



ACCOUNTING

When starting a business, you have to determine the method you are going to use for accounting and paying taxes. The two choices are the cash method and the accrual method.

Cash Method

If you are looking for simplicity, the cash method is probably your best accounting choice. Generally, income and deductions can be claimed when payment is actually received or made. This is best shown with an example.

I open a small business and have to order business cards and stationary. I receive the products and pay the invoice on November 18, 2007. Under the cash method, I can deduct the cost on my 2007 tax return.

Some businesses are restricted from using the cash method. C corporations may only use the cash method if they have less than \$5 million in gross revenues for a particular year. Professional Service Corporations can use the cash method without limit, while farming corporations can do so if gross revenues are less than \$25 million. Tax shelters are prohibited from using the cash method.

Accrual Method

The Accrual Method of accounting is a bit more complex. Under this method, the focus is on the date the expense is incurred, not paid. Although this may seem a small difference, it can play havoc with your books and piece of mind.

Using our previous example, assume I order business cards and stationary on the December 18, 2006. I receive the products on December 30th, but don't pay the invoice until January 20, 2007. When can the expense be claimed? It depends on when economic performance occurred.

Generally, economic performance occurs when goods or services are provided to you. In the above example, economic performance would arguably occur when the business cards and stationary were delivered with the invoice on December 30th. Thus, I would be able to deduct the expense for the 2007 tax year.

In Closing

As you can see, the cash method is the easier of the two accounting methods. To determine the best method for your business, speak with a tax professional.

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