PERSONAL Newsletter

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Business or Hobby?

In an era of side hustles and monetizing your hobbies, many people earn money from activities that started as hobbies. Common examples could include online content creation, selling food or crafts, or artistic endeavours such as performing music or making art. However, when a hobby has some prospect of making money, it is important to consider the attendant tax implications.

The CRA and the courts draw an important distinction between a business and a hobby or other personal endeavour. That distinction affects whether:

- the income is taxable;
- related expenses or losses are deductible;
- the taxpayer must register for GST/HST; and
- the income and expenses must be reported on the taxpayer's return.

If an activity is not a business (for example, it is simply a hobby), then:

- amounts earned may not be taxable as business income; and
- expenses related to that activity are generally not deductible.

If the activity is a business:

- income is fully taxable as business income; and
- reasonable expenses incurred to earn that income are generally deductible.

A hobby can evolve into a business if it is carried on in a commercial manner with the intention of earning profit.

The Legal Framework: "Source of Income" and the Pursuit of Profit

To deduct expenses or losses, there must first be a valid source of income, such as a business or property. Historically, courts used a "reasonable expectation of profit" test to decide whether a business source existed. However, this changed with the Supreme Court of Canada's landmark decision in *Stewart v. Canada*, 2002 SCC 46. The Court rejected the stand-alone "reasonable expectation of profit" test and adopted a two-stage "pursuit of profit" framework:

- Threshold Test — Is the activity undertaken in pursuit of profit, or is it a personal endeavour (such as a hobby or lifestyle activity)?
- Categorization — If it is not a personal endeavour, is the source of income a business or property?

The purpose of this two-part test is to distinguish commercial activities from personal activities. If there is no personal or hobby element in the activity and it's clearly commercial, the first part of the test is met and the taxpayer's pursuit of profit is established.

However, where a venture contains elements that could be considered a hobby or other personal pursuit, it will be considered a source of income only if it is undertaken in a "sufficiently commercial manner":

- The taxpayer must have a subjective intention to make a profit, and
- There must be objective evidence of business-like behaviour supporting that intention.

When Is an Activity a Personal Hobby or Endeavour?

A personal endeavour is an activity undertaken primarily for pleasure, entertainment, or enjoyment rather than for profit, business, or commercial reasons. Even if an activity has a hobby-like flavour, the key question is whether it is pursued in a sufficiently commercial and business-like way. If it is, the courts have recognized a personal endeavour or hobby can be considered a business activity for tax purposes.

In *Walls v. Canada*, 2002 SCC 47, the taxpayers were involved in a storage park operation structured to produce losses. The Supreme Court held that, where an endeavour is clearly commercial in nature and has no personal element (no hobby aspect), there is a source of income and loss for income tax purposes. No one would ever operate a storage park for personal pleasure. Thus, where an activity is clearly commercial and has no personal or hobby element, a source of income exists and the tax authorities should not second-guess the taxpayer's business decisions.

Objective Signs That an Activity Is a Business

Because intention is subjective, the courts and the CRA look to objective indicators to decide whether that intention is credible. The following factors are often examined:

- Profit and loss history
  - Has the activity ever made a profit?
  - Are losses shrinking as the business grows or are losses persistent with no real plan to turn things around?
- Training and experience
  - Does the individual have relevant education, training, or experience, or have they sought expert advice?
- Business plan and intended course of action
  - Is there a written or clearly articulated plan to make the activity profitable?

- Is the taxpayer following and adjusting that plan based on results?
- Capacity of the activity to be profitable
  - Is the activity realistically capable of producing a profit, after allowing for normal expenses and depreciation?
- Time and effort devoted
  - How many hours does the taxpayer spend on the activity?
  - Is time spent organized and regular, or sporadic and casual?
- Business-like behaviour
  - Does the taxpayer keep proper books and records?
  - Does the taxpayer maintain a separate bank account, invoice customers, and track receivables and payables?
  - Does the taxpayer advertise or promote the services/products in a structured way?

No single factor is decisive and the above list isn't exhaustive. The overall question is whether the taxpayer intends to make a profit and is acting in accordance with objective standards of commercial behaviour.

Reporting Income and Claiming Expenses

If the activity is a business:

- You must report all income from that activity on your income tax return;
- You may deduct reasonable expenses incurred to earn that income, subject to the usual rules in the *Income Tax Act*; and
- If your business generates a loss, that loss may be deductible against other income, provided the activity is genuinely carried on in pursuit of profit and is not primarily a personal or hobby activity.

If your activity is a hobby or personal endeavour:

- Amounts you earn may not be treated as business income; and
- Expenses are generally not deductible because there is no business source of income. .

Note on Personal-Use Property

Selling personal-use property (for example, artwork, crafts, or items you made for yourself) at a significant gain can create capital gains in certain cases. If you sell a personal-use property produced in such an activity for more than $1,000, any gain may be taxable as a capital gain from personal-use property — even if the overall activity is still a hobby.

Conclusion

In Canadian tax law, the difference between a business and a hobby does not depend solely on whether you enjoy what you do or whether you make a profit every year. The real questions are whether you are pursuing profit and whether you are conducting the activity in a commercial, business-like way.

When an activity is clearly commercial and has no personal or hobby element, the courts have consistently recognized it as a source of income even if it generates losses. When there is a personal or hobby component, all of the surrounding facts — your intentions, conduct, training, time commitment, and financial results — must be considered.

If you are unsure how these principles apply to your own situation, discuss your specific facts with a qualified tax advisor so you can report correctly, manage your risk with the CRA, and make informed decisions about growing your venture.