THE SPECIAL
12-MONTH RULE

CPA GROUP
OF THE ROCKIES

WHAT EXPENSES QUALIFY?

An expense paid in advance is deductible only in the year to which it applies unless the expense qualifies for the "12-month rule." The 12-month rule is available for both cash and accrual taxpayers, although only cash method taxpayers will get the full benefit. Under the 12-month rule, you are not required to capitalize amounts paid to create certain rights or benefits that do not extend beyond *the earlier of* [Reg. §1.263(a)-4(f)]:

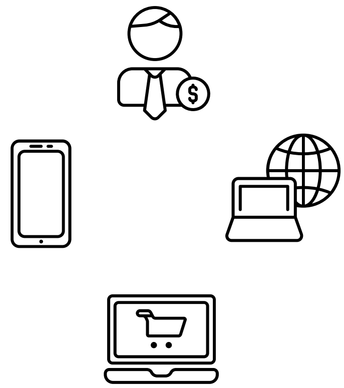
1 | 12 months after the right or benefit begins or
2 | The end of the tax year after the tax year in which payment is made.

Example : Rosa is a calendar-year taxpayer and is planning on buying a new $50,000 pickup at the end of the year because they have had such a good year and "need the deduction." The taxpayer needs to be reminded of a basic rule of business - cash flow decision making:

"Do you need the truck?"

The answer to this basic question is "no" much more often than "yes." If the answer is no, you do not need the truck, then let's look at alternative ways to get the deduction that meets a need. When a taxpayer uses the cash method, consider the 12-month rule prepay up to 12 months of:

1. Utilities (heat, water, sewer, electricity, gas)
2. Internet (cable, fiber, phone)
3. Cell phone usage
4. Rent (if related party only deduct if related party includes in income)
5. Accounting and legal
6. Office supplies
7. Advertising
8. Dues and licenses
9. Continuing education
10. Equipment leases
11. Insurance (but limits apply)



*But not interest or loan payments

The advantage of the 12-month rule is it allows pre-payment and deduction of business expenses that are needed similar to a savings account. If next year is a good year, the taxpayer will do it again, if not, no problem, because cash flow is improved.

Source: Jennings, B. (2023, August 29). TaxSpeaker.