



Selecting a tax accounting method for your small business

Small business owners must answer an important question: Should we use the cash or accrual accounting method for federal income tax purposes? Larger entities are required to use the accrual method. But certain small businesses can elect to use the cash method. You may want to consider this option *if* it will help lower your taxes. However, it's not right (or even available) for every situation.

Does your business qualify for the cash method?

Under Internal Revenue Code Section 448(c), your business may be eligible for the cash accounting method if it had average annual gross receipts that don't exceed a specific, inflation-adjusted threshold for the prior three-year period. For 2026, businesses with average annual gross receipts up to \$32 million are eligible.

Some businesses may be eligible for cash accounting even if their gross receipts are above the threshold. Examples include S corporations, partnerships without C corporation partners, farming businesses and certain personal service corporations.

In addition, the Sec. 448(c) gross receipts test serves as the eligibility standard for several other tax provisions available to qualifying small businesses, such as:

- Simplified inventory accounting,
- An exemption from the uniform capitalization rules,
- An exemption from the business interest deduction limit, and

- The option to use the completed contract method (rather than the percentage-of-completion method) for certain long-term contracts.

When determining your business's gross receipts, you may need to include those earned by certain related entities, such as those under common control. Special rules apply to organizations that have existed for less than three years. Also, tax shelters, including syndicates, don't qualify for small business status, even if their gross receipts are below the threshold.

How do the methods differ?

The cash method often provides significant tax advantages. Because cash-basis businesses recognize income when received and deduct expenses when paid, they have greater control over the timing of income and deductions. For example, toward the end of the year, they can defer income by delaying invoices until the following tax year or shift deductions into the current year by accelerating expense payments.

In contrast, accrual-basis businesses recognize income when earned and deduct expenses when incurred, regardless of the timing of cash receipts or payments. Therefore, they have little flexibility to time the recognition of income or expenses for tax purposes.

The cash method also provides cash flow benefits. Because income is taxed in the year received, it helps ensure that a business has the funds needed to pay its tax bill.

However, for some businesses, the accrual method may be preferable. For instance, if your accrued income tends to be lower than your accrued expenses, the accrual method may result in a lower tax liability. Other potential advantages of the accrual method include the ability to deduct year-end bonuses paid within the first 2½ months of the following tax year and the option to defer taxes on certain advance payments.

Is it time for a change?

Even if your business would benefit from switching its accounting method, you should consider the administrative costs. Changing accounting methods for tax purposes may require IRS approval. And, if your business prepares its financial statements in accordance with U.S. Generally Accepted Accounting Principles, using the cash method for tax purposes would require you to maintain two sets of books (cash-basis tax records and accrual-basis financial reporting records).

Fortunately, you don't have to make this decision by yourself. We can help determine the right method for your situation. Contact us to learn more.