

§ 471. General rule for inventories**(a) General rule**

Whenever in the opinion of the Secretary the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting the income.

(b) Estimates of inventory shrinkage permitted

A method of determining inventories shall not be treated as failing to clearly reflect income solely because it utilizes estimates of inventory shrinkage that are confirmed by a physical count only after the last day of the taxable year if—

(1) the taxpayer normally does a physical count of inventories at each location on a regular and consistent basis, and

(2) the taxpayer makes proper adjustments to such inventories and to its estimating methods to the extent such estimates are greater than or less than the actual shrinkage.

(c) Exemption for certain small businesses**(1) In general**

In the case of any taxpayer (other than a tax shelter prohibited from using the cash receipts and disbursements method of accounting under section 448(a)(3)) which meets the gross receipts test of section 448(c) for any taxable year—

(A) subsection (a) shall not apply with respect to such taxpayer for such taxable year, and

(B) the taxpayer's method of accounting for inventory for such taxable year shall not be treated as failing to clearly reflect income if such method either—

(i) treats inventory as non-incidental materials and supplies, or

(ii) conforms to such taxpayer's method of accounting reflected in an applicable financial statement of the taxpayer with respect to such taxable year or, if the taxpayer does not have any applicable financial statement with respect to such taxable year, the books and records of the taxpayer prepared in accordance with the taxpayer's accounting procedures.

(2) Applicable financial statement

For purposes of this subsection, the term "applicable financial statement" has the meaning given the term in section 451(b)(3).

(3) Application of gross receipts test to individuals, etc.

In the case of any taxpayer which is not a corporation or a partnership, the gross receipts test of section 448(c) shall be applied in the same manner as if each trade or business of such taxpayer were a corporation or partnership.

(4) Coordination with section 481

Any change in method of accounting made pursuant to this subsection shall be treated for purposes of section 481 as initiated by the

taxpayer and made with the consent of the Secretary.

(d) Cross reference

For rules relating to capitalization of direct and indirect costs of property, see section 263A.

(Aug. 16, 1954, ch. 736, 68A Stat. 159; Pub. L. 94-455, title XIX, §1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1834; Pub. L. 99-514, title VIII, §803(b)(4), Oct. 22, 1986, 100 Stat. 2356; Pub. L. 105-34, title IX, §961(a), Aug. 5, 1997, 111 Stat. 891; Pub. L. 115-97, title I, §13102(c), Dec. 22, 2017, 131 Stat. 2103.)

AMENDMENTS

2017—Subsecs. (c), (d). Pub. L. 115-97 added subsec. (c) and redesignated former subsec. (c) as (d).

1997—Subsecs. (b), (c). Pub. L. 105-34 added subsec. (b) and redesignated former subsec. (b) as (c).

1986—Pub. L. 99-514 designated existing provisions as subsec. (a) and added subsec. (b).

1976—Pub. L. 94-455 struck out "or his delegate" after "Secretary" wherever appearing.

EFFECTIVE DATE OF 2017 AMENDMENT

Amendment by Pub. L. 115-97 applicable to taxable years beginning after Dec. 31, 2017, see section 13102(e) of Pub. L. 115-97, set out as a note under section 263A of this title.

EFFECTIVE DATE OF 1997 AMENDMENT

Pub. L. 105-34, title IX, §961(b)(1), Aug. 5, 1997, 111 Stat. 891, provided that: "The amendment made by this section [amending this section] shall apply to taxable years ending after the date of the enactment of this Act [Aug. 5, 1997]."

EFFECTIVE DATE OF 1986 AMENDMENT

If any interest costs incurred after Dec. 31, 1986, are attributable to costs incurred before Jan. 1, 1987, the amendment by Pub. L. 99-514 is applicable to such interest costs only to the extent such interest costs are attributable to costs which were required to be capitalized under section 263 of the Internal Revenue Code of 1954 and which would have been taken into account in applying section 189 of the Internal Revenue Code of 1954 (as in effect before its repeal by section 803 of Pub. L. 99-514) or, if applicable, section 266 of such Code, see section 7831(d)(2) of Pub. L. 101-239, set out as an Effective Date note under section 263A of this title.

Amendment by Pub. L. 99-514 applicable to costs incurred after Dec. 31, 1986, in taxable years ending after such date, except as otherwise provided, see section 803(d) of Pub. L. 99-514, set out as an Effective Date note under section 263A of this title.

COORDINATION WITH SECTION 481

Pub. L. 105-34, title IX, §961(b)(2), Aug. 5, 1997, 111 Stat. 891, provided that: "In the case of any taxpayer permitted by this section [amending this section and enacting provisions set out as a note above] to change its method of accounting to a permissible method for any taxable year—

"(A) such changes shall be treated as initiated by the taxpayer,

"(B) such changes shall be treated as made with the consent of the Secretary of the Treasury, and

"(C) the period for taking into account the adjustments under section 481 [26 U.S.C. 481] by reason of such change shall be 4 years."

STUDY OF ACCOUNTING METHODS FOR INVENTORY;
REPORT NOT LATER THAN DECEMBER 31, 1982

Pub. L. 97-34, title II, §238, Aug. 13, 1981, 95 Stat. 254, directed Secretary of the Treasury to conduct a study of methods of tax accounting for inventory with a view towards development of simplified methods and to re-

port to Congress, not later than Dec. 31, 1982, prior to repeal by Pub. L. 100-647, title VI, § 6252(a)(2), Nov. 10, 1988, 102 Stat. 3752.

§ 472. Last-in, first-out inventories

(a) Authorization

A taxpayer may use the method provided in subsection (b) (whether or not such method has been prescribed under section 471) in inventorying goods specified in an application to use such method filed at such time and in such manner as the Secretary may prescribe. The change to, and the use of, such method shall be in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

(b) Method applicable

In inventorying goods specified in the application described in subsection (a), the taxpayer shall:

- (1) Treat those remaining on hand at the close of the taxable year as being: First, those included in the opening inventory of the taxable year (in the order of acquisition) to the extent thereof; and second, those acquired in the taxable year;
- (2) Inventory them at cost; and
- (3) Treat those included in the opening inventory of the taxable year in which such method is first used as having been acquired at the same time and determine their cost by the average cost method.

(c) Condition

Subsection (a) shall apply only if the taxpayer establishes to the satisfaction of the Secretary that the taxpayer has used no procedure other than that specified in paragraphs (1) and (3) of subsection (b) in inventorying such goods to ascertain the income, profit, or loss of the first taxable year for which the method described in subsection (b) is to be used, for the purpose of a report or statement covering such taxable year—

- (1) to shareholders, partners, or other proprietors, or to beneficiaries, or
- (2) for credit purposes.

(d) 3-year averaging for increases in inventory value

The beginning inventory for the first taxable year for which the method described in subsection (b) is used shall be valued at cost. Any change in the inventory amount resulting from the application of the preceding sentence shall be taken into account ratably in each of the 3 taxable years beginning with the first taxable year for which the method described in subsection (b) is first used.

(e) Subsequent inventories

If a taxpayer, having complied with subsection (a), uses the method described in subsection (b) for any taxable year, then such method shall be used in all subsequent taxable years unless—

- (1) with the approval of the Secretary a change to a different method is authorized; or,
- (2) the Secretary determines that the taxpayer has used for any such subsequent taxable year some procedure other than that

specified in paragraph (1) of subsection (b) in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (A) to shareholders, partners, or other proprietors, or beneficiaries, or (B) for credit purposes; and requires a change to a method different from that prescribed in subsection (b) beginning with such subsequent taxable year or any taxable year thereafter.

If paragraph (1) or (2) of this subsection applies, the change to, and the use of, the different method shall be in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.

(f) Use of government price indexes in pricing inventory

The Secretary shall prescribe regulations permitting the use of suitable published governmental indexes in such manner and circumstances as determined by the Secretary for purposes of the method described in subsection (b).

(g) Conformity rules applied on controlled group basis

(1) In general

Except as otherwise provided in regulations, all members of the same group of financially related corporations shall be treated as 1 taxpayer for purposes of subsections (c) and (e)(2).

(2) Group of financially related corporations

For purposes of paragraph (1), the term “group of financially related corporations” means—

(A) any affiliated group as defined in section 1504 determined by substituting “50 percent” for “80 percent” each place it appears in section 1504(a) and without regard to section 1504(b), and

(B) any other group of corporations which consolidate or combine for purposes of financial statements.

(Aug. 16, 1954, ch. 736, 68A Stat. 159; Pub. L. 94-455, title XIX, §§ 1901(b)(36)(A), 1906(b)(13)(A), Oct. 4, 1976, 90 Stat. 1802, 1834; Pub. L. 97-34, title II, §§ 235, 236(a), Aug. 13, 1981, 95 Stat. 252; Pub. L. 98-369, div. A, title I, § 95(a), July 18, 1984, 98 Stat. 616.)

AMENDMENTS

1984—Subsec. (g). Pub. L. 98-369 added subsec. (g).

1981—Subsec. (d). Pub. L. 97-34, § 236(a), substituted “3-year averaging for increases in inventory value” for “Preceding closing inventory” in heading, substituted first sentence reading “The beginning inventory for the first taxable year for which the method described in subsection (b) is used shall be valued at cost.” for “In determining income for the taxable year preceding the taxable year for which the method described in subsection (b) is first used, the closing inventory of such preceding year of the goods specified in the application referred to in subsection (a) shall be at cost.” and inserted “Any change in the inventory amount resulting from the application of the preceding sentence shall be taken into account ratably in each of the 3 taxable years beginning with the first taxable year for which the method described in subsection (b) is first used.”

Subsec. (f). Pub. L. 97-34, § 235, added subsec. (f).