HANDLING YOUR CANINE SPORT BUSINE$$

Does Your Hobby Qualify as a Business Venture?

By Geoffrey Goudy

I know what you're thinking… you win some money in a couple of local USDAA Steeplechase events and teach part-time at your canine training school… oh boy, you can now deduct all your entry fees, vet bills, and travel costs.

You and a hundred million other taxpayers want to turn an expensive hobby into a business and report the activity, generally a sizable loss, on Schedule C of your Form 1040. In some cases this treatment may be correct, but in most cases it is not.

The Internal Revenue Service has codified hobby activities under IRS Code Section 183: Losses incurred by an individual that are attributable to an activity not engaged in for profit are generally deductible only to the extent of income produced by the activity. An activity is presumed not to be a hobby if profits result in any three of five consecutive tax years.

However, I take the definition a bit further with the use of another test: If the business activity reported relates to one or more of your pets, canines or equines, then profit motive must be the primary purpose for owning said animal(s).

So for the individual who shows most weekends and earns nominal compensation through students or competition, I recommend *not* reporting losses in any tax year. Simply report income earned and expenses to the extent of income earned. In other words, if you earn $2,000, then report $2,000 in expenses. Think of it this way: at least you were able to offset taxable income with deductible, yet basically personal, expenditures.

I would also recommend that you not report the above example for three years and then report an income of $2,000 and expenses of $12,000 in the alternating years. While you would be adhering to the letter of the law, the Internal Revenue Service could prove (and rather easily) that profit is not the primary purpose for the endeavor and re-characterize the $10,000 losses as non-deductible hobby expenses.

For those of you who are judges or trainers, earn decent income, and also happen to train your own dogs, the bar is raised, but only so far. An old unwritten rule of thumb still prevails: If your sole proprietorship (single-owner business) earns more than $25,000 in annual receipts, then the hobby rules no longer apply, since you are seen in the eyes of the IRS as a viable trade or business. And therefore losses can occur each and every year if they're reasonable and accurate.

But for those individuals who frequently judge or present seminars and earn less than $25,000, use caution when reporting annual activity, especially if you are also an employee of another business and have wage income reported on a W-2. While you clearly have a second job in the canine sport industry, incurring losses as a result of deducting substantial personal canine-related expenditures is risky and may be disallowed.

A common choice is to create a legal business entity, such as a limited liability company (LLC) or subchapter S corporation. You must act and operate accordingly, as a formal business entity. However, profit-motive rules still apply and you must comply with numerous federal and state filing requirements.

In summary, follow the three steps below to determine the nature of your canine-related activity. The first is to figure out your level of involvement. Is it

- Hobby
- Second job
- Business

Then you must review and tabulate

- Revenue streams
- Direct expenditures
- Indirect expenditures

Finally, you must assess your risk tolerance with

- IRS reporting requirements
- Blurred appearance (for example, personal pet versus business asset)
- Reputation

The hard part is working through these three steps to determine your status; the easy part is filling out the Schedule C or C-EZ for your individual income tax return. Be sure to go through the three-step process every year since circumstances may change, even if your business venture has historically generated profits. And each individual situation is unique, so don't be afraid to actively engage your financial advisor. Your dog jumps through hoops, shouldn't your accountant?

Geoffrey Goudy is a certified public accountant who has been in practice for 15 years and has participated in canine sporting events since the mid-90s. To learn more about or direct questions to Geoffrey and his practice, go to CSpotCount.com/CanineSport.asp.

Defining Your Income and Expenditures

What Your Accountant Will Need to Know

Revenue Streams—segregate income into various categories:

- Teaching arrangements
- Judging engagements
- Competitive events
- Reimbursed travel costs
- Product sales
- Service sales
- Other income

Direct Expenditures—expenses required to generate receipt of income:

- Reimbursed and certain unreimbursed travel costs
- Competition costs, if a reasonable portion of total income earned
- Cost of product sales—product acquired and/or assembled
- Cost of service sales—services outsourced and consumables used
- Miscellaneous direct costs

Indirect Expenditures—expenses not required to generate receipt of income:

- Certain other travel and vehicle costs
- Competition costs, if limited, or no income earned from competition
- Dog food and supplies
- Veterinarian and boarding fees
- Education and training
- Licenses and fees
    - Business insurance
    - Dues and subscriptions
    - Office supplies
- Equipment rent and supplies
- Communications—phone and email
- Legal and accounting
- Interest expense
- Miscellaneous indirect costs
- Depreciation*

**Personal tangible property (equipment) with a useful life greater than 1 year is to be capitalized and subsequently depreciated over a period generally not to exceed 5 years.*