“Jingles-R-Us”

Simon, John, and Nick were best friends in college who played in a very cool synth-pop/glam rock band back in the day. After graduation, they went their separate ways and traded in their rock star dreams for respectable 9-to-5 jobs. But, after reuniting at their 20-year college reunion, they decided that, even though they didn’t have their “rock star” looks anymore, and even though they lived on opposite coasts (Simon and John were in LA, Nick was in NY), maybe they could join together and form a little side business to write jingles for commercials. They were excited to “get the band back together” and make music again. And, while the idea was mostly just for fun, deep down, the old friends really wanted to make a go of it and see if they could make a little money as musicians.

They tracked down their old groupie, Jennifer, who had since become a successful tax attorney, and asked her advice. She referred them to a colleague of hers who could help them draw up a business plan. They formed a partnership called “Jingles-R-Us.” Simon and John were responsible for writing the lyrics and the music, and Nick would focus on marketing the jingles.

Although they were very excited, in reality, the jingle business got off to a slow start. Since each of them retained their regular day jobs, it was tough to really devote the necessary time to the band. Nevertheless, each of them had spent significant amounts of money on instruments, software and equipment for mixing music, travel and dining expenses for wooing potential jingle buyers, and all manner of music-making and music-promoting accoutrements. They did manage to sell a jingle on occasion, but after 5 years of off-and-on effort, they had yet to turn a profit. Every year, when tax season came around, each band member reported their share of the partnership’s meager profits, and fully deducted all of their expenses as business expenses under section 162.

One day, the IRS came knocking. After an exam, the IRS concluded that the deductions were not allowable under section 162, and were instead limited by section 183, because the band members didn’t have the necessary profit motive. Their jingle business was really just a hobby. Simon, John, and Nick each received notices of deficiency, showing that they each owed an additional $30,000 to $40,000 in tax for the years under exam, and promptly called Jennifer for help.

Jennifer’s research on hobby losses revealed a variety of available case law on point; some positive, some negative. The Ninth Circuit – the court of appeals to which an appeal of Simon’s and John’s cases would lie – has clear negative authority on point, requiring that to get the full deductions under section 162, the taxpayer has to show that the activity was entered into with the “dominant hope and intent” of realizing a profit. The Second Circuit – the court of appeals to which an appeal of Nick’s case would lie – has similar tough language in a case, but the case is unpublished. In the Tax Court, in decisions appealable to other circuits, the case law is favorable to the band members. The Court of Federal Claims also has favorable case law, but the Federal Circuit has not yet ruled on this subject.