



IRS Nationwide
TaxForum | 2017

Advocating for Your Client in
Trade and Business Expense
Cases – Hobby Losses



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Course Objectives

After completing this course you will be able to:

- Identify a trade or business expense;
- Understand the application of the Cohan rule;
- Differentiate between a business or personal expense; and
- Articulate the factors used by courts in determining hobby losses.



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What is a Most Litigated Issue?

The Most Litigated Issues for 2015

2015	Cases	Rank
Accuracy-Related Penalties	113 cases	(1)
Trade or Business Expenses	99 cases	(2)
Summons Enforcement	84 cases	(3)
Gross Income	80 cases	(4)
Collection Due Process	79 cases	(5)



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The Most Litigated Issues for 2016

2016	Cases	Rank
Accuracy-Related Penalties	122 cases	(1)
Collection Due Process	99 cases	(2)
Summons Enforcement	87 cases	(3)
Gross Income	81 cases	(4)
Trade or Business Expenses	73 cases	(5)



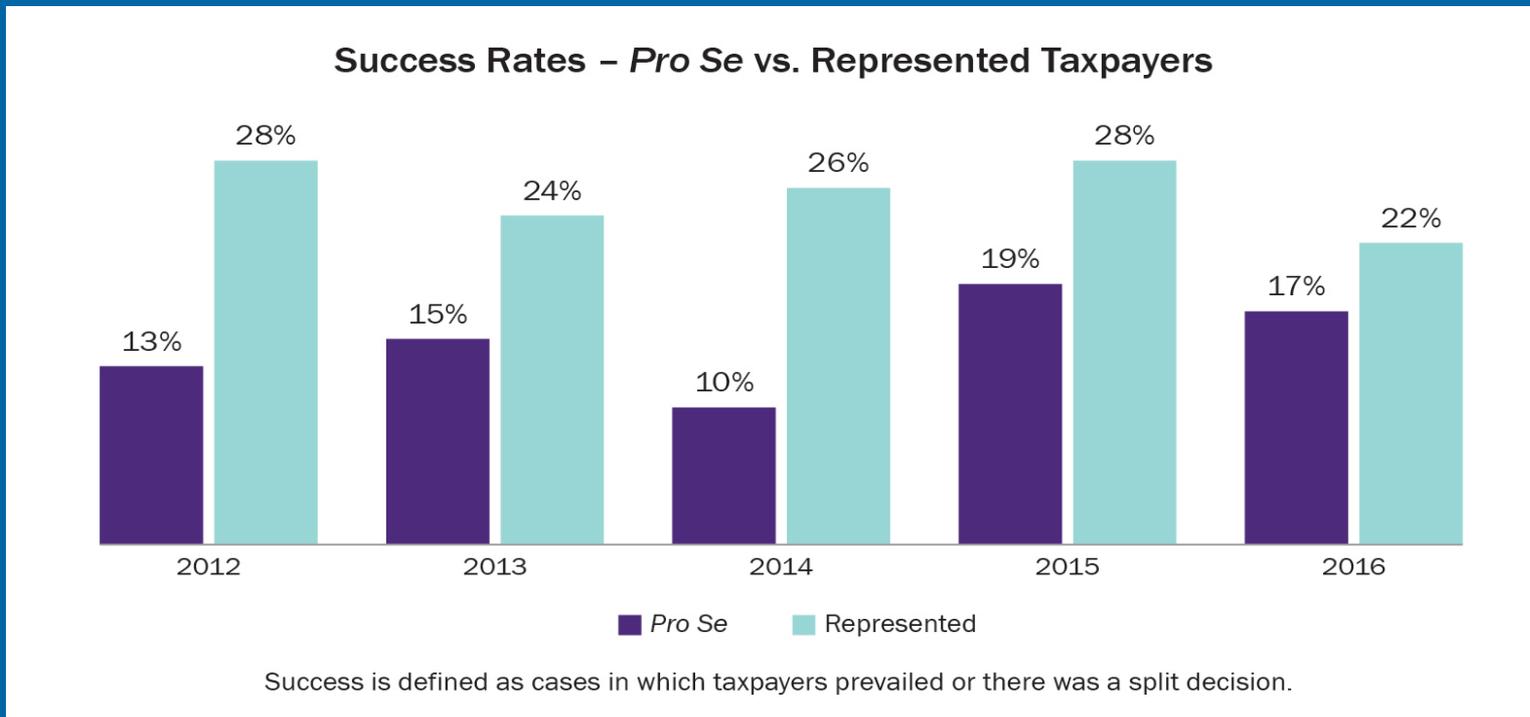
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Success Rates: *Pro Se* vs. Represented Taxpayers





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Trade or Business Expenses Under IRC § 162

Allows deductions for ordinary and necessary trade or business expenses paid or incurred during the course of a taxable year.



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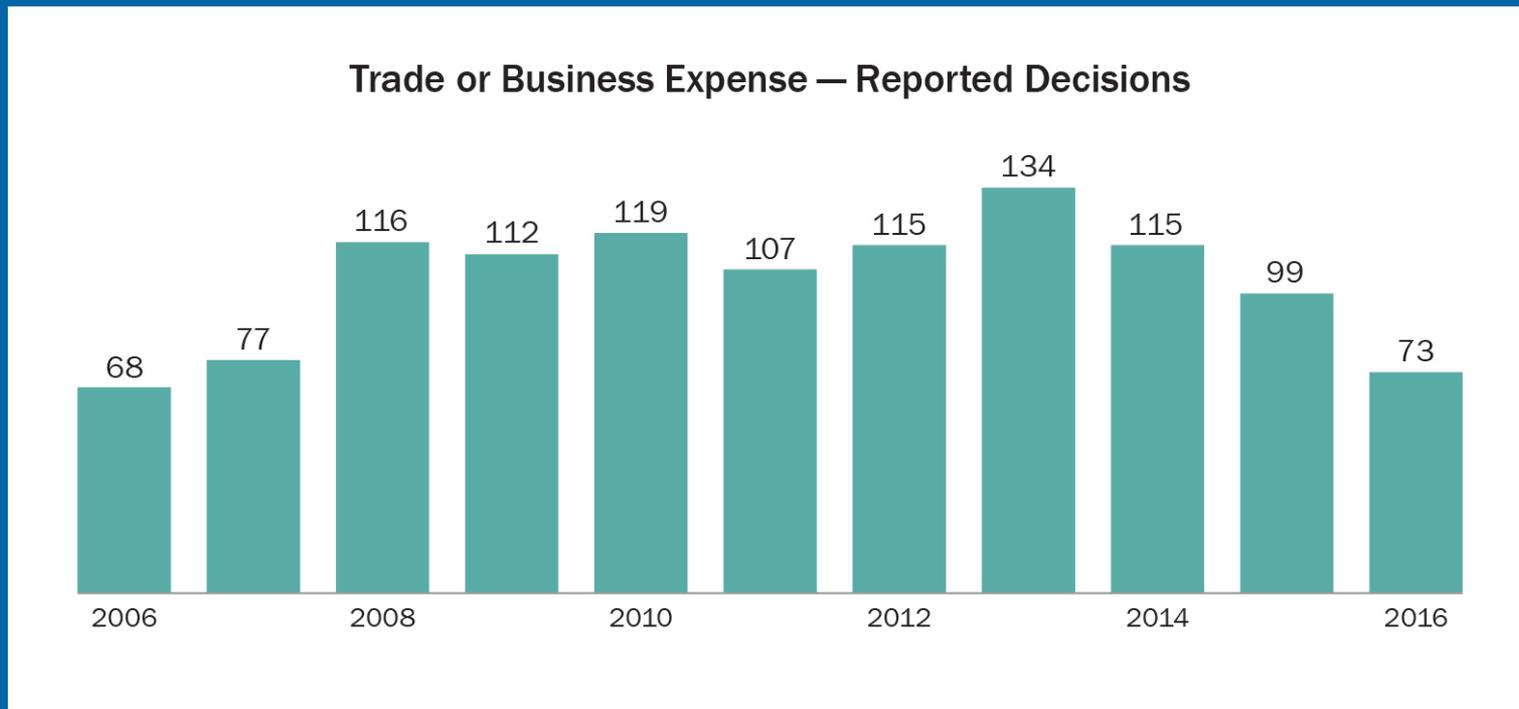
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What is a trade or
business expense?



Trade or Business Expense – Reported Decisions





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Currently Deductible or Capital Expenditure?

IRC § 162(a)

vs.

IRC § 263



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When Did the Expense Occur and What's the Proof?

- Expense must be incurred or paid in the taxable year
- Taxpayers must substantiate expenses



Cohan Rule

- Allows courts to grant reasonable deductions even without proof
- Not applicable when IRC § 274(d) applies



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IRC § 274(d)

- Taxpayers must have substantiation for the following expenses:
 - Travel expenses;
 - Entertainment, amusement, or recreation expenses;
 - Gifts; and
 - Certain “listed property.”



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Who has the burden of proof in a substantiation case?

- Generally the taxpayer has the burden of proof.
- The burden shifts to the IRS where the taxpayer produces credible evidence.



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Common Trade or Business Expense Issues

- Substantiation
- Personal vs. Business Expenses
- For Profit Activity
- Ordinary and Necessary Expenses



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Substantiation

- Most cases involve issues of substantiation



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Cases Involving Substantiation

- *Engstrom, Lipscomb & Lack, APC v. Commissioner* (T.C. Memo. 2014-221, *aff'd*, 118 A.F.T.R.2d (RIA) 7001 (9th Cir. 2016))
- *Garcia v. Commissioner* (T.C. Memo. 2016-21)



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Personal vs. Business Expenses

- Must prove a business purpose



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Cases Involving Personal vs. Business Expenses

- *Peterson v. Commissioner*
(T.C. Memo. 2015-23)
- *Chen v. Commissioner*
(T.C. Memo. 2015-167)



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IRC § 162(a)

Ordinary and Necessary Expenses Include:

- Salaries or compensation for personal services actually rendered;
- Travel expenses incurred while away from home in the pursuit of the trade business; and
- Rentals or other payments for property for the trade or business.



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Case Involving Ordinary and Necessary

- *Guardian Industries Corp.*
v. Commissioner (143 T.C. 1 (2014))



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For Profit Activity

- Taxpayers must be actively engaged in an activity, with the intent of making a profit, to qualify to deduct trade or business expenses.



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Cases Involving For Profit Activities

- *Crile v. Commissioner* (T.C. Memo. 2014-202)
- *Roberts v. Commissioner* (820 F.3d 247 (7th Cir. 2016), *rev'g* T.C. Memo. 2014-74)



Hobby Losses

- IRC § 183
 - Added by the Tax Reform Act of 1969 to limit deductions attributed to hobbies.



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Income and Losses

- IRC § 183(b)
 - Activity not engaged in for profit (9 factors) taxpayers can take a deduction up to the amount of gross income earned in that year from the activity.



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For Profit Presumption

- Rebuttable presumption
- Gross income is greater than deduction for 3 of 5 years



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When Are Hobby Losses Deductible?

- It's all about the facts!
- IRS Fact Sheet 2008-23
- IRS Publication 535, *Business Expenses*



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Applying Case Law

- Facts and circumstances
- Need to look at precedential cases



Cases Involving Hobby Losses

- *Estate of Stuller v. U.S.* (811 F.3d 890 (7th Cir. 2016), *aff'g* 55 Supp.3d 1091 (C.D. Ill. 2014))
- *Ranciato v. Comm'r* (52 F.3d 23 (2d Cir. 1995) *vacating and remanding* T.C. Memo. 1993-536)



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Cases Involving Hobby Losses (cont'd)

- *Moyer v. Comm'r* (T.C. Memo. 2016-236)
- *Main v. Comm'r* (T.C. Memo. 2016-127, appeal docketed No. 17-71070 (9th Cir. Apr. 13, 2017))



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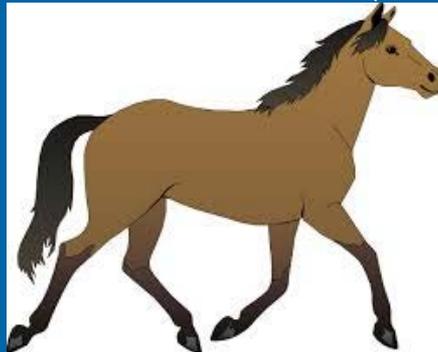
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Cases Involving Hobby Losses (cont'd)

- *Vest v. Comm'r* (T.C. Memo. 2016-187, appeal filed (5th Cir. Jan. 10, 2017))
- *Carmody v. Comm'r* (T.C. Memo. 2016-225)





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- www.youtube.com/tasnta
- www.facebook.com/YourVoiceAtIRS
- Call 877.777.4778
- twitter.com/YourVoiceatIRS
- File Form 911, Request for Taxpayer Advocate Service Assistance (And Application for Taxpayer Assistance Order)



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