



What's a "small business," and why does it matter?

Although your business may seem big to you, you may wonder how the government classifies it for tax purposes. If your organization qualifies as a "small business," you may enjoy several important tax advantages. But the rules for specific tax provisions vary. So, depending on your size, you might be eligible for some so-called small business breaks but not others. Here's a closer look.

No universal definition

Under federal tax law, there's no one definition of a small business. Instead, several definitions apply depending on the context, various criteria and certain thresholds. Criteria may include a business's:

- Gross assets,
- Gross receipts, and
- Number of shareholders and employees.

Even if a criterion such as gross receipts is the same across definitions, different thresholds may apply. Also, for some purposes, the tax code might define a small business in more than one way. Depending on how your performance and operations change over time, you might meet the government's definition of a small business one year but not the next year.

5 special breaks for certain small businesses

The Section 448(c) gross receipts test serves as a common eligibility standard for several tax provisions available to qualifying small businesses. Under this test, your business may qualify for five potential tax breaks if it had average annual gross receipts of \$25 million or less for the prior three-year period. This threshold is adjusted for inflation — for 2026, businesses that had average gross receipts up to \$32 million are eligible for:

1. Cash accounting. You're generally permitted to use the cash method of accounting for tax purposes even if you have inventories or use the accrual method for financial reporting. With certain exceptions, larger businesses — particularly those that carry inventory — must use accrual accounting. Using the cash method will likely allow you to defer more taxable income than you could under the accrual method.

2. Inventory simplification. You're generally exempt from complex inventory accounting rules and may account for inventories by:

- Treating them as nonincidental materials and supplies, or
- Conforming to the inventory method you use in your financial statements or books and records.

Treating inventories as nonincidental materials or supplies allows you to deduct their cost when they're "used or consumed." Final IRS regulations clarify that materials aren't used and consumed until the inventory is sold. So businesses can't treat raw materials as used and consumed when converted into work-in-progress or finished goods.

3. Relief from UNICAP rules. You're exempt from the uniform capitalization (UNICAP) rules, which require taxpayers to capitalize certain direct and indirect production costs to inventory, rather than deduct them when incurred. Not only can these rules increase your tax liability, but they also make tax reporting more complex.

4. Exemption from the business interest deduction limitation. You're not subject to the cap on business interest write-offs, which generally limits deductions of net business interest expense to 30% of adjusted taxable income.

5. The completed contract method. If your business is in construction, manufacturing or another industry where long-term contracts are common, you may 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. The completed contract method allows you to defer tax until the contract is substantially complete, while the percentage-of-completion method can accelerate the tax.

When determining your business's gross receipts, you may need to include those earned by certain related entities, such as those with common control. Special rules apply to organizations in existence for less than three years. Also, tax shelters, including syndicates, don't qualify for small business status, even if their gross receipts are below the threshold.

Sizing up your business

Of course, these five relief measures aren't the only tax-saving opportunities for small business owners at the federal and state levels. And determining eligibility can be more complicated than it appears. We can help evaluate your eligibility for these breaks and others — and develop a long-term plan that's tailored to your situation. Contact us to explore the potential tax benefits of small business status.

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