Generate cash savings through tax accounting method changes and strategic tax elections

Adopting or changing income tax accounting methods can provide taxpayers with valuable opportunities for timing the recognition of items of taxable income and expense, which determines when cash is needed to pay federal tax liabilities.

In general, accounting methods can either result in the acceleration or deferral of an item or items of taxable income or deductible expense, but they do not alter the total amount of income or expense that is recognized during the lifetime of a business. As interest rates continue to rise and debt becomes more expensive, many businesses want to preserve their cash, and one way to do this is to defer their tax liabilities through their choice of accounting methods.

Companies that want to reduce their 2022 tax liability should consider traditional tax accounting method changes, tax elections and other actions for 2022 to defer recognizing income to a later taxable year and accelerate tax deductions to an earlier taxable year, including the following:

- Changing from recognizing certain advance payments (e.g., upfront payments for goods, services, gift cards, use of intellectual property, sale or license of software) in the year of receipt to recognizing a portion in the following taxable year.
- Changing from the overall accrual to the overall cash method of accounting (i.e., where accounts receivable exceed accounts payable and accrued expenses).
- Changing from capitalizing certain prepaid expenses (e.g., insurance premiums, warranty service contracts, taxes, government permits and licenses, software maintenance) to deducting when paid using the "12-month rule."
- Deducting eligible accrued compensation liabilities (such as bonuses and severance payments) that are fixed and determinable by the end of the year and paid within 2.5 months of year end.
- Accelerating deductions of liabilities such as warranty costs, rebates, allowances and product returns, state income and franchise taxes, and real and personal property taxes under the "recurring item exception."
- Purchasing qualifying property and equipment before the end of 2022 to take advantage of the 100% bonus depreciation provisions (before bonus depreciation begins to gradually phase out starting in 2023) and the Section 179 expensing rules.
- Deducting "catch-up" depreciation (including bonus depreciation, if previously missed) of personal property by changing to shorter recovery periods or changing from non-depreciable to depreciable.
- Optimizing inventory valuation methods. For example, adopting, or making changes within, the last-in, first-out (LIFO) method of valuing inventory generally will result in higher cost of goods sold deductions as costs are increasing.

- Changing from amortizing commissions paid to employees to deducting in the year paid or incurred under the simplifying conventions.
- Electing to deduct 70% of success-based fees paid or incurred in 2022 in connection with certain acquisitive transactions under Rev. Proc. 2011-29. Other transaction costs that are not inherently facilitative may also be deductible. Taxpayers that incur transaction costs should consider undertaking a transaction cost study to maximize their tax deductions.
- Electing the de minimis safe harbor to deduct small-dollar expenses for the acquisition or production of property that would otherwise be capitalizable under general rules.

Is "reverse" planning better for your situation?

Depending on their facts and circumstances, some businesses may instead want to accelerate taxable income into 2022 if, for example, they believe tax rates will increase in the near future or they want to optimize use of NOLs. These businesses may want to consider "reverse" planning strategies, such as:

- Implementing a variety of "reverse" tax accounting method changes, such as changing to recognize advance payments in the year of receipt or changing to deduct certain tax liabilities (state income, state franchise, real and personal property taxes, payroll taxes) when paid.
- Selling and leasing back appreciated property before the end of 2022, creating gain that is taxed currently offset by future deductions of lease expense, being careful that the transaction is not recharacterized as a financing transaction.
- Accelerating taxable capital gain into 2022.
- Electing out of the installment sale method for installment sales closing in 2022.
- Delaying payments of liabilities whose deduction is based on when the amount is paid, so that the payment is deductible in 2023 (e.g., paying year-end bonuses after the 2.5-month rule).

Treatment of R&E Expenses

Under the 2017 Tax Cuts and Jobs Act (TCJA), research and experimental (R&E) expenditures incurred or paid for tax years beginning after December 31, 2021 will no longer be immediately deductible for tax purposes. Instead, businesses are required to capitalize and amortize R&E expenditures over a period of five or 15 years beginning in 2022. The mandatory capitalization rules also apply to software development costs, including software developed for internal use. The new rules present additional considerations for businesses that invest in R&E.