

How entrepreneurs must treat expenses on their tax returns

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Have you recently started a new business? Or are you contemplating starting one? Launching a new venture is a hectic, exciting time. And as you know, before you even open the doors, you generally have to spend a lot of money. You may have to train workers and pay for rent, utilities, marketing and more.

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

Key points on how expenses are handled

When starting or planning a new enterprise, remember these factors:

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 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. Needless to say, \$5,000 doesn't go 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 write-offs are allowed until the year when "active conduct" of your new business commences. That usually means the year when the enterprise 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? Has the activity actually begun?

Examples of expenses

Start-up expenses generally include all expenses that are incurred 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 would be the money you spend analyzing potential markets for a new product or service.

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

An important decision

Time may be of the essence 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 important. Please contact us about your business start-up plans. We can help with the tax and other aspects of your new venture.

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