

Hobby or Business... Is Being an Artist a Business?

The first hurdle visual artists often have is the question regarding whether their "art" is indeed a business for tax purposes. The heart of this matter is whether the IRS sees the endeavor as a real "business" or as a "hobby." IRS publications discuss these nine criteria:

1. Whether you carry on the activity in a businesslike manner.
2. Whether the time and effort you put into the activity indicate you intend to make it profitable.
3. Whether you are depending on income from the activity for your livelihood.
4. Whether your losses from the activity are due to circumstances beyond your control (or are normal in the start-up phase of your type of business).
5. Whether you change your methods of operation in an attempt to improve the profitability.
6. Whether you have the knowledge needed to carry on the activity as a successful business.
7. Whether you were successful in making a profit in similar activities in the past.
8. Whether the activity makes a profit in some years, and how much profit it makes.
9. Whether you can expect to make a future profit from the appreciation of the assets used in the activity.

If your efforts result in a profit in three out of five consecutive years, your activity is presumed *not* to be a hobby by the IRS. If you don't meet the three-out-of-five years profit rule, but you can prove to the IRS's satisfaction that you have made a genuine effort to earn a profit and that the reason you were not successful was related to special circumstances, the IRS might agree that your art is, in fact, a business.

Doing such things as having business cards and stationery printed, maintaining a separate business checking account, keeping accurate records of the time you put in, and carefully documenting all business-related expenses will help support your case.

The IRS places great credence on computerized accounting records as evidence of the artist's "businesslike" intent. Keep records of all show

entries (even including ones that you don't get into) and all gallery activity. In short, activity related to attempts to sell your artwork should be recorded.

FORMS

A majority of visual artists are considered "self-employed" in regards to filing their taxes. Artists usually file:

- a "Schedule C" as part of their regular 1040 income tax form, which is where you report your art income and expenses
- a form 8829 for the home office (studio) deduction
- self-employment tax (Schedule SE) on your net income (profit) as well as federal income tax
- as a self-employed artist, you will usually be required to pay estimated quarterly taxes using Form 1040-ES if your Federal tax liability is over \$1,000 for the year.
- (all these forms are part of the year-end 1040 income tax filing)

INCOME...for the artist includes:

- amounts paid to the artist for their artwork, including prizes, awards, fellowships, and endowments received
- "taxable income other than cash," including trades of art between artist and other individuals. For example an artist agrees to "sell" a painting to another artist by exchanging artwork. The painting that the first artist gives up "costs" \$75 (paint, canvas, and framing). The artwork received by the first artist has a market value or price of \$1,000. The first artist will have a taxable income of \$925 (\$1,000 - \$75) because they received something worth \$1,000 but only paid \$75.

DEDUCTIBLE BUSINESS EXPENSES

For the IRS all deductible business expenses are those that are:

1. Incurred in connection with your trade, business, or profession
2. Must be "ordinary" and "necessary"
3. Must "NOT be lavish or extravagant under the circumstances" It does not take much analysis to see that these guidelines are not an exacting science. The artist has a large group of basic expenses that easily fit the above criteria: travel (hotel, meals, etc.), vehicle and transportation costs, equipment, art supplies, home studio expenses, legal and professional fees, gallery costs & commissions, etc (see our attached list).

HOW TO DEDUCT YOUR HOME OFFICE

If you use a room (or rooms) in your home exclusively as your office, you may be able to qualify for the home office deduction. To qualify, space must generally be:

- The principal place of business
- The place where the taxpayer meets with clients, customers or patients

The use of the room can be as an office, storage area for equipment and supplies, record keeping for the business, marketing, etc. The home office is a fairly straightforward deduction to calculate on *Federal form 8829*. It simply utilizes a formula based on the square footage of the business portion (the home office) of your home vs. the total square footage of the house or apartment and then applies that percentage to all associated costs. The costs can include rent, mortgage interest, real estate taxes, condo fees, utilities, insurance, repairs, etc. If you own your own home you can even depreciate that portion of your house for an additional write-off.

For example:

Business use (square footage)	250
Total square footage of home	1250
Business use % (250/1250)	20%

Mortgage Interest	\$7,500
Real Estate Tax	\$2,500
Utilities	\$1,820
Water & Sewer	\$820
Insurance	\$400
Repairs	<u>\$225</u>
Total home expenses	\$13,265

Potential home office deduction:
(\$13,265*20%) **\$2,653**

Other rules that come into play here include the "*exclusive use*" requirement. This rule states that the home office must be used only for the business - no "mixed use" allowed. In other words the studio cannot be a part of a larger room such as the living room unless the business part is partitioned off in some way.

Tax Tip - One thing to keep in mind is that when you start utilizing the home office deduction you are essentially converting a portion of your home into a business property. Know that by doing this you may be putting in jeopardy the "exclusion on the sale of a principle residence." Depending on your situation this can be a strong argument against using the home office deduction. Be sure to discuss this situation with a qualified tax advisor, especially if you are planning on selling your home in the near future.

The home office can be a powerful write-off in that it allows the taxpayer to deduct a part of what were non-deductible personal expenses. This brochure is meant to be a brief overview. Please consult your tax advisor for particulars that relate to your circumstances.

ArtWorks-NH



Language Lessons For record keeping & talking shop with an accountant

MicroCredit-NH
7 Wall Street
Concord, NH 03301

For more information:
224-2069 or 1-800-769-3482
geninfo@microcreditnh.org
www.microcreditnh.org

Tax Deductions for the Self-Employed Artist

Travel

- Can be deducted for expenses associated with overnight business travel.
- Can include meals (only 50% deductible), hotel & lodging, reasonable tips, dry-cleaning, phone calls home, etc.
- Could include gallery visits, openings of shows, delivering artwork, art fairs, etc.
- Also includes a mixed business/pleasure trip is primarily business then deductibility will be maintained.

For example, what if the artist has a five-day trip to NYC for a gallery opening and outdoor art fair that includes a two-day stopover in Philadelphia to visit a friend. In this case the entire NYC trip would be deductible but the expenses related to the Philadelphia stopover, which was personal would not be.

Meals

- are deductible (remember, only 50%) as part of the overnight travel and they are also allowed as a separate (non-travel) deduction when they meet the criteria of "ordinary," "necessary" and business related.
- can mean lunch or dinner meetings with agents, fellow artists, gallery owners, etc. for the purposes of talks on potential gallery showings, museum exhibits, future sales, Website design or setup, and meetings with lawyers or accountants.
- records for these expenses can be kept in an appointment book. Log into your book who was present, and briefly the nature and substance of the discussion. Keep a copy of the person's business card as further substantiation.
- Receipts are difficult to maintain, so you may consider using the IRS "meal allowance" for deducting meals when traveling. This "allowance" (adjusted annually by the IRS) ranges from \$30 to \$40 per day depending on the location.

Automobile & Vehicle Expenses

- can be one of the most common and largest deductions for the artist.
- Use the IRS "standard mileage allowance." In 2006 this annually defined allowance is 44.5 cents a mile. To take this deduction you do not need receipts, only records that show the distances driven and the business purpose of the trips.
- includes travel to galleries and museums; trips to the art supply store, classes, etc.
- Can be tracked and calculated in your appointment book or calendar. If your calendar has a record of business travel it can be used as a tool to estimate your mileage deduction (odometer readings are appreciated by IRS but NOT required).

Equipment

- purchased is generally "depreciated" and written off over 5 or 7 years on Form 4562. Depreciation is a technique for expensing or writing off purchases that have a useful life of greater than one (1) year. In other words, a kiln or printing press is intrinsically different in nature than clay, a tube of paint, brushes or photographic chemicals.
- Supplies such as inks, film, canvas, welding material, etc. will be written off (or deducted) in the year of purchase. The main tax strategy when it comes to depreciation is the use of what is often called "the section 179 election."
- In 2001 the IRS allows taxpayers to "expense" up to \$24,000 of equipment in any one year. In this case the potter is allowed to write-off his/her \$5,000 kiln in one year rather than wait seven years to do it. Remember this "section 179 expensing election" only accelerates the deduction into one year. Either way, the artist is able to write-off (depreciate) the full cost of the purchase.

Remember that this outline is not intended to be the whole story. The Federal Tax Code is very complicated and your specific applications should be reviewed with a tax professional before filing your taxes. When you are shopping for a tax preparer please make sure they have some experience in taxation for artists. Organizing your numbers using our attached worksheets will make the process easier, cheaper and will help you maximize your deductions. Ask your preparer about other tax saving strategies for self-employed individuals.

Information contained within this brochure has been generously compiled by Peter Jason Riley,
CPA of RILEY & ASSOCIATES, P.C., Newburyport, Massachusetts,
Phone ~ 978.463.9350 E-mail ~ priley@cpa-services.com
<http://www.artstaxinfo.com>

