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Abstract: Small businesses enjoy several tax advantages that may allow them to reduce their tax bills, defer taxes and simplify the reporting process. Until recently, federal tax rules generally defined "small business" as one with average annual gross receipts of $5 million or less ($1 million or $10 million in some cases) for the three preceding tax years. But the TCJA increased the threshold to $25 million for tax years beginning after 2017. This article explains the benefits of being a "small" business.

"Small" is bigger than ever

Is your business eligible for expanded tax benefits?

Small businesses enjoy several tax advantages that may allow them to reduce their tax bills, defer taxes and simplify the reporting process. Until recently, federal tax rules generally defined "small business" as one with average annual gross receipts of $5 million or less ($1 million or $10 million in some cases) for the three preceding tax years. But the Tax Cuts and Jobs Act (TCJA) increased the threshold to $25 million for tax years beginning after 2017.

The new threshold expands eligibility for small business tax benefits to a greater number of companies. It also simplifies tax compliance by establishing a uniform definition of "small business." Previously, different thresholds applied depending on the tax accounting rules involved, as well as a company's industry and whether it carried inventories.

Small business benefits

Potential benefits of small business status include:

***Cash accounting*.** Businesses that pass the gross receipts test are eligible to use the cash method of accounting for tax purposes. Typically, but not always, the cash method allows a business to defer more taxable income than the accrual method.

Note that, as before, companies that are structured as S corporations, limited liability companies (LLCs) or partnerships without a C corporation partner — and that don't carry inventories — may use the cash method regardless of their level of gross receipts.

***Avoidance of inventory accounting requirements*.** Small businesses need not account for inventories, which can be complex, time-consuming and expensive.

***Relief from uniform capitalization rules*.** Small businesses are exempt from these rules, which require companies to capitalize, rather than expense, certain overhead costs, adding complexity to the tax reporting process and potentially increasing their tax liability.

Eligibility for completed-contract method. Small businesses are permitted to use the completed-contract method, rather than the percentage-of-completion method, to account for long-term contracts expected to be completed within two years, allowing them to defer tax until a contract is substantially complete.

***Full deductibility of business interest*.** The TCJA generally capped deductions for net business interest expense at 30% of adjusted taxable income. Small businesses are exempt from this limit.

Be aware that, for businesses that normally would be subject to the limit, the Coronavirus Aid, Relief and Economic Security Act (CARES Act) generally increases the limit to 50% for 2019 and 2020. (Special partnership rules apply for 2019.)

Related entities' receipts included

When determining your company's gross receipts, you must include not only your own receipts, but also those earned by certain related entities, such as other members of a parent-subsidiary group, a brother-sister group or combined group under common control. A parent-subsidiary group exists when one company owns more than 50% of one or more other companies. For example, if your company owns 51% of another company — or another company owns 51% of yours — you must combine that company's gross receipts with your own when determining whether your gross receipts are below the $25 million threshold.

Your company is part of a brother-sister group if the same five or fewer persons collectively own at least 80% of each company and certain other requirements are met. For example, if the same three partners each own 30% interests in partnerships A and B, the two entities' gross receipts must be combined in evaluating their small business status. A combined group exists when a parent is part of a parent-subsidiary group *and* a brother-sister group. In that case, both groups' gross receipts are combined.

Be aware that, when calculating a person's ownership percentage, you must include interests owned by certain family members.

Tax shelters need not apply

There's an important exception to the general definition of small business: If your company is deemed a "tax shelter," it won't qualify for small business benefits, even if its gross receipts are below the $25 million threshold. Usually thought of as tax-advantaged investment vehicles, tax shelters may also include companies structured as partnerships, S corporations or LLCs that allocate more than 35% of their losses to limited partners or other "limited entrepreneurs."

See the small picture

If your company's average gross receipts are $25 million or less, consult your tax advisor to find out whether it's eligible for small business tax benefits. If it is, determine whether a change in accounting methods may be worthwhile to take advantage of these benefits. If it's not currently eligible, there may be planning opportunities to qualify for these benefits in the future.