# Which business start-up costs are tax deductible?

By Graeme Palmer

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While the formation of new business is important for economic growth, start-up costs incurred before the commencement of, or in preparation for carrying on the trade can be substantial. SARS has provided guidance in a new Interpretation Note 51 on when pre-trade expenditure may be deducted for the purpose of determining taxable income.


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A business usually relies on the general deduction formula in section 11(a) of the Income Tax Act, 1962 as read with section 23(g) when deducting expenses for tax purposes. In order to claim a deduction under these sections a person must be carrying on a trade. Claiming a deduction of expenditure incurred before the commencement of trade, must be done under section 11A, which allows a taxpayer to deduct expenditure which would have qualified but for the requirement that the business must be trading. The expenditure is deductible in the year of assessment in which trade commences, subject to certain requirements, and irrespective of when the expenses were incurred.

There are four key requirements before pre-trade expenses will qualify as a deduction:

- The trade in respect of which the pre-trade expenses were incurred must have been commenced. Therefore, any pre-trade expenses where a project is abandoned would not be deductible. Also, if the nature of the trade changes, the expenses are not deductible. For example, if Company X starts an airport project and incurs expenditure but the operating licence is declined and it changes the project to a storage business, Company X cannot deduct the pre-trade expenditure in respect of the airport project for the storage business.

- Pre-trade expense must have actually been incurred before commencement, and in preparation for carrying on the trade. For the expenditure to have been actually incurred by a taxpayer, there must be an accrued present obligation.

- For pre-trade expenses to qualify they must meet the “post-trade test”, that is, had the expenditure been incurred after the commencement of trade the requirements in section 11(a) would have been met e.g. the expenditure was incurred in the production of income and is not of a capital nature.

- The pre-trade expense must not have been allowed as a deduction in that year or any previous year.

Section 11A(2) provides for a ring fencing of pre-trade expenses. If the pre-trade expenses exceed the taxable income of that trade, the excess pre-trade expenses cannot be set off against the income from any other trade. If any pre-trade expense is not allowed due to insufficient taxable income from a particular trade, the amount can be carried forward and set off against any future taxable income from that trade.

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