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Treasury Decision 9411

Start-up and organizational expenses-deduction vs. capitalization-elections-deemed elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to elections to deduct start-up expenditures under section 195 of the Internal Revenue Code (Code), organizational expenditures of corporations under section 248, and organizational expenses of partnerships under section 709. The American Jobs Creation Act of 2004 amended these three sections of the Code to provide similar rules for deducting these types of expenses that are paid or incurred after October 22, 2004. The regulations affect taxpayers that pay or incur these expenses and provide guidance on how to elect to deduct the expenses in accordance with the new rules. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in the Proposed Rules section in this issue of the Federal Register.

DATES: Effective Date: These regulations are effective on July 8, 2008.

SUPPLEMENTARY INFORMATION:

Background

This document amends the Income Tax Regulations (26 CFR part 1) under sections 195, 248, and 709 of the Code to reflect amendments made by section 902 of the American Jobs Creation Act of 2004 (Pub. L. 108-357, 118 Stat. 1418) (the Act). The amendments made by section 902 of the Act are effective for amounts paid or incurred after October 22, 2004, the date of the enactment of the Act.

As amended by section 902(a) of the Act, section 195(b) allows an electing taxpayer to deduct, in the taxable year in which the taxpayer begins an active trade or business, an amount equal to the lesser of (1) the amount of the start-up expenditures that relate to the active trade or business, or (2) \$5,000, reduced (but not below zero) by the amount by which the start-up expenditures exceed \$50,000. The remainder of the start-up expenditures is deductible ratably over the 180-month period beginning with the month in which the active trade or business begins.

As amended by section 902(b) of the Act, section 248(a) allows an electing corporation to deduct, in the taxable year in which the corporation begins business, an amount equal to the lesser of (1) the amount of the organizational expenditures of the corporation, or (2) \$5,000, reduced (but not below zero) by the amount by which the organizational expenditures exceed \$50,000. The remainder of the organizational expenditures is deductible ratably over the 180-month period beginning with the month in which the corporation begins business.

As amended by section 902(c) of the Act, section 709(b) allows an electing partnership to deduct, in the taxable year in which the partnership begins business, an amount equal to the lesser of (1) the amount of the organizational expenses of the partnership, or (2) \$5,000, reduced (but not below zero) by the amount by which the organizational expenses exceed \$50,000. The remainder of the organizational expenses is deductible ratably over the 180-month period beginning with the month in which the partnership begins business.

Explanation of Provisions

This Treasury decision revises the regulations under sections 195, 248, and 709 to reflect the amendments made by section 902 of the Act. This Treasury decision also updates the manner in which taxpayers elect to deduct costs under sections 195, 248, and 709. Under these regulations, taxpayers are no longer required to file a separate election statement to deduct costs under sections 195, 248, and 709. The manner of filing these elections is changed because of various electronic return filing initiatives and in acknowledgment that the vast majority of taxpayers that incur costs that may be deducted under sections 195, 248, and 709 elect to deduct those costs. The change also reduces the administrative burden of making the elections.

The temporary regulations under sections 195, 248, and 709 apply to expenditures paid or incurred after September 8, 2008. However, taxpayers may apply all the provisions of these regulations to expenditures paid or incurred under sections 195, 248, and 709 after October 22, 2004, provided the period of limitations on assessment of tax has not expired for the year the election under section 195, 248, or 709 is deemed made. Expenditures paid or incurred on or before October 22, 2004, may be amortized over a period of not less than 60 months as provided for under prior law.

Temporary Regulations Under Section 195

Section 195(a) provides that, except as otherwise provided in section 195, no deduction shall be allowed for start-up expenditures. Under section 195(b)(1), a taxpayer may elect to deduct start-up expenditures as provided in sections 195(b)(1)(A) and (B). Section 195(b)(1)(A) allows an electing taxpayer to deduct start-up expenditures in the year in which the active trade or business to which the expenditures relate begins. The amount that may be deducted under section 195(b)(1)(A) in that year is the lesser of the amount of the start-up expenditures or \$5,000, reduced (but not below zero) by the amount by which the start-up expenditures exceed \$50,000. Any start-up expenditures that are not deductible under section 195(b)(1)(A) may be deducted by the taxpayer under section 195(b)(1)(B) ratably over the 180-month period beginning with the month in which the active trade or business begins. All start-up expenditures incurred by the taxpayer that relate to the active trade or business are considered in determining whether the start-up expenditures exceed \$50,000, including expenditures incurred on or before October 22, 2004.

For start-up expenditures as defined in section 195(c)(1) paid or incurred after September 8, 2008, the temporary regulations under section 195 provide that a taxpayer is deemed to make an election under section 195(b) to deduct start-up expenditures for the taxable year in which the active trade or business to which the expenditures relate begins. Therefore, under the temporary regulations a taxpayer is no longer required to attach a statement to the return or specifically identify the deducted amount as start-up expenditures for the election under section 195(b) to be effective. A taxpayer may choose to forgo the deemed election by clearly electing to capitalize its start-up expenditures on a timely filed Federal income tax return (including extensions) for the taxable year in which the active trade or business begins. The election to capitalize start-up expenditures is made in accordance with the form and instructions used by the taxpayer to file its

Federal income tax return. An election either to deduct start-up expenditures under section 195(b) or to capitalize start-up expenditures is irrevocable and applies to all start-up expenditures of the taxpayer that are related to the active trade or business.

In general, a change in the characterization of an item as a start-up expenditure, or a change in the determination of the taxable year in which the active trade or business begins, will be treated as a change in method of accounting with a section 481(a) adjustment.

Temporary Regulations Under Section 248

In general, the organizational expenditures of a corporation are not deductible except as provided in section 248. Under section 248(a), a corporation may elect to deduct organizational expenditures as provided in sections 248(a)(1)(A) and (B). Section 248(a)(1)(A) allows an electing corporation to deduct organizational expenditures in the year in which the corporation begins business. The amount that may be deducted under section 248(a)(1)(A) in that year is the lesser of the amount of the organizational expenditures of the corporation or \$5,000, reduced (but not below zero) by the amount by which the organizational expenditures exceed \$50,000. Any organizational expenditures that are not deductible under section 248(a)(1)(A) may be deducted by the corporation under section 248(a)(1)(B) ratably over the 180-month period beginning with the month in which the corporation begins business. All organizational expenditures incurred by the corporation are considered in determining whether the organizational expenditures exceed \$50,000, including expenditures incurred on or before October 22, 2004.

For organizational expenditures as defined in section 248(b) and § 1.248-1(b) paid or incurred after September 8, 2008, the temporary regulations under section 248 provide that a corporation is deemed to make an election under section 248(a) to deduct organizational expenditures for the taxable year in which the corporation begins business. Therefore, under the temporary regulations a corporation is no longer required to attach a statement to the return or specifically identify the deducted amount as organizational expenditures for the election under section 248(a) to be effective. A corporation may choose to forgo the deemed election by clearly electing to capitalize its organizational expenditures on a timely filed Federal income tax return (including extensions) for the taxable year in which the corporation begins business. The election to capitalize organizational expenditures is made in accordance with the form and instructions used by the corporation to file its Federal income tax return. An election either to deduct organizational expenditures under section 248(a) or to capitalize organizational expenditures is irrevocable and applies to all organizational expenditures of the corporation.

In general, a change in the characterization of an item as an organizational expenditure, or a change in the determination of the taxable year in which the corporation begins business, will be treated as a change in method of accounting with a section 481(a) adjustment.

Temporary Regulations Under Section 709

Section 709(a) provides that, except as otherwise provided in section 709(b), no deduction shall be allowed for organizational expenses. Under section 709(b), a partnership may elect to deduct organizational expenses as provided in section 709(b)(1)(A) and (B). Section 709(b)(1)(A) allows an electing partnership to deduct organizational expenses in the year in which the partnership begins business. The amount that may be deducted under section 709(b)(1)(A) in that year is the lesser of the amount of the organizational expenses of the partnership or \$5,000, reduced (but not below zero) by the amount by which the organizational expenses exceed \$50,000. Any organizational expenses that are not deductible under section 709(b)(1)(A) may be

deducted by the partnership under section 709(b)(1)(B) ratably over the 180-month period beginning with the month in which the partnership begins business. All organizational expenses incurred by the partnership are considered in determining whether the organizational expenses exceed \$50,000, including expenses incurred on or before October 22, 2004.

For organizational expenses as defined in section 709(b)(3) and § 1.709-2(a) paid or incurred after September 8, 2008, the temporary regulations under section 709 provide that a partnership is deemed to make an election under section 709(b) to deduct organizational expenses for the taxable year in which the partnership begins business. Therefore, under the temporary regulations a partnership is no longer required to attach a statement to the return or specifically identify the deducted amount as organizational expenses for the election under section 709(b) to be effective. A partnership may choose to forgo the deemed election by clearly electing to capitalize its organizational expenses on a timely filed Federal income tax return (including extensions) for the taxable year in which the partnership begins business. The election to capitalize organizational expenses is made in accordance with the form and instructions used by the partnership to file its Federal income tax return. An election either to deduct organizational expenses under section 709(b) or to capitalize organizational expenses is irrevocable and applies to all organizational expenses of the partnership.

In general, a change in the characterization of an item as an organizational expense, or a change in the determination of the taxable year in which the partnership begins business, will be treated as a change in method of accounting with a section 481(a) adjustment.

Examples

The temporary regulations under sections 195, 248, and 709 contain examples that illustrate how the election is made, how to calculate the amount of the deduction that is allowed in the year in which the election is made, and how to effect subsequent redeterminations in the characterization of an item or the year in which the trade or business begins.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Please refer to the cross-referenced notice of proposed rulemaking published elsewhere in this issue of the Federal Register for applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6). Pursuant to section Code Sec. 7805(f) 7805(f) of the Code, these final and temporary regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

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