

Chapter 3: Hobby Losses

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Corrections were made to this workbook through January of 2014. No subsequent modifications were made.

INTRODUCTION

Tax practitioners frequently use the term “hobby loss rules” when referring to the IRS rules regarding activities not engaged in for profit.

In recent years, the IRS has become more aggressive in looking at farm and business losses. On September 27, 2007, the Treasury Inspector General for Tax Administration (TIGTA) issued a report on the results of its review to determine what actions the IRS is taking to address noncompliant taxpayers who claim business losses on Schedule C, *Profit or Loss From Business*, for activities considered to be not-for-profit.¹ TIGTA looked at taxpayers with total income of \$100,000 or more. The report recommended changes to IRS procedures based on the following information.

In general, if a taxpayer has hobby income and expenses, the expense deduction should be limited to the hobby income amount. About 1.5 million taxpayers, many with significant income from other sources, filed Form 1040 Schedules C showing no profits, only losses, over consecutive Tax Years 2002–2005 (4 years); 73 percent of these taxpayers were assisted by tax practitioners. By claiming these losses to reduce their taxable incomes, about 1.2 million of the 1.5 million taxpayers potentially avoided paying \$2.8 billion in taxes in Tax Year 2005. Changes are needed to prevent taxpayers from continually deducting losses in potentially not-for-profit activities to reduce their tax liabilities.²

The report limited its scope to Schedules C with losses for four or more consecutive years. It did not cover Schedule F, *Profit or Loss From Farming*, or other types of entities.

BASIC HOBBY LOSS RULE

IRC §183 provides the “hobby loss rule.” IRC §183 was enacted in 1969 when it replaced a previous Code section. The previous Code section was repealed because Congress felt that taxpayer abuse was preventing it from adequately limiting expense deductions and hobby loss claims.³

¹ *Significant Challenges Exist in Determining Whether Taxpayers With Schedule C Losses Are Engaged in Tax Abuse*, Reference Number 2007-30-173, Treasury Inspector General for Tax Administration, Sept. 7, 2007.

² Ibid.

³ See H.R. Rep. No. 413, 91st Cong., 1st Sess. 62 (1969); S. Rep. No. 552, 91st Cong., 1st Sess. (1969).

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IRC §183 states in part:

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 section.⁴

Whether an activity is engaged in for profit is a facts and circumstances determination. **Neither the Code nor regulations provide an absolute definition.** However, the Code and regulations serve as a guide in formulating the facts necessary to determine whether an activity is not engaged in for profit. Taxpayers bear the burden of proving that they engage in the activity with an actual and honest objective of realizing a profit.⁵

Several Code sections have an impact on the deductibility of expenses. **Under IRC §212, expenses related to the production of income or investment income are generally deductible against unrelated income.** Under IRC §162, business expenses can be deducted only if the activity qualifies as a **trade or business**. IRC §162 allows deductions for all ordinary and necessary expenses paid or incurred during the year in carrying on a trade or business.⁶ Even though the intent is to make a profit, the IRS can deem the business to be a hobby under §183 and disallow all of the business expenses in excess of the business income.⁷

Example 1. Tom and Martha provide their 2013 income tax information to Jerry, their tax return preparer. Jerry has prepared annual tax returns for Tom and Martha for many years. In addition to their usual Forms W-2 and various Forms 1099, they include a sheet of notebook paper showing the following.

T & M Aquarium Fish and Supplies

Sales	\$ 125
Fish	\$1,950
Fish food	100
Fish tanks	2,000
Tank filters	500
Tank gravel	300
Air freight	85
Trip to Caribbean to select fish (air, meals, lodging, car rental, scuba gear rental)	2,500
Advertising	300
Remodel garage	4,000
Heat	400
Electric	300
Website development	600
Internet access	480
Water	700
Business license	50
Refrigerator/freezer	1,200
Shelving	3,000
Computer	499
Cash register	300
Software	150
Books	95

⁴ IRC §183(a).

⁵ *Keanini v. Comm'r*, 94 TC 41 (1990).

⁶ IRC §162(a).

⁷ IRC §183(c).

Tom and Martha tell Jerry that they think they will have a large loss to claim for the year from the new business. This is the first time that Tom and Martha have indicated that they are operating a business.

Part of Jerry's due diligence is to determine whether Tom and Martha have a profit motive in order to file a Schedule C and report business income and expenses. He knows that there are grounds that may be used by the IRS to challenge the business loss. He knows that he should ask Tom and Martha some additional questions about the business effort but is unsure what to ask them. Before contacting Tom and Martha, he begins some tax research on the subject.

Jerry reviews IRC §183, which generally states that in order for this activity to be treated as a business for tax purposes, Tom and Martha must be engaging in the activity for the purpose of earning a profit.⁸ He also learns that if Tom and Martha do not have a profit motive for engaging in the activity, they will not be able to claim a loss because their deductions may be limited to the amount of gross income from the activity.⁹ Jerry notes that this limitation on deductions for activities engaged in without a profit motive is known as the “**hobby loss rule.**”

As the tax return preparer, Jerry now knows that he must determine whether Tom and Martha have a profit motive. Jerry continues his tax research and finds the TIGTA report mentioned earlier as well as some helpful regulations under §183, particularly Treas. Reg. §1.183-2. This regulation provides several factors that are looked to in order to determine whether a taxpayer has a bona fide profit motive in connection with a business activity. In addition, Jerry finds some other tax provisions helpful. Some details of his research follow.

FOR-PROFIT DETERMINATION FACTORS

Although many trades or businesses incur losses for one or more years, they are not necessarily considered to be not-for-profit activities. The IRS is more likely to make the not-for-profit determination for activities primarily carried on as a sport, hobby, or for recreation. The IRS makes its determination using objective standards, taking into account all the relevant **facts and circumstances** of each case.

Although a reasonable expectation of profit is not required, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the expectation of making a profit. It may be sufficient that there is a small chance of making a large profit.

Example 2. Frank is an accomplished automobile mechanic. He invests a substantial amount of his personal savings into a new production racer. He hires a master builder to make all the required race-legal modifications to the car and provide him with assistance with recruiting a top-rated driver.

Although Frank's expenses for the car and driver total approximately \$200,000, he is focused on the possibility of placing either first, second, or third in the car's particular racing category. This would provide winnings in the range of \$500,000 to \$1 million. Despite fierce competition, Frank believes his acumen as a mechanic with assistance from the master builder gives him some advantages over other cars, especially with the top-rated driver he is able to employ. Winning would easily offset his substantial expenses and place him in a significant profit position after recouping his investment. Even though Frank only has a small chance at a profit, this factor alone does not negate his profit motive for engaging in the activity.

In making the for-profit determination, greater weight is placed on **objective facts** than on the **taxpayer's statement** of intent.

⁸ IRC §183(a).

⁹ IRC §183(b).

RELEVANT FACTORS

Treas. Reg. §1.183-2(b) provides the relevant guidance in determining whether an activity is engaged in for profit. All the facts and circumstances are taken into account, but there are nine particular factors that should normally be considered. In making the for-profit determination, **no one factor** is determinative. Other factors not listed in the regulations can also be taken into account. The number of factors in favor of the taxpayer is also not determinative. The nine factors that should be considered are the following.¹⁰

- 1. Manner in which the taxpayer carried on the activity.** Does the taxpayer have complete and accurate **books and records** on the activity? Do they carry on the activity in a manner similar to other activities of the same nature that are profitable? Have there been operational changes in an attempt to improve profitability?

Sophisticated double entry accounting software is not required, but “shoebox” accounting with summarization only at tax time is generally not sufficient to show a profit motive. The presence of sophisticated books and records does not automatically equate to a profit motive. However, the taxpayer must rely on the available records in order to operate the activity and make decisions or changes that demonstrate a profit-seeking motive.

Having a business plan is very helpful in overcoming a hobby loss challenge by the IRS. Details of what should be included in a business plan are discussed later in this chapter.

Keeping separate business and personal checking accounts is another way to show the venture is being run in a business-like manner. Running the business in a manner similar to a profitable business also helps show a profit motive.

If the activity is audited, the examiner may ask for copies of advertising promoting the business. One item the examiner is cautioned to evaluate is the taxpayer’s children’s activities. There is a possibility that expenses related to such activities are being deducted on the parent’s return. For example, if the parents have a horse activity, the taxpayer may contend that the children are promoting the activity through competitions. IRS examiners are trained to consider the substance of the facts.¹¹ Examiners are also instructed to examine the actual copy of advertising regarding the activity. Many taxpayers purchase “vanity” ads which contain photographs of their children. These ads may wish the child luck prior to upcoming competitions. The examiner is told to use professional judgment as to whether the advertisements truly represent promotion of the taxpayer’s activity.

- 2. The expertise of the taxpayer or their advisors.** Did the taxpayer prepare for the activity through an extensive study of accepted business, economic, and scientific practices, or consult with experts in the field? If the study occurred but the taxpayer does not carry on the business in accordance with the findings or recommendations, it might indicate that there is no profit motive. However, if the taxpayer is trying to develop new or superior techniques, it might indicate that a profit motive exists.

Even if the taxpayer has no previous experience in the business, the activity is not necessarily a hobby. Experience can be obtained from schooling, the use of qualified advisors, and reading. However, this needs to be documented as evidence in case the IRS challenges the status of the business.

An IRS examiner is instructed to ask for types of advice received from expert consultants and to document when the taxpayer failed to heed this advice.¹²

¹⁰ Treas. Reg. §1.183-2(b).

¹¹ Internal Revenue Service, *Audit Technique Guide for IRC §183 Activities Not Engaged in for Profit* (Jun. 2009).

¹² *Ibid.*

- 3. The time and effort expended by the taxpayer in carrying on the activity.** If the taxpayer devotes substantial personal time to an activity that does not have recreational aspects, it could indicate a profit motive exists. If the taxpayer leaves another occupation to devote most of their energy to the activity, it may indicate the activity is engaged in for profit. However, the fact that the taxpayer devotes limited time to the activity does not necessarily indicate the lack of a profit motive when competent and qualified persons are employed to carry on the business.

If the activity is being conducted by someone other than the business owner, the owner should be able to show that the person is capable. For example, if the taxpayer is deducting expenses for a backyard garden and selling produce to the local farmer's market, they should keep records that indicate that the individual(s) providing the work are experienced in growing produce. If all of the work is provided by a child of the taxpayer after school, it is more likely that the project is not intended to make a profit.

Example 3. Tom and Jennie live on a 3-acre parcel of land and their children plant one acre of pumpkins for the Halloween market. Pumpkins do not require much work throughout the growing season. It is very possible for this to make a profit if Tom and Jennie have developed a market for the crop. Even though a venture is not profitable, establishing the relevant facts can indicate a profit motive.

- 4. An expectation that assets used in the business may appreciate in value.** The term "profit" encompasses the appreciation of assets, such as land, used in the activity.

Example 4. Arielle realizes that the community garden she has created will not produce a profit in the first three years but knows the land will appreciate in value. Also, income from the garden will help defray some of the expenses for the years prior to the sale of the land.

Example 5. Ivan believes that a parcel of land will appreciate in value. However, during the time he holds the property, he wants to have some income to pay for expenses (interest, taxes, etc.). Consequently, he forms a business that will utilize the property and pay a portion of the costs. In calculating whether the business showed a profit, Ivan considers including unrecognized appreciation in the calculation. However, there must be evidence that appreciation is occurring. Unsubstantiated appreciation will be discounted by the IRS.

An examiner may argue that holding the land and the conduct of the activity are two separate activities and each should stand on its own merits.

- 5. The success of the taxpayer in carrying on similar or dissimilar activities.** The fact that the taxpayer has undertaken similar activities in the past and converted them from unprofitable to profitable may indicate that the taxpayer has a profit motive.

If the taxpayer has shown success in other businesses, it is valid to assume that they will be successful in the new venture. This can be used as an indication that there is a profit motive. Likewise, if the taxpayer has been involved in other activities and has not made them profitable, the taxpayer's prior history can be used against the taxpayer.

Example 6. Dr. John has a very profitable medical practice. However, he was involved in two sideline businesses that were never profitable and were abandoned. This fact would weigh against Dr. John in evaluating the profit motive of his current sideline activities.

- 6. The taxpayer's history of income and losses with respect to the activity.** A series of losses in the start-up years of an activity does not necessarily indicate the activity is not engaged in for profit. However, if unexplained losses continue beyond that period, it may indicate the activity is not being carried on to make a profit. Losses due to business reversals or customary business risks are explained losses. Losses due to unforeseen circumstance that are beyond the taxpayer's control such as drought, disease, fire, theft, weather damages, other involuntary conversions, or depressed market conditions are not indications that the activity is not engaged in for profit. A series of prior profitable years is an indication of a for-profit activity even if the most recent years have resulted in losses.

7. **The amount of occasional profits, if any, which are earned.** The amount of profits in relation to the amount of losses incurred and to the taxpayer's investment and the value of the assets used is a factor considered in making the for-profit determination. An occasional small profit from an activity that generates large ongoing losses is not generally indicative of whether the activity is engaged in for profit. However, large occasional profits are an indication of a profit motive if the investment or losses are comparatively small. An opportunity to earn a substantial ultimate profit in a highly speculative venture is ordinarily sufficient to indicate the activity is engaged in for profit. This is the case even though losses or only occasional small profits are actually generated.

IRS examiners are instructed to examine the gross receipts of the activity when they are making a determination about whether the activity is engaged in for profit. There are cases in which the taxpayer included income in the activity that was not a part of the activity. The examiner subtracts this income when evaluating the profitability of the activity. In these situations, the examiner considers the implication of the misrepresentation on the profitability results and whether civil fraud is a possibility.¹³

Example 7. Ben forms a movie production company. The first three movies result in substantial losses. However, the opportunity to make a large profit is possible if he finds the right situation. Substantial, repeated business losses are common in the movie industry. If Ben can establish that he has taken creative steps and has made prudent business decisions within his endeavor to eventually produce a profitable movie, he may be able to establish a profit-seeking motive despite the initial losses.

8. **The financial status of the taxpayer.** A taxpayer without substantial income or capital from other sources is more likely to engage in an activity for profit. If the taxpayer has substantial income from other sources and engages in an activity that generates substantial tax benefits, it is more likely the intent of the activity is not to make a profit, especially if the taxpayer continues with the activity for a number of years. This is especially true if there are personal or recreational elements involved.

Example 8. Ralph is a high-level executive at an international engineering and construction corporation that completes major projects worldwide. Ralph receives a Form W-2 each year with annual income in the \$250,000 to \$300,000 range. Ralph has accumulated significant personal wealth.

Ralph purchases a new 40-foot luxury fishing boat in 2013 and starts his own charter boat business, which he operates on weekends and holidays when he is not working. The new boat costs \$200,000 and Ralph uses a small portion of one of his several brokerage accounts to pay cash to purchase the boat. The business is operated on Lake Michigan, near Chicago. Accordingly, the business is seasonal and the boat is dry-docked during the winter months.

Ralph's brother-in-law, Sam, also buys a similar luxury fishing boat and starts a charter boat business near Chicago. However, Sam decides to leave his \$60,000 per year full-time job as administrator of a private school to operate his charter boat business on a full-time basis. Sam also paid \$200,000 for his boat, but decided to purchase it with \$50,000 of savings that he managed to slowly accumulate over the past 10 years and finance the remaining \$150,000 through a loan with a local bank. In the winter months, Sam plans to take the boat to Florida so that he can continue to earn income on a year-round basis.

Based on these facts, Ralph will probably have more difficulty establishing a profit motive than Sam.

9. **Elements of personal pleasure or recreation.** If the taxpayer has personal motives in carrying on the activity, it could indicate that the activity is not engaged in for profit. This is especially true if the activity involves **recreational or personal elements**. This is not true for an activity that lacks any appeal other than profit. It is not necessary to engage in the activity with the exclusive intent to make a profit or with the intention of maximizing profits. For example, the availability of other investments that would yield a higher return, or that would be more likely to be profitable, is not evidence that no profit motive exists. An element of personal pleasure from engaging in the activity is not determinative of the lack of a profit motive.

¹³ Ibid.

Example 9. Anne purchases a small horse farm. She buys horses because she and her family like to ride horses. Unless Anne can show how this can become a profitable venture, it will be presumed by the IRS to be an activity not engaged in for profit.

9-Factor Application

Example 10. Assume the same facts as **Example 1**. Now that Jerry has completed some tax research on the hobby loss rule, he knows that he must ask Tom and Martha some questions to ascertain whether they have a profit motive for their aquarium and fish supply activity. With reference to the nine factors outlined in Treas. Reg. §1.183-2(b), Jerry contacts Tom and Martha and learns some additional information.

- The sheet of notebook paper with income and expenses was a summary of several detailed spreadsheets that Tom and Martha have carefully maintained to track all business expenditures. The expenditures have been tracked on an itemized basis, with a date and amount indicated for each item. Tom and Martha have retained all receipts for these expenses.
- The expenditures have been made gradually throughout 2013 in accordance with a cash flow budget. The cash flow budget is part of their business plan that they prepared with the assistance of a paid business consultant and an attorney. The business plan consists of detailed financial projections. It summarizes the potential demand for aquariums, aquarium equipment, exotic fish, and related services in the local area. It also describes the marketing studies that Tom and Martha hired the business consultant to conduct.
- Tom and Martha began advertising the business in December 2013 after they accumulated enough savings to purchase the advertising space in local print media. The other start-up expenses were incurred over the course of the year.
- Because Tom and Martha never operated a business before, they did not open a separate checking account for the business. However, they did indicate that they were hopeful Jerry could provide them with some advice in this area when they pick up their completed 2013 tax returns.
- Jerry knew that Martha works as an information officer for a technology company, but he has now learned that Martha has master's degrees in marine biology and library science. Her employer specializes in the development of oceanographic data collection and photographic equipment. Tom and Martha decided to start their new endeavor because the company is moving its headquarters to Florida from Chicago and Tom and Martha do not wish to move to Florida. Martha will need new full-time employment within two years as a result of her severance from the technology company. Tom and Martha wanted to get their new business established before Martha quits her job. Martha plans to work at the new business on a full-time basis after her employer moves because her family will need a continued source of income from her in addition to the income Tom earns as pilot of a small airplane.
- Tom and Martha applied for and successfully obtained a zoning change for their home so that a commercial establishment could be legally operated from their garage. Later, their business plan calls for the erection of a retail building next to their home, which would be within the scope of the zoning change they obtained from their locality.
- Tom and Martha were pleased with their very first sale of \$125 on December 28, 2013, shortly after they launched their advertising campaign. This represented the sale of one exotic fish that Martha obtained at a cost of \$50. The margin on the fish was higher than expected and sales have continued to steadily increase in January and February of 2014.

After obtaining all of the above additional information, Jerry determines that Tom and Martha are engaging in the activity with a profit motive. He makes a note to discuss with them the need to open a separate checking account for the business and begins to complete the necessary calculations to prepare the first Schedule C for Tom and Martha's 2013 joint return.

ORDER OF DEDUCTIONS

In determining whether an activity is engaged in for profit, the IRS compares the activity's expenses with its gross income. **Gross income** from the activity includes the total gains from the sale, exchange, or other disposition of property and all other gross receipts derived from the activity. This includes capital gains and rents received for use of the property held in connection with the activity. Gross income may be determined by **subtracting the cost of goods sold from the gross receipts** as long as the taxpayer consistently follows generally accepted accounting methods.¹⁴

Whether an activity is “engaged in for profit” has more implications than whether the loss is allowed to offset other income. Areas affected by the determination include, but are not limited to, the following.

- Self-employment tax
- Deductions for health insurance premiums
- Alternative minimum tax (AMT)
- Itemized deductions
- Adjusted gross income (AGI)
- Personal exemption phaseout
- Roth IRA contributions
- Various tax credits

Because AGI is affected by the determination, many other items on the return are also affected. These include — but are not limited to — rental losses, medical expenses, casualty losses, miscellaneous deductions, the adoption expense credit, and interest on education loans.

If the activity is determined to be an activity not engaged in for profit, its expenses are miscellaneous itemized deductions. Because these are not deductible for AMT, the amount of AMT liability may increase.

For purposes of §183, if the activity is not engaged in for profit, the deductions are classified as tier 1, 2, or 3. **The deductions are then allowable to the extent of income in the following order.**

- Tier 1.** These are otherwise allowable deductions. They include taxes, casualty losses, contributions, and mortgage interest. These items are deductible even if the activity is not engaged in for profit **because they are deductible under other sections of the Code.** For example, real estate taxes on a structure used in the activity are allowable as an itemized deduction.¹⁵ These deductions should be entered in the proper places on Schedule A and are allowed in full after taking into account any limitations, such as the limitation on excess investment interest.
- Tier 2.** These are the typical operating expenses that are allowable deductions for a profitable activity. They include such items as rent, labor, wages, travel, transportation, etc. For the activity not engaged in for profit, these items **are only deductible to the extent of gross income remaining after deducting tier 1 expenses.** Although the gross income is reported on line 21 of Form 1040, the expenses are an itemized deduction subject to the 2%-of-AGI limitation. These deductions cannot result in the reduction of the basis of property used in the activity.¹⁶
- Tier 3.** These include any deductions that would result in a reduction of basis. They include depreciation, amortization, and the nondeductible portion of casualty losses that are disallowed in tier 1. They are only allowed to the extent that the gross income from the activity exceeds the tier 1 and tier 2 expenses.¹⁷

¹⁴ Treas. Reg. §1.183-1(e).

¹⁵ Treas. Reg. §1.183-1(b)(1)(i).

¹⁶ Treas. Reg. §1.183-1(b)(1)(ii).

¹⁷ Treas. Reg. §1.183-1(b)(1)(iii).

The allowed expenses are reported as itemized deductions subject to any overall limitation on itemized deductions and subject to the 2% AGI floor for miscellaneous itemized deductions with the exception of mortgage interest, real estate taxes, and contributions, which are statutory deductions. For AMT, no deduction is allowed for miscellaneous itemized deductions.¹⁸

Under §183(a), profit does not include any income tax savings. If there is no economic profit other than tax savings, §183 applies.

Example 11. Mary Jo has gross receipts of \$13,000 from a direct sales activity determined to be not engaged in for profit. After expenses of \$50,000, an ordinary loss of \$37,000 was reported on Schedule C as if the activity had been engaged in for profit.

Gross receipts	\$13,000
Less: mortgage interest expense	(2,000)
Less: supplies, repairs, etc.	<u>(11,000)</u>
Balance of gross receipts	\$ 0
Remaining expenses (\$50,000 – \$13,000) = incorrect adjustment. (The loss is not deductible because the activity was determined not to be engaged in for profit.)	
	\$37,000

If the IRS had allowed this incorrect computation, the AGI would have been increased by \$37,000 and no adjustment would have been made to Schedule A.

If Mary Jo had reported the activity correctly, her AGI would be increased by \$50,000 because of the following adjustments.

1. Removing the \$13,000 of gross receipts from Schedule C
2. Reclassifying the \$13,000 of gross receipts to other income (line 21 of Form 1040)
3. Removing all \$50,000 in expenses from Schedule C
4. Taking a \$2,000 mortgage expense deduction (tier 1 item) on Schedule A
5. Taking \$11,000 (tier 2 items) as Schedule A miscellaneous itemized deductions subject to the 2%-of-AGI limitation

Using the correct computation method, there will be an additional adjustment because of the miscellaneous itemized deductions limitation. Other adjustments are also possible, such as the limitations on itemized deductions and personal exemptions for higher-income taxpayers, AMT, and other items that could be affected by the change in AGI.

Note. Expenses for activities not engaged in for profit are deductible only as Schedule A deductions. Therefore, individuals who do not itemize cannot claim any deductions attributable to a §183 activity except for tier 1 items that can be capitalized and deducted elsewhere. These are permanent adjustments unlike passive activity losses, which are timing adjustments. Any adjustments made due to §183 cannot be carried forward.

¹⁸ IRC §67(b).

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Example 12. Thelma Hotrode, CPA, owns a race car and competes at the local dirt track. In 2012, her AGI was \$140,000, which included a Schedule C loss of \$30,000. All expenses on her Schedule C were verified during an IRS audit. It was determined in the audit that her activity was not engaged in for profit.

Her original Schedule C showed the following.

Schedule C gross income	\$ 500
Expenses	<u>(30,500)</u>
Schedule C loss per return	(\$30,000)

The audit adjustments follow.¹⁹

- Step 1.** Remove gross income of \$500 from the Schedule C.
- Step 2.** Reclassify income of \$500 as other income on line 21 of Form 1040.
- Step 3.** Remove all \$30,500 of expenses from Schedule C.
- Step 4.** Compute corrected AGI.

AGI per return as originally filed	\$140,000
Less: Schedule C gross income	(500)
Plus: other unearned income (reported on line 21 of Form 1040)	500
Plus: disallowed expenses	<u>30,500</u>
Corrected AGI	\$170,500

- Step 5.** Sort expenses into tiers 1, 2, and 3.

Expense	Amount	Tier 1	Tier 2	Tier 3
Entry fees	\$ 700		\$ 700	
Fuel	600		600	
2 new engines	10,000		10,000	
Racing tires	3,200		3,200	
Travel to races (2,000 miles)	1,110		1,110	
Trailer license	90		90	
Meals (50%)	300		300	
Repairs	5,000		5,000	
Wages to mechanic	1,000		1,000	
Racing magazines	100		100	
Depreciation	3,000			\$3,000
Miscellaneous expenses	<u>5,400</u>		<u>5,400</u>	
Total expenses	\$30,500		\$27,500	\$3,000

¹⁹ IRC §183: *Activities Not Engaged in For Profit (ATG)*. [[www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/IRC-§-183---Activities-Not-Engaged-in-For-Profit-\(ATG\)](http://www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/IRC-§-183---Activities-Not-Engaged-in-For-Profit-(ATG))] Accessed on May 2, 2013.

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Step 6. Determine amount of tier 1, 2 and 3 expenses allowable.

Gross income	\$500
Less: tier 1 expenses	(0)
Maximum tier 2 and 3 deductions	\$500
Less: tier 2 expenses	(500)
Remaining gross income to offset against tier 3 expenses	\$ 0

The tier 2 expenses must be further reduced by 2% of AGI ($2\% \times \$170,500 = \$3,410$).²⁰ Therefore, no tier 2 expenses are deductible.

Note. It is not correct to merely add the amount of disallowed loss to AGI. If this was done with the above example, the AGI would have been incorrectly calculated to be \$170,000 (\$140,000 AGI as originally filed + \$30,000).

Example 13. Bass Fisherman files Schedule C for his bass fishing activity. As a result of an IRS audit, it is determined that the activity is not engaged in for profit. Bass has an AGI of \$120,000. His Schedule C gross receipts were \$3,000.

Bass's total expenses reported on Schedule C were \$63,700, resulting in a net loss of \$60,700. The Schedule C income and expenses were then reclassified as follows.

Expense	Amount	Tier 1	Tier 2	Tier 3
Property taxes	\$ 700	\$ 700		
Mortgage interest	900	900		
Insurance	400		\$ 400	
Utilities	700		700	
Auto and travel	23,000		23,000	
Bait and tackle	2,000		2,000	
Entrance fees	8,000		8,000	
Depreciation	28,000			\$28,000
Total expenses	\$63,700	\$1,600	\$34,100	\$28,000

The tier 1 expenses of \$1,600 are used in full, leaving \$1,400 ($\$3,000 - \$1,600$) for tier 2 and 3 expenses. Because the tier 2 expenses of \$34,100 exceed the remaining gross income of \$1,400, Bass is allowed only \$1,400 of the tier 2 expenses. None of the tier 3 expenses are allowed because there is no gross income remaining.

AGI per return	\$120,000
Plus: Schedule C expense disallowed	63,700
Less: Schedule C gross income	(3,000)
Plus: other unearned income (line 21)	3,000
Corrected AGI	\$183,700

²⁰ IRC §67.

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Bass's return originally showed an AGI of \$120,000. After the adjustments, the AGI is \$183,700. Miscellaneous itemized deductions are limited by the 2%-of-AGI threshold ($2\% \times \$183,700 = \$3,674$). Assuming Bass has no other miscellaneous deductions, he is not allowed any tax deduction for the \$1,400 in tier 2 expenses because the total did not exceed 2% of his AGI.

If the IRS auditor had only disallowed the loss from Bass's Schedule C activity, it would have resulted in a total adjustment of \$60,700 to AGI. By correctly removing the income and expenses from the Schedule C and reporting the income on line 21 of Form 1040, the adjustments result in an increase in AGI of \$63,700 and an increase in total itemized deductions of \$1,600, for a total adjustment of \$62,100 ($\$63,700 - \$1,600$).

Also, Bass may have other items on his tax return that could be affected by the increase in AGI.

Depreciation Allocation

If there is gross income remaining after the tier 1 and tier 2 deductions, the depreciation is allocated pro rata to the depreciable assets.

Example 14. Marty had gross receipts of \$20,000 from her activity that was determined to be not for profit. She had no tier 1 expenses, \$18,000 of tier 2 expenses, and \$5,000 of tier 3 depreciation. Because only \$2,000 ($\$20,000 - \$18,000$) of the depreciation is allowed to offset the remaining income of the activity, it must be allocated between the assets. The activity had total depreciation expense of \$5,000, of which \$4,000 was for asset 1 and the remaining \$1,000 was for asset 2. The allowable depreciation is allocated as follows.

1. Asset 1 depreciation allowed ($\$4,000 \div \$5,000$) \times $\$2,000 = \$1,600$
2. Asset 2 depreciation allowed ($\$1,000 \div \$5,000$) \times $\$2,000 = \400

The bases of assets 1 and 2 are only reduced by the amount of depreciation **actually allowed**.

Excess Deductions

High-Income Taxpayers. Beginning in 2013, the limitation of expenses allowed for an activity not engaged in for profit can have an even more severe impact on the high-income taxpayer.

Example 15. Heidi Harhar is a successful comedian. She has always wanted to be a part of the horse racing society. In 2005, she purchased three race horses and 30 acres of pasture, and she built a stable costing \$100,000. Her adjusted gross income in 2013 was \$1.05 million, which included a \$175,510 loss from her racing activity. Heidi only participates in the horse racing activity as an owner. All work is performed by others. Heidi's gross income from racing in 2013 is \$45,000.

Heidi's total expenses reported on Schedule C were \$220,510, resulting in a net loss of \$175,510 ($\$45,000$ income $-$ $\$220,510$ expenses). The Schedule C activity was determined to be an activity not engaged in for profit.

The audit adjustments follow.

- Step 1.** Remove gross income of \$45,000 from the Schedule C.
- Step 2.** Reclassify income of 45,000 as other income on line 21 of Form 1040.
- Step 3.** Remove all \$220,510 of expenses from Schedule C.
- Step 4.** Compute corrected AGI.

AGI per return	\$1,050,000
Less: removal of Schedule C income	(45,000)
Plus: other income on line 21	45,000
Plus: Schedule C expense disallowed	220,510
Corrected AGI	<u>\$1,270,510</u>

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Step 5. Sort expenses into tiers 1, 2, and 3.

Expense	Amount	Tier 1	Tier 2	Tier 3
Mortgage interest	\$ 24,000	\$24,000		
Real estate taxes	4,000	4,000		
Stable rent at track	15,000		\$ 15,000	
Training fees	50,000		50,000	
Jockey fee	4,500		4,500	
Feed	14,400		14,400	
Auto/travel	5,000		5,000	
Insurance	2,000		2,000	
Supplies	1,000		1,000	
Entry fees	7,000		7,000	
Association dues	3,000		3,000	
Veterinary	9,000		9,000	
Repairs and maintenance	2,000		2,000	
Farrier fee	4,050		4,050	
Utilities	4,500		4,500	
Horse transportation	8,000		8,000	
Stable manager/employees	40,000		40,000	
Payroll taxes	3,060		3,060	
Depreciation	20,000			\$20,000
Total expenses	\$220,510	\$28,000	\$172,510	\$20,000

Step 6. Determine amount of tier 1, 2 and 3 expenses allowable.

Gross income	\$45,000
Less: tier 1 expenses	(28,000)
Maximum tier 2 and 3 deductions	\$17,000
Less: tier 2 expenses	(17,000)
Remaining gross income to offset against tier 3 expenses	\$ 0

Heidi's tier 2 expenses must be further reduced by 2% of AGI ($2\% \times \$1,270,510 = \$25,410$). Therefore, no tier 2 expenses are deductible.

If the IRS auditor only disallowed the loss from Heidi's Schedule C activity, it would have resulted in a total adjustment of \$175,510 to AGI. By correctly removing the income and expenses from the Schedule C and reporting the income on line 21 of Form 1040, the adjustments result in an increase to AGI of \$220,510 ($\$1,270,510 - \$1,050,000$) and an increase in total itemized deductions of \$28,000 (tier 1 expenses), for a total adjustment of \$192,510 ($\$220,510 - \$28,000$) to taxable income.

Assuming Heidi has no other itemized deductions, her Schedule A deduction is \$28,000 (\$24,000 of mortgage interest and \$4,000 of real estate taxes). **However, the Pease limitation on itemized deductions for higher-income taxpayers is reinstated for 2013.** Consequently, Heidi must reduce her otherwise allowable itemized deductions by the **lesser** of 3% of the amount her AGI exceeds \$250,000 or 80% of the total itemized deductions. The 3% limitation would reduce the itemized deductions to \$0 ($(\$1,270,510 \text{ AGI} - \$250,000 \text{ threshold}) \times 3\% = \$30,615$). The 80% limitation would reduce her itemized deductions to \$5,600 ($\$28,000 - (\$28,000 \times 80\%)$). Therefore, Heidi's total allowable itemized deduction are \$5,600. **Because this is less than the 2013 standard deduction for single taxpayers of \$6,100, Heidi will probably not choose to itemize.**

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Furthermore, due to the reinstatement of the personal exemption phaseout (PEP) in 2013 for higher-income taxpayers, personal exemptions for a single filer are reduced by 2% for each \$2,500 (or fraction thereof) the AGI exceeds \$250,000. Because Heidi's AGI exceeds the threshold amount by \$1,020,510 (\$1,270,510 AGI – \$250,000 threshold), she is not entitled to any personal exemption for 2013.

Note. The Pease limitation and PEP are discussed in more detail in the 2013 *University of Illinois Federal Tax Workbook*, Volume A, Chapter 1: New Legislation.

FOR-PROFIT PRESUMPTION

The IRS presumes an activity to be engaged in for profit if the gross income from the activity **for three or more years in a consecutive 5-year period** is more than the expenses incurred. **For activities involving breeding, training, showing, or racing horses**, if the gross income is more than the deductions **for two out of seven consecutive years**, the IRS presumes it is a for-profit activity.²¹ However, the IRS can rebut this presumption.

The presumption rule applies only after an activity incurs a third profitable (or second for horse activities) year within a 5-year (or 7-year) presumption period that begins with the first profitable year.²²

Example 16. Johnny Speed owns and drives a race car. The profit and loss summary for the race car activity for the first eight years follows.

	Year	Profit/(Loss)
1	2006	(\$30,000)
2	2007	5,000
3	2008	(60,000)
4	2009	2,000
5	2010	5,000
6	2011	(70,000)
7	2012	3,000
8	2013	(63,000)

The first 5-year presumption period begins with the first profit year, 2007, but the benefit of the presumption does not begin until the third profit year of 2010. The presumption is not available for 2007 through 2009 because it does not apply until the third profit year. The presumption is available during the first presumption period only in 2010 and 2011.

The second 5-year presumption period begins with the 2009 profit year and runs through 2013. The presumption applies to the third profit year of 2012 and will be of benefit to the taxpayer only for 2012 and 2013.²³

²¹ IRC §183(d).

²² Internal Revenue Service, *Audit Technique Guide for IRC §183 Activities Not Engaged in for Profit* (Jun. 2009).

²³ This example is adapted from *IRC §183: Activities Not Engaged in For Profit (ATG)* — Chapter Four [www.irs.gov/Businesses/Small-Businesses-&Self-Employed/IRC-§-183:-Activities-Not-Engaged-in-For-Profit-(ATG)] Accessed on May 2, 2013.

If the taxpayer meets the presumption rule, the IRS can still argue that the activity is not engaged in for profit; however, the presumption serves to shift the burden of proof to the IRS. In addition, examiners cannot use §183(d) as the sole basis for disallowing losses under §183 even if it is shown the taxpayer has not met the presumption rule.

Note. The audit training guide for §183 activities warns IRS auditors not to tell a taxpayer involved in a particular activity that it would be impossible to make a profit in the activity and that the losses are therefore disallowed. Each taxpayer is entitled to an impartial examination of the activity allowing for a fully reasoned determination of whether the activity is engaged in for profit.²⁴

For-Profit Presumption Election

If a taxpayer knows they will not show a profit in the early years, they can make an election that the presumption will not be made before the close of the fourth year (sixth year for horse activities) in which the activity begins.²⁵ If the election is made, the presumption applies each year in the 5- or 7-year period if the gross income exceeds the deductions for three (or two, if applicable) or more of the tax years.²⁶

If a taxpayer makes the election, the statutory period for the assessment of any deficiency attributable to the activity is extended for two years after the end of the 5- (or 7-, if applicable) year period. This gives the IRS additional time to assess any taxes if the activity is determined to be an activity not engaged in for profit. The case is suspended until the end of the presumption period. The for-profit determination is made after the close of the suspension period.

The election also extends the statute of limitations for amending a return **if the taxpayer failed to claim all allowable deductions on the return.**

The election is made by filing Form 5213, *Election to Postpone Determination as To Whether the Presumption Applies That an Activity Is Engaged In for Profit*, **within three years after the due date of the taxpayer's return for the first year of the activity.** The 3-year period **does not include extensions of time to file the original return.** Form 5213 must be filed within 60 days of the date a taxpayer receives a notice from the IRS disallowing deductions attributable to the activity. The 60-day period does not extend the 3-year period previously mentioned.

Example 17. Granny Smith opened a quilt business in 2010. The first return was extended and filed on September 1, 2011. If she wants to make the election, she must file Form 5213 on or before April 15, 2014. If Granny does not file Form 5213 but instead receives a notice from the IRS on May 1, 2013, that it is disallowing the quilt activity loss, she must file Form 5213 on or before June 29, 2013 (60 days from the date of the IRS notice) for the election to apply. Granny's Form 5213 follows.

²⁴ IRC §183: *Activities Not Engaged in For Profit (ATG)* — Chapter Four [www.irs.gov/Businesses/Small-Businesses-&-Self-Employed/IRC-§-183--Activities-Not-Engaged-in-For-Profit-(ATG)] Accessed on May 2, 2013.

²⁵ IRC §183(e)(1).

²⁶ IRC §183(e)(2).

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For Example 17

Form **5213**
(Rev. February 2006)
Department of the Treasury
Internal Revenue Service

Election To Postpone Determination as To Whether the Presumption Applies That an Activity Is Engaged in for Profit

OMB No. 1545-0195

► To be filed by individuals, estates, trusts, partnerships, and S corporations.

Name(s) as shown on tax return

Granny Smith

Identifying number as shown on tax return

111-22-3333

Address (number and street, apt. no., rural route) (or P.O. box number if mail is not delivered to street address)

21 Sewers Street

City, town or post office, state, and ZIP code

Fabric, IA 44444

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:

- The 6th tax year, for an activity that consists mainly of breeding, training, showing, or racing horses or
- The 4th tax year for any other activity,

after the tax year in which the taxpayer first engaged in the activity.

1 Type of taxpayer engaged in the activity (check the box that applies):

Individual Partnership S corporation Estate or trust

2a Description of activity for which you elect to postpone a determination

Selling handmade quilts

2b First tax year you engaged in activity described in 2a

2010

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.

(Signature of taxpayer or fiduciary)

(Date)

(Signature of taxpayer's spouse, if joint return was filed)

(Date)

(Signature of general partner authorized to sign partnership return)

(Date)

(Signature and title of officer, if an S corporation)

(Date)

For Privacy Act and Paperwork Reduction Act Notice, see instructions on back.

Cat. No. 42361U

Form **5213** (Rev. 2-2006)

Change in Activity

If a taxpayer meets the for-profit presumption and then changes activities, the new activity must qualify for the for-profit presumption.

Example 18. Johnny Speed's race car from **Example 16** was totaled in year 8 (2013). This left Johnny wanting to find a new "hobby." He decided to purchase a yacht and charter it for fishing trips. Johnny must make a new election if he wants to deduct losses in the first years using the for-profit presumption.

MULTIPLE ACTIVITIES

If the taxpayer is involved in multiple undertakings, each of these may be a separate activity, or several undertakings may constitute one activity.²⁷ If the activities are sufficiently interconnected, they may be treated as one activity. Whether two or more activities may be grouped together is determined by looking at all the facts and circumstances. The factors that are generally the most significant are the following.

- The degree of organizational and economic interrelationship of the activities
- The business purpose served by operating the activities either separately or together
- The similarity of the activities²⁸

Example 19. Ima Painter is a starving artist. She works in watercolors and attends several street festivals each year attempting to sell her paintings. She has never sold enough paintings to cover her expenses. Ima is also a stained glass artist. She is able to sell her creations and also accepts commissions to create works for others. This is a profitable venture. Because both businesses are in the creative arts field, she can combine the activities in determining whether she has a for-profit activity.

Example 20. Assume the same facts as **Example 19**, except Ima's stained glass activity is operated as an S corporation because of liability concerns. The painting activity is operated as a sole proprietorship and Ima's paintings are sold to individual customers at a local studio. Because of the absence of organizational and economic relationship between the painting and stained glass activity, it is not likely that these two activities can be grouped together.

Example 21. Jeffrey Trotter owns a racing stable. He has not had any success with his race horses. In eight years, he has not had a horse even place in a race. Consequently, he loses in excess of \$100,000 per year. Jeffrey also has a farming operation in which he raises corn and soybeans. The farming operation is very successful and furnishes Jeffrey with the money to continue operating his racing stable. These activities are not sufficiently connected and each must stand on its own merits.

OTHER ENTITIES

The hobby loss provisions of §183(a) apply to individuals, S corporations, partnerships, estates, and trusts and are applied at the entity level. The rules apply on an activity-by-activity basis and the income and deductions from one activity cannot be combined with the income and deductions of another activity. However, the hobby loss rules do not apply to C corporations.

Note. Any losses by C corporations are only available to offset future profits of the C corporation.

²⁷ Treas. Reg. §1.183-1(d).

²⁸ Ibid.

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In a 2004 case, the taxpayer (an S corporation) had the burden of proving that it was engaged in the activity of restoring, chartering, and selling a yacht with the actual or honest objective of realizing a profit. The court determined that the S corporation was involved in an activity that was not engaged in for a profit.²⁹

When the IRS makes an adjustment on an activity not engaged in for profit in an entity, it reduces the ordinary income and reclassifies it on the Schedule K-1 as separately stated income (usually as other income). All expenses are grouped by category and shown as separately stated expenses but are limited to gross income from the activity. There are seldom any tier 1 expenses other than investment interest or contributions. The limitation is determined at the entity level.

Even if the expenses of the activity are not beneficial to the shareholder/partner due to the gross income limitation, they still result in a reduction in the basis of the shareholder/partner as nondeductible expenses.

Example 22. Speedy Gonzales is the sole shareholder in an S corporation. The S corporation's only activity is car racing. In 2012, the corporation had gross receipts of \$4,000 and, after expenses of \$55,000, the ordinary loss was \$51,000.

Expense	Amount	Tier 1	Tier 2	Tier 3
Entrance fees	\$10,000		\$10,000	
Interest (on race car)	12,000		12,000	
Insurance	400		400	
Utilities	1,600		1,600	
Auto and travel	13,000		13,000	
Repairs	2,000		2,000	
Depreciation	16,000			\$16,000
Total expenses	\$55,000		\$39,000	\$16,000

Upon audit, all of the income and expenses are separated from the ordinary business operations reported on the S corporation return. The income is then separately stated and reported on Schedule K, line 10 (other income) of Form 1120S, *U.S. Income Tax Return for an S Corporation*. This income is then reported on the shareholder's Form 1040 on line 21 (other income).

The interest expense is not included in tier 1 expenses. It is not deductible on Form 1040, Schedule A, because the interest is not home mortgage interest or investment interest.

Tier 2 expenses are allowed up to the \$4,000 of gross income from the car racing activity and are separately stated on line 12d of the Form 1120S Schedule K and on line 12 of Schedule K-1. The \$4,000 is passed through to Speedy and reported as a miscellaneous itemized deduction on his Form 1040 Schedule A subject to the 2%-of-AGI limitation.

The remaining nondeductible expenses of \$51,000 (\$55,000 total expenses – \$4,000 allowable tier 2 expenses) are reported on line 16c of the Schedules K and K-1. The \$51,000 in nondeductible expenses results in a reduction to Speedy's stock basis and the accumulated adjustments account (AAA) of the S corporation.

The S corporation return before any adjustments were made follows.

²⁹ *Magassy v. Comm'r*, TC Memo 2004-4 (Jan. 5, 2004).

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For Example 22

Form 1120S Department of the Treasury Internal Revenue Service	<h3 style="margin: 0;">U.S. Income Tax Return for an S Corporation</h3> <p style="font-size: small; margin: 0;">▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. ▶ Information about Form 1120S and its separate instructions is at www.irs.gov/form1120s.</p>	OMB No. 1545-0130 <h2 style="margin: 0;">2012</h2>																																																																																																
For calendar year 2012 or tax year beginning _____, 2012, ending _____, 20																																																																																																		
A S election effective date 1/01/2010	TYPE OR PRINT	Name Gonzales Racing, Inc. Number, street, and room or suite no. If a P.O. box, see instructions. 20 Upton Drive City or town, state, and ZIP code Anytown, AR 55555																																																																																																
B Business activity code number (see instructions) 711210	D Employer identification number 11-111111	E Date incorporated 1/01/2010																																																																																																
C Check if Sch. M-3 attached <input type="checkbox"/>	F Total assets (see instructions) \$ 11,000																																																																																																	
G Is the corporation electing to be an S corporation beginning with this tax year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," attach Form 2553 if not already filed H Check if: (1) <input type="checkbox"/> Final return (2) <input type="checkbox"/> Name change (3) <input type="checkbox"/> Address change (4) <input type="checkbox"/> Amended return (5) <input type="checkbox"/> S election termination or revocation I Enter the number of shareholders who were shareholders during any part of the tax year ▶ 1																																																																																																		
Caution. Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.																																																																																																		
Income	1a Gross receipts or sales b Returns and allowances c Balance. Subtract line 1b from line 1a 2 Cost of goods sold (attach Form 1125-A) 3 Gross profit. Subtract line 2 from line 1c 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) 5 Other income (loss) (see instructions—attach statement) 6 Total income (loss). Add lines 3 through 5 ▶	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 5%; text-align: center;">1a</td><td style="width: 15%; text-align: right;">4,000</td><td style="width: 5%;"></td><td style="width: 15%;"></td><td style="width: 5%;"></td><td style="width: 5%;"></td></tr> <tr><td style="text-align: center;">1b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">1c</td><td></td><td></td><td style="text-align: right;">4,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">2</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">3</td><td></td><td></td><td style="text-align: right;">4,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">4</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">5</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">6</td><td></td><td></td><td style="text-align: right;">4,000</td><td></td><td></td></tr> </table>	1a	4,000					1b						1c			4,000			2						3			4,000			4						5						6			4,000																																																		
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Deductions <small>(see instructions for limitations)</small>	7 Compensation of officers 8 Salaries and wages (less employment credits) 9 Repairs and maintenance 10 Bad debts 11 Rents 12 Taxes and licenses 13 Interest 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) 15 Depletion (Do not deduct oil and gas depletion.) 16 Advertising 17 Pension, profit-sharing, etc., plans 18 Employee benefit programs 19 Other deductions (attach statement) 20 Total deductions. Add lines 7 through 19 ▶ 21 Ordinary business income (loss). Subtract line 20 from line 6	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 5%;"></td><td style="width: 15%;"></td><td style="width: 5%;"></td><td style="width: 15%;"></td><td style="width: 5%;"></td><td style="width: 5%;"></td></tr> <tr><td style="text-align: center;">7</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">8</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">9</td><td></td><td></td><td style="text-align: right;">2,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">10</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">11</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">12</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">13</td><td></td><td></td><td style="text-align: right;">12,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">14</td><td></td><td></td><td style="text-align: right;">16,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">15</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">16</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">17</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">18</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">19</td><td></td><td></td><td style="text-align: right;">25,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">20</td><td></td><td></td><td style="text-align: right;">55,000</td><td></td><td></td></tr> <tr><td style="text-align: center;">21</td><td></td><td></td><td style="text-align: right;">-51,000</td><td></td><td></td></tr> </table>							7						8						9			2,000			10						11						12						13			12,000			14			16,000			15						16						17						18						19			25,000			20			55,000			21			-51,000		
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Tax and Payments	22a Excess net passive income or LIFO recapture tax (see instructions) b Tax from Schedule D (Form 1120S) c Add lines 22a and 22b (see instructions for additional taxes) 23a 2012 estimated tax payments and 2011 overpayment credited to 2012 b Tax deposited with Form 7004 c Credit for federal tax paid on fuels (attach Form 4136) d Add lines 23a through 23c 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached <input type="checkbox"/> 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid 27 Enter amount from line 26 Credited to 2013 estimated tax ▶ Refunded ▶	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 5%;"></td><td style="width: 15%;"></td><td style="width: 5%;"></td><td style="width: 15%;"></td><td style="width: 5%;"></td><td style="width: 5%;"></td></tr> <tr><td style="text-align: center;">22a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">22b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">22c</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">23a</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">23b</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">23c</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">23d</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">24</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">25</td><td></td><td></td><td style="text-align: right;">0</td><td></td><td></td></tr> <tr><td style="text-align: center;">26</td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td style="text-align: center;">27</td><td></td><td></td><td></td><td></td><td></td></tr> </table>							22a						22b						22c						23a						23b						23c						23d						24						25			0			26						27																													
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Sign Here Signature of officer _____ Date _____ Title _____	Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.																																																																																																	
Print/Type preparer's name Preparer's signature _____ Date _____	May the IRS discuss this return with the preparer shown below (see instructions)? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No																																																																																																	
Use Only Firm's name ▶ University of Illinois Tax School Firm's address ▶ 1301 W. Gregory Drive, Urbana, IL 61801	Check <input type="checkbox"/> if self-employed Firm's EIN ▶ Phone no. 217-333-0502	PTIN																																																																																																

3

2013 Workbook

For Example 22

Form 1120S (2012)

Gonzales Racing Inc. 11-1111111

Page **3**

Schedule K Shareholders' Pro Rata Share Items		Total amount	
Income (Loss)	1 Ordinary business income (loss) (page 1, line 21)	1	-51,000
	2 Net rental real estate income (loss) (attach Form 8825)	2	
	3a Other gross rental income (loss)	3a	
	b Expenses from other rental activities (attach statement)	3b	
	c Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4 Interest income	4	
	5 Dividends: a Ordinary dividends	5a	
	b Qualified dividends	5b	
	6 Royalties	6	
	7 Net short-term capital gain (loss) (attach Schedule D (Form 1120S))	7	
Deductions	8a Net long-term capital gain (loss) (attach Schedule D (Form 1120S))	8a	
	b Collectibles (28%) gain (loss)	8b	
	c Unrecaptured section 1250 gain (attach statement)	8c	
	9 Net section 1231 gain (loss) (attach Form 4797)	9	
	10 Other income (loss) (see instructions) . . . Type ▶	10	
Credits	11 Section 179 deduction (attach Form 4562)	11	
	12a Charitable contributions	12a	
	b Investment interest expense	12b	
	c Section 59(e)(2) expenditures (1) Type ▶ (2) Amount ▶	12c(2)	
Foreign Transactions	d Other deductions (see instructions) . . . Type ▶	12d	
	13a Low-income housing credit (section 42(j)(5))	13a	
	b Low-income housing credit (other)	13b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468)	13c	
	d Other rental real estate credits (see instructions) Type ▶	13d	
	e Other rental credits (see instructions) . . . Type ▶	13e	
	f Alcohol and cellulosic biofuel fuels credit (attach Form 6478)	13f	
g Other credits (see instructions) Type ▶	13g		
Alternative Minimum Tax (AMT) Items	14a Name of country or U.S. possession ▶		
	b Gross income from all sources	14b	
	c Gross income sourced at shareholder level Foreign gross income sourced at corporate level	14c	
	d Passive category	14d	
	e General category	14e	
	f Other (attach statement)	14f	
	g Deductions allocated and apportioned at shareholder level		
	h Interest expense	14g	
	i Other	14h	
	j Deductions allocated and apportioned at corporate level to foreign source income		
	k Passive category	14i	
	l General category	14j	
	m Other (attach statement)	14k	
n Other information			
Items Affecting Shareholder Basis	l Total foreign taxes (check one): <input type="checkbox"/> Paid <input type="checkbox"/> Accrued	14l	
	m Reduction in taxes available for credit (attach statement)	14m	
	n Other foreign tax information (attach statement)		
	15a Post-1986 depreciation adjustment	15a	
	b Adjusted gain or loss	15b	
	c Depletion (other than oil and gas)	15c	
Items Affecting Shareholder Basis	d Oil, gas, and geothermal properties—gross income	15d	
	e Oil, gas, and geothermal properties—deductions	15e	
	f Other AMT items (attach statement)	15f	
	16a Tax-exempt interest income	16a	
	b Other tax-exempt income	16b	
Items Affecting Shareholder Basis	c Nondeductible expenses	16c	
	d Distributions (attach statement if required) (see instructions)	16d	
	e Repayment of loans from shareholders	16e	

Form **1120S** (2012)

2013 Workbook

For Example 22

Schedule K-1
(Form 1120S)
Department of the Treasury
Internal Revenue Service

2012

For calendar year 2012, or tax
year beginning _____, 2012
ending _____, 20____

Final K-1 Amended K-1 OMB No. 1545-0130

Shareholder's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Corporation		Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items	
A Corporation's employer identification number 11-1111111		1 Ordinary business income (loss) -51,000	13 Credits
B Corporation's name, address, city, state, and ZIP code Gonzales Racing Inc. 20 Upton Drive Anytown, AR 55555		2 Net rental real estate income (loss)	
C IRS Center where corporation filed return Ogden, UT		3 Other net rental income (loss)	
Part II Information About the Shareholder		4 Interest income	
D Shareholder's identifying number 111-11-1111		5a Ordinary dividends	
E Shareholder's name, address, city, state, and ZIP code Speedy Gonzales 20 Upton Drive Anytown, AR 55555		5b Qualified dividends	14 Foreign transactions
F Shareholder's percentage of stock ownership for tax year 100 %		6 Royalties	
For IRS Use Only		7 Net short-term capital gain (loss)	
		8a Net long-term capital gain (loss)	
		8b Collectibles (28%) gain (loss)	
		8c Unrecaptured section 1250 gain	
		9 Net section 1231 gain (loss)	
		10 Other income (loss)	15 Alternative minimum tax (AMT) items
		11 Section 179 deduction	16 Items affecting shareholder basis
		12 Other deductions	
			17 Other information
			* See attached statement for additional information.

For Paperwork Reduction Act Notice, see Instructions for Form 1120S. IRS.gov/form1120s Cat. No. 11520D Schedule K-1 (Form 1120S) 2012

3

2013 Workbook

For Example 22

Speedy's corrected return follows.

Form 1120S Department of the Treasury Internal Revenue Service	U.S. Income Tax Return for an S Corporation ▶ Do not file this form unless the corporation has filed or is attaching Form 2553 to elect to be an S corporation. ▶ Information about Form 1120S and its separate instructions is at www.irs.gov/form1120s .	OMB No. 1545-0130 <div style="font-size: 2em; font-weight: bold; text-align: center;">2012</div>																																																																																																																																																																
For calendar year 2012 or tax year beginning _____, 2012, ending _____, 20																																																																																																																																																																		
A S election effective date 1/01/2010	TYPE OR PRINT	Name Gonzales Racing, Inc. Number, street, and room or suite no. If a P.O. box, see instructions. 20 Upton Drive City or town, state, and ZIP code Anytown, AR 55555																																																																																																																																																																
B Business activity code number (see instructions) 711210	D Employer identification number 11-1111111	E Date incorporated 1/01/2010																																																																																																																																																																
C Check if Sch. M-3 attached <input type="checkbox"/>	F Total assets (see instructions) \$ 11,000																																																																																																																																																																	
G Is the corporation electing to be an S corporation beginning with this tax year? <input type="checkbox"/> Yes <input checked="" type="checkbox"/> No If "Yes," attach Form 2553 if not already filed																																																																																																																																																																		
H Check if: (1) <input type="checkbox"/> Final return (2) <input type="checkbox"/> Name change (3) <input type="checkbox"/> Address change (4) <input type="checkbox"/> Amended return (5) <input type="checkbox"/> S election termination or revocation																																																																																																																																																																		
I Enter the number of shareholders who were shareholders during any part of the tax year ▶ 1																																																																																																																																																																		
Caution. Include only trade or business income and expenses on lines 1a through 21. See the instructions for more information.																																																																																																																																																																		
Income	1a Gross receipts or sales 1b Returns and allowances 1c Balance. Subtract line 1b from line 1a 2 Cost of goods sold (attach Form 1125-A) 3 Gross profit. Subtract line 2 from line 1c 4 Net gain (loss) from Form 4797, line 17 (attach Form 4797) 5 Other income (loss) (see instructions—attach statement) 6 Total income (loss). Add lines 3 through 5 ▶	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td></tr> <tr><td></td><td>1a</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>1b</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>1c</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>2</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>3</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>4</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>5</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>6</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> </table>												1a										1b										1c										2										3										4										5										6																																																																														
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Deductions <small>(see instructions for limitations)</small>	7 Compensation of officers 8 Salaries and wages (less employment credits) 9 Repairs and maintenance 10 Bad debts 11 Rents 12 Taxes and licenses 13 Interest 14 Depreciation not claimed on Form 1125-A or elsewhere on return (attach Form 4562) 15 Depletion (Do not deduct oil and gas depletion.) 16 Advertising 17 Pension, profit-sharing, etc., plans 18 Employee benefit programs 19 Other deductions (attach statement) 20 Total deductions. Add lines 7 through 19 ▶ 21 Ordinary business income (loss). Subtract line 20 from line 6	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td></tr> <tr><td></td><td>7</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>8</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>9</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>10</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>11</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>12</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>13</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>14</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>15</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>16</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>17</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>18</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>19</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>20</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>21</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> </table>												7										8										9										10										11										12										13										14										15										16										17										18										19										20										21								
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Tax and Payments	22a Excess net passive income or LIFO recapture tax (see instructions) 22b Tax from Schedule D (Form 1120S) 22c Add lines 22a and 22b (see instructions for additional taxes) 23a 2012 estimated tax payments and 2011 overpayment credited to 2012 23b Tax deposited with Form 7004 23c Credit for federal tax paid on fuels (attach Form 4136) 23d Add lines 23a through 23c 24 Estimated tax penalty (see instructions). Check if Form 2220 is attached ▶ <input type="checkbox"/> 25 Amount owed. If line 23d is smaller than the total of lines 22c and 24, enter amount owed 26 Overpayment. If line 23d is larger than the total of lines 22c and 24, enter amount overpaid 27 Enter amount from line 26 Credited to 2013 estimated tax ▶ Refunded ▶	<table border="1" style="width: 100%; border-collapse: collapse;"> <tr><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td><td style="width: 10%;"></td></tr> <tr><td></td><td>22a</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>22b</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>22c</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>23a</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>23b</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>23c</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>23d</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>24</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>25</td><td></td><td></td><td></td><td></td><td></td><td></td><td style="text-align: center;">0</td><td></td></tr> <tr><td></td><td>26</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> <tr><td></td><td>27</td><td></td><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr> </table>												22a										22b										22c										23a										23b										23c										23d										24										25							0			26										27																																																
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Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.																																																																																																																																																																		
Sign Here	Signature of officer _____ Date _____ Title _____	May the IRS discuss this return with the preparer shown below (see instructions)? <input checked="" type="checkbox"/> Yes <input type="checkbox"/> No																																																																																																																																																																
Paid Preparer Use Only	Print/Type preparer's name _____ Preparer's signature _____ Date _____ Firm's name ▶ University of Illinois Tax School Firm's address ▶ 1301 W. Gregory Drive, Urbana, IL 61801	Check <input type="checkbox"/> if self-employed PTIN _____ Firm's EIN ▶ _____ Phone no. 217-333-0502																																																																																																																																																																
For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11510H Form 1120S (2012)																																																																																																																																																																		

2013 Workbook

For Example 22

Form 1120S (2012)

Gonzales Racing Inc. 11-1111111

Page **3**

Schedule K	Shareholders' Pro Rata Share Items	Total amount	
Income (Loss)	1 Ordinary business income (loss) (page 1, line 21)	1	
	2 Net rental real estate income (loss) (attach Form 8825)	2	
	3a Other gross rental income (loss)	3a	
	b Expenses from other rental activities (attach statement)	3b	
	c Other net rental income (loss). Subtract line 3b from line 3a	3c	
	4 Interest income	4	
	5 Dividends: a Ordinary dividends	5a	
	b Qualified dividends	5b	
	6 Royalties	6	
	7 Net short-term capital gain (loss) (attach Schedule D (Form 1120S))	7	
Deductions	8a Net long-term capital gain (loss) (attach Schedule D (Form 1120S))	8a	
	b Collectibles (28%) gain (loss)	8b	
	c Unrecaptured section 1250 gain (attach statement)	8c	
	9 Net section 1231 gain (loss) (attach Form 4797)	9	
	10 Other income (loss) (see instructions) Type ▶ See Statement 1	10	4,000
	11 Section 179 deduction (attach Form 4562)	11	
	12a Charitable contributions	12a	
	b Investment interest expense	12b	
	c Section 59(e)(2) expenditures (1) Type ▶ (2) Amount ▶	12c(2)	
	d Other deductions (see instructions) Type ▶ See Statement 2	12d	4,000
Credits	13a Low-income housing credit (section 42(j)(5))	13a	
	b Low-income housing credit (other)	13b	
	c Qualified rehabilitation expenditures (rental real estate) (attach Form 3468)	13c	
	d Other rental real estate credits (see instructions) Type ▶	13d	
	e Other rental credits (see instructions) Type ▶	13e	
	f Alcohol and cellulosic biofuel fuels credit (attach Form 6478)	13f	
	g Other credits (see instructions) Type ▶	13g	
Foreign Transactions	14a Name of country or U.S. possession ▶		
	b Gross income from all sources	14b	
	c Gross income sourced at shareholder level	14c	
	Foreign gross income sourced at corporate level		
	d Passive category	14d	
	e General category	14e	
	f Other (attach statement)	14f	
	Deductions allocated and apportioned at shareholder level		
	g Interest expense	14g	
	h Other	14h	
	Deductions allocated and apportioned at corporate level to foreign source income		
	i Passive category	14i	
	j General category	14j	
	k Other (attach statement)	14k	
Other information			
l Total foreign taxes (check one): ▶ <input type="checkbox"/> Paid <input type="checkbox"/> Accrued	14l		
m Reduction in taxes available for credit (attach statement)	14m		
n Other foreign tax information (attach statement)			
Alternative Minimum Tax (AMT) Items	15a Post-1986 depreciation adjustment	15a	
	b Adjusted gain or loss	15b	
	c Depletion (other than oil and gas)	15c	
	d Oil, gas, and geothermal properties—gross income	15d	
	e Oil, gas, and geothermal properties—deductions	15e	
	f Other AMT items (attach statement)	15f	
Items Affecting Shareholder Basis	16a Tax-exempt interest income	16a	
	b Other tax-exempt income	16b	
	c Nondeductible expenses	16c	51,000
	d Distributions (attach statement if required) (see instructions)	16d	
	e Repayment of loans from shareholders	16e	

Form **1120S** (2012)

2013 Workbook

For Example 22

Form 1120S (2012)

Gonzales Racing Inc. 11-1111111

Page **5**

Schedule M-1		Reconciliation of Income (Loss) per Books With Income (Loss) per Return	
Note. Schedule M-3 required instead of Schedule M-1 if total assets are \$10 million or more—see instructions			
1	Net income (loss) per books		
2	Income included on Schedule K, lines 1, 2, 3c, 4, 5a, 6, 7, 8a, 9, and 10, not recorded on books this year (itemize) _____		
3	Expenses recorded on books this year not included on Schedule K, lines 1 through 12 and 14l (itemize):		
a	Depreciation \$ _____		
b	Travel and entertainment \$ _____		
4	Add lines 1 through 3		
5	Income recorded on books this year not included on Schedule K, lines 1 through 10 (itemize):		
a	Tax-exempt interest \$ _____		
6	Deductions included on Schedule K, lines 1 through 12 and 14l, not charged against book income this year (itemize):		
a	Depreciation \$ _____		
7	Add lines 5 and 6		
8	Income (loss) (Schedule K, line 18). Line 4 less line 7		

Schedule M-2			
Analysis of Accumulated Adjustments Account, Other Adjustments Account, and Shareholders' Undistributed Taxable Income Previously Taxed (see instructions)			
	(a) Accumulated adjustments account	(b) Other adjustments account	(c) Shareholders' undistributed taxable income previously taxed
1	Balance at beginning of tax year	0	
2	Ordinary income from page 1, line 21		
3	Other additions See Statement 3	4,000	
4	Loss from page 1, line 21	()	
5	Other reductions See Statement 4	(55,000)	
6	Combine lines 1 through 5	-51,000	
7	Distributions other than dividend distributions		
8	Balance at end of tax year. Subtract line 7 from line 6	-51,000	

Form **1120S** (2012)

3

2013 Workbook

For Example 22

Schedule K-1
(Form 1120S)
Department of the Treasury
Internal Revenue Service

2012

For calendar year 2012, or tax
year beginning _____, 2012
ending _____, 20____

Final K-1 Amended K-1 OMB No. 1545-0130

Shareholder's Share of Income, Deductions, Credits, etc. ▶ See back of form and separate instructions.

Part I Information About the Corporation		Part III Shareholder's Share of Current Year Income, Deductions, Credits, and Other Items	
A Corporation's employer identification number 11-1111111		1	Ordinary business income (loss)
B Corporation's name, address, city, state, and ZIP code Gonzales Racing Inc. 20 Upton Drive Anytown, AR 55555	5a Ordinary dividends 5b Qualified dividends 6 Royalties 7 Net short-term capital gain (loss)	13	Credits
C IRS Center where corporation filed return Ogden, UT	8a Net long-term capital gain (loss) 8b Collectibles (28%) gain (loss) 8c Unrecaptured section 1250 gain 9 Net section 1231 gain (loss)	14	Foreign transactions
Part II Information About the Shareholder			
D Shareholder's identifying number 111-11-1111	E Shareholder's name, address, city, state, and ZIP code Speedy Gonzales 20 Upton Drive Anytown, AR 55555	10	Other income (loss)
F Shareholder's percentage of stock ownership for tax year _____ 100 %	11 Section 179 deduction 12 Other deductions S*	15	Alternative minimum tax (AMT) items
For IRS Use Only		E*	4,000
		C	51,000
		S*	4,000
		17	Other information
* See attached statement for additional information.			

2013 Workbook

For Example 22

GONZALES RACING INC 11-1111111

Schedule K-1 (Form 1120S) 2012

Supplemental Information

Page 2

**Box 10
Other Income (Loss)**

*** Descriptive Information**

E AUTO RACING..... \$ 4,000.

**Box 12
Other Deductions**

*** Descriptive Information**

S AUTO RACING..... \$ 4,000.

3

Shareholder 1 : SPEEDY GONZALES 111-11-1111

SPSL1201L 05/21/12

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For Example 22

2012	Federal Statements	Page 1
Client 102	GONZALES RACING INC	11-1111111
1/15/13		11:23AM
Statement 1 Form 1120S, Schedule K, Line 10 Other Income (loss)		
AUTO RACING.....		
		\$ 4,000.
		Total \$ <u>4,000.</u>
Statement 2 Form 1120S, Schedule K, Line 12d Other Deductions		
Other: AUTO RACING.....		
		\$ 4,000.
		Total \$ <u>4,000.</u>
Statement 3 Form 1120S, Schedule M-2, Column A, Line 3 Other Additions		
Other Income.....		
		\$ 4,000.
		Total \$ <u>4,000.</u>
Statement 4 Form 1120S, Schedule M-2, Column A, Line 5 Other Reductions		
AUTO RACING.....		
		\$ 51,000.
Other Deductions.....		
		4,000.
		Total \$ <u>55,000.</u>

BUSINESS PLAN

Before entering into a business, the taxpayer should have a business plan. Whether the plan is elaborate or brief, it is important to show that the business is more than a hobby or a tax shelter. The plan helps the taxpayer decide whether they want to take the risks involved in starting the business. It should be realistic and show both a short- and long-range forecast for the activity.

The plan may be reviewed by the lender to determine whether to loan money to the new venture. It can also serve as proof that the taxpayer had an expectation of profits.

Preparation for the activity by extensive study of its accepted business, economic, and scientific practices, or consultation with those who are experts in those areas, may indicate that the taxpayer has a profit motive when the taxpayer carries on the activity in accordance with such practices. When a taxpayer undertakes this type of preparation or procures 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 that may result in profits from the activity.

Note. IRS examiners are instructed by the audit technique guide³⁰ not to request the business plan in the initial document request. Otherwise, the taxpayer may come up with a document that is prepared solely for the audit. The examiner is told to inquire about the business plan in the initial interview and then request a copy for a subsequent meeting.

There are eight major sections to a typical business plan.

EXECUTIVE SUMMARY

The executive summary is what the reader first sees when they look at the plan, but it should be written last. It includes the mission, objectives, and keys for success of the business. It should be no more than one or two pages.

BUSINESS DESCRIPTION

In the business description section, various aspects of the business are discussed, such as the following.

- Is the business a legal entity such as a partnership, corporation, or LLC?
- What is the history of the business?
- What are the start-up plans?
- Where will the business be located?
- Who are the owners of the business?

PRODUCT OR SERVICE

The description of the business's products or services should include the following information.

- What is the business going to produce or what services is it going to provide?
- What will be the benefits to the customer?
- How do the products and services differ from the competition?

³⁰ *IRC §183: Activities Not Engaged in For Profit (ATG)* — Chapter Four [[www.irs.gov/Businesses/Small-Businesses-&Self-Employed/IRC-§-183:-Activities-Not-Engaged-in-For-Profit-\(ATG\)](http://www.irs.gov/Businesses/Small-Businesses-&Self-Employed/IRC-§-183:-Activities-Not-Engaged-in-For-Profit-(ATG))] Accessed on May 2, 2013.

MARKET ANALYSIS

The prospective business owner should do a market analysis that addresses the following questions.

- Who are the customers?
- How much does the typical customer spend?
- Who presently competes for the market the new business is trying to attract?
- Where are the potential customers located and what is the plan to reach them?
- What percentage of the market is required to become profitable?

STRATEGY AND IMPLEMENTATION

The strategy and implementation section includes specific plans with budgets and sales forecasts. This section should project the dates at which various tasks will be accomplished along with the name of the individual or group assigned to the task. It is very important to track all of the steps in the process. Delays in the process can have an adverse effect on the outcome of the business.

WEBSITE PLAN SUMMARY

If the plan has an e-commerce aspect, the following factors should be discussed.

- Who will develop the website and contribute to its operation?
- What is the marketing strategy for the website?

MANAGEMENT TEAM

The key management team must be identified in the business plan, along with their experiences in similar businesses. This includes both employees and advisors.

FINANCIAL ANALYSIS

The business plan should include a projected profit and loss statement and a pro forma cash flow statement.

SELF-EMPLOYMENT TAX

A trade or business is a for-profit activity. If the trade or business is conducted as a sole proprietorship or partnership, profits are taxed as self-employment (SE) income. However, it is possible to have a for-profit activity that does not qualify as a trade or business and is exempt from SE tax.

If the taxpayer is in business, the income is often reported on Schedule C, *Profit or Loss From Business*. However, that may not be the correct place to report the income. It is important to first establish the nature of the activity in order to properly report its income and deductible expenses. Unfortunately, the Code does not define “business” except in a few specific circumstances.³¹ The courts have concluded that the facts and circumstances of each situation determine whether the taxpayer is in business or if the taxpayer is engaged in a hobby or other nonbusiness activity.³²

If the income is from a trade or business, the taxpayer pays SE tax on the profit. If it is a hobby rather than a trade or business, the income is reported on line 21 of Form 1040 and the expenses are reported on Schedule A, *Itemized Deductions*, as explained earlier in this chapter.

³¹ *Comm'r v. Groetzinger*, 480 U.S. 23 (1987).

³² *Higgins v. Comm'r*, 312 U.S. 212 (1941).

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In 1987, the U.S. Supreme Court identified a 2-prong test³³ to determine whether an activity is engaged in as a business. To meet this test, the taxpayer must:

- Intend to generate a **profit**, and
- Be involved in the activity with **continuity and regularity**.

The first prong, intent to generate a profit, was discussed earlier in this chapter.

The second prong of the test is subjective and should be determined based on the taxpayer's particular situation. A sporadic activity or hobby does not qualify as a business,³⁴ **even if it is profitable**.

The frequency of the activity was the subject of Rev. Rul. 77-356. The IRS was asked to determine whether a member of Congress was required to pay SE tax on money earned from making ten speeches. In this situation, the IRS decided it was SE income. This amplified Rev. Rul. 55-431, which said that whether speech making is a trade or business depends on whether the speaking engagements are carried on with a degree of regularity.

Observation. There is a tendency among practitioners and the IRS to **first** establish whether there is a profit and **then** base the categorization of the activity on the extent of the profit or loss and the tax consequences of each treatment. **This may not result in an accurate treatment of the activity.**

Example 23. One weekend in the cold of winter, Annette was bored. She found an Internet site that invites the psychically gifted to register as psychic hotline advisors. Advisors receive 50% of all fees generated for their calls. Over the weekend, Annette earned \$2,000. Despite the lucrative pay, she decided not to continue working the hotline due to the strain on her voice and ears.

Because the activity was a single event, it does not meet the continuity test to be considered a business.³⁵ The \$2,000 is reported as "other income" on line 21 of Form 1040 and is not subject to SE tax.

³³ *Comm'r v. Groetzinger*, 480 U.S. 23 (1987).

³⁴ *Ibid.*

³⁵ *Ibid.*

APPENDIX

The following worksheet can be used to help analyze whether an activity is a business or a hobby. No one factor is determinative. Comments should be entered as to why a decision was made. This worksheet should be kept with the taxpayer's records in case of an IRS challenge.

Test	Description	Place a Checkmark in the Applicable Box		Comments For or Against
		Profit Motive	No Profit Motive	
1	Manner in which the taxpayer carried on the activity			
2	The expertise of the taxpayer or their advisors			
3	The time and effort expended by the taxpayer in carrying on the activity			
4	Expectation that assets used in the business may appreciate in value			
5	The success of the taxpayer in carrying on similar or dissimilar activities			
6	The taxpayer's history of income and losses with respect to the activity			
7	The amount of occasional profits, if any, which are earned			
8	The financial status of the taxpayer			
9	Elements of personal pleasure or recreation			

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Having a history of the profits and losses of the business will help determine whether the activity is engaged in for profit.

Taxpayer/Business Name:		Type of Business:			Year Business Started:	
Year	20__	20__	20__	20__	20__	
Gross Income						
Expenses (Other than depreciation)						
Depreciation						
Gain or (Loss)						

Year	Reasons for the loss in a year.

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The following table lists cases in which the court had to decide whether the taxpayer had a profit motive in connection with an activity. The cases are sorted by the type of activity. These cases should be reviewed if a client has a similar activity that consistently shows a loss. The table shows whether the court decided to allow or disallow the loss.

Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Accounting	1988	Jenkins v. Comm'r	TC Memo 1988-292, aff'd by unpub. opin. (6th Cir. 1989)		X
Actor	1996	Kellner v. Comm'r	TC Memo 1986-524		X
Actor	1979	Regan v. Comm'r	38 TCM 1330 (1979)	X	
Aircraft rental	1986	Campbell v. Comm'r	52 TCM 1096 (1986), aff'd, rev'd, and rem'd, 868 F.2d 833 (6th Cir. 1989)		X
Airplane	2002	Parker v. Comm'r	TC Memo 2002-76		X
Airplane	1981	Akers v. Comm'r	TC Memo 1981-627		X
Amway	2002	Minnick v. Comm'r	TC Summ. Op. 2002-147		X
Amway	1997	Brennan v. Comm'r	TC Memo 1997-60		X
Amway	1988	Elliott v. Comm'r	90 TC 960 (1988), aff'd, 899 F.2d 18 (9th Cir. 1990)		X
Amway	1986	Goldstein v. Comm'r	TC Memo 1986-338		X
Antiques	1973	Barcus v. Comm'r	32 TCM 660 (1973), aff'd per curiam, 492 F.2d 1237 (2d Cir. 1974)		X
Apartment	1986	Landry v. Comm'r	86 TC 1284 (1986)	X	
Art publishing	1989	Barr v. Comm'r	TC Memo 1989-69		X
Artist	1977	Churchman v. Comm'r	68 TC 696, 701 (1977), acq., 1979-2 C.B. 1	X	
Asset sales	1980	Wittstruck v. Comm'r	39 TCM 1168 (1980), aff'd per curiam, 645 F.2d 618 (8th Cir. 1981)		X
Attorney	1995	Beard v. Comm'r	TC Memo 1995-41		X
Author	1964	Lamont v. Comm'r	339 F.2d 377 (2d Cir. 1964)		X
Auto racing	2001	Zidar v. Comm'r	TC Memo 2001-200		X
Auto racing	1991	Dwyer v. Comm'r	61 TCM 2187 (1991)	X	
Auto racing	1985	Woods v. Comm'r	49 TCM 1490 (1985)		X
Auto racing	1980	Barton v. Comm'r	TC Memo 1980-179		X
Bed and breakfast	2003	Hogan v. Comm'r	TC Summ. Op. 2003-8		X
Beekeeping	2000	Dirkse v. Comm'r	TC Memo 2000-356		X
Bondholder	1963	Hirsch v. Comm'r	315 F.2d 731 (9th Cir. 1963), aff'g, TC Memo 1961-256		X
Book publisher	1985	Beck v. Comm'r	85 TC 557 (1985)		X
Bowler	2003	Whitehurst v. Comm'r	TC Summ. Op. 2003-7	X	
Cable TV	1999	Weiss v. Comm'r	TC Memo 1999-17		X
Car sales	2003	Mayo v. Comm'r	TC Summ. Op. 2003-51		X
Cattle	1999	Wessinger v. Comm'r	78 TCM 771, TC Memo 1999-372		X
Cattle	1996	Gerres v. Comm'r	TC Memo 1986-573, 52 TCM 1119 (1986).		X
Cattle	1993	Westbrook v. Comm'r	TC Memo 1993-634, aff'd per curiam, 68 F.3d 868 (5th Cir. 1995)		X
Cattle	1989	Hatch v. Comm'r	TC Memo 1989-202, 57 TCM 280 (1989)	X	
Cattle	1987	Archer v. Comm'r	53 TCM 45 (1987)	X	
Cattle	1985	Hrdlicka v. Comm'r	TC Memo 1985-403, 50 TCM 675 (1985)		X
Cattle	1983	Arrington v. Comm'r	TC Memo 1983-673, 47 TCM 270 (1983)	X	
Cattle	1981	Fields v. Comm'r	42 TCM 1220 (1981)	X	
Cattle	1981	Lemmen v. Comm'r	77 TC 1326 (1981), acq., 1983-2 C.B. 1	X	

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Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Cattle	1977	Holderness v. Comm'r	36 TCM 13 (1977), aff'd per curiam, 615 F.2d 401 (6th Cir. 1980)		X
Cattle	1976	Ginsburg v. Comm'r	35 TCM 860 (1976)		X
Cattle	1976	Barbour v. Comm'r	TC Memo 1976-85, 35 TCM 360 (1976)	X	
Charter boat	2004	Magassy v. Comm'r	TC Memo 2004-4		X
Charter boat	2000	McKeever v. Comm'r.	TC Memo 2000-288		X
Charter boat	1996	Ballard v. Comm'r	TC Memo 1996-68		X
Charter boat	1992	Lewis v. Comm'r	64 TCM 269 (1992)		X
Charter boat	1991	Pryor v. Comm'r	61 TCM 2139 (1991)	X	
Charter boat	1989	Underwood v. Comm'r	TC Memo 1989-625		X
Charter boat	1988	Pacey v. Comm'r	TC Memo 1988-68, 55 TCM 165 (1988)	X	
Charter boat	1984	Zwicky v. Comm'r	TC Memo 1984-471	X	
Charter boat	1982	McLarney v. Comm'r	TC Memo 1982-461	X	
Charter boat	1977	Lyon v. Comm'r	36 TCM 979 (1977)		X
Collector	1982	Dailey v. Comm'r	44 TCM 1352 (1982), aff'd by unpub. opin., 718 F.2d 1107 (8th Cir. 1983), cert. denied, 465 U.S. 1103 (1984)		X
Collector	1980	Stanley v. Comm'r	40 TCM 516 (1980)		X
Collector	1970	Wrightsmen v. U.S.	428 F.2d 1316 (Ct. Cl. 1970)		X
Computer software	1988	Ronnen v. Comm'r	90 TC 74 (1988)	X	
Computer software	1988	B. D. Morgan & Co., Inc. v. Comm'r	TC Memo 1988-569		X
Cosmetics sales	2004	Konchar v. Comm'r	TC Summ. Op. 2004-59		X
Dance	2002	Bush v. Comm'r	TC Memo 2002-33		X
Dogs	1987	Burger v. Comm'r	809 F.2d 355 (7th Cir. 1987), aff'g, TC Memo 1985-523		X
Dogs	1978	Ballich v. Comm'r	TC Memo 1978-497		X
Dogs	1977	Boyer v. Comm'r	69 TC 521 (1977), acq., 1978-2 C.B. 1		X
Dogs	1974	Benz v. Comm'r	63 TC 375 (1974)		X
Dogs	1969	Currie v. Comm'r	TC Memo 1969-4, 28 TCM 12 (1969)		X
Dogs	2007	Smith v. Comm'r	TC Memo 2007-368		X
Dogs	1997	Smith v. Comm'r	TC Memo 1997-503		X
Dogs	1990	Keanini v. Comm'r	94 TC 41, 46 (1990)	X	
Dogs	1981	Steele v. Comm'r	41 TCM 1092 (1981)		X
Dogs	1966	Imbesi v. Comm'r	361 F.2d 640 (3d Cir. 1966)		X
Emu	2000	Brannon v. Comm'r	TC Memo 2000-76		X
Energy management	2003	Walford v. Comm'r	TC Memo 2003-296, aff'd by unpub. opin., 123 Fed. Appx. 952 (10th Cir. 2005)		X
Farm	2009	Fowler v. U.S.	2009 U.S. Dist. LEXIS 78805 (W.D. La. 2009)		X
Farm	2006	Bangs v. Comm'r	TC Memo 2006-83		X
Farm	2002	Mullins v. U.S.	334 F. Supp. 2d 1042 (E.D. Tenn. 2004), costs and fees proceeding, motion granted in part and denied in part, 366 F. Supp. 2d 573 (E.D. Tenn. 2005)	X	
Farm	2002	Baldwin v. Comm'r	TC Memo 2002-162		X
Farm	1999	Holmes v. Comm'r	184 F.3d 536 (6th Cir. 1999), rev'g and rem'g, TC Memo 1997-401	X	

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Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Farm	1994	Hendricks v. Comm'r	32 F.3d 94 (4th Cir. 1994)		X
Farm	1992	Schaefer v. Comm'r	TC Memo 1992-205	X	
Farm	1992	Cole v. Comm'r	TC Memo 1992-51	X	
Farm	1987	Perillo v. Comm'r	TC Memo 1987-206		X
Farm	1983	Power Est. v. Comm'r	TC Memo 1983-552, aff'd, 736 F.2d 826 (1st Cir. 1984)		X
Farm	1983	Olive v. Comm'r	45 TCM 1249 (1983)		X
Farm	1983	Daugherty v. Comm'r	TC Memo 1983-188, 45 TCM 1224 (1983)	X	
Farm	1982	Tarutis v. Comm'r	44 TCM 48 (1982)		X
Farm	1982	Hambleton v. Comm'r	43 TCM 1257 (1982)		X
Farm	1981	Palmer v. Comm'r	TC Memo 1981-354	X	
Farm	1981	Nickerson v. Comm'r	42 TCM 211 (1981), rev'd, 700 F.2d 402 (7th Cir. 1983)	X	
Farm	1981	Calbom v. Comm'r	41 TCM 1009 (1981)		
Farm	1980	Sparre v. Comm'r	39 TCM 1044 (1980)	X	
Farm	1978	Hurd v. Comm'r	37 TCM 499 (1978)		X
Farm	1975	Wood v. Comm'r	34 TCM 817 (1975)	X	
Farm	1973	Wroblewski v. Comm'r	32 TCM 169 (1973)	X	
Farm	1973	Edge v. Comm'r	32 TCM 1291, 1298 (1973)	X	
Farm	1971	Hill v. Comm'r	30 TCM 534 (1971), aff'd per curiam, 75-2 USTC ¶9632 (10th Cir. 1973)		X
Farm	1968	Blackmon v. U.S.	68-2 USTC ¶9655 (N.D. Tex. 1968)	X	
Farm	1967	Schley v. Comm'r	375 F.2d 747 (2d Cir. 1967)		X
Farm	1967	Mercer v. Comm'r	25 TCM 467 (1966), rev'd, 376 F.2d 708 (9th Cir. 1967)	X	
Farm	1967	Lazonby v. Tomlinson	272 F. Supp. 558 (N.D. Fla. 1967)	X	
Farm	1965	Wright v. U.S.	249 F. Supp. 508 (D. Nev. 1965)	X	
Farm	1965	Teitelbaum v. Comm'r	346 F.2d 266 (7th Cir. 1965)		X
Farm	1965	H. Monette and Co. v. Comm'r	45 TC 15 (1965), acq., 1966-1 CB 171, aff'd per curiam, 374 F.2d 116 (4th Cir. 1967)		X
Farm	1965	Cox v. Comm'r	24 TCM 23 (1965), aff'd per curiam, 354 F.2d 659 (3d Cir. 1966); aff'd per curiam, 285 F.2d 756 (4th Cir. 1961)		X
Farm	1965	Bennet v. U.S.	65-2 USTC ¶9701 (E.D. Va. 1965)	X	
Farm	1964	Godfrey v. Comm'r	335 F.2d 82 (6th Cir. 1964), cert. denied, 379 U.S. 966 (1965)		X
Farm	1964	DuPont v. U.S.	234 F. Supp. 681 (D. Del. 1964)	X	
Farm	1962	Worcester v. Comm'r	21 TCM 1138 (1962)	X	
Farm	1962	Ellsworth v. Comm'r	21 TCM 145 (1962)	X	
Farm	1961	Teitelbaum v. Comm'r	294 F.2d 541 (7th Cir. 1961), cert. denied, 368 U.S. 987 (1962)		X
Farm	1958	Stay v. Comm'r	17 TCM 861 (1958)	X	
Farm	1951	Rosemond v. Comm'r	10 TCM 625 (1951)	X	
Farm	1948	Tatt v. Comm'r	166 F.2d 697 (5th Cir. 1948)	X	
Farm	1928	Kean v. Comm'r	10 BTA 97 (1928)	X	
Farm	1928	Deering v. Blair	23 F.2d 975 (D.C. Cir. 1928)	X	
Farm	1922	Thacher v. Lowe	288 Fed. 994 (S.D.N.Y. 1922)		X

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Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Film distribution	1986	Abramson v. Comm'r	86 TC 360 (1986)	X	
Fishing	2002	Peacock v. Comm'r	TC Memo 2002-122		X
Fishing	2000	Busbee v. Comm'r	TC Memo 2000-182	X	
Fishing	1998	Brockenbrough Est. v. Comm'r	TC Memo 1998-454	X	
Fishing	1996	Lamb v. Comm'r	TC Memo 1996-166	X	
Fishing	1994	Briggs v. Comm'r	TC Memo 1994-125	X	
Fishing	1991	Moody v. Comm'r	TC Memo 1991-596		X
Gambling	2011	Moore v. Comm'r	TC Memo 2011-173		X
Gambling	2008	Merkin v. Comm'r	TC Memo 2008-146		X
Gambling	1987	Bathalter v. Comm'r	TC Memo 1987-530	X	
Gambling	1974	Shiosaki v. Comm'r	61 TC 861 (1974)		X
Gold mining	2002	Heidrick v. Comm'r	TC Summ. Op. 2002-115		X
Golf	1988	Kimbrough v. Comm'r	TC Memo 1988-185, 55 TCM 730 (1988)	X	
Golf Club	1990	Portland Golf Club v. Comm'r	110 S. Ct. 2780 (1990)		X
Gunsmith	1982	Cox v. Comm'r	45 TCM 138 (1982)		X
Horses	2012	Bronson v. Comm'r	TC Memo 2012-17		X
Horses	2011	Blackwell v. Comm'r	TC Memo 2011-188	X	
Horses	2009	Helmick v. Comm'r	TC Memo 2009-220, 2009 TNT 182-6	X	
Horses	2007	Keating v. Comm'r	TC Memo 2007-309, aff'd, 544 F.3d 900 (8th Cir. 2008)		X
Horses	2006	Sanders-Castro v. Comm'r	TC Summ. Op. 2006-161		X
Horses	2006	Montagne v. Comm'r	2006-1 USTC ¶150,158 (8th Cir. 2006), aff'g in unpub. opin., TC Memo 2004-252		X
Horses	2003	Prieto v. Comm'r	TC Memo 2001-266, aff'd by unpub. opin., 59 Fed. Appx. 999 (9th Cir. 2003)		X
Horses	2003	Howard v. Comm'r	TC Summ. Op. 2003-124		X
Horses	2002	Rinehart v. Comm'r	TC Memo 2002-9	X	
Horses	2000	McGee v. Comm'r	TCM 438, TC Memo 2000-308		X
Horses	2000	Lundquist v. Comm'r	211 F.3d 600 (11th Cir. 2000)		X
Horses	2000	Filios v. Comm'r.	224 F.3d 16 (1st Cir. 2000)		X
Horses	2000	Cramer v. Comm'r	TC Memo 2000-229		X
Horses	2000	Berry v. Comm'r	TC Memo 2000-109		X
Horses	1999	Wadlow v. Comm'r	112 TC 247 (1999)	X	
Horses	1999	Taras v. Comm'r	99-1 USTC ¶150,489		X
Horses	1999	Hillman v. Comm'r	TC Memo 1999-255		X
Horses	1999	Hastings v. Comm'r	77 TCM 2024, TC Memo 1999-167		X
Horses	1998	Sullivan v. Comm'r	TC Memo 1998-367, aff'd, 202 F.3d 264 (5th Cir. 1999)		X
Horses	1998	Drummond v. Comm'r	198-2 USTC ¶150,562		X
Horses	1998	Abbene v. Comm'r	TC Memo 1998-330		X
Horses	1997	Purdey v. Comm'r	97-2 USTC ¶150,894		X
Horses	1997	Phillips v. Comm'r	TC Memo 1997-128		X
Horses	1997	Machado v. Comm'r	97-2 USTC ¶150,593	X	
Horses	1997	Johnston III v. Comm'r	74 TCM 968, TC Memo 1997-475	X	
Horses	1996	Yates v. Comm'r	98-2 USTC ¶150,694 Affirming the Tax Court, 72 TCM 1193, Dec. 51,641(M), TC Memo 1996-499		X

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Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Horses	1996	Wilkinson v. Comm'r	TC Memo 1996-39		X
Horses	1996	Cronhardt v. Comm'r	TC Memo 1986-399, 52 TCM 287 (1986)	X	
Horses	1995	Osteen v. Comm'r	95-2 USTC ¶150,465 Affirming in part and reversing in part the Tax Court, 66 TCM 1237, Dec. 49,388(M) , TC Memo 1993-519		X
Horses	1995	Machado v. Comm'r	TC Memo 1995-526, aff'd by unpub. opin., 119 F.3d 6 (9th Cir. 1997)		X
Horses	1995	Bischoff v. Comm'r	TC Memo 1995-34	X	
Horses	1994	Meaney v. Comm'r	TC Memo 1994-91, aff'd by unpub. opin., 95-2 USTC ¶150,406 (11th Cir. 1995)		X
Horses	1993	Steinbrecher v. Comm'r	(CA-9), U.S. Court of Appeals, 9th Circuit, 90-70456, 90-70471, 90-70472, 2/1/1993, 1993 U.S. App. LEXIS 2229. Vacating and remanding the Tax Court, 58 TCM 884, Dec. 46,200(M) (1989), TC Memo 1989-653	X	
Horses	1993	Holbrook v. Comm'r	TC Memo 1993-383		X
Horses	1993	Borsody v. Comm'r	TC Memo 1993-534		X
Horses	1993	Arwood v. Comm'r	TC Memo 1993-352	X	
Horses	1992	Welch v. Comm'r	92-2 USTC ¶150,592		X
Horses	1992	Siegal v. Comm'r	TC Memo 1992-334		X
Horses	1991	Ferguson v. Comm'r	61 TCM 2367, TC Memo 1991-156		X
Horses	1991	Bingo v. Comm'r	61 TCM 2782, TC Memo 1991-248		X
Horses	1990	Webb v. Comm'r	60 TCM 1229, TC Memo 1990-581		
Horses	1990	Stephens v. Comm'r	TC Memo 1990-376	X	
Horses	1989	Stokes v. Comm'r	58 TCM 974 (1989)		X
Horses	1989	Smith v. Comm'r	89-1 USTC ¶9155		X
Horses	1989	Mary v. Comm'r	TC Memo 45	X	
Horses	1989	Givens v. Comm'r	TC Memo 1989-529, 58 TCM 255 (1989)	X	
Horses	1988	Stubblefield v. Comm'r	56 TCM 405 (1988)		X
Horses	1988	Seebold v. Comm'r	55 TCM 723 (1988)	X	
Horses	1988	Hopcus v. Comm'r	55 TCM 717 (1988)	X	
Horses	1988	Harvey v. Comm'r	54 TCM 1508 (1988)	X	
Horses	1988	Feldman v. Comm'r	55 TCM 450 (1988)	X	
Horses	1987	Zegeer v. Comm'r	54 TCM 1203 (1987)	X	
Horses	1987	Snyder v. Comm'r	TC Memo 1987-539	X	
Horses	1984	Yancy v. Comm'r	48 TCM 872 (1984)	X	
Horses	1984	Faulconer v. Comm'r	748 F.2d 890 (4th Cir. 1984), rev'g and rem'g, TC Memo 1983-165	X	
Horses	1984	Boddy v. Comm'r	47 TCM 1381 (1984)		X
Horses	1983	Wagner v. Comm'r	TC Memo 1983-606		X
Horses	1983	Breckenridge v. Comm'r	45 TCM 650 (1983)		X
Horses	1982	Stuckey v. Comm'r	44 TCM 1148 (1982)	X	
Horses	1980	Sealy v. Comm'r	39 TCM 847 (1980)		X
Horses	1980	Eastman v. U.S.	635 F.2d 833 (Ct. Cl. 1980)		X
Horses	1979	Golanty v. Comm'r	72 TC 411, 426 (1979), aff'd by unpub. opin., 647 F.2d 170 (9th Cir. 1981)		X

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Activity	Year	Case	Citation	Ruling in Favor of...	
				Taxpayer	IRS
Horses	1979	Engdahl v. Comm'r	2 TC 659, 666 (1979), acq., 1979-2 CB 1	X	
Horses	1979	Appley v. Comm'r	39 TCM (1979)	X	
Horses	1978	Blake Const. Co., Inc. v. U.S.	572 F.2d 820 (Ct. Cl. 1978)		X
Horses	1977	Brown v. Comm'r	36 TCM 77 (1977)	X	
Horses	1974	Coe v. Comm'r	33 TCM 592 (1974)	X	
Horses	1973	Foster v. Comm'r	32 TCM 42 (1973)	X	
Horses	1972	Farris v. Comm'r	TC Memo 1972-165, 46 TCM 1290 (1983)	X	
Horses	1972	Drew v. Comm'r	31 TCM 799 (1972)		X
Horses	1971	Morton v. Comm'r	30 TCM 671 (1971)		X
Horses	1970	Stoltzfus v. Comm'r	29 TCM 1610 (1970)		X
Horses	1970	Luce v. Comm'r	29 TCM 894 (1970)		X
Horses	1969	Thacker v. Comm'r	28 TCM 1433 (1969)	X	
Horses	1969	Starr v. Comm'r	28 TCM 167 (1969)	X	
Horses	1967	Solomon Est. v. Comm'r	26 TCM 919 (1967)	X	
Horses	1967	Bessenyey v. Comm'r	45 TC 261 (1965), acq., 1966-2 CB 4, aff'd, 379 F.2d 252 (2d Cir. 1967), cert. denied, 389 U.S. 931 (1967)		X
Horses	1962	Thomas v. Comm'r	21 TCM 382 (1962), vac'd and rem'd on other grounds, 324 F.2d 798 (5th Cir. 1963)		X
Horses	1962	Sabelis v. Comm'r	37 TC 1058 (1962) acq., 1962-2 CB 5	X	
Horses	1960	McLean v. Comm'r	19 TCM 673 (1960), aff'd per curiam, 285 F.2d 756 (4th Cir. 1961)		X
Horses	1956	Brodrick v. Derby	236 F.2d 35 (10th Cir. 1956)		X
Horses	1939	Farish v. Comm'r	103 F.2d 63 (5th Cir. 1939)		
Horses	1938	Blake v. Comm'r	38 BTA 1457 (1938), acq., 1939-1 CB 4	X	
Horses	1932	Field v. Comm'r	26 BTA 117 (1932), nonacq., XI-2 CB 12, aff'd, 67 F.2d 876 (2d Cir. 1933)	X	
Horses	1922	Wilson v. Eisner	282 F. 38 (2d Cir. 1922)	X	
Horses	1922	Curtis v. Comm'r	28 BTA 631 (1922)	X	
Import/export	1999	Dahl v. Comm'r	99-2 USTC ¶150,655	X	
Investments	1999	Arevaldo v. Comm'r	TC Memo 1999-350		X
Investments	1993	Wolf v. Comm'r	4 F.3d 709 (9th Cir. 1993), aff'g, TC Memo 1991-212		X
Investments	1988	Goldman v. Comm'r	55 TCM 1490 (1988)	X	
Investments	1970	Cohen Est. v. Comm'r	29 TCM 1221 (1970)		X
Laboratory	1955	White v. Comm'r	23 TC 90 (1954), aff'd, 227 F.2d 779 (6th Cir. 1955), cert. denied, 351 U.S. 939 (1956)		X
Leasing	1995	Johnson v. U.S.	32 Fed. Cl. 709 (1995)		X
Leasing	1986	Johnson v. U.S.	11 Cl. Ct. 17 (1986)		X
Leasing	1980	Worley v. Comm'r	39 TCM 1090 (1980)		X
Leasing	1961	Martens v. Comm'r	1991 U.S. App. LEXIS 12116, 934 F.2d 319 (4th Cir. 1991)		X
Leasing	1958	Lorraine Corp. v. Comm'r	17 TCM 719 (1958)	X	
Legal practice	1988	Sloan v. Comm'r	TC Memo 1988-294, aff'd by unpub. opin., 896 F.2d 547 (4th Cir. 1990)		X

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				Taxpayer	IRS
Lending	2005	Doxtotor v. Comm'r	TC Memo 2005-113		X
Limousine service	1992	Jasienski v. Comm'r	TC Memo 1992-674	X	
Maintenance service	1989	Tarkowski v. Comm'r	TC Memo 1989-379, 57 TCM 1096 (1989)		X
Manager	1962	Wiles v. U.S.	312 F.2d 574 (10th Cir. 1962)		X
Marketing	2007	Smith v. Comm'r	TC Memo 2007-154		X
Master recording	1988	Morrow v. Comm'r	55 TCM 1551 (1988)		X
Master recording	1985	Call v. Comm'r	TC Memo 1985-318		X
Master recording	1984	Baron Est. v. Comm'r	83 TC 542 (1984), aff'd, 798 F.2d 65 (2d Cir. 1986)		X
Mining	1992	Balkissoon v. Comm'r	TC Memo 1992-223		X
Mining	1990	Cannon v. Comm'r	TC Memo 1990-148, aff'd, 91-2 USTC ¶150,559 (10th Cir. 1991)		X
Motion pictures	1990	Evans v. Comm'r	908 F.2d 369 (8th Cir. 1990), on remand, 61 TCM 2917, supp'l opin. on remand, 62 TCM 614 (1991)	X	
Motion pictures	1987	Polakof v. Comm'r	820 F.2d 321 (9th Cir. 1987), aff'g, TC Memo 1985-197		X
Motion pictures	1983	Bizub v. Comm'r	TC Memo 1983-280		X
Motorcycle racing	1988	Mills v. U.S.	699 F. Supp. 1245 (E.D. Ohio 1988)	X	
Movie	1985	Jameson v. Comm'r	50 TCM 6 (1985)		X
Movie distributor	1986	Breck v. Comm'r	51 TCM 1185 (1986)		X
Movie distributor	1982	Brannen v. Comm'r	78 TC 471 (1982), aff'd, 722 F.2d 695 (11th Cir. 1984)		X
Movie making	1983	Van Allen v. Comm'r	46 TCM 1612 (1983)		X
Music promotion	1992	Krebs v. Comm'r	TC Memo 1992-154, 63 TCM 2413 (1992)	X	
Music recording	2007	Wesley v. Comm'r	TC Memo 2007-78		X
Musician	1989	McMillan v. Comm'r	TC Memo 1989-441, 57 TCM 1364 (1989)		X
Oil & Gas	2000	Hill v. Comm'r	204 F.3d 1214 (9th Cir. 2000)		X
Oil & Gas	1994	Hildebrand v. Comm'r	28 F.3d 1024 (10th Cir. 1994), aff'g, Krause v. Comm'r 99 TC 132 (1992)		X
Oil & Gas	1993	Peat Oil & Gas Assoc. v. Comm'r	100 TC 271 (1993), aff'd sub nom.		X
Orchard	1954	Katz v. Comm'r	13 TCM 188 (1954)	X	
Photography	2011	Wilmot v. Comm'r	TC Memo 2011-293		X
Photography	2001	Tamms v. Comm'r	TC Memo 2001-201	X	
Photography	1996	Windisch v. Comm'r	TC Memo 1996-369		X
Photography	1988	Bentley v. Comm'r	TC Memo 1988-444, aff'd by unpub. opin., 908 F.2d 976 (9th Cir. 1990)		X
Ranch	2004	Garbini v. Comm'r	TC Summ. Op. 2004-7		X
Real estate	2003	Medlin v. Comm'r	TC Memo 2003-224		X
Real estate	1988	Hulter v. Comm'r	91 TC 371 (1988)		X
Real estate	1982	Beltran v. Comm'r	TC Memo 1982-153		X
Real estate	1979	Nicolette v. Comm'r	38 TCM 845 (1979)		X
Real estate	1967	Smith v. Comm'r	26 TCM 149 (1967), aff'd per curiam, 397 F.2d 804 (9th Cir. 1968)	X	
Recording	1969	Thompson v. Comm'r	TC Memo 1969-19, 28 TCM 75 (1969)		X
Recycling	2000	Addington v. Comm'r	205 F.3d 54 (2d Cir. 2000), aff'g, TC Memo 1997-259		X

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				Taxpayer	IRS
Research	1991	Agro Sci. Co. v. Comm'r	TC Memo 1989-687		X
Research	1959	Brooks v. Comm'r	274 F.2d 96 (9th Cir. 1959), rev'g, 30 TC 1087 (1958)	X	
Resort	1998	Akerson v. Comm'r.	TC Memo 1998-129	X	
Ski lodge	1979	Allen v. Comm'r	72 TC 28 (1979), acq., 1979-2 CB 1	X	
Ski lodge	1978	Lindow v. Comm'r	TC Memo 1978-301	X	
Snow plowing	1989	Edmands v. Comm'r	58 TCM 167 (1989)		X
Store	1995	Ranciato v. Comm'r	52 F.3d 23 (2d Cir. 1995), vac'g and rem'g, TC Memo 1993-536, on remand, TC Memo 1996-67	X	
Taxicab	1989	Bolenge v. Comm'r	89-1 USTC ¶9323 (D. Md. 1989)		X
Tree farm	2002	Zarins v. Comm'r	2002-2 USTC ¶150,471 (6th Cir. 2002)		X
Truck pulling	1984	Plunkett v. Comm'r	TC Memo 1984-170, 47 TCM 1439 (1984)	X	
Trucking	1991	Beltzhoover v. Comm'r	62 TCM 905 (1991)		X
Tutor	2006	Corlis v. Comm'r	TC Summ. Op. 2003-68		X
Wind turbine	1985	Baxter v. Comm'r	50 TCM 545 (1985), aff'd and rev'd, 816 F.2d 493 (9th Cir. 1987)		X
Writer	1980	Stahnke v. Comm'r	40 TCM 1177 (1980)	X	
Writer	1980	Hires v. Comm'r	40 TCM 342 (1980)		X
Writer	1979	Dreicer v. Comm'r	39 TCM 233 (1979), rev'd and rem'd, 665 F.2d 1292 (D.C. Cir. 1981), on remand, 78 TC 642 (1982), aff'd by unpub. opin., 702 F.2d 1205 (D.C. Cir. 1983)		X
Writer	1967	Szmak v. Comm'r	376 F.2d 154 (2d Cir. 1967), aff'g, TC Memo 1965-301		X
Writer	1960	Wright v. Comm'r	274 F.2d 883 (6th Cir. 1960)		X
Yacht lease	1988	Antonides v. Comm'r	91 TC 686, 694 (1988), aff'd, 893 F.2d 656 (4th Cir. 1990)		X
Yachting	2003	Schwartz v. Comm'r	TC Memo 2003-86	X	