IRM 4.43.1.13.6.4

Pre-Opening Store Expenses (07-23-2009)

4.43.1.13.6.4 Pre-Opening Store Expenses (07-23-2009)

(1) Multi-outlet retailers open new stores as part of their long-term expansion plans. New stores are often indistinguishable from one another, or from a retailer's already established stores. Opening a new store usually takes only a brief period of time.

(2) A multi-outlet retailer's stores typically receive various operating services from headquarters, including management information systems, accounting, financing, personnel, purchasing, inventory, management, advertising, payroll, and training services.

(3) Retailers incur a variety of pre-opening expenses in connection with new stores. Pre-opening expenses may include:

a. Payroll and related costs for hiring and training new employees and managers to operate a new store
b. Costs for maintenance, service and supplies
c. Utility (e.g. electricity, gas, telephone, water) and occupancy (e.g. rent) costs preceding the opening of a store
d. Office, non-selling, and janitorial supplies normally consumed within a few months
e. Expenses for selling supplies such as paper and plastic bags
f. Maintenance and incidental repairs incurred prior to opening a store
g. Other normal and recurring store operating costs, including advertising, freight and postage, security, travel, employee relocation.

(4) As a general rule, pre-opening costs do not involve the acquisition of tangible assets. Rather, these costs result in a new store ready for operation. With employees in place and the shelves stocked, new stores open for business. The efforts to get the stores ready are intended to produce immediate benefits.

(5) For financial reporting purposes, retailers generally expense the costs incurred prior to opening a new store.

(6) Audit Considerations

a. Whether pre-opening costs represent costs incurred to protect, promote, or expand a business (i.e. deductible business expansion costs) or whether such costs represent a new line of business (i.e. capital expenditure).
b. Whether pre-opening costs produce a significant long-term benefit by allowing the retailer to open new stores that will produce income for an indefinite number of years.

c. Whether the retailer uses a new subsidiary for a new store or a new chain of stores.
d. Whether an existing trade or business is expanded or a new trade or business is acquired or created is based on the facts and circumstances of each case.

(7) Potential Compliance Risks

a. To the extent pre-opening costs are normal and recurring costs that a retailer incurs in operating all of its stores, such costs are generally currently deductible under IRC 162. Even though some future incidental benefits would be realized, a better matching of income and expense results when such costs are deducted currently. Store opening costs produce short-term benefits because inventory will have to be restocked, new employees will have to be hired and trained to replace departures and so forth. The combination of short-term benefits and the recurring nature of the costs lead to the conclusion that such costs need not be capitalized.

b. The use of a new subsidiary for a new store or new chain is common and frequently prudent. The use of subsidiaries can compartmentalize liability and sometimes assist in controlling state taxes. In this situation, the expenses incurred by a new subsidiary, even though reflected on the parent's consolidated return, are those of a separate tax entity that should be viewed as a separate entity, starting a new business. Accordingly, the amounts expended by a parent to get the new operation going should be treated as a capital contribution to the subsidiary and not expenses of the parent or the subsidiary.