



Starting a business? How expenses will be treated on your tax return

Government officials saw a large increase in the number of new businesses launched during the COVID-19 pandemic. And the U.S. Census Bureau reports that business applications are still increasing slightly (up 0.4% from April 2023 to May 2023). The Bureau measures this by tracking the number of businesses applying for Employer Identification Numbers.

If you're one of the entrepreneurs, you may not know that many of the expenses incurred by start-ups can't be currently deducted on your tax return. You should be aware that the way you handle some of your initial expenses can make a large difference in your federal tax bill.

Handling expenses

If you're starting or planning to launch a new business, here are three rules to keep in mind:

1. Start-up costs include those incurred or paid while creating an active trade or business — or investigating the creation or acquisition of one.
2. Under the tax 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 go very far these days! 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.
3. 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 start 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?

Rules to qualify

In general, start-up expenses are those you incur 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 qualify 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 be eligible as an “organization expense,” an expense must be related to establishing 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.

Decision to be made

If you have start-up expenses that you’d like to deduct this year, you need to decide whether to take the election 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.