

CHAPTER 5

SELECTING A YEAR-END

If the new business is a sole proprietorship, partnership, S corporation or personal service corporation, the company will usually be required to use a calendar year-end. However, if the business is incorporated and does not elect to be taxed as an S corporation, the corporation is often allowed to select a fiscal year-end using a month end other than December.

Which Month to Choose

The selection of a year-end involves several considerations. The most important factor is the ease by which data is accumulated. For this purpose, most companies prefer to use a quarter-end as the last day of the fiscal year (e.g. March 31st, June 30th, September 30th, or December 31st). Many companies not using a quarter-end date find that it complicates several government filings and can be confusing to shareholders and others when disclosing quarterly data.

A second consideration involves the nature and seasonal fluctuations of the business (natural business year). As a general rule, the year-end causes a disruption to the normal course of business, especially if a physical inventory is required. It is usually better to have this disruption occur during the off-season. Also, since the periods just before and just after year-end often involve an additional time commitment by the key officers, a year-end that does not conflict with normal vacation schedules is preferable.

There are also tax reasons to select a year-end other than December 31st. If the company has, for example, a June 30th year-end, it is possible for the corporation to pay bonuses in June and obtain a tax deduction. The employee then has six months to decide whether to pay tax currently on the income or attempt to shelter it.

Proper planning in selecting a year-end can also defer the payment of taxes at the corporate level. Suppose the company incorporated in July and operated at break-even through the next April, but expected May and June to be big income months. By selecting a March or April year-end, the company can delay for ten months the payment of taxes on the May and June income. Since cash is often scarce for a start-up company, this deferral can be of significant benefit.

How to Make the Election

The election of a year-end is made on the first tax return of the corporation. Even though the corporate by-laws disclose the fiscal year and the request for Federal Identification Number (Form SS-4) asks for the year-end, a final election is not made until the tax return is filed. There is not a separate form for making the election. The corporation merely states the fiscal year on page one of Form 1120. There are two important requirements for making the election. First, it must be made on a **timely filed** (including extensions) return. If the first return is not timely filed the year-end of the corporation is, by default, December 31st. Secondly, the first year can not be longer than twelve months. For example, if a company is incorporated on June 25th, and wants to select a June year-end, it must file a return for the five day period, June 25th through June 30th. Otherwise, the first return would be for twelve months and five days which is not allowed.

Joyner, Kirkham, Keel & Robertson, P.C.
Certified Public Accountants

804-288-0496

<http://www.jkkr.com>

Changing the Year-End

Once a year-end is selected, it may be changed under certain conditions without the prior approval of the Internal Revenue Service. If the conditions are not met, it can only be changed if permission is obtained from the Internal Revenue Service. In considering a request for change of year-end, the Internal Revenue Service will look closely at the business or economic reasons for the change. The absence of a tax avoidance motive is generally a requirement.

Certain corporate events will require a change of year-end. For example, if the company's stock is acquired by another corporation, the acquired corporation will be required to use the same year-end as the parent company.