

Accounting Method Tax Strategy

LONG TERM CONSIDERATIONS IN
HOW YOU REPORT YOUR TAXES



Most business owners don't think about accounting methods. Why should they? Well, because it can have a major impact on your taxes, and the timing of when you pay. In the end, you're going to pay taxes on your net income, but you maybe able to control when and how much with a change in accounting method.

Generally speaking small businesses have two options for reporting their taxes, Cash and Accrual. There is a third called Hybrid, but we won't cover that here. Cash is the simplest and it is what most business owners are familiar with. For taxes, you report income when you receive it, and deduct expenses when you pay them.

Accrual is a fancy accounting term to match the TIMING of revenue and expenses to when they actually occur. For instance, some businesses have accounts receivable, where they have billed for work done, but haven't received the payment yet. For some businesses this may be a preferable way to report your taxes. If your business has accounts receivable (what is owed you) at year end that is equal to or less than your accounts payable (what you owe others), the accrual method probably benefits you.

But be careful, you can't just change your accounting method with the IRS whenever you want (once every 5 years). Businesses with average revenue (last 3 years) of \$26 million or less can generally use the cash method. If you've previously filed with the accrual method, you can change to cash by filing Form 3115 with the IRS. This election is automatically approved by the IRS, but you have to make the election by filing form.

ACTION ITEMS AND NEXT STEPS

- Review your last 3 years financial statements and tax returns if you have accounts receivable and/or accounts payable.
- Determine if OVER TIME the accrual or cash method is best for taxes.
- If you need to change your method of accounting with the IRS, file Form 3115 in a timely manner (date return is due plus extension)

