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The way businesses keep their books can affect when their taxes are due, which can affect their cash flow, their ability to invest in new opportunities, and their ability to meet their obligations.

That's why a Senate Finance Committee proposal to force many businesses to maintain their accounts using what is known as the accrual method of accounting instead of the cash method has the American Institute of Certified Public

chairman of the New Mexico Society of CPAs. "With the cash method, you only pay taxes when you receive revenue."

How each works:

Under the cash method of accounting, the business records transactions only when cash changes hands. So a small business will record on its income statement that it has received revenue when a customer hands over cash, swipes a credit card or writes a check. A sale on store credit would not be recorded as revenue until the customer's payment is received.

A small builder using the cash method who charges half of the fee for a homeowner's project up front and half upon completion would record half the revenue on his income statement when the first payment is in hand and half when the second payment is received.

The same philosophy goes for expenses. That builder records an expense on the income statement when he pays the lumber yard and hardware store for the materials he needs for the job.

The accrual method, however, requires the business operator to record transactions when they occur, even if no cash changes hands.

The builder records on his income statement the entire amount of the job when he and the customer have an agreement, even if the builder won't be paid for weeks or months. If the builder buys materials for the job using store credit, he records on his income statement the expense, even though he might not pay that bill until weeks or months later.

A business' income taxes are calculated on what is recorded on the income statement. An accrual approach can mean a business is reporting meaningful amounts of income before anyone has paid a bill. At tax time, the IRS is interested only in what

The Senate Finance Committee proposal would allow taxpayers to use cash accounting if “the taxpayer's average annual gross receipts for a three taxable-year period are $10 million or less,” according to the AICPA. That would “effectively eliminate” the ability of many businesses with gross receipts over the $10 million threshold to use cash accounting.

Sole proprietors and some pass-through entities — such as business partnerships and S corporations, personal service corporations such as law firms, and farmers — “are permitted to use the cash basis method of accounting regardless of their gross receipts, unless they have inventory,” the AICPA said in its letter to Baucus and Hatch. All of those taxpayers would be forced to use accrual accounting under the proposal once gross receipts exceed $10 million.

Forcing more businesses into accrual accounting would increase the tax revenue the government collects in the short term, said Richard Anklam, New Mexico Tax Research Institute president.

“It will accelerate the reporting of revenue, which should raise tax collections in the short run,” Anklam said. Over the long haul, tax collections should be about the same, regardless of the method used, he said. A committee spokesman did not respond to requests for comment.

Reasons why:

There are reasons businesses want to use accrual accounting, Anklam said. It can provide analysts and managers with a better understanding of a company's health. Expenses and revenues are matched, so a manager can more easily say, for example, if a line of business or an investment is paying off.

“A reason not to use the accrual method is if a business is growing, you increase your

they have not received, since they would need to recognize accounts payable and work-in-progress in income without a significant ability to manage accounts payable.”

That could force some businesses to make cash distributions to partners and shareholders so they can pay their taxes. That would harm the business' cash flow and limit its ability to invest in growing the business, according to the AICPA.

“The AICPA believes the proposal would also discourage natural business growth because exceeding $10 million in annual receipts would trigger an accounting change,” the letter said.

A service firm, like an accounting firm, might be discouraged from acquiring another firm because doing so could put the combined company over the $10 million threshold, it said.

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