



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
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OFFICE OF
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Dear :

This letter responds to your telephone calls and email dated April 14, 2005, regarding the proper tax treatment of certain expenses related to a boat that is primarily for personal use. This letter calls your attention to certain general principles of the law without applying them to a specific set of facts. See Rev. Proc. 2005-1, § 2.04, 2005-1 I.R.B. 7.

Section 262(a) of the Internal Revenue Code generally denies a deduction for personal, living, or family expenses. Section 162(a) allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 212, in relevant part, allows an individual a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year for the production of income. Section 183(a) provides that, 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 is allowed except as provided in § 183. Section 183(c) defines an activity not engaged in for profit as an activity other than one for which deductions are allowable under §§ 162 or 212. No deductions are allowable under § 162 or § 212 for activities that are carried on primarily as a sport, hobby, or for recreation. Section 1.183-2(a).

Section 183(b) provides that, in relation to an activity not engaged in for profit, a taxpayer can take those deductions that would be allowable without regard to profit motive, and can take deductions that would be allowed if the activity were engaged in for profit, but only to the extent that gross income derived from such activity for the taxable year exceeds the deductions allowable without regard to profit motive. In sum, section 183 allows deductions for expenses incurred in an activity not engaged in for profit, but only to the extent of gross income from that activity; therefore, taxpayers may not deduct losses incurred in an activity not engaged in for profit.

The regulations under § 183 list nine factors to be considered in determining whether a taxpayer has a profit motive in conducting a certain activity: (1) the extent to which the taxpayer carries out the activity in a businesslike manner; (2) the expertise of the taxpayer or his advisors; (3) the time and effort expended by the taxpayer in carrying on the activity; (4) the expectation that assets used in the activity may appreciate in value; (5) the success of the taxpayer in other similar or dissimilar activities; (6) the taxpayer's history of income or losses with respect to the activity; (7) the amount of occasional profits, if any, that are earned; (8) the taxpayer's financial status; and (9) any elements of personal pleasure or recreation derived from the activity. Section 1.183-2(b)(1)-(9) of the Income Tax Regulations. Although a taxpayer's expectation of profit need not be reasonable, the facts and circumstances must indicate that the taxpayer entered into the activity, or continued the activity, with the actual and honest objective of making a profit. *Dreicer v. Commissioner*, 78 T.C. 642, 645 (1982); § 1.183-2(a).

In *Fischer v. Commissioner*, 50 T.C. 164, 170-72 (1968), the Tax Court denied the taxpayer deductions for the cost of flying a private plane for reasons unrelated to his work or earning profits. The court found that the taxpayer was not in the aircraft chartering business where he earned only minimal chartering income in the taxable years in question, did not advertise or hold himself out in any manner as being in the business of chartering aircraft, and devoted his time instead to performing services as an engineering consultant. Similarly, in *McCormick v. Commissioner*, T.C. Memo 1969-261, the Tax Court held that the taxpayer did not have a bona fide profit objective in operating two boats even though he expected to derive some gross receipts from the boats; the primary use was for personal pleasure.

I hope this general information is helpful to you. This letter is intended for informational purposes only and does not constitute a ruling. See Rev. Proc. 2005-1, § 2.04, 2005-1 I.R.B. 7. If you have any additional questions, please contact _____ at _____

Sincerely,

Thomas A. Luxner
Chief, Branch 1
Office of Associate Chief Counsel (Income Tax &
Accounting)