Writing Off Your Start-Up Expenses

Article Highlights:

- Startup expenses first-year write off
- Expense amortization
- First-year write-off limitations
- Qualifying expenses

Business owners, especially those operating small businesses, may deduct up to $5,000 of their start-up expenses in the first year of the business's operation. This is in lieu of amortizing the expenses over 180 months (15 years).

Generally, start-up expenses include all expenses incurred to investigate the formation or acquisition of a business or to 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 the business actually began. An example of a start-up expense is the cost of analyzing the potential market for a new product.

As with most tax benefits, there is always a catch. Congress put a cap on the amount of the start-up expenses that can be claimed as a deduction under this special election. Here's how: If the expenses are $50,000 or less, you can elect to deduct up to $5,000 in the first year, plus you can amortize the balance over 180 months. If the expenses are more than $50,000, then the $5,000 first-year write-off is reduced dollar-for-dollar for every dollar start-up expenses exceed $50,000. For example, if start-up costs were $54,000, the first-year write-off would be limited to $1,000 ($5,000 – ($54,000 - $50,000)).

The election to deduct start-up costs is made by claiming the deduction on the return for the year in which the active trade or business begins, and the return must be filed by the extended due date.

On IRS Schedule C, Profit or Loss from Business (Sole Proprietorship), the deduction is taken as part of the "Other Expenses" in Part V. If the entire amount of start-up costs isn't deductible in the business's first year, use Form 4562 to amortize the excess amount over 180 months, beginning with the month that you start operating the business. For example, the $53,000 of start-up expenses in the prior example that couldn't be deducted as an expense in the first year of business would be deductible at $294 per month ($53,000/180), beginning with the first month the business became operational.

Qualifying Start-Up Costs – A qualifying start-up cost is one that would be deductible if it were paid or incurred to operate an existing active business in the same field as the new business, and the cost is paid or incurred before the day the active trade or business begins. Not includible are taxes, interest or research and experimental costs. Examples of qualified start-up costs include:

- Surveys/analyses of potential markets, labor supply, products, transportation facilities, etc.;
- Wages paid to employees and their instructors while they are being trained;
- Advertisements related to opening the business;
- Fees and salaries paid to consultants or others for professional services; and
- Travel and other related costs to secure prospective customers, distributors, and suppliers.

For the purchase of an active trade or business, only investigative costs incurred while conducting a general search for or preliminary investigation of the business (i.e., costs that help the taxpayer decide whether to purchase a new business and which one to purchase) are qualified start-up costs. Costs incurred while attempting to buy a specific business are capital expenses that aren't treated as start-up costs.

If you have any questions related to the start-up expenses election and whether it will benefit your business, please give this office a call.