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## **Treasury Decision 9542**

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

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to elections to deduct start-up expenditures, organizational expenditures of corporations, and organizational expenses of partnerships. The American Jobs Creation Act of 2004 amended the Internal Revenue Code to permit the optional deduction of a limited amount of 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.

DATES: Effective Date: These regulations are effective on August 16, 2011.

Applicability Dates: For dates of applicability, see § § 1.195-1(d), 1.248-1(f), and 1.709-1(b)(5).

FOR FURTHER INFORMATION CONTACT: R. Matthew Kelley, (202) 622-7900 (not a toll-free number).

### **SUPPLEMENTARY INFORMATION:**

#### **Background**

This document contains final amendments to the Income Tax Regulations (26 CFR part 1) under sections 195, 248, and 709 of the Internal Revenue 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.

On July 8, 2008, temporary regulations (TD 9411) regarding elections to deduct start-up and organizational expenditures under sections 195, 248, and 709 were published in the Federal Register (73 FR 38910). A notice of proposed rulemaking (REG-164965-04) cross-referencing the temporary regulations was published in the Federal Register (73 FR 38940) on the same day. One written comment responding to the notice of proposed rulemaking was received. No public hearing was requested or held. After consideration of the comment, the regulations are adopted as amended by this Treasury decision. The comment is discussed elsewhere in this preamble. These regulations apply to expenditures paid or incurred after August 16, 2011. 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.

#### Summary of Comment

The commentator recommended that the final regulations clarify what is meant in the proposed regulations by "clearly electing to capitalize" start-up and organizational costs. The commentator noted that it is unclear whether a taxpayer that unintentionally does not deduct or amortize start-up and organizational costs could be considered to have "clearly elected to capitalize" them. The IRS and the Treasury Department agree with the recommendation to clarify the election requirements, and the final regulations provide that a taxpayer wishing to make an election to capitalize start-up and organizational costs must "affirmatively elect to capitalize" the costs on a timely filed Federal income tax return.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866 as supplemented by Executive Order 13563. 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. Because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

#### Drafting Information

The principal author of these regulations is R. Matthew Kelley of the Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

#### List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### Part 1-Income Taxes

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805

Par. 2. Section 1.195-1 is revised to read as follows:

#### § 1.195-1 Election to amortize start-up expenditures.

((a)) In general. Under section 195(b), a taxpayer may elect to amortize start-up expenditures as defined in section 195(c)(1). In the taxable year in which a taxpayer begins an active trade or business, an electing taxpayer may deduct an amount equal to the lesser of the amount of the start-up expenditures that relate to the active trade or business, or \$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. All start-up expenditures 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.

((b)) Time and manner of making election. A taxpayer is deemed to have made an election under section 195(b) to amortize start-up expenditures as defined in section 195(c)(1) for the taxable year in which the active trade or business to which the expenditures relate begins. A taxpayer may choose to forgo the deemed election by affirmatively 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 to which the expenditures relate begins. The election either to amortize start-up expenditures under section 195(b) or to capitalize start-up expenditures is irrevocable and applies to all start-up expenditures that are related to the active trade or business. A change in the characterization of an item as a start-up expenditure is a change in method of accounting to which sections 446 and 481(a) apply if the taxpayer treated the item consistently for two or more taxable years. A change in the determination of the taxable year in which the active trade or business begins also is treated as a change in method of accounting if the taxpayer amortized start-up expenditures for two or more taxable years.

((c)) Examples. The following examples illustrate the application of this section:

Example 1. Expenditures of \$5,000 or less. Corporation X, a calendar year taxpayer, incurs \$3,000 of start-up expenditures after October 22, 2004, that relate to an active trade or business that begins on July 1, 2011. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2011. Therefore, Corporation X may deduct the entire amount of the start-up expenditures in 2011, the taxable year in which the active trade or business begins.

Example 2. Expenditures of more than \$5,000 but less than or equal to \$50,000. The facts are the same as in Example 1 except that Corporation X incurs start-up expenditures of \$41,000. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2011. Therefore, Corporation X may deduct \$5,000 and the portion of the remaining \$36,000 that is allocable to July through December of 2011 ( $\$36,000/180 \times 6 = \$1,200$ ) in 2011, the taxable year in which the active trade or business

begins. Corporation X may amortize the remaining \$34,800 ( $\$36,000 - \$1,200 = \$34,800$ ) ratably over the remaining 174 months.

Example 3. Subsequent change in the characterization of an item. The facts are the same as in Example 2 except that Corporation X determines in 2013 that Corporation X incurred \$10,000 for an additional start-up expenditure erroneously deducted in 2011 under section 162 as a business expense. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2011, including the additional \$10,000 of start-up expenditures. Corporation X is using an impermissible method of accounting for the additional \$10,000 of start-up expenditures and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 4. Subsequent redetermination of year in which business begins. The facts are the same as in Example 2 except that, in 2012, Corporation X deducted the start-up expenditures allocable to January through December of 2012 ( $\$36,000/180 \times 12 = \$2,400$ ). In addition, in 2013 it is determined that Corporation X actually began business in 2012. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2012. Corporation X impermissibly deducted start-up expenditures in 2011, and incorrectly determined the amount of start-up expenditures deducted in 2012. Therefore, Corporation X is using an impermissible method of accounting for the start-up expenditures and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 5. Expenditures of more than \$50,000 but less than or equal to \$55,000. The facts are the same as in Example 1 except that Corporation X incurs start-up expenditures of \$54,500. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2011. Therefore, Corporation X may deduct \$500 ( $\$5,000 - \$4,500$ ) and the portion of the remaining \$54,000 that is allocable to July through December of 2011 ( $\$54,000/180 \times 6 = \$1,800$ ) in 2011, the taxable year in which the active trade or business begins. Corporation X may amortize the remaining \$52,200 ( $\$54,000 - \$1,800 = \$52,200$ ) ratably over the remaining 174 months.

Example 6. Expenditures of more than \$55,000. The facts are the same as in Example 1 except that Corporation X incurs start-up expenditures of \$450,000. Under paragraph (b) of this section, Corporation X is deemed to have elected to amortize start-up expenditures under section 195(b) in 2011. Therefore, Corporation X may deduct the amounts allocable to July through December of 2011 ( $\$450,000/180 \times 6 = \$15,000$ ) in 2011, the taxable year in which the active trade or business begins. Corporation X may amortize the remaining \$435,000 ( $\$450,000 - \$15,000 = \$435,000$ ) ratably over the remaining 174 months.

((d)) Effective/applicability date. This section applies to start-up expenditures paid or incurred after August 16, 2011. However, taxpayers may apply all the provisions of this section to start-up expenditures paid or incurred after October 22, 2004, provided that the period of limitations on assessment of tax for the year the election under paragraph (b) of this section is deemed made has not expired. For start-up expenditures paid or incurred on or before September 8, 2008, taxpayers may instead apply § 1.195-1, as in effect prior to that date ( § 1.195-1 as contained in 26 CFR part 1 edition revised as of April 1, 2008). § 1.195-1T [Removed]  
Par. 3. Section 1.195-1T is removed.

Par. 4. Section 1.248-1 is amended by revising paragraphs (a) and (c), and adding paragraphs (d), (e), and (f) to read as follows: § 1.248-1 Election to amortize organizational expenditures.

(a) In general. Under section 248(a), a corporation may elect to amortize organizational expenditures as defined in section 248(b) and § 1.248-1

(b). In the taxable year in which a corporation begins business, an electing corporation may deduct an amount equal to 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). The remainder of the organizational expenditures is deducted ratably over the 180-month period beginning with the month in which the corporation begins business. All organizational expenditures of the corporation are considered in determining whether the organizational expenditures exceed \$50,000, including expenditures incurred on or before October 22, 2004.

(c) Time and manner of making election. A corporation is deemed to have made an election under section 248(a) to amortize organizational expenditures as defined in section 248(b) and § 1.248-1(b) for the taxable year in which the corporation begins business. A corporation may choose to forgo the deemed election by affirmatively 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 either to amortize organizational expenditures under section 248(a) or to capitalize organizational expenditures is irrevocable and applies to all organizational expenditures of the corporation. A change in the characterization of an item as an organizational expenditure is a change in method of accounting to which sections 446 and 481(a) apply if the corporation treated the item consistently for two or more taxable years. A change in the determination of the taxable year in which the corporation begins business also is treated as a change in method of accounting if the corporation amortized organizational expenditures for two or more taxable years.

(d) Determination of when corporation begins business. The deduction allowed under section 248 must be spread over a period beginning with the month in which the corporation begins business. The determination of the date the corporation begins business presents a question of fact which must be determined in each case in light of all the circumstances of the particular case. The words "begins business," however, do not have the same meaning as "in existence." Ordinarily, a corporation begins business when it starts the business operations for which it was organized; a corporation comes into existence on the date of its incorporation. Mere organizational activities, such as the obtaining of the corporate charter, are not alone sufficient to show the beginning of business. If the activities of the corporation have advanced to the extent necessary to establish the nature of its business operations, however, it will be deemed to have begun business. For example, the acquisition of operating assets which are necessary to the type of business contemplated may constitute the beginning of business.

(e) Examples. The following examples illustrate the application of this section:

Example 1. Expenditures of \$5,000 or less. Corporation X, a calendar year taxpayer, incurs \$3,000 of organizational expenditures after October 22, 2004, and begins business on July 1, 2011. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize

organizational expenditures under section 248(a) in 2011. Therefore, Corporation X may deduct the entire amount of the organizational expenditures in 2011, the taxable year in which Corporation X begins business.

Example 2. Expenditures of more than \$5,000 but less than or equal to \$50,000. The facts are the same as in Example 1 except that Corporation X incurs organizational expenditures of \$41,000. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize organizational expenditures under section 248(a) in 2011. Therefore, Corporation X may deduct \$5,000 and the portion of the remaining \$36,000 that is allocable to July through December of 2011 ( $\$36,000/180 \times 6 = \$1,200$ ) in 2011, the taxable year in which Corporation X begins business. Corporation X may amortize the remaining \$34,800 ( $\$36,000 - \$1,200 = \$34,800$ ) ratably over the remaining 174 months.

Example 3. Subsequent change in the characterization of an item. The facts are the same as in Example 2 except that Corporation X determines in 2013 that Corporation X incurred \$10,000 for an additional organizational expenditure erroneously deducted in 2011 under section 162 as a business expense. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize organizational expenditures under section 248(a) in 2011, including the additional \$10,000 of organizational expenditures. Corporation X is using an impermissible method of accounting for the additional \$10,000 of organizational expenditures and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 4. Subsequent redetermination of year in which business begins. The facts are the same as in Example 2 except that, in 2012, Corporation X deducted the organizational expenditures allocable to January through December of 2012 ( $\$36,000/180 \times 12 = \$2,400$ ). In addition, in 2013 it is determined that Corporation X actually began business in 2012. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize organizational expenditures under section 248(a) in 2012. Corporation X impermissibly deducted organizational expenditures in 2011, and incorrectly determined the amount of organizational expenditures deducted in 2012. Therefore, Corporation X is using an impermissible method of accounting for the organizational expenditures and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 5. Expenditures of more than \$50,000 but less than or equal to \$55,000. The facts are the same as in Example 1 except that Corporation X incurs organizational expenditures of \$54,500. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize organizational expenditures under section 248(a) in 2011. Therefore, Corporation X may deduct \$500 ( $\$5,000 - \$4,500$ ) and the portion of the remaining \$54,000 that is allocable to July through December of 2011 ( $\$54,000/180 \times 6 = \$1,800$ ) in 2011, the taxable year in which Corporation X begins business. Corporation X may amortize the remaining \$52,200 ( $\$54,000 - \$1,800 = \$52,200$ ) ratably over the remaining 174 months.

Example 6. Expenditures of more than \$55,000. The facts are the same as in Example 1 except that Corporation X incurs organizational expenditures of \$450,000. Under paragraph (c) of this section, Corporation X is deemed to have elected to amortize organizational expenditures under section 248(a) in 2011. Therefore, Corporation X may deduct the amounts allocable to July through December of 2011 ( $\$450,000/180 \times 6 = \$15,000$ ) in 2011, the taxable year in which Corporation X begins business. Corporation X may amortize the remaining \$435,000 ( $\$450,000 - \$15,000 = \$435,000$ ) ratably over the remaining 174 months.

(f) Effective/applicability date. This section applies to organizational expenditures paid or incurred after August 16, 2011. However, taxpayers may apply all the provisions of this section to organizational expenditures paid or incurred after October 22, 2004, provided that the period of limitations on assessment of tax for the year the election under paragraph (c) of this section is deemed made has not expired. For organizational expenditures paid or incurred on or before September 8, 2008, taxpayers may instead apply § 1.248-1, as in effect prior to that date ( § 1.248-1 as contained in 26 CFR part 1 edition revised as of April 1, 2008).

Par. 5. Section 1.248-1T is removed.

Par. 6. Section 1.709-1 is amended by revising paragraph (b) to read as follows:

§ 1.709-1 Treatment of organization and syndication costs.

(b) Election to amortize organizational expenses-

(1) In general. Under section 709(b), a partnership may elect to amortize organizational expenses as defined in section 709(b)(3) and § 1.709-2(a). In the taxable year in which a partnership begins business, an electing partnership may deduct an amount equal to 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). The remainder of the organizational expenses is deductible ratably over the 180-month period beginning with the month in which the partnership begins business. All organizational expenses of the partnership are considered in determining whether the organizational expenses exceed \$50,000, including expenses incurred on or before October 22, 2004.

(2) Time and manner of making election. A partnership is deemed to have made an election under section 709(b) to amortize organizational expenses as defined in section 709(b)(3) and § 1.709-2(a) for the taxable year in which the partnership begins business. A partnership may choose to forgo the deemed election by affirmatively 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 either to amortize organizational expenses under section 709(b) or to capitalize organizational expenses is irrevocable and applies to all organizational expenses of the partnership. A change in the characterization of an item as an organizational expense is a change in method of accounting to which sections 446 and 481(a) apply if the partnership treated the item consistently for two or more taxable years. A change in the determination of the taxable year in which the partnership begins business also is treated as a change in method of accounting if the partnership amortized organizational expenses for two or more taxable years.

(3) Liquidation of partnership. If there is a winding up and complete liquidation of the partnership prior to the end of the amortization period, the unamortized amount of organizational expenses is a partnership deduction in its final taxable

year to the extent provided under section 165 (relating to losses). However, there is no partnership deduction with respect to its capitalized syndication expenses.

(4) Examples. The following examples illustrate the application of this section:

Example 1. Expenditures of \$5,000 or less. Partnership X, a calendar year taxpayer, incurs \$3,000 of organizational expenses after October 22, 2004, and begins business on July 1, 2011. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2011. Therefore, Partnership X may deduct the entire amount of the organizational expenses in 2011, the taxable year in which Partnership X begins business.

Example 2. Expenditures of more than \$5,000 but less than or equal to \$50,000. The facts are the same as in Example 1 except that Partnership X incurs organizational expenses of \$41,000. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2011. Therefore, Partnership X may deduct \$5,000 and the portion of the remaining \$36,000 that is allocable to July through December of 2011 ( $\$36,000/180 \times 6 = \$1,200$ ) in 2011, the taxable year in which Partnership X begins business. Corporation X may amortize the remaining \$34,800 ( $\$36,000 - \$1,200 = \$34,800$ ) ratably over the remaining 174 months.

Example 3. Subsequent change in the characterization of an item. The facts are the same as in Example 2 except that Partnership X realizes in 2013 that Partnership X incurred \$10,000 for an additional organizational expense erroneously deducted in 2011 under section 162 as a business expense. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2011, including the additional \$10,000 of organizational expenses. Partnership X is using an impermissible method of accounting for the additional \$10,000 of organizational expenses and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 4. Subsequent redetermination of year in which business begins. The facts are the same as in Example 2 except that, in 2012, Partnership X deducted the organizational expenses allocable to January through December of 2012 ( $\$36,000/180 \times 12 = \$2,400$ ). In addition, in 2013 it is determined that Partnership X actually began business in 2012. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2012. Partnership X impermissibly deducted organizational expenses in 2011, and incorrectly determined the amount of organizational expenses deducted in 2012. Therefore, Partnership X is using an impermissible method of accounting for the organizational expenses and must change its method under § 1.446-1(e) and the applicable general administrative procedures in effect in 2013.

Example 5. Expenditures of more than \$50,000 but less than or equal to \$55,000. The facts are the same as in Example 1 except that Partnership X incurs organizational expenses of \$54,500. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2011. Therefore, Partnership X may deduct \$500 ( $\$5,000 - \$4,500$ ) and the portion of the remaining \$54,000 that is allocable to July through December of 2011 ( $\$54,000/180 \times 6 = \$1,800$ ) in 2011, the taxable year in which Partnership X begins business. Corporation X may amortize the remaining \$52,200 ( $\$54,000 - \$1,800 = \$52,200$ ) ratably over the remaining 174 months.



Example 6. Expenditures of more than \$55,000. The facts are the same as in Example 1 except that Partnership X incurs organizational expenses of \$450,000. Under paragraph (b)(2) of this section, Partnership X is deemed to have elected to amortize organizational expenses under section 709(b) in 2011. Therefore, Partnership X may deduct the amounts allocable to July through December of 2011 ( $\$450,000/180 \times 6 = \$15,000$ ) in 2011, the taxable year in which Partnership X begins business. Corporation X may amortize the remaining \$435,000 ( $\$450,000 - \$15,000 = \$435,000$ ) ratably over the remaining 174 months.

(5) Effective/applicability date. This section applies to organizational expenses paid or incurred after August 16, 2011. However, taxpayers may apply all the provisions of this section to organizational expenses paid or incurred after October 22, 2004, provided that the period of limitations on assessment of tax for the year the election under paragraph (b)(2) of this section is deemed made has not expired.

For organizational expenses paid or incurred on or before September 8, 2008, taxpayers may instead apply § 1.709-1, as in effect prior to that date ( § 1.709-1 as contained in 26 CFR part 1 edition revised as of April 1, 2008).

Par. 7. Section 1.709-1T is removed.

Steven T. Miller,  
Deputy Commissioner for Services and Enforcement.  
Approved: August 9, 2011.  
Emily S. McMahon,  
Acting Assistant Secretary of the Treasury (Tax Policy).