable income of a partner shall be computed in the same manner as in the case of an individual.
- It even applies to estates and trusts pursuant to Treas. Reg. 1.183-1(a) which states that "pursuant to IRC 641(b), the taxable income of an estate or trust is computed in the same manner as in the case of an individual. Accordingly, where an estate or trust engages in an activity that is not for profit, the rules of IRC 183 apply in computing the allowable deductions of such trust or estate."

(4) IRC 183 does not apply to a C corporation.

### **C. Deductions Allowable**

- (1) IRC 183(b) - "In the case of an activity not engaged in for profit to which subsection (a) applies, there shall be allowed-- (1) the deductions which would be allowable under this chapter for the taxable year without regard to whether or not such activity is engaged in for profit, and (2) a deduction equal to the amount of the deductions which would be allowable under this chapter for the taxable year only if such activity were engaged in for profit, but only to the extent that the gross income derived from such activity for the taxable year exceeds the deductions allowable by reason of paragraph (1)."
- (2) Comments:
- (3) Paragraph (1): The statute allows deductions that are allowed regardless of whether the activity was engaged in for profit or not. These deductions are deductions that are otherwise allowable under other code sections such as IRC 163 for interest and IRC 164 for taxes.
- (4) Paragraph (2): The statute allows deductions that are not allowed under paragraph (1) but which would be allowable if activity was engaged in for profit under IRC 162 or IRC 212. However, the amount allowed is limited to the gross income of the activity.
- (5) Deductions allowed under IRC 183 are generally allowable as miscellaneous itemized deductions and are subject to the 2% adjusted gross income (AGI) limit on miscellaneous itemized deductions if the taxpayer qualifies and elects to itemize the deductions on Schedule A. However, the Tax Credits and Jobs Act (TCJA) suspended these deductions for tax years beginning after December 31, 2017, and before January 1, 2026.

### **D. Activity Not Engage in for Profit Defined**



- (1) IRC 183(c) – “For purposes of this section, the term ‘activity not engaged in for profit’ means any activity other than one with respect to which deductions are allowable for the taxable year under IRC 162 or under paragraph (1) or (2) of section 212.”
- (2) Comments:
- (3) The statutory language casts a very wide net in defining an activity not engaged in for profit. An activity not engaged in for profit is any activity except an activity that qualifies under IRC 162 (trade or business) or IRC 212 (production of income or investment).
- (4) Although IRC 183 was originally enacted primarily to limit the deduction of farm hobby losses, it has also been applied to a wide variety of activities including: acting, art work, writing, auto racing, gunsmithing, practicing law, making movies and videotapes, operating a talent agency, dog breeding, horse breeding, cattle ranching, farming, operating a bed and breakfast, aircraft rentals, boat chartering, boat racing, fishing, golfing, venture capitalization, used car sales, mining and drilling, sound recordings, Amway distributorships, tax shelters, and drag racing.
- (5) The IRS also identified photography, stamp collecting, bowling, gambling, motocross racing, horse racing, artists, entertainers, and craft sales as potential IRC 183 activities.

## **E. Presumption**

- (1) IRC 183(d) - “If the gross income derived from an activity for 3 or more of the taxable years in the period of 5 consecutive taxable years which ends with the taxable year exceeds the deductions attributable to such activity (determined without regard to whether or not such activity is engaged in for profit), then, unless the Secretary establishes to the contrary, such activity shall be presumed for purposes of this chapter for such taxable year to be an activity engaged in for profit. In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, the preceding sentence shall be applied by substituting ‘2’ for ‘3’ and ‘7’ for ‘5’.”
- (2) Comments:
- (3) The regulations have not been amended since October 19, 1982, and do not reflect the 1986 amendment increasing the number of profit years required from two to three out of five years.
- (4) Section 183(d) gives a taxpayer a presumption of profit intent if gross income from an activity exceeds the deductions from the activity for at least 3 out of 5 taxable years ending with the relevant taxable year.
- (5) In the case of an activity which consists in major part of the breeding, training, showing, or racing of horses, it is 2 out of 7 taxable years ending with the relevant taxable year.

- (6) Under the regulations, the presumption applies only for the 3rd profitable year and all subsequent years within the 5-year period beginning with the first profit year. IRC 183(d) should not be confused with the provisions under IRC 183(e)(2) which applies the presumption to every year in the initial presumption period.
- (7) A presumption period is defined as a period consisting of 5 (or 7 in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) consecutive tax years. Since a full presumption period may not be available when the taxpayer first begins the activity, IRC 183(e) allows the taxpayer to make an election to defer the determination until the taxpayer has had the opportunity to achieve the presumption period during the initial years of the activity. IRC 183(e) is discussed later.
- (8) Example 1: Illustration of the Presumption
- (9) Assume a taxpayer who is engaged in an activity has the following profits and losses:

(10)

<b>TAX YEAR</b>	<b>PROFIT</b>	<b>(LOSS)</b>
2013		(\$30,000)
2014	\$5,000	
2015		(\$60,000)
2016	\$2,000	
2017	\$5,000	
2018		(\$70,000)
2019	\$3,000	
2020		(\$63,000)

(11)

- First Presumption Period: The 1st 5-year presumption period begins with the 1st profit year or 2014, but the benefit of the presumption does not begin until the 3rd profit year or 2017.
- The presumption is not available for tax years 2014 through 2016 because the presumption does not apply until the 3rd profit year.
- The presumption is only available during the 1st presumption period for tax years 2017 and 2018.
- Second Presumption Period: The 2nd 5-year presumption period begins with the 2nd profit year or 2016 and continues through 2020.
- The presumption applies to the 3rd profit year or 2019 and will be of benefit to the taxpayer for 2019 and 2020.

- (12) Even if the taxpayer qualifies for the presumption, the IRS can rebut that presumption. But the burden of proving that the activity is not engaged in for profit shifts to the IRS.
- (13) Examiners cannot use IRC 183(d) as the reason for disallowing losses under IRC 183 even when the taxpayer fails to meet the presumption.
- (14) Examiners should be alert to the possibility that income and/or expenses may have been manipulated for the sole purpose of satisfying the presumption rule.

## **F. Special Rules – In General**

- (1) IRC 183(e)(1) - “In general, a determination as to whether the presumption provided by subsection (d) applies with respect to any activity shall, if the taxpayer so elects, not be made before the close of the fourth taxable year (sixth taxable year, in the case of an activity described in the last sentence of such subsection) following the taxable year in which the taxpayer first engages in the activity.”
- (2) Comments:
- (3) This only applies to the initial presumption period where an activity has been in operation for less than 5 (or 7 in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) tax years. This should not be confused with the presumption under IRC 183(d).
- (4) IRC 183(e)(1) allows the taxpayer to elect to postpone a determination until the close of the 4th (or 6th in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) tax year following the tax year that the taxpayer first engages in the activity.

## **G. Special Rules – Initial Period**

- (1) IRC 183(e)(2) - “If the taxpayer makes an election under paragraph (1), the presumption provided by subsection (d) shall apply to each taxable year in the 5-taxable year (or 7-taxable year) period beginning with the taxable year in which the taxpayer first engages in the activity, if the gross income derived from the activity for 3 (or 2 if applicable) or more of the taxable years in such period exceeds the deductions attributable to the activity (determined without regard to whether or not the activity is engaged in for profit).”
- (2) Comments:
- (3) If the taxpayer files an election to postpone the determination as to whether the presumption applies that an activity is engaged in for profit, the presumption will apply to each tax year in the 5 (or 7 in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) tax year period beginning with the taxable year in which the taxpayer first engages in the activity.

- (4) However, this only applies if the gross income derived from the activity for 3 (or 2 in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) or more of the taxable years in such period exceeds the deductions attributable to the activity
- (5) If the taxpayer satisfies the presumption rule during the initial presumption period, the presumption will apply to each of the 5 (or 7 in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) tax years in the initial presumption period.
- (6) Again, IRC 183(e)(1) only applies to the initial presumption period. This should not be confused with the presumption period discussed under IRC 183(d).

## H. Special Rules – Election

- (1) IRC 183(e)(3) - “An election under paragraph (1) shall be made at such time and manner, and subject to such terms and conditions, as the Secretary may prescribe.”
- (2) Comments:
- (3) The taxpayer should make an election by filing Form 5213, Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit, with the IRS service center where the taxpayer's return is filed.
  - [Exhibit 4: Form 5213, Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit.](#)
- (4) For the election to be timely, the taxpayer must file Form 5213 within 3 years after the due date of the return (determined without regard to extensions of time to file) for the first taxable year in which the taxpayer engages in the activity.
- (5) Or, if the taxpayer received a written notice (statutory notice of deficiency) from the appropriate Internal Revenue Service official proposing to disallow deductions attributable to an activity not engaged in for profit under IRC 183, the taxpayer must file Form 5213 no later than 60 days after the taxpayer received such notice.
- (6) Examiners are highly encouraged to refer to the Form 5213 Instructions when reviewing and determining whether a taxpayer's election is valid (accurate, complete, and timely) because the election may affect the statute of limitations. A valid election will extend the statute of limitations, but an invalid election will not. Statute of limitations is discussed in the next section. See IRM 4.1.1.7.12.2, Determine if Election Is Valid and/or Form Is Complete.
  - [Exhibit 5: Instructions to Form 5213, Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit.](#)

## I. Special Rules – Time for Assessing Deficiency Attributable to

## Activity

- (1) IRC 183(e)(4) - "If a taxpayer makes an election under paragraph (1) with respect to an activity, the statutory period for the assessment of any deficiency attributable to such activity shall not expire before the expiration of 2 years after the date prescribed by law (determined without extensions) for filing the return of tax under chapter 1 for the last taxable year in the period of 5 taxable years (or 7 taxable years) to which the election relates. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such an assessment."
- (2) Comments:
- (3) A valid (accurate, complete, and timely) election on Form 5213 will extend the period of limitations for the determination and allowance of overpayments.
- (4) In *Wadlow v. Commissioner*, 112 T.C. 247 (1999), the Tax Court concluded that Congress intended that an IRC 183(e)(1) election supersedes the requirements of IRC 6501(c)(4) which requires the mutual consent in writing of the IRS and the taxpayer for an extension of the limitations period.
- (5) A taxpayer's valid (accurate, complete, and timely) election on Form 5213 automatically extends the statute of limitations for all years in the postponement period until 2-years after the due date of the return for the last year of the postponement period. The extension also applies to partners or shareholders in the activity.
- (6) As discussed earlier, the initial presumption period begins with the taxable year in which the taxpayer first engages in the activity and ends with the close of the 5<sup>th</sup> (or 7<sup>th</sup> in the case of an activity which consists in major part of the breeding, training, showing, or racing of horses) tax year in the initial presumption period.
- (7) Form 5213 should be reviewed to determine that it is accurate, complete, and timely. See IRM 4.1.1.7.12.2, Determine if Election Is Valid and/or Form Is Complete.
- (8) This automatic extension applies only to a deficiency attributable to the activity and does not extend the statute of limitations for items that are not related to IRC 183.
- (9) Additional information and guidance are provided in IRM 4.10.13,6 Examination of Returns, Certain Technical Issues, Activities Not Engaged in For Profit - Hobby Loss (IRC 183).

## IV. Special Considerations

### A. Multiple Activities

- (1) If a taxpayer engages in two or more separate activities, deductions and income from each separate activity are not aggregated either in determining whether a

particular activity is engaged in for profit or in applying the limitations under IRC 183. Treas. Regs. 1.183-1(d).

- (2) Multiple activities may be treated as one activity if the activities are sufficiently interconnected. The regulations define an activity and provide that where the taxpayer is engaged in several activities, each of these may be a separate activity, or several activities may constitute one activity. In ascertaining the activity or activities of the taxpayer, all the facts and circumstances of the case must be considered. The most significant facts and circumstances in making this determination are:
  - The degree of organizational and economic interrelationship of various activities.
  - The business purpose which is served by carrying on the various activities separately or together in a trade or business or in an investment setting.
  - The similarity of various activities.
- (3) The Commissioner will generally accept the characterization by the taxpayer of several activities either as a single activity or as separate activities. However, the taxpayer's characterization will not be accepted if the characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.

## **B. Farming Activities and Farmland Appreciation**

- (1) Where land is purchased with the intent to profit from its appreciation and the taxpayer also farms on the land, the farming and the holding of the land will ordinarily be considered a single activity. But only if the farming activity reduces the net cost of carrying the land for its appreciation.
- (2) The purpose of this regulation is to prevent taxpayers who are engaged in farming activities from offsetting farming losses with land appreciation. If taxpayers were able to successfully achieve this result, the IRC 183 gross income limit on farm losses would be rendered meaningless because farming requires a lot of land.
- (3) Farming and holding of the land will be considered a single activity if the income from farming exceeds the farming expenses that are not directly attributable to the holding of the land. Deductions other than those directly attributable to the holding of the land include interest on a mortgage secured by the land, property taxes attributable to the land, improvements to the land, and depreciation of improvements to the land. See Treas. Reg. 1.183-1(d).

## **V. The Nine Factors in Treasury Regulation 1.183(2)(b2)**

### **A. Introduction**

- (1) Examiners should ascertain the taxpayer's intent for engaging in the activity to determine if the taxpayer had the requisite profit motive. While this is very

subjective, the regulations require a focus on objective factors. Consequently, a determination as to whether an activity is engaged in for profit can only be made by applying the objective standards in the regulations and considering all facts and circumstances of each case.

- (2) A taxpayer's mere statement of intent is given less weight than the objective facts. For purposes of IRC 183, the facts and circumstances are to be considered without regard to the taxpayer's subjective intent. This implies that the taxpayer must have entered and continued to operate the activity with the objective of making a profit
- (3) The regulations provide that all the facts and circumstances must be considered when evaluating the taxpayer's profit intent. So, balancing all the relevant factors is the correct way of determining whether a profit motive exists. Some factors may not apply, but examiners should still document the workpapers that they were considered.
- (4) The regulations state that no one factor, or simple mathematical preponderance of the factors is conclusive. And even factors not listed in the regulations may be the deciding factor.
- (5) The Objective Factors Decision Matrix is a one-page snapshot job aid that examiners may find useful in managing the developmental status of each factor.
  - [Exhibit 6: Objective Factors Decision Matrix](#).

## **B. Factor 1 – The Manner in Which the Taxpayer Carries on the Activity**

- (1) Regulation: “The fact that the taxpayer carries on the activity in a businesslike manner and maintains complete and accurate books and records may indicate that the activity is engaged in for profit. Similarly, where an activity is carried on in a manner substantially similar to other activities of the same nature which are profitable, a profit motive may be indicated. A change of operating methods, adoption of new techniques or abandonment of unprofitable methods in a manner consistent with an intent to improve profitability may also indicate a profit motive.” Treas. Reg. 1.183(2)(b)(1).
- (2) Issue: Whether the taxpayer conducts the activity in a businesslike manner, maintains complete and accurate books, and records, and made changes to operating methods with the intent to improve profitability.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques: Generally, the term "business" refers to the organized efforts and activities of individuals to produce and sell goods and services for profit. The term “businesslike” generally refers to a person who carries out tasks

efficiently, systematically, and in a practical way without wasting time or being distracted by personal or other concerns. Therefore, an activity is more likely to be profitable if it is operated in a businesslike manner.

- (5) If the activity is in its “start-up” phase, examiners should develop this factor as well by researching and documenting the normal start-up phase for the activity.
- (6) A taxpayer may have an intent to make a profit but be losing money because his activity is still within its start-up phase. Some activities have start-up phases that last several years. Examiners should anticipate that the taxpayer’s representative will argue to the appeals officer or court that the activity is still within its start-up phase where losses are expected.
- (7) If it is determined that the activity has gone beyond its start-up phase, examiners should discuss the issue in the examination report and cite a reputable industry source for the start-up phase.
- (8) Businesslike Manner: According to the Small Business Administration, there are ten fundamental steps for operating a successful (profitable) business. They include idea, business plan, funding, location, legal structure, name, registration, identification numbers, licenses, permits, and bank account.
- (9) Without diminishing the importance of them all, four are particularly of interest when determining a taxpayer’s profit intent. These items include idea, business plan, bank account, and location. In fact, many tax practitioners advise their clients to develop a business plan and open a business bank account among other things.
- (10) Examiners should inquire into the taxpayer’s: (1) idea, (2) business plan, (3) business bank account, and (4) business location.
  - Idea: Behind every business is an idea and every idea has a story, so let the taxpayer tell their story. Their stories are not only interesting, but they may also provide clues and other important information relevant to the taxpayer’s motives for engaging in the activity.
  - Business Plan: While there is no right or wrong way to prepare a business plan, a plan is better than no plan. The plan can be scribbled on a scrap piece of paper or it can be professionally prepared. In some situations, the business plan may not even be written because it is all in the taxpayer’s mind. Nonetheless, it is important to determine what the taxpayer’s “plan” is for making the activity profitable. And even more important is whether the taxpayer put the plan into action. A plan without action is not any better than not having a plan at all.
  - Business Bank Account: A business bank account helps the taxpayer to separate personal and business activity and assess the profitability of the activity. This is discussed in greater detail below under the “Books and Records” section.



- Business Location: This is important if the location has an impact on profitability or if the taxpayer plans to retire on the land, as in the case of “farming,” and the taxpayer expects to profit from the land’s appreciation.
- (11) When developing the issue on whether the taxpayer carries on the activity in a businesslike manner, examiners should consider the following:
- Determine how the taxpayer operates the activity.
  - Determine how another person would operate a similar, but profitable activity.
  - Compare the similarities and differences in operating methods
- (12) Books and Records: Examiners should begin by determining what books and records are being maintained. And then, determine how the taxpayer used their books and records.
- (13) Books and records are used for tax purposes, but this factor emphasizes their use to: (1) determine if the activity is profitable; and (2) identifying changes to operating methods as a means of reducing expenses and improving profitability. The latter is discussed in greater detail below under the “Change in Operating Methods” section.
- (14) What constitutes adequate recordkeeping can vary depending upon the nature of the activity and the taxpayer’s accounting needs. Although a taxpayer’s books and records do not need to be sophisticated, they should allow the taxpayer to make sound business decisions. It has been determined that even a “shoebox” record keeping method done in an “unprofessional” and disorganized manner may be adequate as long as they allowed the taxpayer to know that the activity is not turning a profit.
- (15) However, courts have generally held that the purpose of maintaining books and records is more than to record income and expenses for tax purposes. They should provide a means of periodically determining profitability and analyzing expenses so that cost saving measures may be implemented in a timely and efficient manner for the primary purpose of improving profitability.
- (16) Change in Operating Methods: If an activity is not profitable year after year, it is reasonable to expect the taxpayer to review their operating methods with an eye towards identifying potential changes that may improve profitability. It is intriguing that some taxpayers operate an unprofitable activity by doing the same thing year after year with the expectation that the outcome will be different. It just does not work that way if a profit objective is involved.
- (17) Examiners should inquire about any changes to the activity’s operating methods and gather the details for each change. This includes the following items:
- Who identified the change and who implemented the change?
  - What operating method was changed and what were the results?
  - When was the change identified and when was the change implemented?

- Where was the change made?
  - Why was the change made or why was the change not made?
  - How was the change implemented?
- (18) Remember to focus on the changes to operating methods that are intended to improve profitability. It is not sufficient that a change be made; it must also be implemented in a way that is consistent with the intent of improving profitability.
- (19) The following steps should be taken when evaluating changes to operating methods.
- Establish the baseline by determining the original operating methods since the activity's inception.
  - Identify all the changes that were made to the activity's operational methods.
  - Compare the income, expenses, and overall profitability during the period to which a change in operating methods occurred. Although profitability may not have improved, it should be sufficient provided that the taxpayer implemented the change with the intention of improving profitability.
- (20) The regulations mention the two kinds of operating method changes shown below and emphasizes the importance that they be implemented in a way that is consistent with an intent to improve profitability.
- Adopting new techniques.
  - Abandoning of unprofitable methods.
- (21) Examiners should also consider the nature of the changes because the results, if any, may not be determined immediately. While some results may be observed in the short-term, others may require a longer period before any assessment can be made.
- (22) Examiners should adequately develop and document the facts and circumstances relevant to this factor because this factor may also be the "tipping-point" in the overall determination on profit objective.
- (23) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **C. Factor 2 - Expertise of the Taxpayer or His Advisors**

- (1) Regulation: "Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are expert therein, may indicate that the taxpayer has a profit motive where the taxpayer carries on the activity in accordance with such practices. Where a taxpayer has such preparation or procures such expert advice but does not carry on the activity in accordance with such practices, a lack of intent to derive profit may be indicated unless it appears that the taxpayer is attempting to develop new or superior techniques which may result in profits from the activity." Treas. Reg. 1.183(2)(b)(2).
- (2) Issue: Whether the taxpayer has the expertise in operating the activity, consulted those who are experts, and followed such practices and/or advice.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques: The techniques for this factor are discussed in the sections shown below:
- (5) Expertise of the Taxpayer: Examiners should inquire about what the taxpayer did to prepare for operating the activity. This may include informal, formal, or a degree in a related field of study. Informal methods can include attending seminars or trade meetings, study at home, or buying books or other learning aids in the process of developing expertise on the accepted business, economic, and scientific practices of the activity.
- (6) Although professional experts may not be needed if the taxpayer is sufficiently knowledgeable about the activity and can be considered an expert, the taxpayer's expertise can be disputed if the activity is not profitable.
- (7) Consult with Advisors: Despite the taxpayer's expertise, examiners should still ask the taxpayer if they consulted with any experts. If the taxpayer consulted with advisors, examiners should obtain the names, position titles, addresses, and credentials of the advisors. If necessary, the taxpayer's use of advisors can be verified by inspecting invoices, consulting reports, or cancelled checks made out to the expert, consultant, or advisor.
- (8) Examiners should also inquire as to how the taxpayer selected the advisor(s) to determine if a personal relationship exists that may affect the credibility of any advice provided.
- (9) If advisors are consulted, examiners should request a copy of the consulting report. If there are no written consulting reports, examiners should ask the taxpayer to provide details as to what specifically the advisor recommended. Examiners should consider interviewing the advisors, pursuing a third-party contact, or issuing a summons as necessary.
- (10) Follow Advisor's Advice: It is equally important for examiners to inquire as to whether the taxpayer followed the advisor's advice and operated the activity in

accordance with those recommendations. If the taxpayer did not follow their advice, examiners should ask the taxpayer to explain and provide their reasons for not doing so. It is possible that the taxpayer's reasons may have merit. The regulations provide an exception if the taxpayer is attempting to develop new or superior techniques that may result in profits.

- (11) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

#### **D. Factor 3 - Time and Effort Expended by the Taxpayer in Carrying on the Activity**

- (1) Regulation: "The fact that the taxpayer devotes much of his personal time and effort to carrying on an activity, particularly if the activity does not have substantial personal or recreational aspects, may indicate an intention to derive a profit. A taxpayer's withdrawal from another occupation to devote most of his energies to the activity may also be evidence that the activity is engaged in for profit. The fact that the taxpayer devotes a limited amount of time to an activity does not necessarily indicate lack of profit motive where the taxpayer employs competent and qualified persons to carry on such activity." Treas. Reg. 1.183(2)(b)(3).
- (2) Issue: Whether the time and effort expended by the taxpayer on carrying on the activity is consistent with an intent to make a profit.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) While the primary focus of this factor is on the time and effort spent by the taxpayer in carrying on the activity, it draws on the financial status of the taxpayer (factor 8) and elements of personal pleasure or recreation (factor 9) for context.
- (6) Generally, the time and effort spent by the taxpayer in operating the activity does not need to be exclusive or significant if competent management or employees are hired to operate the activity. However, it is important for the taxpayer to account for how they spend all their time and not just the time spend on operating the activity. This includes all business, investment, employment (e.g., W-2 employee), and personal activities.

- (7) Why is the financial status of the taxpayer relevant to this factor? This information is necessary to evaluate to what degree to the taxpayer relies on the profitability of the activity for their sole source of money or livelihood. If the taxpayer's reliance on the activity's profitability is significant, it is more likely that they have a profit objective. On the other hand, if the taxpayer has substantial income from other sources and does not rely on the profitability of the activity to sustain their livelihood, then a profit objective may not be present.
- (8) For example, if a taxpayer quit another activity (e.g., job as a W-2 employee) so that they could devote more time and effort the activity, it would suggest that a profit objective is present. Conversely, if the taxpayer spent little time and effort in carrying on the activity so that they could be employed elsewhere or to pursue personal or recreational activities, this may indicate a lack of profit objective.
- (9) Why are elements of personal pleasure or recreation relevant to this factor? They are important considerations because the taxpayer's personal motivations may outweigh their profit motivations for expending a significant amount of time and effort to the activity. Similarly, if the activity has little or no elements of personal pleasure or recreation, the taxpayer may choose to devote less time and effort to the activity.
- (10) Examiners should consider an alternative position under IRC 469 for passive activities where applicable.
- (11) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **E. Factor 4 - Expectation that Assets Used in the Activity may Appreciate in Value**

- (1) Regulation: "The term profit encompasses appreciation in the value of assets, such as land, used in the activity. Thus, the taxpayer may intend to derive a profit from the operation of the activity, and may also intend that, even if no profit from current operations is derived, an overall profit will result when appreciation in the value of land used in the activity is realized since income from the activity together with the appreciation of land will exceed expenses of operation. See, however, paragraph (d) of IRC 1.183-1 for definition of an activity in this connection." Treas. Reg. 1.183(2)(b)(4).
- (2) Issue: Whether the taxpayer expects the assets used in the activity may appreciate.

- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) The term “profit” for purposes of IRC 183 includes the appreciation of assets, such as land, that are used in the activity. And, despite the history of losses, an overall profit may occur if the appreciation of the assets is realized. Some courts seem more likely to consider unrealized appreciation of assets if the appreciation outweighs cumulative losses and not the IRC 183 focus on an annual profit computation. *Wroblewski v. Commissioner*, 32 T.C.M. 169, 172 (1973).
- (6) Examiners should ask the taxpayer if they are relying on an asset (primary land) to appreciate and overcome the activity’s losses. If there are several parcels of land, the taxpayer should be asked to specify which parcel as the taxpayer may be relying on all the land or perhaps some of the land. This needs to be established because as in the case of farming activities, farms usually include acreage for farming as well as a parcel of land upon which the personal residence sits on.
- (7) Once the land has been identified, examiners should also ask the taxpayer for his/her motivations for purchasing the land. This is critical because if a taxpayer fails to consider the possibility of asset appreciation before purchasing the requisite assets for a given activity, this may tend to indicate that the taxpayer was not expecting an increase in the value of the acquired assets. *Scull v. Commissioner*, T.C. Memo 1983-33.
- (8) Examiners should ask the taxpayer if they have offered to sell the land or if anyone had offered to buy the land. If so, examiners should request all the details.
- (9) Examiners should ask the taxpayer to provide supporting documents on the potential for appreciation of land by reviewing appraisals or comparables for properties like the taxpayer’s property.
- (10) Examiners should determine if the land used in operating the activity and holding of the land is a single activity or if they are multiple activities.
- (11) Multiple Activities:
- (12) “If a taxpayer engages in two or more separate activities, deductions and income from each separate activity are not aggregated either in determining whether a particular activity is engaged in for profit or in applying section 183.” *Treas. Regs. 1.183-1(d)*.
- (13) Multiple activities may be treated as one activity if the activities are sufficiently interconnected. The regulations define an activity and provide that where the taxpayer is engaged in several activities, each of these may be a separate

activity, or several activities may constitute one activity. In ascertaining the activity or activities of the taxpayer, all the facts and circumstances of the case must be considered. The most significant facts and circumstances in making this determination are:

- The degree of organizational and economic interrelationship of various activities.
- The business purpose which is served by carrying on the various activities separately or together in a trade or business or in an investment setting.
- The similarity of various activities.

(14) The Commissioner will accept the characterization by the taxpayer of several activities either as a single activity or as separate activities. However, the taxpayer's characterization will not be accepted if the characterization is artificial and cannot be reasonably supported under the facts and circumstances of the case.

(15) Farming Activities and Farmland Appreciation:

(16) Examiners should know the fine points of Treas. Reg. 1.183-1(d)(1) and develop facts relating to the taxpayer's intent for purchasing the land.

(17) There are special rules for farming activities. Treas. Reg. 1.183-1(d) provides that where land is purchased or held primarily with the intent to profit from increase in its value, and the taxpayer also engages in farming on such land, farming and the holding of the land will ordinarily be considered a single activity but only if the farming activity reduces the net cost of carrying the land for its appreciation in value.

(18) However, courts have treated the land and the farming activity as one activity where they found that the taxpayer purchased the property with the primary intent to use it in farming. See e.g., *Engdahl v. Commissioner*, 72 T.C. 659 n.4 (1979), acq. 1979-C.B.1; cf. *Burrus v. Commissioner*, T.C. Memo 2003-285 (finding for the Commissioner on distinguishable facts).

(19) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **F. Factor 5 - Success of the Taxpayer in Carrying on Other Similar or Dissimilar Activities**

(1) Regulation: "The fact that the taxpayer has engaged in similar activities in the past and converted them from unprofitable to profitable enterprises may

indicate that he is engaged in the present activity for profit, even though the activity is presently unprofitable.” Treas. Reg. 1.183-2(b)(5).

- (2) Issue: Whether the taxpayer had any success in carrying on other activities.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) Examiners should determine if the taxpayer has engaged in other similar or dissimilar activities. If so, examiners should consider such experience.
- (6) Examiners needs to document the taxpayer’s financial success in other activities. This information can be gathered from the tax returns.
- (7) Examiners should prepare a worksheet that details the history of other activities and show the profits and losses derived from those activities.
- (8) Examiners should focus on activities other than the taxpayer’s primary source of income. For example, if the taxpayer is a medical doctor, examiners should not focus on their success with their medical practice. Instead, examiners should focus on the taxpayer’s success or failure in other unrelated ventures such as the operation of a restaurant or a kennel.
- (9) Examiners should determine if the taxpayer has abandoned other activities when those activities were proven to be unsuccessful.
- (10) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **G. Factor 6 - Taxpayer's History of Income or Losses with Respect to the Activity**

- (1) Regulation: “A series of losses during the initial or start-up stage of an activity may not necessarily be an indication that the activity is not engaged in for profit. However, where losses continue to be sustained beyond the period which customarily is necessary to bring the operation to profitable status such continued losses, if not explainable, as due to customary business risks or reverses, may be indicative that the activity is not being engaged in for profit. If losses are sustained because of unforeseen or fortuitous circumstances which are beyond the control of the taxpayer, such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market



conditions, such losses would not be an indication that the activity is not engaged in for profit. A series of years in which net income was realized would of course be strong evidence that the activity is engaged in for profit.” Treas. Reg. 1.183-2(b)(6).

- (2) Issue: Whether the taxpayer has a history of losses with respect to the activity.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) Examiners should gather and research the activity’s income or loss history since its inception, if possible.
- (6) A Comparative Analysis of Income, Expenses and Profit or (Loss) should be prepared like the one prepared during the pre-examination stage. The only difference is that the one prepared during the pre-examination stage is likely to be limited to the current tax year and perhaps the prior and/or subsequent tax year. For purposes of this factor, the comparative Analysis of Income, Expenses and Profit or (Loss) should include all tax years for the activity since the inception, if possible. The information necessary to complete this analysis can be obtained from the Integrated Data Retrieval System (IDRS).
- (7) Examiners should order the original returns for any prior years that are no longer “online” since its inception by requesting them for review purposes using local procedures.
- (8) Examiners should make a copy of the original returns and place them in the administrative file. Many IRC 183 cases are appealed to the Office of Appeals and/or petitioned to U.S. Tax Court. So, if examiners do not put the copies of relevant documents in the file, they will not be in the file when Appeals reviews the case or when Counsel prepares the case for trial several years later. Prior year income tax returns are particularly important to establish the history of prior losses. Under certain circumstances, it may be necessary to request them from the taxpayer.
- (9) Examiners should prepare the worksheet with a separate column that shows the amount of depreciation that was deducted in each tax period. This separation is required for use in the development of other relevant factors. If the taxpayer has deducted other land carrying costs, such as real estate taxes or related interest expense, then these expenses should be shown in a separate column because real estate taxes and mortgage interest would be deductible on Schedule A and subject to AGI phase-out limitations.
- (10) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner

should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **H. Factor 7 - Amount of any Occasional Profits that are Earned**

- (1) Regulation: “The amount of profits in relation to the amount of losses incurred, and in relation to the amount of the taxpayer's investment and the value of the assets used in the activity, may provide useful criteria in determining the taxpayer's intent. An occasional small profit from an activity generating large losses, or from an activity in which the taxpayer has made a large investment, would not generally be determinative that the activity is engaged in for profit. However, substantial profit, though only occasional, would generally be indicative that an activity is engaged in for profit, where the investment or losses are comparatively small. Moreover, an opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate that the activity is engaged in for profit even though losses or only occasional small profits are actually generated.” Treas. Reg. 1.183-2(b)(7).
- (2) Issue: Whether the taxpayer have any occasional earned profits.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) Examiners should address the amount of any occasional profits resulting from the activity. In most IRC 183 cases, the activity usually does not have any profits. And if they do, they are usually not significant. A comparative Analysis of Income, Expenses and Profit or (Loss) should be prepared.
- (6) Examiners should tie-down the exact source of the gross receipts reported on the tax return for the activity. Sometimes the income reported is an error, or it may have been a deliberate attempt to show revenue (usually for purposes of the meeting the requirements under the presumption rule) where income did not exist.
- (7) If an examiner determines that gross receipts were mistakenly reported on the activity's Schedule C, Schedule F, or other form or schedule, the examiner should not include them in any of the worksheets prepared for the purpose of developing the IRC 183 issue. Otherwise, the misplaced gross receipts will not reflect a true picture of the taxpayer's activity. However, if any worksheets are prepared with the omission of any such gross receipts, a footnote should be included on each worksheet and include the details for such omission.

- (8) Some taxpayers have misstated income for the activity to make it appear that the activity has a profit motive. So, examiners need to verify the income. Under these circumstances, the examiner should consider potential fraud.
- (9) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## I. Factor 8 - Financial Status of the Taxpayer

- (1) Regulation: "The fact that the taxpayer does not have substantial income or capital from sources other than the activity may indicate that an activity is engaged in for profit. Substantial income from sources other than the activity (particularly if the losses from the activity generate substantial tax benefits) may indicate that the activity is not engaged in for profit especially if there are personal or recreational elements involved." Treas. Reg. 1.183-2(b)(8).
- (2) Issue: Whether the taxpayer's financial status can sustain the losses from the activity.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) Examiners need to obtain information regarding the income and loss history of the activity and prepare a Tax Savings Benefit Analysis. The analysis should begin, if possible, with the first year of the activity and should be included in the examination report.
  - [Exhibit 7: Tax Savings Benefit Analysis.](#)
- (6) Examiners should ask the taxpayer about how the activity is financed or funded.
- (7) Examiners should ask the taxpayer to provide any financial statements, loan documents, or other financial records, as applicable,
- (8) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and

circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **J. Factor 9 - Elements of Personal Pleasure or Recreation**

- (1) Regulation: “The presence of personal motives in carrying on of an activity may indicate that the activity is not engaged in for profit, especially where there are recreational or personal elements involved. On the other hand, a profit motivation may be indicated where an activity lacks any appeal other than profit. It is not, however, necessary that an activity be engaged in with the exclusive intention of deriving a profit or with the intention of maximizing profits. For example, the availability of other investments which would yield a higher return, or which would be more likely to be profitable, is not evidence that an activity is not engaged in for profit. An activity will not be treated as not engaged in for profit merely because the taxpayer has purposes or motivations other than solely to make a profit. Also, the fact that the taxpayer derives personal pleasure from engaging in the activity is not sufficient to cause the activity to be classified as not engaged in for profit if the activity is in fact engaged in for profit as evidenced by other factors whether or not listed in this paragraph.” Treas. Reg. 1.183-2(b)(8).
- (2) Issue: Whether the taxpayer’s activity involves elements of personal pleasure or recreation.
- (3) Facts: Although there are similarities, no two cases are identical. So, examiners should tailor their examinations accordingly and gather all the relevant facts and circumstances necessary to determine if this factor weighs in favor or against the taxpayer.
- (4) Examination Techniques:
- (5) Examiners should be alert for any facts and circumstances that specifically relate to personal motivations and recreational or personal elements.
- (6) Examiners should conduct a deeper investigation into the facts and circumstances relating to personal motivations and recreational elements.
- (7) Examiners should determine if the taxpayer’s primary motive is driven by profits or personal motivations.
  - Profit Motives: The courts have found inadequate profit motive if a taxpayer’s primary motive is personal or if personal motives outweighed profit motives.
- (8) Examiners should determine if the activity has any recreational facilities and whether the taxpayer or the taxpayer’s family use them. In addition, examiners should determine the extent to which the taxpayer or the taxpayer’s family use the recreational facilities.

- Recreational Element: Similarly, the existence of recreational facilities and use by the taxpayer or members of the taxpayer's family indicate inadequate profit motive.
- (9) The regulations allow the taxpayer to derive personal pleasure if profit objective is evidenced in other factors. Examiners should determine the extent of personal pleasure and whether profit motive is present in other factors
  - (10) Summary: This is only one of nine factors that need to be developed, so it is easy to get lost in the details. Do not look at this factor in a vacuum. Instead, consider the story that this factor tells. So, step-back and look at the big picture. When all the facts and circumstances are looked at together, an examiner should be able to decide if this factor weighs in favor or against the taxpayer. Do not forget to document the examination steps taken, the facts and circumstances relevant to this factor, how the facts and circumstances were applied to the regulation, and the conclusions made.

## **K. Interplay with Other IRC Sections**

- (1) When conducting an IRC 183 examination, examiners should consider other IRC sections that may come into play. Some of which should also be considered as a potential alternative position when applicable.
- (2) IRC 67(a) – In the case of an individual, the miscellaneous itemized deductions are allowed only to the extent that the aggregate of such deductions exceeds 2% of AGI. Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.
- (3) IRC 67(c) – In the case of passthrough entities (e.g., partnerships and S corporations), a partner or shareholder must consider separately their distributive or pro rata share of the partnership's or S corporation's miscellaneous itemized deductions which are subject to the 2% limitation under IRC 67(a). The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.
- (4) IRC 68(a) – Overall limitation on itemized deductions. The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.
- (5) IRC 162 – A deduction is allowed for all the ordinary and necessary expenses paid or incurred in carrying on any trade or business.
- (6) IRC 167 – A depreciation deduction is allowed with respect to property used in the trade or business or held for the production of income, but not for personal use property.

- (7) IRC 168 – The ACRS and MACRS deductions are treated as depreciation deductions.
- (8) IRC 179 – A taxpayer may elect to deduct, rather than capitalize and recover through MACRS or ACRS, the cost of IRC 179 property, up to specified dollar limits. The deduction is allowable in the year the property is placed in service by the taxpayer whether for use in a trade or business, for the production of income, in a tax-exempt activity, or in a personal activity. The deduction is not allowable if the property is placed in service as personal use property and later converted to business use or when the taxpayer fails to substantiate the business purpose for purchasing the item.
- (9) IRC 183 – Generally, an activity is not engaged in for profit is allowed deductions but are limited to the gross income of the activity and are allowable in the following order:
- Category 1: Amounts allowable as deductions during the taxable year without regard to whether the activity was engaged in for profit are allowable in full (e.g., home mortgage interest, real estate taxes).
  - Category 2: Amounts that would otherwise be allowable if the activity were engaged in for profit and that would not result in an adjustment to the basis of the property are allowed but only to the extent the gross income of the activity exceeds the deductions allowed or allowable under Category 1.
  - Category 3: Amounts that would otherwise be allowable if the activity were engaged in for profit and would result in an adjustment to the basis of the property are allowed but only to the extent that gross income of the activity exceeds the deductions allowed or allowable under Category 1 and Category 2.
- (10) IRC 195 – Allows a taxpayer to elect to deduct a limited amount of start-up expenditures (which may include legal and other professional fees) and amortize the balance over 180 months. There are special rules and exceptions if the taxpayer disposes of the business before the amortization period ends. Any remaining unamortized start-up expenditures are deductible, with certain limitations, under IRC 165.
- (11) IRC 212 – An itemized deduction is allowed for individuals for all ordinary and necessary expenses paid or incurred for the production or collection of income, for the management, conservation, or maintenance held for the production of income, or in connection with the determination, collection, or refund of any tax.
- (12) IRC 262 – Except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expense.
- (13) IRC 274(d) – Deductions are not allowed unless the taxpayer substantiates by adequate records or by sufficient evidence corroborating the taxpayer's own statement: (1) the amount of such expense; (2) the time and place of the travel or the date and description of the gift; (3) the business purpose of the expense;

and (4) the business relationship to the taxpayer of the person receiving the benefit.

- (14) IRC 280A – A trade or business expense deduction under IRC 162 is not permitted with respect to a taxpayer’s residence unless specifically permitted in limited circumstances by IRC 280A(a). For allocable expenses to be deductible, the portion of the taxpayer’s residence must be used exclusively by the taxpayer on a regular basis as a principal place of business for the taxpayer’s trade or business, or to meet and deal with patients, clients or customers in the normal course of the taxpayer’s trade or business. If the taxpayer is an employee, the exclusive and regular use of a portion of the taxpayer’s residence must be for the convenience of the taxpayer’s employer before any expenses relating to the part of the taxpayer’s residence may be deducted.
- (15) IRC 465 – This code section limits a taxpayer’s deduction for losses from an activity to the amount at risk. IRC 465 applies to activities in which the taxpayer is engaged in carrying on a trade or business or for the production of income. For the IRC 465 rules to apply, the taxpayer must be engaged in the activity for profit. An activity subject to IRC 183 cannot be subject to IRC 465 in the same year. If IRC 465 applies, any loss in excess of the taxpayer’s amount at-risk cannot be deducted in the current year. If the taxpayer has no personal liability but has pledged property as security for repayment of the debt, the amount at-risk is the fair market value of the pledged property, less any superior liens. If the taxpayer pledges property that is used in the activity as security, that property does not increase the amount at-risk. There is a special rule for real estate activities – a nonrecourse loan qualifies as an amount at-risk if it is “qualified non-recourse financing.”
- (16) IRC 469 – Passive losses in excess of passive income are nondeductible. A passive activity is any rental activity or any business activity in which the taxpayer does not materially participate. If the average customer use is 7 days or less, the rental activity falls outside the rental definition and is treated like a business subject to material participation. If the average customer use is 30 days or less, and there are significant personal services, the activity falls outside the rental definition and is treated like a business subject to material participation.
- (17) IRC 704 – A partner’s distributive share of partnership loss shall be allowed only to the extent of the adjusted basis of such partner’s interest in the partnership.
- (18) IRC 1366 – An S corporation’s shareholder’s pro rata share of loss is not deductible if the loss exceeds the shareholder’s basis in their stock, plus certain debt basis.

## **L. Disguised Personal Expenses**

- (1) Examiners should be alert for situations where taxpayers may be deducting personal expenses. Examiners should be especially alert for any one or a combination of the following situations where a taxpayer is deducting:
- (2) All or most of the cost of maintaining a personal residence. See IRC 280A. Taxpayers sometimes erroneously claim that the “exclusive use” restriction of IRC 280A can be avoided by placing business-related items in any given room of the house. Taxpayers sometimes cite the IRC 280A(c)(2) exception for storage on a regular basis of inventory or product samples. For example, the taxpayer may believe that the business use requirement can be established by simply placing a poster, calendar, desk, file cabinet, telephone, or other business items in a room without regard to the fact that the same room is also used for personal purposes (e.g., kitchen, bathroom, children’s bedroom, etc.).
- (3) Paying children and/or other family members for household duties that are not ordinary and necessary to the operation of any business (e.g., disposing of trash, mowing the lawn, answering the telephone, or washing cars). And these payments may also be excessive.
- (4) Deducting family education expenses by claiming an Education Assistance Program for family members that are treated as employees. See IRC 127.
- (5) Deducting excessive car and truck expenses when the vehicle was used for both personal and business use. Taxpayers sometimes attempt to justify these expenses by arguing that there is a business purpose for every trip, whether it is to commute to a regular job or a trip to the grocery store, golf course, church, etc. Taxpayers sometimes make the argument that the trips are deductible because there is always a potential for recruiting new clients or customers.
- (6) Deducting personal furniture, home entertainment equipment, children’s toys, etc.
- (7) Deducting personal travel, meals, and entertainment expenses under the pretense that everyone everywhere is a potential new client or customer and therefore deductible.
- (8) Deducting 100% of personal medical expenses merely by “employing” a family member who is not really an employee and creating a medical reimbursement plan.

## **VI. Guiding Principles**

### **A. Reasons Appeals Did Not Support the IRC 183 Issue**

- (1) In cases where the IRC 183 issue was not sustained in Appeals was because examiners failed to adequately development the issue and/or failed to appropriately apply the tax law. The most frequently cited reasons are:
  - Alternative arguments were not addressed.
  - Disallowed expenses were not first verified as to whether they would be deductible at all or were personal in nature.



- The nine objective factors in the regulations were not addressed.
  - No mention was made on whether a realistic possibility of a profit would ever occur.
  - No mention was made documenting the history of the activity including losses incurred and taxes saved in the prior years.
  - Lack of factual development.
- (2) This emphasizes the importance of gathering all the facts and circumstances and applying them to the tax law. And equally important is that examiners document the workpapers accordingly.

## **B. Avoiding the Deduction Limitations of IRC 183**

- (1) The internet is full of articles from many different tax practitioners who advise their clients on things that the taxpayer can do to try to avoid the IRC 183 limitations on deductions. These articles generally include the following:
- Factor 1: A taxpayer who engages in an activity that might be potentially considered a “hobby” should try to conduct the activity in a businesslike manner. The taxpayer should generally operate the activity as though they intend to make a profit. The factors identified in IRC 183 regulations can be used as a guide to achieve the businesslike approach to an activity that will help to avoid the deduction limitations of IRC 183. The taxpayer should prepare a detailed written business plan, including the project goals, start-up costs, advertising, projected results, and the criteria for discontinuing an unsuccessful activity. The taxpayer should maintain a separate bank account and appropriate books and records on the financial aspects of the activity. The taxpayer should consider changes in their operating methods if the activity is not very successful or document the reasons for failing to make changes.
  - Factor 2: Similarly, the taxpayer should either acquire a reasonable level of expertise in the field, or regularly consult experts. Their advice should be followed unless the taxpayer has legitimate business reasons for not doing so.
  - Factor 3: The nature and extent of the taxpayer's participation in the activity should be significant both in terms of time and importance to the activity. And if the taxpayer cannot, then they should hire competent persons to do so.
  - Factor 4: The Expectation that Assets Used in the Activity may Appreciate in Value. This factor is historical in nature and is like water under the bridge meaning that it has happened and cannot now be changed, so there is no point in worrying about it anymore.
  - Factor 5: The Success of the Taxpayer in Carrying on Other Similar or Dissimilar Activities. This factor is historical in nature and is like water

under the bridge meaning that it has happened and cannot now be changed, so there is no point in worrying about it anymore.

- Factor 6: The Taxpayer's History of Income or Losses with Respect to the Activity. This factor is historical in nature and is like water under the bridge meaning that it has happened and cannot now be changed, so there is no point in worrying about it anymore.
  - Factor 7: The Amount of any Occasional Profits which are Earned. This factor is historical in nature and is like water under the bridge meaning that it has happened and cannot now be changed, so there is no point in worrying about it anymore.
  - Factor 8 - The Financial Status of the Taxpayer. This factor is historical in nature and is like water under the bridge meaning that it has happened and cannot now be changed, so there is no point in worrying about it anymore.
  - Factor 9: The taxpayer should try to minimize any recreational and/or personal pleasure elements of the activity.
- (2) Although this advice is usually provided by tax practitioners to their clients who may be engaging in an activity that the IRS may determine to be an activity not engaged in for profit, it may also provide clues to examiners on what areas may require additional scrutiny when conducting IRC 183 tax examinations. But there is no shortcut, examiners should always consider and develop all nine objective factors.
- (3) It is not entirely clear how significant the taxpayer's profit motive must be to avoid the application of IRC 183. Case law reflects great confusion as to the degree of profit intent required.
- (4) Nonetheless, examiners should remember that an activity is not deemed to be engaged in for profit unless it is conducted by the taxpayer with an actual and honest objective of making a profit. And the taxpayer's profit objective must be bona fide. That is, in good faith without any attempts to cheat, deceive, or defraud.

## **VII. Tips for Developing IRC 183 Examination Issues**

### **A. Tip 1: Develop the Nine Factors**

- (1) Determining whether a taxpayer has an actual and honest objective of making a profit is a fact-intensive inquiry. Examiners should not merely focus the examination on one or a few factors, the appeals officer or judge might give little weight to the factor(s) developed and give more weight to other factor(s) that was not adequately developed. Focus and develop all nine objective factors in the regulations.

### **B. Tip 2: Retain Documentation in the Case File**

- (1) IRC 183 cases involve intensive fact-finding inquiries, so documentation is critical to the case development and subsequent analysis.
- (2) Frequently, IRC 183 cases are appealed to the Independent Office of Appeals and/or petitioned to U.S. Tax Court. Examiners should put copies of relevant documents in the file because, if they are not in the case file when the case is closed, they obviously are not in the file when Appeals reviews the case or when Counsel prepares the case for trial. Prior year income tax returns are particularly important to establish the history of prior losses.
- (3) Counsel has some ability to develop facts through discovery in Tax Court cases, but the documents needed to support the determination should be gathered before the case is forwarded to the Independent Office of Appeals. The appeals officer may not request the missing documents and any delay in obtaining them from the taxpayer and third parties increases the possibility that those documents could be lost or destroyed.

### **C. Tip 3: Research and Document the Start-Up Phase for the Activity**

- (1) A taxpayer may have an intent to make a profit but may be losing money because the activity is still within its start-up phase. Some activities have start-up phases that last several years. Examiners should research the industry to determine the normal start-up phase for the activity involved.
- (2) Examiners should anticipate that the taxpayer's representative will argue to the appeals officer or court that the activity is still within its start-up phase where losses are expected.
- (3) If an examiner determines that the activity has gone beyond its start-up phase, discuss the issue in the report and cite a reputable industry source for the start-up phase that is used.

### **D. Tip 4: Learn from Internal Experts and Resources**

- (1) Internal experts may include technical advisors, subject matter experts, industry specialists, IRS engineers, or even the other examiners. People with knowledge about the type of activity being examined can help examiners in identifying and examining the important issues.
- (2) When a potential IRC 183 issue surfaces, the examiner should search current internal online resources for the industry and IRC 183 issues in general. For example, Knowledge Base and the IRC 183 Activities Not Engaged in For Profit Audit Technique Guide are excellent sources for information on developing an IRC 183 issue.

### **E. Tip 5: Go to the Taxpayer Interview Armed with Pointed Questions**

- (1) Effective preparation is the key to a successful interview. Examiners should do the necessary homework before the interview by becoming familiar with the

nine objective factors and gaining a basic understanding of the industry relating to the activity under examination.

- (2) Examiners should not merely rely on pro forma interview questions or information document requests. Instead, examiners should focus on questions involving the factual issues that matter most to the examiner's case.
- (3) Whenever possible, consider asking the taxpayer to provide documents prior to the interview so that questions can be prepared ahead of time. For example, if one exists, a business plan can provide a wealth of information. It is helpful when conducting business tax examinations in general as well as IRC 183 issues.

#### **F. Tip 6: Are Farming and the Land One Activity? Know the Fine Points of Treas. Reg. 1.183-1(d)(1)**

- (1) A key issue in many IRC 183 farming cases is whether the farming activity and the land are treated as a single activity or multiple activities.
- (2) Where land is purchased or held primarily with the intent to profit from increase in its value, and the taxpayer also engages in farming on such land, farming and the holding of the land will ordinarily be considered a single activity only if the farming activity reduces the net cost of carrying the land for its appreciation in value. Treas. Reg. 1.183-1(d).
- (3) Examiners regularly rely on Treas. Reg. 1.183-1(d) to treat the farming activity and the land as separate activities for purposes of IRC 183. However, courts have treated the land and the farming activity as one activity where they found that the taxpayer purchased the property with the primary intent to use it in farming. See e.g., *Engdahl v. Commissioner*, 72 T.C. 659 n.4 (1979), acq. 1979-C.B.1; cf. *Burrus v. Commissioner*, T.C. Memo 2003-285 (finding for the Commissioner on distinguishable facts).
- (4) As part of an examiner's analysis of a farming activity where this issue is present, examiners should develop facts relating to the taxpayer's intent in purchasing the land.

#### **G. Tip 7: Develop and Document the Taxpayer's Positions**

- (1) An examiner's IRC 183 issue will be stronger when the taxpayer's position on the various factors and a rebuttal is included in the examiner's report.
- (2) Documenting the taxpayer's position will bind the taxpayer to a story. And if the taxpayer later changes their story, the taxpayer will appear less credible.
- (3) Do not summarily dismiss the taxpayer's arguments. They may be valid and are worthy of the examiner's consideration. For example, the effect of extended drought or a bad economy on the taxpayer's bottom line might be an important issue in an appeals officer's or judge's analysis.

#### **H. Tip 8: Step Back and Look at the Big Picture**

- (1) With nine objective factors to develop, it is easy to get lost in the details.
- (2) Examiners should not look at the factors in a vacuum. Consider the story that the nine factors tell.
- (3) Do the factors when reviewed together show that the taxpayer had an honest intent to make a profit, or does it show that the taxpayer was engaged in a hobby and did not care much about profits?

## **I. Tip 9: Don't Let the Taxpayer's Representative Control the Examination**

- (1) An undeveloped IRC 183 case is more likely to be conceded in Appeals than a case where the nine factors are developed. So, some taxpayer representatives demand a statutory notice of deficiency as soon after they learn that the examiner is developing an IRC 183 issue.
- (2) In response to requests to interview the taxpayer, representatives will sometimes try to shield the taxpayer from an examiner's interview, contending that the representative can answer all the questions in an interview or in writing. With the fact-intensive inquiries involved in IRC 183 cases, the examiner should interview the taxpayer. Examiners should not be reluctant or afraid to summons the taxpayer for an interview.

## **J. Tip 10: Examiner's Write-Up**

- (1) Take time to make a good first impression.
- (2) An examiner's report will probably introduce an appeals officer or Counsel attorney to the examiner's case. Write up a report that will make a good first impression.
- (3) Examiners should organize the facts around a theme that ties the factors together. Facts that tell an organized story are more effective than a bunch of random disorganized facts.
- (4) Examiners should consider including an executive summary at the beginning of their IRC 183 discussion so that the reader can get an overview of the case before diving into the details.
- (5) Examiners should cite the evidence in the file that supports the examiner's report. The examiner's report will be more persuasive if the reader can easily refer to the evidence that it supports instead of having to rummaging through the entire case file looking for it.

## **VIII. Examination Closing Procedures**

### **A. Computing IRC 183 Tax Adjustments**

- (1) Gross income for purposes of IRC 183 is defined as "the total of all gains from the sale, exchange, or other disposition of property, and all other gross receipts derived from such activity." Treas. Reg. 1.183-1(e).

- (2) “The taxpayer may determine gross income from any activity by subtracting the cost of goods sold from the gross receipts so long as he consistently does so and follows generally accepted methods of accounting in determining such gross income.” Treas. Reg. 1.183-1(e).
- (3) A taxpayer who engages in an activity without the required profit motive is not allowed any deductions related to the activity, except as allowed by IRC 183(b). IRC 183(b) allows the following deductions:
- IRC 183(b)(1) allows deductions for expenses that are allowable under other code sections such as mortgage interest and real estate taxes. Treas. Reg. 1.183-1(b)(1)(i).
  - IRC 183(b)(2) allows deductions that would be allowed if the activity was engaged in for profit. But such deductions are limited to the gross income of the activity.
- (4) The regulations require the allowable deductions to be categorized into the three categories shown below and are deducted in numerical sequence.
- Category 1: These are deductions that are allowable regardless of the gross income of the activity or whether the activity is not engaged in for profit because these deductions are allowed under other code sections. See Treas. Reg. 1.183-1(b)(1)(i).
  - Category 2: These are deductions that would otherwise be allowable if the activity was engaged in for profit (e.g., IRC 162 or IRC 212). However, these deductions are limited to the amount of gross income of the activity reduced by the Category 1 deductions. See Treas. Reg. 1.183-1(b)(1)(ii).
  - Category 3: These are deductions that lead to basis adjustments and must be allocated to each depreciable asset if more than one asset is involved. These deductions are limited to the amount of gross income of the activity reduced by Category 1 and Category 2 deductions. See Treas. Reg. 1.183-1(b)(1)(iii).
- (5) The rules for deductions requiring basis adjustments under Treas. Reg. 1.183-1(b)(2) are shown below.
- (6) “In General. — If deductions are allowed under subparagraph (1)(iii) of this paragraph, and such deductions are allowed with respect to more than one asset, the deduction allowed with respect to each asset shall be determined separately in accordance with the computation set forth in subdivision (ii) of this subparagraph.” Treas. Reg. 1.183-1(b)(2)(i).
- (7) “Basis Adjustment Fraction. — The deduction allowed under subparagraph (1)(iii) of this paragraph is computed by multiplying the amount which would have been allowed, had the activity been engaged in for profit, as a deduction with respect to each particular asset which involves a basis adjustment, by using the basis adjustment fraction.”

- Treas. Reg. 1.183-1(b)(2)(ii)(a) — “The numerator of which is the total of deductions allowable under subparagraph (1)(iii) of this paragraph, and”
  - Treas. Reg. 1.183-1(b)(2)(ii)(b) — “The denominator of which is the total of deductions which involve basis adjustments which would have been allowed with respect to the activity had the activity been engaged in for profit.”
- (8) “The amount resulting from this computation is the deduction allowed under subparagraph(1)(iii) of this paragraph with respect to the particular asset. The basis of such asset is adjusted only to the extent of such deduction.” Treas. Reg. 1.183-1(b)(2)(ii).
- (9) If needed, examiners can refer to Treas. Reg. 1.183-1(b)(3) for examples illustrating basis adjustments.
- (10) Example 2: Illustration on Computing IRC 183(b) Adjustments
- (11) Assume the taxpayer has an AGI of \$125,000 which includes a Schedule F loss of \$64,000. The Schedule F activity is an activity not engaged in for profit and all expenses have been verified. The Schedule F loss was computed as follows:

(12)

<b>SCHEDULE F</b>	<b>AMOUNT</b>
Gross Income	\$23,200
Less Expenses	\$87,200
Net (Loss)	(\$64,000)

(13)

(14) The following steps are required to make the IRC 183 tax adjustments:

(15) Step 1 – Remove gross income of \$23,200 from the Schedule F.

(16) Step 2 – Reclassify income of \$23,200 as other income – unearned, to line 21 of the Form 1040. Important Note: For tax years 2018 or later it should be reported on Form 1040 Schedule 1, line 8.

(17) Step 3 – Remove all \$87,200 expenses from the Schedule F.

(18) Step 4 – Compute the corrected AGI

(19)

<b>COMPUTE CORRECTED AGI</b>	<b>AMOUNT</b>
AGI Per Return	\$125,000
Subtract Schedule F Gross Income	(\$23,200)
Add Other Income (Unearned)	\$23,000
Add Disallowed Scheule F Expenses	\$87,200
AGI Per Examination	\$212,200

(20)

(21) Step 5 – Sort Schedule F expenses into the three Categories

(22)

EXPENSE	AMOUNT	CATEGORY		
		1	2	3
Real Estate Taxes	\$6,000	\$6,000		
Mortgage Interest	\$12,000	\$12,000		
Insurance	\$1,600		\$1,600	
Utilities	\$4,200		\$4,200	
Cellphone	\$400		\$400	
Veternary Visits	\$2,000		\$2,000	
Auto	\$6,000		\$6,000	
Repairs	\$16,000		\$16,000	
Feed	\$8,000		\$8,000	
Depreciation	\$31,000			\$31,000
<b>Total</b>	<b>\$87,200</b>	<b>\$18,000</b>	<b>\$38,200</b>	<b>\$31,000</b>

(23)

(24) Step 6 – Determine the amount of Category 1, Category 2 and Category 3 expenses that are allowable.

(25)

Gross Income	\$23,200	Allowed	Balance
Category 1 Expenses	\$18,000	\$18,000	\$5,200
Category 2 Expenses	\$38,200	\$5,200	0
Category 3 Expenses	\$31,000	0	0

(26)

(27) Category 1 expenses of \$18,000 are allowed in full.

(28) Category 2 expenses of \$38,200 are limited to \$5,200 (gross income remaining after Category 1 expenses are deducted from gross income) and are subject to IRC 67 and IRC 68. Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.

- The Category 2 expenses of \$5,200 are reduced further by IRC 67 or 2% of the corrected AGI (2% X 212,200) or \$4,244.
- The itemized deduction limitation under IRC 68 applies but not enough facts have been presented to determine this limitation.

(29) Category 3: There is no gross income remaining to allow any of the Category 3 expenses.



## B. IRC 183 Tax Adjustments and Report Generation Software (RGS)

- (1) A Lead Sheet is available for IRC 183 Activities Not Engaged in for Profit and should be used when the examiner determines that an activity not engaged in for profit issue is possible. This issue should be categorized as de minimis with “Per Return” and “Per Exam” fields being zero. The compliance information will be completed with Reason Code 52, Form/Schedule X. and Line number 99. For the NAICS code, enter “D.”
- (2) All workpapers and supporting documentation pertaining to the development of the IRC 183 issue should be contained in the Activities Not Engaged in for Profit Lead Sheet and should be included with the report issued to the taxpayer. The supporting documentation should include a schedule showing how Category 1, Category 2, and Category 3 expenses were calculated along with the factual development of the case addressing each of the nine relevant factors found in Treas. Reg. 1.183-2(b) which were used in determining whether the taxpayer is conducting the activity with the intent to make a profit.
- (3) The actual adjustments should be made in each income and expense Lead Sheet and reference should be made to the documentation contained in the IRC 183 Lead Sheet. If an expense item is adjusted because of lack of verification or reasons other than IRC 183, the supporting documentation and conclusions should be contained in each individual issue Lead Sheet and be treated as an alternative position in the event that the primary activity not engaged in for profit issue is not sustained in Appeals.
- (4) Entering Adjustments in Report Generation Software (RGS):
- (5) After determining the expense categories and limitations, the adjustments need to be entered in RGS.
- (6) Each income and expense item on the schedule used to report the activity should be disallowed. Items should not be combined into one adjustment. The issues for these items may already be classified and created. Reason Code 10 or 14 should be used only if the item is allowed in full elsewhere on the return. All adjustments using Reason Code 10 or 14 must net to zero. Appropriate reason codes should be used for other adjustments.
- (7) Reason Code 10 description is “Income/Expenses entered on wrong item to reduce tax or increase credits.” This reason code should be made to issues when penalties are applied
- (8) Reason Code 14 description is “Taxpayer entered item on the wrong form, schedule or line” for any expense disallowed which has been allowed in full on the Schedule A. In this example, Reason Code 14 would be used for all the Category 1 expenses. This reason code should be made when no penalties have been asserted and the item has been allowed in full on the Schedule A.
- (9) An issue must be created moving the “earned income” to “unearned income (line 21 of Form 1040)” for the activity. Important Note: For tax years 2018 or

later, it should be reported on Form 1040 Schedule 1, line 8. This income should be categorized as “other income – unearned.” Issues must be created separately for any Category 1 expenses fully allowable on Schedule A (e.g., mortgage interest, real estate taxes).

- (10) An additional issue must be added for any Category 2 and Category 3 expenses that are allowable as miscellaneous itemized deductions (these items may be grouped into one adjustment). The Category 2 and Category 3 expenses are limited by the gross income from the activity after subtracting Category 1 expenses. Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.
- (11) Partnerships and S Corporations:
- (12) Where a passthrough entity is engaged in several activities, the income and expenses from the activities may not be aggregated to apply the limits of IRC 183.
- (13) Passthrough entities are required to “separately state” certain items of income and deductions. Items must be “separately stated” if the item would result in a tax liability for any partner or shareholder different from the person’s tax liability, if the items weren’t “separately stated” such as charitable contributions, portfolio income, IRC 179 deduction, investment interest expense.
- (14) Each income and expense item on the schedule used to report the activity should be disallowed. Income from an activity not engaged in for profit should be categorized separately in RGS as “Other Income” for both the Schedule K and K-1. Similarly, expenses should be grouped by category (Category 1, Category 2 or Category 3) and categorized as “other deductions” and deducted only up to the extent of hobby income. Any remaining deductions should be categorized as non-deductible expenses.
- (15) The non-deductible expenses will result in a reduction in the investor basis. An issue should be created in RGS to reflect the non-deductible expenses.
- (16) Example 3: 1040 Schedule C
- (17) Assume the taxpayer has an AGI of \$120,000. A Schedule C is classified as a potential IRC 183 (activity not engaged in for profit) issue. The Schedule C shows \$3,000 in gross income and expenses of \$63,700 resulting in a net loss of \$60,700. All the expenses shown below have been verified.

(18)

EXPENSE	AMOUNT	CATEGORY		
		1	2	3
Property Taxes	\$700	\$700		
Mortgage Interest	\$900	\$900		
Insurance	\$400		\$400	

EXPENSE	AMOUNT	CATEGORY		
		1	2	3
Utilities	\$700		\$700	
Auto/Travel	\$23,000		\$23,000	
Bait/Tackle	\$2,000		\$2,000	
Entrance Fees	\$8,000		\$8,000	
Depreciation	\$28,000			\$28,000
Total	\$63,700	\$1,600	\$34,100	\$28,000

- (19)
- (20) Category 1 expenses of \$1,600 are allowed in full leaving \$1,400 remaining of gross income for Category 2 and Category 3 expenses.
- (21) Since Category 2 expenses totaling \$34,100 exceed the remaining gross income of \$1,400, the taxpayer is only allowed \$1,400 of the Category 2 expenses.
- (22) None of the Category 3 expenses may be allowed since there is no remaining gross income remaining.
- (23) The following steps are needed to input the IRC 183 adjustments into RGS.
- (24) Step 1: Remove Income from Schedule C
- (25) Remove the Schedule C income. Enter \$3,000 in the “Per Return” field and enter zero in the “Per Exam” field. For the NAICS code enter “D” in the “Per Exam” field if the Schedule C is disallowed in full.
- (26) Step 2: Add an issue for Other Income – Unearned
- (27) Add an issue as a New Issue Resulting from a Classified Issue. Categorize the adjustment as Other Income – Unearned (this income is not subject to self-employment tax). Enter zero in the “Per Return” field. Enter \$3,000 in the “Per Exam” Field.
- (28) Step 3: Remove all Schedule C expenses
- (29) In the example, all Schedule C expenses have been classified. Disallow the Category 1 expenses in full by entering zero in the “Per Exam” field. Use Reason code 10 or 14 only if the item is allowed in full elsewhere on the return. Enter “D” in the NAICS code in the “Per Exam” field. If these issues were not classified, the examiner would need to add each individual expense item as a separate adjustment into RGS.
- (30) Step 4: Allow Category 1 expenses on Schedule A
- (31) Category 1 expenses are allowable in full on Schedule A without regard to gross income limitations. Add each issue as a New Issue Resulting from a Classified Issue. In this example, there are two separate adjustments, one to

mortgage interest and the other to real estate taxes. Use Reason Code 10 or 14.

(32) Step 5: Allow Category 2 and Category 3 expenses on Schedule A

(33) The remaining allowable expenses (\$3,000 income less \$1,600 Category 1 expenses) are limited to the remaining income from the activity and entered as Schedule A Miscellaneous Itemized Deductions subject to 2% of AGI. One adjustment can be made for the combined expenses. In this example, the taxpayer will have \$1,400 of Category 2 expenses. There is no remaining gross income with which to offset Category 3 expenses.

(34) Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.

(35)

<b>COMPUTE CORRECTED AGI</b>	<b>AMOUNT</b>
AGI Per Return	\$120,000
Subtract Schedule F Gross Income	(\$3,000)
Add Other Income (Unearned)	\$3,000
Add Disallowed Schedule F Expenses	\$63,700
AGI Per Examination	\$183,700

(36)

(37) In the above example the taxpayer's AGI per return was \$120,000. After the IRC 183 adjustments, AGI increases to \$183,700. Miscellaneous itemized deductions are limited to the amount that they exceed 2% of AGI ( $2\% \times \$183,700 = \$3,674$ ).

(38) In this example, the taxpayer would get no tax deduction for the \$1,400 in Category 2 expenses since they did not exceed the 2% of AGI.

(39) Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.

(40) Partnerships, S Corporations, Trusts and Estates:

(41) IRC 183, activities not engaged in for profit, rules are applied at the entity level for passthrough entities (e.g., partnerships, S corporations, trusts, and estates). These rules apply on an activity-by-activity basis and the income and deductions arising in one activity cannot be combined with the income and deductions from another activity. The determination as to whether an activity is a single activity or are multiple activities may be required. See "[Multiple Activities](#)" for a more detailed discussion.

(42) Income from passthrough entities should be removed from ordinary income and reclassified as separately stated income (generally as other income) if it is determined that such entity is not engaged in for profit under IRC 183.

(43) All expenses should be grouped by category and separately stated and limited to gross income from the activity. There would seldom be any Category 1 expenses other than possibly investment interest or contributions. The limitation is determined at the entity level.

(44) Even if the expenses of the activity are not beneficial to the partner or shareholder because of the gross income limitation, they will still result in a reduction to the partner's or shareholder's basis.

(45) Example: S Corporation

(46) An S corporation has gross receipts of \$4,000 from an activity not engaged in for profit and total expenses of \$55,000 resulting in an ordinary loss of \$51,000. The interest expense is not interest on a mortgage.

(47)

EXPENSE	AMOUNT	CATEGORY		
		1	2	3
Entrance Fees	\$10,000		\$10,000	
Interest	\$12,000		\$12,000	
Insurance	\$400		\$400	
Utilities	\$1,600		\$1,600	
Auto/Travel	\$13,000		\$13,000	
Repairs	\$2,000		\$2,000	
Depreciation	\$16,000			\$16,000
Total	\$55,000	\$0	\$39,000	\$16,000

(48)

(49) All the income and expenses should be removed from the ordinary business operations of the S corporation return. The income should then be separately stated and reported on line 10 of the 1120S Schedule K. This income would then be reported on the shareholder's individual income tax return on line 21 as other income – unearned. Important Note: For tax years 2018 or later it should be reported on Form 1040 Schedule 1, line 8.

(50) The interest expense in this example is not included as a Category 1 expense because it would not be deductible on the 1040 Schedule A since the interest is not home mortgage interest or investment interest.

(51) Category 2 expenses would be allowed up to the \$4,000 of gross income from the car racing activity and would be separately stated on line 12d of the 1120S Schedule K. The remaining non-deductible expenses of \$51,000 would be reported as non-deductible expenses on line 16c of the 1120S Schedule K and K-1. The shareholder would then have \$4,000 as a miscellaneous itemized deduction.

(52) Important Note: The Tax Cuts and Jobs Act (TCJA) suspended miscellaneous itemized deductions, so these deductions are not available for tax years beginning after December 31, 2017 and before January 1, 2026.

(53) The \$51,000 in non-deductible expenses will result in a reduction in the shareholder's stock basis and the Accumulated Adjustments Account (AAA) of the S corporation.

(1) The \$51,000 in non-deductible expenses will result in a reduction in the shareholder's stock basis and the Accumulated Adjustments Account (AAA) of the S corporation.

### **C. Reports**

(1) If there are other issues which are agreed and generate a deficiency, two reports will be required. One report will contain the agreed issues and the other report only the IRC 183 issues as unagreed.

(1) If there are other unagreed issues besides the IRC 183 issue, the unagreed report will contain the unagreed issues and the IRC 183 issue before the case is forwarded to Appeals.

### **D. Alternative Minimum Tax**

(1) The IRS has taken the position that a taxpayer cannot deduct IRC 183(b)(2) expenses in calculating alternative minimum taxable income. In *Purdey v. United States*, the Court of Federal Claims agreed, because the expenses are miscellaneous itemized deductions, they may not be used, not even to the extent of gross income, in calculating alternative minimum taxable income. 39 Fed. Cl. 413, (Fed. Cl. 1997).

### **E. Penalties**

(1) In 1955, there were approximately 14 penalty provisions in the Internal Revenue Code. There are now more than ten times that number. With the increasing number of penalty provisions, the IRS recognized the need to develop a fair, consistent, and comprehensive approach to penalty administration.

(2) Examiners should refer to IRM 20.1.1, Penalty Handbook, which discusses the purpose of civil penalties and provides the legal authorities, criteria for relief, and other general information about civil penalties.

(3) The Office of Servicewide Penalties (OSP) mission is to promote fair, consistent, and accurate application and use of civil penalties to encourage voluntary compliance through penalty policy guidance and support. OSP owns and maintains the Penalties Knowledge Base (KB) to provide guidance, resources, and information for all employees considering assessment and/or abatement of civil penalties.

- (4) Examiners should refer to the OSP KB website for guidance and support when considering penalties. The following books should be of particular interest to examiners who are conducting examinations of an activity not engaged in for profit.
- (5) Accuracy Related - This book contains overviews of the accuracy-related penalty provisions under IRC sections 6662 and 6662A.
- (6) Fraud Penalty - This book contains an overview of the fraud penalty provisions under IRC section 6663.
- (7) Promoter and Material Advisor Penalties - This book contains overviews of penalty provisions under IRC sections 6700, 6701, 6707, and 6708 applicable to promoters and material advisors.
- (8) The Fraud Development Knowledge Base KB site conveys information to develop the knowledge and skills needed by Compliance employees to address potential fraud and to foster voluntary compliance through the recommendation of criminal prosecutions and/or civil penalties against taxpayers who evade the assessment and/or payment of taxes known to be due and owing. In addition, IRM 25.1.2.3(6), Indicators of Fraud, Conduct of Taxpayer, provides an overview of indicators of fraud relating to the conduct of the taxpayer.
- (9) Fraud indicators are clues that the taxpayer has deliberately misrepresented pertinent facts. These indicators usually outline actions that the taxpayer has taken to deceive, to conceal, or to make things appear different from the actual facts.
- (10) Fraud indicators are commonly referred to as the first indications of fraud or badges of fraud. It is essential to remember that fraud indicators are only "indicators" and do not "establish" firm proof of fraud. In addition, there could be patterns of repeated failures to file or failures to report income, despite the receipt of substantial amounts of taxable income. Willfulness may be inferred from any taxpayer conduct shown to mislead or conceal acts of evasion.
- (11) Some indicators and suggestions for developing potential fraud cases related to the taxpayer's conduct are shown below:
  - Indicator 1: Taxpayer fails to cooperate with the compliance employee.
  - Suggestion: Examiners should look at this as a first indication of fraud and begin documenting all attempted contacts and requests for records in chronological order and memorandums. As appropriate, examiners should issue summonses.
  - Indicator 2: Taxpayer repeatedly procrastinates in making and keeping appointments with IRS representatives.
  - Suggestion: Examiners should summons the taxpayer for testimony and/or summons for the applicable records.

- Indicator 3: Taxpayer is belligerent, threatening or attempts to interfere with an examiner's official duties.
- Suggestion: Examiners should notify TIGTA.
- Indicator 4: Taxpayer does not follow the advice of attorney or accountant.
- Suggestion: Examiners should document the interview with the attorney or accountant in the form of a memorandum or affidavit and consider interviewing business partners or the spouse.
- Indicator 5: Taxpayer does not fully disclose relevant facts to an accountant.
- Suggestion: Examiners should interview the accountant and summons the workpapers and records that taxpayer provided to accountant or the return preparer. Examiners should specifically ask about the item that was not disclosed and document answers. This may involve interviewing prior and subsequent accountants and/or interviewing the internal bookkeeper, if any.
- Indicator 6: Taxpayer makes false statements or submits false documents.
- Suggestion: Examiners should obtain the documents and document any false statements in a memorandum to the file. Examiners should also obtain testimony about those documents. If possible, have the originator of the document provide an original unaltered version of the document. Examiners should document interviews in memorandums and/or affidavits.

## **F. Report Writing**

- (1) General: IRM 4.10.8, Report Writing, provides guidelines for the preparation of examination reports. In addition to basic report writing procedures, it includes details regarding the preparation of corrected reports and discusses issues which require special reports and forms. It also provides instructions for some case closing requirements.
- (2) IRC 183: The taxpayer often disagrees with the proposed IRC 183 adjustments arising from an activity not engaged in for profit issue. Therefore, examiners should prepare the report showing the facts, law and argument, taxpayer's position, and conclusion. Since the report is the government's position, all pertinent information must be included in the case write up. All relevant documents and computations should be attached to the report.
- (3) It is important that the issues be fully developed to be sustained in Appeals or the courts. Alternative positions, if any, should be included in the unagreed report.
- (4) Examiners should attempt to secure a partial agreement for any issue or adjustments that are not related to the activity not engaged in for profit issue.



- (5) Examiners should prepare a rebuttal to the protest the taxpayer provides in response to the 30-day letter. The rebuttal should be shared with the taxpayer and their authorized representative. The purpose of sharing this information is to attempt to resolve any factual disputes before the case is submitted to Appeals. The rebuttals should focus on the all the points raised in the protest. Sometimes the protest raises valid points that the report does not address requiring examiners to reconsider and make any corrections, if necessary.
- (6) If it is determined that there is no profit motive, examiners should consider an alternative position to the primary position (activity not engaged in for profit) if the primary position is not upheld. An alternative position for an issue in an unagreed case is a secondary position that the IRS may ultimately rely on if the primary position cannot be upheld.
- (7) Potential alternative positions relating to IRC 183 examination may include IRC 162, IRC 179, IRC 195, IRC 262, IRC 274(d), IRC 280A, IRC 465, and IRC 469, or if the taxpayer failed to substantiate the expense.
- (8) IRC 183 adjustments are permanent adjustments and should generally be treated as the primary position unless the alternative issue converts the loss into a profit. The passive activity loss rules of IRC 469, the at-risk limitations of IRC 465, and the basis limitations of IRC 1366 and IRC 704 are timing adjustments and should be treated as alternative positions when the IRC 183 issue is also present.
- (9) Examiners should discuss the alternative position with the taxpayer and/or authorized representative prior to issuing the examination report. The unagreed report should include all alternative positions that may be applicable if the primary position is not upheld.
- (10) The facts, applicable law, taxpayer's position, and conclusions for the alternative position should be presented on a separate Lead Sheet apart from the primary position.

## **G. Inadequate Records**

- (1) IRC 6001 contains the requirements for taxpayers to maintain and keep records. Treas. Reg. 1.6001-1(a) provides that taxpayers must keep permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in the taxpayer's returns.
- (2) Treas. Reg. 1.6001-1(e) provides that the books or records required by this section shall be always kept available for inspection by authorized internal revenue officers or employees and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.
- (3) If the taxpayer has not kept adequate books and records this should be documented in the examiners workpapers as it is relevant to the objective factor in the regulations. See Treas. Reg. 1.183-2(b)(1).

- (4) Whenever the taxpayer's books and records are deemed inadequate for purposes of an examination of income, examiners should consider the issuance of an inadequate records notice at the conclusion of the examination. The procedures for issuance of an inadequate records notice can be found in IRM 4.10.8.16.

## **H. IRC 183 Suspense**

- (1) If there is an election to postpone the determination, examiners will generally close the case to suspense until the end of the presumption period. Upon the filing of all or sufficient returns for the presumption period, the case file will be returned to the examiner for a final determination on whether the activity is an activity not engaged in for profit.
- (2) Examiners should refer to IRM 4.8.2.11.2, IRC 183(e) Hobby Loss Suspense and IRM 4.10.13.6, Activities Not Engaged in For Profit - Hobby Loss (IRC 183), for additional guidance.

## **IX. Resources**

- (1) The Internal Revenue Code, Treasury Regulations, Revenue Rulings, Revenue Procedures are the legal authorities.
- (2) The Internal Revenue Manual offers administrative, procedural, and some technical guidance.
- (3) The Virtual Library is a must visit internal resource site for examiners who are searching for the knowledge and information needed to perform their jobs. "Examination" is the floor that covers topics related to tax examinations and issues. And the "Form 1040 Knowledge Base" contains resources, job aids and information to help examiners identify, develop, and examine Form 1040 issues.
- (4) Examiners can also use the "Contact an Expert" feature to identify and reach out to technical advisors or subject matter experts.

## **X. List of Exhibits:**

- (1) Exhibit 1: Analysis of Income, Expenses, and Profit or (Loss).
- (2) Exhibit 2: Report Generation Software (RGS) IRC 183 Lead Sheet (Page 1).
- (3) Exhibit 3: Report Generation Software (RGS) IRC 183 Lead Sheet (Page 2).
- (4) Exhibit 4: Form 5213, Election to Postpone Determination as to Whether the Presumption Applies That an Activity is Engaged in for Profit, (Page 1).
- (5) Exhibit 5: Form 5213 Instructions (Page 2).
- (6) Exhibit 6: Objective Factors Decision Matrix.
- (7) Exhibit 7: Tax Savings Benefit Analysis.

## A. Exhibit 1: Analysis of Income, Expenses, and Profit or (Loss)

(1) This exhibit shows the income, expenses, and profit or (loss) for different years.

ANALYSIS OF INCOME, EXPENSES, AND PROFIT OR (LOSS)						
INCOME	2015	2016	2017	2018	2019	2020
Gross Receipts or Sales						
Less Returns and Allowances						
Less Cost of Goods Sold						
Gross Profit						
Other Income						
<b>GROSS INCOME</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>
<b>EXPENSES</b>						
Advertising						
Car and truck expenses						
Commissions and fees						
Contract labor						
Depletion						
Depreciation and section 179 expense						
Employee benefit programs						
Insurance (other than health)						
Interest						
a Mortgage (paid to banks, etc.)						
b Other						
Legal and professional services						
Office expense						
Pension and profit-sharing plans						
Rent or lease						
a Vehicles, machinery, and equipment						
b Other business property						
Repairs and maintenance						
Supplies (not included in Part III)						
Taxes and licenses						
Travel and meals						
a Travel						
b Deductible meals						
Utilities						
Wages (less employment credits)						
Other expenses						
<b>TOTAL EXPENSES</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>
<b>PROFIT OR (LOSS)</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>

## B. Exhibit 2: RGS IRC 183 Lead Sheet (Page 1)

(1) This exhibit shows the IRC 183 Activity Not Engaged in for Profit Lead Sheet.

Lead Sheet Issue Reference Guide (LSIRG)		
Activity Not Engaged in for Profit (Rev 8/2016)		
IRC § 162, 183		
IMF/SAIN Code(s): 743, 4CGL, 4FGL, 7C10X, 7C20X, 7C30X, 7E10X, 7E20X, 7E30X, 7F10X, 7F20X		
<b>Audit Steps:</b>		
Pre-audit analysis of LUQs revealed that taxpayer has significant business losses		
Does business activity meet the requirements of either "Carrying on a trade or business" under IRC 162 or "For the production of income" under IRC 212?		
Determine Code requirements of IRC 162: Consult <a href="#">IRC 183 Activity Not Engaged in for Profit ATG Appendixes A and B</a> for 9 factors explanation and interview questions.		
Test	Criteria	Result Met/ not met / unknown
Manner in which taxpayer carries on the activity	Separate books, records, bank account, change method of operations	
The expertise of the taxpayer and of advisors	TP and spouse have background	
The time and effort expended by the taxpayer in this activity	How much time spent on daily basis	
Expectation that assets used may appreciate in value	None	
The success of the taxpayer in carrying on other similar or dissimilar activity	Prior experience in similar field	
The taxpayer's history of income or losses with respect to activity	Activity has only posted losses	
The amounts of occasional profits, if any, which are earned	None	
The financial status of the taxpayer	W-2 earnings and Sch C income provide adequate support	
Elements of personal pleasure or recreation	High	
Question the taxpayer/representative about above criteria and gain an understanding about the issue		
<b>Additional Law:</b>		
Per IRC 162, an activity is allowed to deduct expenses that are ordinary and necessary in carrying on the trade/business. If expenses exceed income, the loss is deductible against other income. If the loss is attributable to an activity not engaged in for profit, the loss is not allowed as a deduction against other income.		
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## C. Exhibit 3: RGS IRC 183 Lead Sheet (Page 2)

- (2) This exhibit shows page 2 of the IRC 183 Activity Not Engaged in for Profit Lead Sheet

### Lead Sheet Issue Reference Guide (LSIRG)

IRC 183 Activities not engaged in for profit, no deductions are allowed when an activity is not engaged in for profit. It is presumed that the activity is a business, not a hobby, if profit results from the activity in three out of five consecutive years in most cases. It is possible for the taxpayer to make an election which will defer the determination until the taxpayer has had the opportunity to achieve the presumption during the first five years of the activity.

Per Reg. 1.183-2(b), which addresses whether an activity is a trade/business, or whether it is attributable to an activity "not engaged in for profit," look at the facts and circumstances as a whole. The regulation provides nine tests that may be applied in order to look at the activity as a whole. List is not all inclusive.

## D. Exhibit 4: Form 5213, Election to Postpone Determination as to Whether the Presumption Applies that an Activity is Engaged in for Profit (Page 1)

- (1) This exhibit shows Form 5213, Election to Postpone Determination as to Whether the Presumption Applies that an Activity is Engaged in for Profit.

<p>Form <b>5213</b> (Rev. February 2006) Department of the Treasury Internal Revenue Service</p>	<p><b>Election To Postpone Determination as To Whether the Presumption Applies That an Activity Is Engaged in for Profit</b></p> <p>► To be filed by individuals, estates, trusts, partnerships, and S corporations.</p>	<p>OMB No. 1545-0195</p>
<p>Name(s) as shown on tax return _____</p>		<p>Identifying number as shown on tax return _____</p>
<p>Address (number and street, apt. no., rural route) (or P.O. box number if mail is not delivered to street address) _____</p>		
<p>City, town or post office, state, and ZIP code _____</p>		
<p>The taxpayer named above elects to postpone a determination as to whether the presumption applies that the activity described below is engaged in for profit. The determination is postponed until the close of:</p> <ul style="list-style-type: none"> <li>• The 6th tax year, for an activity that consists mainly of breeding, training, showing, or racing horses or</li> <li>• The 4th tax year for any other activity,</li> </ul> <p>after the tax year in which the taxpayer first engaged in the activity.</p>		
<p><b>1</b> Type of taxpayer engaged in the activity (check the box that applies):</p> <p><input type="checkbox"/> Individual      <input type="checkbox"/> Partnership      <input type="checkbox"/> S corporation      <input type="checkbox"/> Estate or trust</p>		
<p><b>2a</b> Description of activity for which you elect to postpone a determination _____</p>		
<p><b>2b</b> First tax year you engaged in activity described in 2a _____</p>		
<p>Under penalties of perjury, I declare that I have examined this election, including accompanying schedules, and to the best of my knowledge and belief, it is true, correct, and complete.</p>		
<p>_____ (Signature of taxpayer or fiduciary)</p>	<p>_____ (Date)</p>	
<p>_____ (Signature of taxpayer's spouse, if joint return was filed)</p>	<p>_____ (Date)</p>	
<p>_____ (Signature of general partner authorized to sign partnership return)</p>	<p>_____ (Date)</p>	
<p>_____ (Signature and title of officer, if an S corporation)</p>	<p>_____ (Date)</p>	
<p>For Privacy Act and Paperwork Reduction Act Notice, see instructions on back.      Cat. No. 42361U      Form <b>5213</b> (Rev. 2-2006)</p>		

## E. Exhibit 5: Instructions to Form 5213, Election to Postpone Determination as to Whether the Presumption Applies that an Activity is Engaged in for Profit (Page 2).

- (1) This exhibit shows the instructions to Form 5213, Election to Postpone Determination as to Whether the Presumption Applies that an Activity is Engaged in for Profit.

Form 5213 (Rev. 2-2006)	Page 2
<h3>General Instructions</h3>	
<p><b>Purpose of Form</b></p> <p>Use Form 5213 to elect to postpone an IRS determination as to whether the presumption applies that an activity is engaged in for profit.</p>	<p>Generally, in determining whether you are engaged in more than one activity, you must consider all of the following:</p> <ul style="list-style-type: none"> <li>• The similarity of the activities.</li> <li>• The business purpose that is (or might be) served by carrying on the activities separately or together in a trade or business or investment setting, and</li> <li>• The organizational and economic interrelationship of the activities.</li> </ul>
<p><b>General Information</b></p> <p>Generally, if you are an individual, estate, trust, partnership, or S corporation in an activity not engaged in for profit, some of your deductions may not be allowed. However, an activity is presumed to be engaged in for profit (and, therefore, deductions are not limited) if the gross income exceeds the deductions:</p> <ul style="list-style-type: none"> <li>• From an activity that consists mainly of breeding, training, showing, or racing horses for each of 2 or more of the tax years in the period of 7 consecutive tax years ending with the tax year in question or</li> <li>• From any other activity for each of 3 or more of the tax years in the period of 5 consecutive tax years ending with the tax year in question.</li> </ul> <p>For information on the limits on deductions in not-for-profit activities, see Pub. 535, Business Expenses.</p>	<p><b>When To File</b></p> <p>File this form within 3 years after the due date of your return (determined without extensions) for the first tax year in which you engaged in the activity. However, if you received a written notice that the IRS proposes to disallow deductions attributable to an activity not engaged in for profit (under Internal Revenue Code section 183) and you want a postponement of the determination, you must file this form within 60 days after receiving the notice. This 60-day period does not extend the 3-year period referred to above.</p>
<p><b>Who Should File</b></p> <p>Individuals, estates, trusts, partnerships (including limited liability companies or other entities that are treated as partnerships for Federal tax purposes), and S corporations should use this form if they want to postpone an IRS determination as to whether the presumption applies that they are engaged in an activity for profit. An election made by a partnership or an S corporation is binding on all persons who were partners or shareholders at any time during the presumption period.</p> <p>You may not use this form if you have been engaged in:</p> <ul style="list-style-type: none"> <li>• Breeding, training, showing, or racing horses for more than 7 years or</li> <li>• Any other activity for more than 5 years.</li> </ul> <p>If you elect a postponement and file this form on time, the IRS will generally postpone the determination until after the end of the 4th consecutive tax year (6th tax year for an activity that consists mainly of breeding, training, showing, or racing horses) after the tax year in which you first engaged in the activity. This period of 5 (or 7) tax years is called the "presumption period." The election to postpone covers the entire presumption period.</p>	<p><b>Where To File</b></p> <p>File this form with the Internal Revenue Service Center where you are required to file your return. Do not send it in with any other return because that will delay processing the election to postpone. However, if the IRS notifies you about proposing to disallow deductions for an activity not engaged in for profit, file the form with the IRS office that sent you the notification.</p>
<p><b>Joint Returns</b></p> <p>If you and your spouse filed a joint return, both of you must elect to postpone the determination even if only one of you is engaged in the activity.</p>	<p><b>Automatic Extension of Period of Limitations</b></p> <p>Generally, filing this form automatically extends the period of limitations for assessing any income tax deficiency specifically attributable to the activity during any year in the presumption period. The extension also applies to partners or shareholders in the activity.</p> <p>The period is extended until 2 years after the due date for filing the return (determined without extensions) for the last tax year in the presumption period. For example, for an activity subject to a 5-year presumption period that began in 2003 and ends in 2007, the period of limitations automatically extends to April 15, 2010, for all tax years in the presumption period that would otherwise expire before that date. Periods of limitations for tax years in the 5-year period expiring after April 15, 2010, would remain open until their normal expiration date. However, early termination of the presumption period does not terminate the automatic extension of the period of limitations.</p> <p>The automatic extension applies only to those deductions attributable to the activity and to any deductions (such as medical expenses or charitable contribution deductions) that are affected by changes made to adjusted gross income.</p> <p>The automatic extension does not affect general waivers of the statute of limitations that may be executed.</p>
<p><b>How Many Forms To File</b></p> <p>Generally, if you want a postponement for more than one activity, you must file a separate Form 5213 for each activity. However, you may file one form for more than one activity if all of the activities have the same presumption period. Be sure to describe each activity in detail and list the first tax year in which you were engaged in the activities.</p>	<p><b>Signature and Date</b></p> <p>Be sure to sign and date the form on the appropriate line or lines. Keep a copy for your records.</p> <p><b>Privacy Act and Paperwork Reduction Act Notice.</b> We ask for the information on this form to carry out the Internal Revenue laws of the United States. We need this information to determine your eligibility for making the election to postpone determination as to whether the presumption applies that an activity is engaged in for profit. If you make this election, you are required by Internal Revenue Code section 183 to provide the information requested on this form. Under section 6109, you must disclose your SSN, individual taxpayer identification number (ITIN), or EIN. Routine uses of this information include giving it to the Department of Justice for civil and criminal litigation, and to cities, states, and the District of Columbia for use in administering their tax laws. We may also disclose this information to other countries under a tax treaty, to federal and state agencies to enforce federal nontax criminal laws, or to federal law enforcement and intelligence agencies to combat terrorism. If you fail to provide this information in a timely manner, or provide incomplete or false information, you may be liable for interest and penalties.</p> <p>You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by Code section 6103.</p> <p>The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for individual taxpayers filing this form is approved under OMB control number 1545-0074 and is included in the estimates shown in the instructions for their individual income tax return. The estimated burden for all other taxpayers who file this form is shown below.</p> <p><b>Recordkeeping.</b> . . . . . 7 min.  <b>Learning about the law or the form</b> . . . . . 10 min.  <b>Preparing the form</b> . . . . . 20 min.  <b>Copying, assembling, and sending the form to the IRS</b> . . . . . 20 min.</p> <p>If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.</p>
<p><b>Specific Instructions</b></p> <p><b>Name and Identifying Number as Shown on Tax Return</b></p> <p>Enter your name(s) and identifying number as shown on your tax return for the first tax year</p>	<p>in which you engaged in the activity. If you are an individual, your identifying number is your social security number (SSN). If you are other than an individual, your identifying number is your employer identification number (EIN).</p> <p>If you and your spouse filed a joint return, enter both your name and your spouse's name as they were shown on your tax return. Enter the SSN that was shown first on your return as your identifying number.</p>

## F. Exhibit 6: Objective Factors Decision Matrix

(1) This shows a graphic of the nine objective factors as a decision matrix.

Factor	Authority	OBJECTIVE FACTORS DECISION MATRIX					To Be Decided	Not Applicable
		Pass	Fail	Favors Taxpayer	Against Taxpayer	Toss Up		
1	Treas. Reg. 1.183-2(b)(1) - Manner in which the taxpayer carries on the activity.			Businesslike Manner				
				Books and Records				
				Change Operating Methods				
				Adopt New Techniques				
2	Treas. Reg. 1.183-2(b)(2) - Expertise of the taxpayer or advisors.			Abandon Unprofitable Methods				
				Taxpayer's Expertise				
				Consults Advisors				
				Follows Advisor's Advice				
3	Treas. Reg. 1.183-2(b)(3) - Time and effort expended by the taxpayer in carrying on the activity.			Time and Effort				
				Hire Others				
4	Treas. Reg. 1.183-2(b)(4) - Expectation that assets used in activity may appreciate.			Land Appreciation				
5	Treas. Reg. 1.183-2(b)(5) - Success of the taxpayer in other activities.			Experience with Other Activities				
6	Treas. Reg. 1.183-2(b)(6) - Taxpayer's history of income or losses with respect to the activity.			Losses Beyond Start-Up Phase				
				Unforeseen or Fortuitous Circumstance				
				Any Profitable Years				
7	Treas. Reg. 1.183-2(b)(7) - Amount of any occasional earned profits.			Profit to Investment Ratio				
				Occasional Small Profit in Activities Large Loss/Investment				
				Substantial Profits in Activities Small Loss/Investment				
				Substantial Profit in Highly Speculative Activity				
8	Treas. Reg. 1.183-2(b)(8) - Financial status of the taxpayer.			Substantial Income from Other Sources				
				Substantial Tax Benefits and Income from Other Sources				
9	Treas. Reg. 1.183-2(b)(9) - Elements of personal pleasure or recreation.			Personal Motives				
				Significant Recreational or Personal Elements				



**G. Exhibit 7: Tax Savings Benefit Analysis**

(1) This exhibit shows a template for the Tax Savings Benefit Analysis.

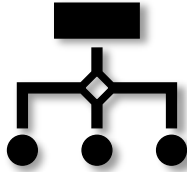
<b>TAX SAVINGS BENEFIT ANALYSIS</b>				
<b>Tax Period</b>	<b>Tax with Loss</b>	<b>Tax without Loss</b>	<b>Tax Savings</b>	<b>Notes</b>
2000	\$	\$	\$	
2001	\$	\$	\$	
2002	\$	\$	\$	
2003	\$	\$	\$	
2004	\$	\$	\$	
2005	\$	\$	\$	
2006	\$	\$	\$	
2007	\$	\$	\$	
2008	\$	\$	\$	
2009	\$	\$	\$	
2010	\$	\$	\$	
2011	\$	\$	\$	
2012	\$	\$	\$	
2013	\$	\$	\$	
2014	\$	\$	\$	
2015	\$	\$	\$	
2016	\$	\$	\$	
2017	\$	\$	\$	
2018	\$	\$	\$	
2019	\$	\$	\$	
2020	\$	\$	\$	
<b>TOTALS</b>	<b>\$0.00</b>	<b>\$0.00</b>	<b>\$0.00</b>	
<b>NOTES:</b>				

## H. Reserved for Additional Exhibit

(1) Alternative Text

## I. Exhibit 1: Example Graphic

(1) Graphic preceded by a paragraph...



(2)

## J. Exhibit 2: Example Table

(1) Table preceded by a paragraph.

<b>Example Header</b>	<b>Example Header 2</b>
Example Text	Example Text 2

(2)