

Farm Hobby or Farm Business?

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When asked why they farm, many farmers cite non-monetary reasons: to work for themselves; to work outdoors; their love of animals; or the family-focused lifestyle farming can provide. Profit is rarely mentioned as a motive; however, profit is exactly what the IRS is looking for when they determine whether your farm is a business or hobby. As you begin your farming enterprise, it is important to establish goals and decide whether profit is one of them – or not.

The IRS presumes that the activity is engaged in for-profit if it is profitable for 3 or more out of 5 consecutive years (or 2 or more out of 7 consecutive years for breeding, showing, training or racing horses). If your business doesn't meet this criteria does that mean you cannot file taxes as a farmer? Not necessarily, but it does shift the burden of proof to the taxpayer to prove that their farming operation is a business with an intent to make a profit and not a hobby. The IRS uses the following **nine factors** in determining whether an activity is conducted as a hobby or a business:



1

The manner in which the taxpayer carries on the activity.

Are accurate financial and production records kept? Is there a business plan with stated goals? Are changes made to improve the business?

2

The expertise of the taxpayer or his or her advisers.

The expertise of the taxpayer or his or her advisers. Has the taxpayer acquired knowledge to enable them to operate the business? Do they seek out educational opportunities? Do they utilize available resources for guidance.

3

The time and effort expended by the taxpayer in carrying on the activity.

Does the activity require a significant time commitment? An activity that requires significant time and effort by the taxpayer, or employees, can indicate profit motive.

4

The expectation that the assets used in the activity may appreciate in value.

Appreciation of assets could be considered profit. Does the appreciation exceed operating expenses?

5

The success of the taxpayer in carry on or other similar or dissimilar activities.

Does the taxpayer have a history of operating similar businesses that were profitable?

6

The taxpayer's history of income or losses with respect to the activity.

Are losses occurring during a normal start-up phase? Are losses due to events beyond the control of taxpayer?

7

The amount of occasional profits earned, if any.

Can the business generate profit even if it's intermittent?

8

The financial status of the taxpayer.

Is there substantial income from another source used to support the business?

9

Whether elements of personal pleasure or recreation are involved.

Not to say the activity can't be enjoyable but if the possibility of profit is low compared to the potential for pleasure then the motive could be questioned.

Why It Matters

The classification of an enterprise as a business or hobby is important because it determines whether the associated expenses are deductible or not. The Tax Cuts and Jobs Act (2018) eliminated the ability to deduct hobby expenses, while still requiring hobby income to be reported. Hobby loss rules are designed to prevent taxpayers from offsetting income with losses from expenses on “toys” and recreational pursuits.

While no one factor alone will determine the classification, taken together they can help in establishing a business-like approach to management. Here are some basic things that you can do to improve the management of your business and reduce the risk of being classified as a hobby:

- Keep accurate business records.
- Separate business and personal bank accounts.
- Establish a business plan with goals and update regularly.
- Make changes to production methods or activities to improve profitability where possible.
- Seek advice of professionals for financial and production issues.

Work with your tax professional to determine a tax strategy for annual expenses and depreciable asset expenses.

What if you want to farm as a hobby? Hobby income is reported on Form 1040 and hobby expenses are not deductible. Check with your tax preparer to determine the difference in gross income from hobby activity versus gross receipts.

For additional resources:

- Rural Tax Education – Rural Tax Education | USU
- Agricultural Finance, Tax and Asset Protection (AgFTAP) – repository of resources to help farmers and ranchers understand farm taxes for enhanced decision making – AgFTAP
- Farmer’s Tax Guide IRS Publication 225

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