Startup costs and taxes: What you need to know before filing

The U.S. Census Bureau reports there were nearly 447,000 new business applications in May of 2025. The bureau measures this by tracking the number of businesses applying for an Employer Identification Number.

If you're one of the entrepreneurs, you may not know that many of the expenses incurred by start-ups can't currently be 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.

How to treat expenses for tax purposes

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 costs 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 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, including amortization deductions, are allowed until the year when "active conduct" of your new business begins. Generally, this means the year when the business has all the necessary components in place to start generating revenue.

To determine if a taxpayer meets this test, the IRS and courts generally ask questions such as: Did the taxpayer undertake the activity with the intention of earning a profit? Was the taxpayer regularly and actively involved? And did the activity actually begin?

Expenses that 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 limited deduction, an expense must also be one that would be deductible if incurred after the 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 these expenses are legal and accounting fees for services related to organizing a new business, and filing fees paid to the state of incorporation.

Plan now

If you have start-up expenses 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.

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