Abstract: Businesses basically have two accounting methods to figure their taxable income: cash and accrual. Many businesses have a choice of which method to use for tax purposes. The cash method often provides significant tax benefits for eligible companies, though some may be better off using the accrual method. Thus, it may be prudent for a business to evaluate its process to ensure that it's the most advantageous approach.

Choosing the optimal accounting method for tax savings

The accounting method your business uses to report income for tax purposes — cash or accrual — can significantly impact your tax bill. While the cash method can offer tax-saving opportunities, the accrual method may be more appropriate — or required — in some cases. So review your current method to help ensure you're using the best method for your business.

Who can use cash accounting?

The Tax Cuts and Jobs Act made the cash method more accessible to businesses than in the past and simplified the associated requirements. In 2025, a "small business" is defined as one with average annual gross receipts of $31 million or less over the prior three years. This higher threshold allows more businesses to take advantage of the cash method, along with associated benefits such as:

- Simplified inventory accounting,
- Exemption from the uniform capitalization rules, and
- Exemption from the business interest deduction limitation.

Some businesses are eligible for cash accounting even if their gross receipts exceed the threshold. This includes S corporations, partnerships without C corporation partners, farming businesses, and certain personal service corporations. But tax shelters of any size are ineligible for the cash method.

Why does the method matter?

For most businesses, the cash method 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 payment of expenses.

In contrast, accrual-basis businesses recognize income when earned and deduct expenses when incurred, without regard to the timing of cash receipts or payments. Therefore, they have little flexibility in recognizing 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 a company's accrued income tends to be lower than its accrued expenses, the accrual method may result in 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.

What should you do?

Evaluating accounting methods can be complex. We can help you weigh all the relevant factors and choose the best accounting method for your company.

Sidebar:

Determining whether a method change is worthwhile

Even if your business would save taxes by changing its accounting method, be mindful of other possible consequences. For example, if your business prepares its financial statements in accordance with U.S. Generally Accepted Accounting Principles, it's required to use the accrual method for financial reporting purposes. So, using cash accounting for tax purposes would mean keeping two sets of books, which can be burdensome.

Also, you may need IRS consent before making a change. Please contact us for assistance.