Tax reform EXPANDS availability of cash accounting

Under the Tax Cuts and Jobs Act (TCJA), many more businesses are now eligible to use the cash method of accounting for federal tax purposes. The cash method offers greater tax-planning flexibility, allowing some businesses to defer taxable income. Newly eligible businesses should determine whether the cash method would be advantageous and, if so, consider switching methods.

What's changed? Previously, the cash method was unavailable to certain businesses, including:

- C corporations — as well as partnerships (or limited liability companies taxed as partnerships) with C corporation partners — whose average annual gross receipts for the previous three tax years exceeded $5 million, and
- Businesses required to account for inventories, whose average annual gross receipts for the previous three tax years exceeded $1 million ($10 million for certain industries).

In addition, construction companies whose average annual gross receipts for the previous three tax years exceeded $10 million were required to use the percentage-of-completion method (PCM) to account for taxable income from long-term contracts (except for certain home construction contracts). Generally, the PCM method is less favorable, from a tax perspective, than the completed-contract method.

The TCJA raised all of these thresholds to $25 million, beginning with the 2018 tax year. In other words, if your business's average gross receipts for the previous three tax years is $25 million or less, you generally now will be eligible for the cash method, regardless of how your business is structured, your industry or whether you have inventories. Construction firms under the threshold need not use PCM for jobs expected to be completed within two years.

You're also eligible for streamlined inventory accounting rules. And you're exempt from the complex uniform capitalization rules, which require certain expenses to be capitalized as inventory costs.

Should you switch?

If you're eligible to switch to the cash method, you need to determine whether it's the right method for you. Usually, if a business's receivables exceed its payables, the cash method will allow more income to be deferred than will the accrual method. (Note, however, that the TCJA has a provision that limits the cash method's advantages for businesses that prepare audited financial statements or file their financial statements with certain government entities.) It's also important to consider the costs of switching, which may include maintaining two sets of books.

The IRS has established procedures for obtaining automatic consent to such a change, beginning with the 2018 tax year, by filing Form 3115 with your tax return. Contact us to learn more.