

Abstract: With the economy expected to improve in the months or quarters ahead, many business owners and entrepreneurs may decide to launch new enterprises. This article discusses the general rules and applicable expenses related to the tax treatment of start-ups.

The tax treatment of start-up expenses

With the economy expected to improve in the months or quarters ahead, many business owners and entrepreneurs may decide to launch new enterprises. If you're among them, be aware that the way you handle some of your initial expenses can make a large difference in your tax bill.

General rules

Start-up costs include those incurred or paid while creating an active trade or business — or investigating the creation or acquisition of one. Under the Internal Revenue Code, taxpayers can deduct up to \$5,000 of business start-up and \$5,000 of organizational costs in the year the business begins.

As you know, \$5,000 doesn't get you very far today! And the \$5,000 deduction is reduced dollar-for-dollar by the amount by which your total start-up or organizational costs exceed \$50,000. Any remaining costs must be amortized over 180 months on a straight-line basis.

In addition, no deductions or amortization deductions are allowed until the year when "active conduct" of your new business begins. Generally, that means the year when the business has all the pieces in place to begin earning revenue. To determine whether a taxpayer meets this test, the IRS and courts generally ask questions such as: Did the taxpayer undertake the activity intending to earn a profit? Was the taxpayer regularly and actively involved? Did the activity actually begin?

Applicable expenses

In general, start-up expenses include all amounts you spend to investigate creating or acquiring a business, launching the enterprise, or engaging in a for-profit activity while anticipating the activity will become an active business.

To be eligible for the election, an expense also must be one that would be deductible if it were incurred after a business began. One example is money you spend analyzing potential markets for a new product or service.

To qualify as an "organization expense," the expenditure must be related to creating a corporation or partnership. Some examples of organization expenses are legal and accounting fees for services related to organizing a new business and filing fees paid to the state of incorporation.

Thinking ahead

If you have start-up expenses that you'd like to deduct this year, you need to decide whether to take the elections described above. Recordkeeping is critical. Contact us about your start-up plans. We can help with the tax and other aspects of your new business.