

TF.6

When a Business Begins—The Earliest You May File

In order for expenses to be deductible the expenses must relate to a trade or business that is functioning when the expenses were incurred.

A business is considered to have started or be functioning as a business when facts and circumstances indicate that the business is engaged in which are directly related to generating profit.

While a business is only engaged in exploration and research activities it is considered to be in the start up phase. Once the business has begun, the first \$5,000 of start-up expenses may be deducted in the first year of business. All other start-up expenses may be deducted over 15 years beginning in the year that the business becomes operational.

If you use assets during the start-up phase of your business you can file a tax return to record the depreciation but also show that the depreciation is part of start-up expenses which will later be amortized. You are filing in order to establish your basis in business assets and start up costs. You may not file to show a loss on your business until the business is considered started under IRS rules. You will need a CPA or expert tax preparer to help you do this correctly.

Technically we say that start-up costs are amortized over 180 months. That is the same as saying deducted over 15 years, but it is the language you will see used by the IRS and accountants and lawyers so if you look into this topic you are looking for information on the amortization of start-up costs.

This is the general rule, but there are specific rules about what expenses count as start-up costs and organizational costs. Also, if you spend more than \$50,000 in startup or organization costs, what you can deduct will be reduced.

When does a farm or ranch business begin?

When does farming/ranching activity begin? When does the "start up" period end for a farmer or rancher?

For annual crops: the first day of the first year you plant a crop which will be harvested within 12 months.

For livestock: the first day of the first year you hold an animal that is intended for sale or the first day of the first year you hold an animal that is intended to be used in breeding animals which will be intended for sale

For permanent crops: There are special rules related to what must be capitalized and what may be expensed. These rules are closely related to the rules for start-up costs.

For operations where the growing period is more than one year or spans a calendar year end, it is not necessary to have sales in the first year your business is operational, but in the first year you claim losses you must be producing items which were reasonably intended for sale.

This resource is derived from materials developed by the University of Arkansas School of Law Agricultural Tax Training as part of the Agricultural Financial, Tax and Asset Protection (AgFTAP) partnership with the University of Arkansas Southern Risk Management Education Center and others.