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Deduction for Death Investigation Denied as "Hobby Loss"

Not merely adding insult to injury

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An estate is generally permitted a tax deduction for costs incurred with respect to the production or collection of income. However, the primary reason for having incurred those costs must have been to generate profit.

In a recent case, the U.S. Court of Appeals for the Fifth Circuit affirmed the Tax Court's holding that a taxpayer couldn't deduct the costs of investigating his father's

death from his father's estate because the investigation wasn't motivated by profit (Vest v. Commissioner, (CA 5 June 2, 2017) 119 AFTR 2d par. 2017-813). But did the Internal Revenue Service have to label them a "hobby loss?"

Hobby Loss Rules

The hobby loss rules of Internal Revenue Code Section 183 prohibit deductions in excess of the hobby income if the activity isn't engaged in for profit. The Treasury Regulations Section 1.183-2(b) enumerate factors to consider in determining whether a taxpayer has a profit motive, including:

- Expertise.
- Time and effort expended in carrying out the activity.
- Amount of profits.
- Taxpayer's financial status.

No Profit Motive

The taxpayer claimed business expenses from investigations into the cause of his father's death after receiving an anonymous letter stating that his father didn't commit suicide, but rather had been murdered. The taxpayer argued that this was a business opportunity that, if publicized, could result in book and movie. Significant costs were incurred hiring private investigators and a writer to draft a manuscript. The IRS held these costs non-deductible hobby losses because there was no profit motive. The Fifth Circuit found that the Tax Court's determination was correct, applying the factors set out in the Treasury regulation.

Surprisingly, the hobby loss deduction limitation rules can surface in many areas of planning, even probate matters. Practitioners should be mindful.

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