SET UP COSTS OF BUSINESS

Rodger the Dodger is a retired scientist who has been experimenting in his garage with bio fuels over the past ten years of his career and believes there is an opportunity to manufacture bio fuel at commercial quantities to supply to certain businesses.

He believes that through the experimenting in the garage, he has all the research and development knowledge to manufacture the bio fuel.

Rodger sets up a new company and incurs costs on:

- Having a business plan prepared.
- Acquiring a manufacturing plant (which has not yet been installed).
- Having customer contract templates drawn up (no customers have been signed up yet).
- Travelling to meet with potential suppliers of raw materials.

Rodger is not yet in a position to start manufacturing but is confident that he will have his first sales in the June 2014 year.

QUESTION

How should the above costs be treated for tax purposes?

OUR ANSWERS

A deduction is available to the company where the cost will have a nexus with the income itself. It is necessary that there is a sufficient relationship between the cost and the income.

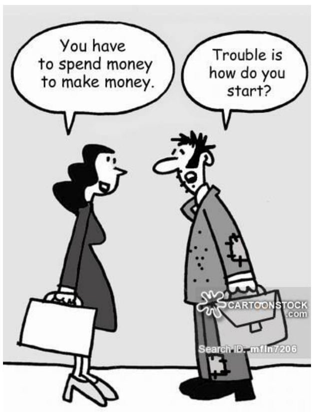
In a start-up business which does not yet have the infrastructure in place to earn income, it is most unlikely that the nexus to income exists.

OUR TREATMENT

Based on the background information that while there is an intention of Rodger carrying on a business, the business does not yet exist. This conclusion is based on:

- The company has no capacity for processing bio fuel (i.e. the plant is not yet installed).
- The company has only met with prospective suppliers.
- The company does not have contracts with buyers of the bio fuel.

Accordingly the key structural parts of the business do not exist.



There is a large amount of case law in this area, which suggests that a manufacturing business does not exist where there is solely a commitment to engage in business. Business will exist where there is capacity for production and where raw materials have been received, or at least the supply of these to the business are under contract.

Where a business does not exist this eliminates the ability to deduct "start-up" costs. These are instead capital, and in some instances will be depreciable, or expensed in the accounts, with no deduction allowed for tax purposes.

Even though some costs, if incurred by an operating business (e.g. business planning, meeting with suppliers, having customer contracts drawn up), may ordinarily be tax deductible, because the General Permission is not met (due to the preliminary nature of the activity), these costs are also non-deductible.

SUMMARY

We hope that this provides you with a good insight into why you might not see these expenses appear through your profit and loss statement even though you would have liked them to.