



Launching a business? How to treat start-up expenses on your tax return

While the COVID-19 crisis has devastated many existing businesses, the pandemic has also created opportunities for entrepreneurs to launch new businesses. For example, some businesses are being launched online to provide products and services to people staying at home.

Entrepreneurs often don't know that many expenses incurred by start-ups can't be currently deducted. You should be aware that the way you handle some of your initial expenses can make a large difference in your tax bill.

How expenses must be handled

If you're starting or planning a new enterprise, keep these key points in mind:

- 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 elect to 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.
- 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 if 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?

Expenses that qualify

In general, start-up expenses include all amounts you spend to:

- Investigate the creation or acquisition of a business,
- Create a business, or
- Engage in a for-profit activity in anticipation of that activity becoming 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. Record keeping is critical.