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the Commissioner or the acquiring corporation may change such methods of accounting for any such taxable year under the provisions of, and to the extent permitted by, section 446 and the regulations thereunder or, where applicable, any section of the Internal Revenue Code (other than section 381(c)(4)), or regulations thereunder, in accordance with which such change may be made without the consent of the Commissioner.

(ii) If the date of distribution or transfer was before August 5, 1964, and the acquiring corporation has, for the taxable year which includes the date of distribution or transfer, adopted or continued a method or methods of accounting other than in the manner described in (a), (b), and (c) of subdivision (i) of this subparagraph, then the acquiring corporation may—

(a) Continue to use the method or methods of accounting so adopted or continued if such method or methods clearly reflect income and if proper adjustments were made to reflect the adoption of such method or methods, or

(b) Adopt the method or methods of accounting prescribed by this section. Such method or methods of accounting shall be adopted by filing an amended return (which includes the proper adjustments required by this section) for the taxable year of the acquiring corporation which includes the date of distribution or transfer, and by filing amended returns for all subsequent taxable years of the acquiring corporation for which returns have previously been filed. Such amended return or returns shall be accompanied by a copy of the statement described in paragraph (b)(3) of § 1.381(b)-1, and by a statement specifying the nature of the transaction which causes section 381 to apply; the difference in accounting methods used by the corporations concerned; the method or methods of accounting originally adopted by the acquiring corporation; the method or methods of accounting adopted on the amended return or returns; and the computation of the amount of the ad-

justments and the resulting increase or decrease in tax.

[T.D. 6750, 29 FR 11263, Aug. 5, 1964, as amended by T.D. 8071, 51 FR 2481, Jan. 17, 1986; T.D. 8995, 67 FR 34605, May 15, 2002]

§ 1.381(c)(5)-1 Inventories.

(a) *Carryover requirement*—(1) *General rule.* Section 381(c)(5) provides that in a transaction to which section 381(a) applies and in which inventories are received by the acquiring corporation (as defined in § 1.381(a)-1(b)(2)) such inventories shall be taken by the acquiring corporation (in determining its income) on the same basis on which such inventories were taken by the distributor or transferor corporation on the date of distribution or transfer unless different inventory methods were used on that date by several distributor or transferor corporations or by a distributor or transferor corporation and the acquiring corporation. If different methods were used, the acquiring corporation shall use the method or combination of methods of taking inventories adopted pursuant to the provisions of this section.

(2) *Rules of application.* Reference in this section to a method or methods of taking inventories are to be construed as referring to both the method or methods of identifying the goods and the method or methods of valuing the goods. The method or methods of taking inventories shall be determined on the date of distribution or transfer, and any corporation, a party to a section 381(a) transaction whose taxable year does not end on such date shall be considered as using the method or methods of taking inventories that it would have employed had its taxable year ended on such date. The amount of the adjustments necessary to reflect the change in method of taking inventories pursuant to this section, the manner in which they are to be taken into account by the acquiring corporation, and the tax attributable thereto shall be determined and computed under section 481 and the regulations thereunder, subject to the rules provided in paragraphs (c) and (d) of this section. However, in the case of any party to a section 381(a) transaction which changes its method of taking inventories to the last-in, first-out method

of identification, the adjustments required by section 472(d) shall be applicable. See paragraph (e) of this section. This section shall not be construed as preventing any party to a section 381(a) transaction from adopting an inventory method which, under the provisions of section 471 or 472, and the regulations thereunder, may be adopted without the consent of the Commissioner. For provisions defining the date of distribution or transfer, see paragraph (b) of § 1.381(b)-1.

(b) *Conditions for continuation of methods of taking inventories*—(1) *No difference in method of taking inventories.*

(i) If all the parties to a section 381(a) transaction used the same method of taking inventories on the date of distribution or transfer, the acquiring corporation, whether or not immediately after the date of distribution or transfer it operates separate or integrated trades or businesses, shall continue to use such method of taking inventories, unless the acquiring corporation has, in accordance with paragraph (e) of § 1.446-1, obtained the consent of the Commissioner to use a different method of taking inventories. For purposes of this determination, a corporation shall be deemed to be using the last-in, first-out method of taking inventories with respect to a particular type of goods on the date of the distribution or transfer, if such corporation elects, under the provisions of section 472, to adopt the last-in, first-out method with respect to such goods for its taxable year within which or with which the date of distribution or transfer occurs.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example. O and P corporations are manufacturing companies which compute their entire inventories by the use of the last-in, first-out method of identification and the cost basis of valuation. In applying the last-in, first-out method both corporations use the dollar-value method, use the double-extension method, pool under the natural business unit method, and value annual inventory increases by reference to the actual cost of goods most recently purchased. P corporation acquires the assets of O corporation in a transaction to which section 381(a) applies. Under the provisions of this subparagraph, on and after the date of distribution or

transfer P corporation must continue to use the last-in, first-out method of identification, the cost basis of valuation, and, in applying the last-in, first-out method, must continue to use the dollar-value method, use the double-extension method, pool under the natural business unit method, and value annual inventory increases by reference to the actual cost of goods most recently purchased, unless, in accordance with paragraph (e) of § 1.446-1, consent of the Commissioner is obtained to change the method of taking inventories.

(2) *Separate businesses.* (i) If, immediately after the date of distribution or transfer, any of the trades or businesses of the parties to a section 381(a) transaction are operated as separate and distinct trades or businesses within the meaning of paragraph (d) of § 1.446-1, then the method or methods of taking inventories employed by such parties to the transaction on the date of distribution or transfer with respect to such trades or businesses shall be used by the acquiring corporation, unless the acquiring corporation has, in accordance with paragraph (e) of § 1.446-1, obtained the consent of the Commissioner to use a different method of taking inventories. This subparagraph shall not be construed as precluding the Commissioner under section 471 or 472, and the regulations thereunder, from requiring that the method of taking inventories used in a particular trade or business be used in another trade or business with respect to similar types of goods, if, in the opinion of the Commissioner, the use of such method of taking inventories is necessary for a clear reflection of income.

(ii) The provisions of this subparagraph may be illustrated by the following example:

Example. R Corporation is engaged in the production of radios and television sets and S Corporation is engaged in the production of washers and driers. In computing their inventories both corporations use the cost basis of valuation. R corporation uses the last-in, first-out method of identification, whereas S corporation uses the first-in, first-out method. T corporation acquires the assets of R corporation and S corporation in a transaction to which section 381(a) applies. T corporation operates as a separate and distinct trade or business, within the meaning of paragraph (d) of § 1.446-1, each of the businesses formerly operated by R corporation

and S corporation. Under the provisions of this subparagraph, T corporation is required to continue to use the method of taking inventories previously used by R corporation and S corporation, respectively, with respect to each trade or business, unless, in accordance with paragraph (e) of § 1.446-1, consent of the Commissioner is obtained to change the methods of taking inventories, on and after the dates of transfer. However, the Commissioner may require T corporation, in accordance with § 1.472-2, to use the last-in, first-out method with respect to that portion of the goods in the trades or businesses formerly operated by S corporation and T corporation which are similar to goods in the trade or business formerly operated by R corporation, if, in his opinion, the use of the last-in, first-out method with respect to such similar goods is necessary for a clear reflection of income.

(3) *Integrated businesses*—(i) *Same inventory method*. If, immediately after the date of distribution or transfer, any of the trades or businesses of the parties to a section 381(a) transaction are not operated as separate and distinct trades or businesses within the meaning of paragraph (d) of § 1.446-1, then, to the extent that the same methods of taking inventories for particular types of goods were employed on the date of distribution or transfer by the parties to the transaction with respect to any trades or businesses which are integrated or are required to be integrated in accordance with paragraph (d) of § 1.446-1, the acquiring corporation shall continue to employ such methods of taking inventories for such types of goods, unless, in accordance with paragraph (e) of § 1.446-1, the acquiring corporation has obtained the consent of the Commissioner to use a different method of taking inventories. This subdivision shall not be construed as precluding the Commissioner under section 471 or 472, and the regulations thereunder, from requiring that the method of taking inventories used with respect to particular types of goods in a particular trade or business operated by the acquiring corporation after the date of distribution or transfer be used with respect to similar types of goods in another trade or business operated by it after such date if, in the opinion of the Commissioner, the use of such method of taking inventories is necessary for a clear reflection of income.

(ii) *Different inventory methods*. If, immediately after the date of distribution or transfer, any of the trades or businesses of the parties to a section 381(a) transaction are not operated as separate and distinct trades or businesses within the meaning of paragraph (d) of § 1.446-1, then, to the extent that different methods of taking inventories for particular types of goods were employed on the date of distribution or transfer by the parties to the transaction with respect to any trades or businesses which are integrated or required to be integrated in accordance with paragraph (d) of § 1.446-1, the acquiring corporation shall not be permitted to continue to use such different methods of taking inventories, and shall adopt the method of taking inventories described in paragraph (c) of this section for such types of goods unless, in accordance with paragraph (d) of this section, consent of the Commissioner is obtained to use a different method of taking inventories.

(iii) *Examples*. The provisions of this subparagraph may be illustrated by the following examples:

Example 1. O and P corporations are manufacturing companies which compute their entire inventories by the use of the last-in, first-out method of identification and the cost basis of valuation. In applying the last-in, first-out method both corporations use the dollar-value method and the double-extension method. However, O corporation pools under the natural business unit method while P corporation pools under the multiple pool method. In addition, O corporation determines the cost of its annual inventory increase by reference to the actual cost of goods most recently purchased, whereas P corporation determines the cost of such increase by reference to the actual cost of the goods purchased during the taxable year in the order of acquisition. P corporation acquires the assets of O corporation in a transaction to which section 381(a) applies and integrates the business formerly operated by O corporation into the business which was operated by P corporation before the date of distribution or transfer. Under the provisions of subdivision (i) of this subparagraph (relating to the same inventory methods in an integrated trade or business), P corporation shall continue to use the last-in, first-out method of identification, the cost basis of valuation, and in applying the last-in, first-out method, shall continue to use the dollar-value method and the double-extension method, unless, in accordance with

paragraph (e) of §1.446-1, consent of the Commissioner is obtained to change the method of taking inventories. However, under the provisions of subdivision (ii) of this subparagraph (relating to different inventory methods in an integrated trade or business), P corporation shall use the method of taking inventories described in paragraph (c) of this section with respect to the method of pooling and the method of determining the cost of annual inventory increases, unless, in accordance with paragraph (d) of this section, consent of the Commissioner is obtained to use a different method of taking inventories.

Example 2. Y and Z corporations are engaged in the manufacture of cereal products. Y corporation uses the first-in, first-out method of identification and the cost or market, whichever is lower, method of valuing its inventories, including oats. Z corporation uses the first-in, first-out method of identification and the cost or market, whichever is lower, method of valuing its inventories, except oats which are valued on the cost method. Y corporation acquires all of the assets of Z corporation in a transaction to which section 381(a) applies and integrates the business formerly operated by Z corporation into the business which was operated by Y corporation before the date of distribution or transfer. Under the provisions of subdivision (i) of this subparagraph (relating to the same inventory methods in an integrated trade or business), Y corporation must continue to use the first-in, first-out method with respect to all of its inventories and must continue to use the cost or market, whichever is lower, method of valuing all inventories except oats, unless, in accordance with paragraph (e) of §1.446-1, consent of the Commissioner is obtained to change the method of taking inventories. In addition, under the provisions of subdivision (ii) of this subparagraph (relating to different inventory methods in an integrated trade or business), Y corporation shall use the method described in paragraph (c) of this section in valuing its inventory of oats, unless, in accordance with paragraph (d) of this section, consent of the Commissioner is obtained to use a different method of valuing its oats.

(4) *Rules of application.* (i) In any case where the method of taking inventories employed on the date of distribution or transfer is continued, it will be unnecessary for the acquiring corporation to renew any election previously made by it or by any distributor or transferor corporation with respect to such method of taking inventories, and the acquiring corporation is bound by any such elections. If, on the date of distribution or transfer, any party to a section 381(a) transaction had no inven-

tories of a particular type of goods, or such party came into existence as a result of the transaction, such party shall not be considered to be using a method of taking inventories for the particular type of goods different from that used by the other parties to the transaction. If, on the date of distribution or transfer, any one of the parties to the transaction is using the cash receipts and disbursements method of accounting and is not required to take inventories, the determination as to whether such method of accounting is to be continued by the acquiring corporation shall be made in accordance with section 381(c)(4) and the regulations thereunder.

(ii) The provisions of this subparagraph may be illustrated by the following examples:

Example 1. M corporation is engaged in manufacturing and computes its inventories under the first-in, first-out method of identification and the cost or market, whichever is lower, method of valuation. N corporation is also engaged in manufacturing and computes its inventories under the first-in, first-out method of identification and the cost method of valuation. M corporation acquires the assets of N corporation in a transaction to which section 381(a) applies and M corporation integrates the business formerly operated by N corporation into the business which was operated by M corporation before the date of distribution or transfer. On the date of distribution or transfer, N corporation has inventories of sheet steel while M corporation has no inventories of this particular type of goods. In all other respects the inventories of the two corporations consist of similar types of goods. Under the provisions of this subparagraph, M corporation must use the first-in, first-out method of identification and the cost method of valuation of inventories of sheet steel, unless, in accordance with paragraph (e) of §1.446-1, consent of the Commissioner is obtained to change the method of taking such inventories. For other goods in its inventories M corporation must use the first-in, first-out method of identification (as required by subparagraph (3)(i) of this paragraph), and with respect to the method of valuation, must use the method of taking inventories described in paragraph (c) of this section, unless, in accordance with paragraph (d) of this section, consent of the Commissioner is obtained to use a different method of taking inventories.

Example 2. W corporation is engaged in the business of raising cattle and uses the cash

receipts and disbursements method of computing taxable income. Inventories, therefore, are not required. X corporation is also engaged in the business of raising cattle and uses the accrual method of computing taxable income under which it has elected to use the “farm-price method” of valuing inventories. The assets of W corporation are acquired by X corporation in a transaction to which section 381(a) applies and X corporation integrates the business formerly operated by W corporation into the business which was operated by X corporation before the date of distribution or transfer. Under the provisions of this subparagraph, whether X corporation is required to take inventories will depend upon which method of accounting is used by X corporation after the date of distribution or transfer, in accordance with the provisions of section 381(c)(4) and the regulations thereunder. Therefore, if X corporation uses the cash receipts and disbursements method, it will not be required to take inventories into account in computing its taxable income. However, if X corporation uses the accrual method, it must use the “farm-price method” of taking inventories, unless, in accordance with paragraph (d) of this section, consent of the Commissioner is obtained to use a different method of taking inventories.

(c) *Change of method of taking inventories without consent of Commissioner—*

(1) *General rule.* If, under the provisions of paragraph (b) of this section, the acquiring corporation is not permitted to continue to use the method of taking inventories used by it or by the distributor or transferor corporation or corporations on the date of distribution or transfer, the acquiring corporation shall use the principal method of taking inventories for each particular type of goods of such corporations, as determined under subparagraph (2) of this paragraph: *Provided, That:*

(i) Such method clearly reflects the income of the acquiring corporation after the distribution or transfer as provided by sections 446(a) and 471 and the regulations thereunder, and

(ii) The use of such method is not inconsistent with the provisions of any closing agreement entered into under section 7121 and the regulations thereunder.

If the principal method does not satisfy the requirements of subdivisions (i) and (ii) of this subparagraph, or if the acquiring corporation wishes to use a method other than the principal method, see paragraph (d)(1) of this section.

If the principal method of taking inventories is adopted under this paragraph, it will not be necessary for the acquiring corporation or corporations to renew any election previously made by it or by the distributor or transferor corporation with respect to such principal method of taking inventories, and the acquiring corporation is bound by any such election.

(2) *Principal method of taking inventories.* The determination of the principal method of taking inventories shall be made with respect to each particular type of goods of each integrated trade or business operated by the acquiring corporation immediately after the date of distribution or transfer. Such determination for each integrated trade or business shall be made by reference to the methods of taking inventories previously used in the component trades or businesses for such types of goods which constitute the subsequent integrated trade or business of the acquiring corporation. For purposes of this determination, a corporation shall be deemed to be using the last-in, first-out method of taking inventories with respect to a particular type of goods on the date of the distribution or transfer, if such corporation elects, under the provisions of section 472, to adopt the last-in, first-out method with respect to such goods for its taxable year within which or with which the date of distribution or transfer occurs. The fair market value of the particular types of goods of each group of component trades or businesses with respect to which one method of taking inventories common to all was employed shall be compared with the fair market value of comparable types of goods of other groups of component trades or businesses with respect to which another method of taking inventories common to all was employed. For purposes of the above comparison and to the extent that particular types of goods are included in inventory by grouping or pooling, then such group or pool shall be considered as a single unit. The total fair market value of such group or pool shall be the basis for comparison in determining the principal method of taking inventories. The method of taking inventories of

the group of component trades or businesses having the largest fair market value of such inventories shall be the principal method of taking inventories. For purposes of this subparagraph, the fair market value of the inventories of a component trade or business shall be determined immediately after the date of distribution or transfer.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example 1. (i) X, Y, and Z corporations are all engaged in the manufacture of sheet metal. In addition, Y and Z corporations are engaged in the manufacture of paper containers. X and Y corporations use the first-in, first-out method of identifying goods and the cost method of valuing all inventories, while Z corporation uses the first-in, first-out method of identifying goods and the cost or market, whichever is lower, method of valuing all inventories. X, Y, and Z corporations enter into a transaction to which section 381(a) applies, and the acquiring corporation integrates the sheet metal businesses formerly operated by X, Y, and Z corporations and also integrates the paper container businesses formerly operated by Y and Z corporations. Each corporation has the same types of goods in the inventories of its sheet metal business and Y and Z corporations have the same types of goods in the inventories of their paper container businesses. Immediately after the date of distribution or transfer the fair market values of the respective inventories are as follows:

	X	Y	Z
Sheet metal	\$10,000	\$7,000	\$15,000
Paper container	6,000	7,000

(ii) Since X, Y, and Z corporations all used the first-in, first-out method of identifying their inventories as of the date of distribution or transfer, then, under the provisions of paragraph (b)(3)(i) of this section, the acquiring corporation shall continue to use the first-in, first-out method of identifying all goods unless, in accordance with paragraph (e) of §1.446-1, consent of the Commissioner is obtained to change the method of accounting.

(iii) Since the acquired corporations used different methods of valuing inventories in their sheet metal business and their paper container business, when the businesses were integrated the acquiring corporation must, under the provisions of this paragraph, determine which method of inventory valuation used by the acquired corporations on the date of distribution or transfer is the principal method of inventory valuation for each of such businesses.

(a) In determining which is the principal method of valuing inventories for the sheet metal business pursuant to subparagraph (2) of this paragraph, the total fair market value of the sheet metal inventories of X and Y corporations, \$17,000 (i.e., \$10,000 + \$7,000 = \$17,000), is compared with the fair market value of the sheet metal inventory of Z corporation, \$15,000. Since the total fair market value of the sheet metal inventories of X and Y corporations (\$17,000) exceeds the fair market value of the sheet metal inventory of Z corporation (\$15,000), the cost method of valuation used by X and Y corporations is the principal method of taking such inventories, and must be used by the acquiring corporation in valuing such inventories, if the conditions set forth in subparagraph (1) of this paragraph are satisfied.

(b) In determining which is the principal method of valuing inventories for the paper container business pursuant to subparagraph (2) of this paragraph, the fair market value of the paper container inventory of Y corporation (\$6,000) is compared with the fair market value of the paper container inventory of Z corporation (\$7,000). Since the fair market value of the paper container inventory of Z corporation (\$7,000) exceeds the fair market value of the paper container inventory of Y corporation (\$6,000), the cost or market, whichever is lower, method of valuation used by Z corporation is the principal method of taking such inventories, and must be used by the acquiring corporation in valuing such inventories, if the conditions set forth in subparagraph (1) of this paragraph are satisfied.

Example 2. (i) X, Y, and Z corporations are all engaged in the manufacture of electrical appliances. In addition, X and Z corporations are engaged in the manufacture of plastic containers. X corporation uses the first-in, first-out method of identifying goods and the cost method of valuing all inventories. Y and Z corporations use the last-in, first-out method of identifying goods and the cost method of valuing all inventories. In applying the last-in, first-out method, Y corporation uses the dollar value method, the double-extension method, and pools under the natural business unit method, while Z corporation uses the dollar value method, the double-extension method, and pools under the multiple pooling method for all inventories. X, Y, and Z corporations enter into a transaction to which section 381(a) applies, and the acquiring corporation integrates the electric appliance businesses formerly operated by X, Y, and Z corporations and also integrates the plastic container businesses formerly operated by X and Z corporations. Each corporation has the same types of goods in the inventories of its electric appliance business and X and Z corporations have the same types of goods in the inventories of

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their plastic container businesses. Immediately after the date of distribution or transfer, the fair market values of the respective inventories are as follows:

	X	Y	Z
Electric appliance	\$13,000	\$10,000	\$5,000
Plastic container	7,000	6,000

(ii) Since X, Y, and Z corporations all used the cost method of valuing their inventories as of the date of distribution or transfer, then, under the provisions of paragraph (b)(3)(i) of this section, the acquiring corporation shall continue to use the cost method of valuing all goods unless, in accordance with paragraph (e) of § 1.446-1, consent of the Commissioner is obtained to change the method of accounting.

(iii) Since the acquired corporations used different methods of identifying inventories in their electric appliance business and their plastic container business, when the businesses were integrated the acquiring corporation must, under the provisions of this paragraph, determine which method of inventory identification used by the acquired corporations on the date of distribution or transfer is the principal method of inventory identification for each of such businesses.

(a)(1) In determining which is the principal method of identifying inventories for the electric appliance business pursuant to subparagraph (2) of this paragraph, the fair market value of the electric appliance inventory of X corporation, \$13,000, is compared with the total fair market value of the electric appliance inventories of Y and Z corporations, \$15,000 (i.e., \$10,000+\$5,000 = \$15,000). Since the total fair market value of the electric appliance inventories of Y and Z corporations (\$15,000) exceeds the fair market value of the electric appliance inventory of X corporation (\$13,000), the last-in, first-out method of identification is the principal method of taking the electric appliance inventories and must be used by the acquiring corporation, if the conditions set forth in subparagraph (1) of this paragraph are satisfied.

(2) Since Y and Z corporations used different pooling methods, in applying the last-in, first-out method, the acquiring corporation must, under the provisions of this paragraph, determine which pooling method as used by Y and Z corporations on the date of distribution or transfer is the principal method. In making such determination pursuant to subparagraph (2) of this paragraph, the fair market value of the electric appliance inventory of Y corporation (\$10,000) is compared with the fair market value of the electric appliance inventory of Z corporation (\$5,000). Since the fair market value of the electric appliance inventory of Y corporation (\$10,000) exceeds the fair market value of the

electric appliance inventory of Z corporation (\$5,000), the natural business unit method is the principal method of pooling and must be used by the acquiring corporation in applying the last-in, first-out method with respect to the electric appliance business, if the conditions set forth in subparagraph (1) of this paragraph are satisfied.

In addition, under the provisions of paragraph (b)(3)(i) of this section, the acquiring corporation must use the dollar value method and the double-extension method for valuing goods in its electric appliance inventory since Y and Z corporations both used such methods in valuing their electric appliance inventories as of the date of distribution or transfer, unless, in accordance with paragraph (e) of § 1.446-1, consent of the Commissioner is obtained to change the method of accounting.

(b) In determining which is the principal method of identifying inventories for the plastic container business pursuant to subparagraph (2) of this paragraph, the fair market value of the plastic container inventory of X corporation (\$7,000) is compared with the fair market value of the plastic container inventory of Z corporation (\$6,000). Since the fair market value of the plastic container inventory of X corporation, (\$7,000) exceeds the fair market value of the plastic container inventory of Z corporation (\$6,000) the first-in, first-out method of identification, as used by X corporation, is the principal method of taking the plastic container inventories and must be used by the acquiring corporation, if the conditions set forth in subparagraph (1) of this paragraph are satisfied.

(d) *Change of method of taking inventories with consent of the Commissioner—*(1) *General rule—*(i) *Carryover and principal method not permitted.* If the acquiring corporation is not permitted, under paragraph (b) of this section, to continue to use the method of taking inventories used by it or the distributor or transferor corporation or corporations on the date of distribution or transfer, and is not permitted, under paragraph (c) of this section, to use the principal method of taking inventories, then such acquiring corporation must request the Commissioner to determine the appropriate method of taking inventories.

(ii) *Principal method required.* If the acquiring corporation wishes to use a method of taking inventories other than the principal method of taking inventories which is required to be used under paragraph (c) of this section, it shall apply to the Commissioner for

permission to use such other method of taking inventories. Permission to use such other method of taking inventories will not be granted unless the acquiring corporation and the Commissioner agree to the terms, conditions, and adjustments under which the change to such method will be effected.

(2) *Time and manner of making application.* Request for a determination of the method of taking inventories to be used under subparagraph (1)(i) of this paragraph or applications for permission to use a method of taking inventories under subparagraph (1)(ii) of this paragraph shall be filed with the Commissioner of Internal Revenue, Attention: T:I:C, Washington, DC 20224, not later than 90 days after the date of distribution or transfer, except that in cases where the date of distribution or transfer occurs before January 15, 1975, such applications or requests shall be filed not later than 90 days after such date. The application shall be accompanied by a copy of the statement described in paragraph (b)(3) of §1.381(b)-1, and by a statement specifying the nature of the transaction which causes section 381 to apply; the differences in methods of taking inventories used by the corporations concerned; the method of taking inventories proposed to be used by the acquiring corporations; and the amount of adjustments necessary to prevent duplication or omission of items in the computation of taxable income under such proposed method. The Commissioner may also require such other information as may be necessary in order to determine the proper method of taking inventories to be used by the acquiring corporation.

(e) *Treatment of layers of inventories by the acquiring corporation and rules for making adjustments—(1) In general.* This paragraph provides rules for treating layers of inventories by the acquiring corporation and rules for making adjustments, once the acquiring corporation's method of taking inventories for its taxable year including the date of distribution or transfer has been determined in accordance with the rules set forth in paragraphs (a) through (d) of this section. Thus, for example, if the acquiring corporation uses the last-in, first-out method of taking inventories for its taxable year including the date

of distribution or transfer, either because such corporation elects the last-in, first-out method of taking inventories under the provisions of section 472 for such year or because such method is otherwise determined to be the principal method of taking inventories under paragraph (c)(2) of this section, then such corporation shall integrate its layers of inventories and make the necessary adjustments in accordance with the rules under paragraph (e)(2) of this section.

(2) *Acquiring corporation uses last-in, first-out method—(i) Dollar-value method—(a) Distributor or transferor corporation using last-in, first-out method.* In any case where the acquiring corporation is required or permitted to use the dollar value method of pricing inventories on the last-in, first-out method for its taxable year including the date of distribution or transfer, the inventories of each distributor or transferor corporation which used the last-in, first-out method for its taxable year in which the distribution or transfer occurred shall be placed on the dollar value method pursuant to the rules contained in paragraph (f) of §1.472-8, and then such inventories shall be integrated with the inventories of the acquiring corporation. If pools of each corporation are permitted or required to be combined, they shall be combined in accordance with the principles set forth in paragraph (g)(2) of §1.472-8. For purposes of combining pools, all base-year inventories or layers of increment which occur in taxable years including the same December 31 shall be combined. A base-year inventory or layer of increment occurring in any short taxable year not including a December 31 or in the final taxable year of a distributor or transferor corporation shall be merged with and considered a layer of increment of its immediately preceding taxable year.

(b) *Distributor or transferor corporation not using last-in, first-out method.* In any case where the acquiring corporation is required or permitted to use the last-in, first-out method of taking inventories for its taxable year including the date of distribution or transfer, the inventories of each distributor or transferor corporation which did not use the last-in, first-out method for its taxable

year in which the distribution or transfer occurred shall be treated by the acquiring corporation as having been acquired at their average unit cost in a single transaction on the date of distribution or transfer. Thus, where the acquiring corporation is required or permitted to use the dollar value method of pricing inventories, if an item of inventory is to be combined in an existing dollar value pool, such item shall be treated as if it were purchased at its average unit cost on the date of distribution or transfer with respect to such pool. On the other hand, if such item is not to be combined in an existing pool and the taxpayer otherwise uses LIFO with respect to such item, such item will be treated as if it were purchased at its average unit cost on the date of distribution or transfer with respect to a new pool (if any), with the base-year being the year of distribution or transfer. Adjustments resulting from a restoration to cost of any write-down to market value of such inventories of a distributor or transferor corporation shall be taken into account by such corporation in its final taxable year (where such year is closed by reason of section 381(b)). See section 472(d).

(ii) *Specific goods method*—(a) *Distributor or transferor corporation using last-in, first-out method.* In any case where the acquiring corporation is required or permitted to use the specific goods method of pricing inventories on the last-in, first-out method for its taxable year including the date of distribution or transfer, the inventories of each distributor or transferor corporation which used the last-in, first-out method for its taxable year in which the distribution or transfer occurred shall be treated by the acquiring corporation as having the acquisition dates and costs of the distributor or transferor corporation.

(b) *Distributor or transferor not using last-in, first-out method.* See paragraph (e)(1)(i)(b) of this section.

(3) *Acquiring corporation uses first-in, first-out method*—(i) *Distributor or transferor corporations not using first-in, first-out method.* In any case where the acquiring corporation is permitted or required to use the first-in, first-out method of taking inventories for its

taxable year including the date of distribution or transfer, the inventories of each distributor or transferor corporation which did not use the first-in, first-out method shall be treated by the acquiring corporation as having the same acquisition dates and costs which such inventory would have had if the distributor or transferor corporation had been using the first-in, first-out method for its taxable year in which the distribution or transfer occurred. However, if the acquiring corporation values its inventories at cost or market, whichever is lower, then the acquired inventories shall be treated as having been acquired at cost or market, whichever is lower.

(ii) *Distributor or transferor corporation using first-in, first-out method.* In any case where the acquiring corporation is required or permitted to use the first-in, first-out method of taking inventories for its taxable year including the date of distribution or transfer, the inventories of each distributor or transferor corporation which used such method for its taxable year in which the distribution or transfer occurred shall be treated by the acquiring corporation as having the same acquisition dates and costs as the distributor or transferor corporations. However, where the acquiring corporation values its inventories at cost or market, whichever is lower, then the acquiring corporation shall treat the acquired inventories as having been acquired at cost or market, whichever is lower.

(4) *Adjustments.* Except as provided in paragraph (e)(1) of this section with respect to any adjustments under section 472(d), the adjustments necessary to reflect the change from the method of taking inventories previously used by any of the corporations involved (including any adjustments required by section 481), shall be determined and computed in the same manner as if on the date of distribution or transfer, each of the several corporations that were not using the method of taking inventories used by the acquiring corporation for its taxable year including the date of distribution or transfer had initiated a change in the method of taking inventories. However, such adjustments (as an item of income or deduction, as the case may be) shall be

taken into account solely by the acquiring corporation in computing its taxable income.

(f) *Basis of inventories received.* The basis of inventories received by the acquiring corporation from a distributor or transferor corporation shall be determined in accordance with section 334(b)(1) or 362(b), and the regulations thereunder. See also section 1013, and the regulations thereunder.

(g) *Additional rules applicable to distributions or transfers before January 15, 1975—(1) Statute of limitations bars assessment or refund.* If the date of distribution or transfer was before January 15, 1975, and if the assessment of any deficiency or the refund or credit of any overpayment for the taxable year of the acquiring corporation which includes the date of distribution or transfer or any subsequent taxable year is prevented by the operation of any law or rule of law, then this section does not authorize the Commissioner or the acquiring corporation to change any method or methods of computing inventories in any taxable year of the acquiring corporation. However, the Commissioner or the acquiring corporation may change such method or methods of computing inventories under the provisions of section 446, 471, or 472 and the regulations thereunder.

(2) *Statute of limitations does not bar assessment and refund.* Except as provided in subparagraph (1) of this paragraph—

(i) If the date of distribution or transfer was before January 15, 1975, and the acquiring corporation has, for the taxable year which includes the date of distribution or transfer:

(a) Adopted or continued a method or methods of taking inventories consistent with the rules of this section,

(b) Been granted permission by the Commissioner, in accordance with section 446, 471, or 472 and the regulations thereunder, to use a method or methods of taking inventories, or

(c) Adopted a method or methods of taking inventories that, under section 446, 471, or 472 and the regulations thereunder may be adopted without the consent of the Commissioner,

then the method or methods of taking inventories adopted or continued in the manner described in (a), (b), or (c) of

this subdivision, shall not be changed, by reason of the rules contained in this section, by the Commissioner or by the acquiring corporation for any taxable year ending after the date of distribution or transfer. However, the Commissioner or the acquiring corporation may change such method or methods of taking inventories for any such taxable year under the provisions of, and to the extent permitted by, section 446, 471, or 472 and the regulations thereunder.

(ii) If the date of distribution or transfer was before January 15, 1975, and the acquiring corporation has, for the taxable year which includes the date of distribution or transfer, adopted or continued a method or methods of taking inventories other than in the manner described in (a), (b), or (c) of subdivision (i) of this subparagraph, then the acquiring corporation may—

(a) Continue to use the method or methods of taking inventories so adopted or continued if such method or methods clearly reflect income and if proper adjustments were made to reflect the adoption of such method or methods, or

(b) Adopt the method or methods of taking inventories prescribed by this section.

Such method or methods of taking inventories shall be adopted by filing an amended return (which includes the proper adjustments required by this section) for the taxable year of the acquiring corporation which includes the date of distribution or transfer, and by filing amended returns for all subsequent taxable years of the acquiring corporation for which returns have previously been filed. Such amended return or returns shall be accompanied by a copy of the statement described in paragraph (b)(3) of § 1.381(b)-1, and by a statement specifying the nature of the transaction which causes section 381 to apply; the difference in methods of taking inventories used by the corporation concerned; the method or methods of taking inventories originally adopted by the acquiring corporation; the method or methods of taking inventories adopted on the amended return or returns; and the computation of the amount of the adjustments and the resulting increase or decrease in tax.

(h) *Effective date.* This section is applicable with respect to taxable years beginning after January 15, 1975. However, if a taxpayer wishes to rely on the rules stated in this section for taxable years beginning before January 15, 1975 it may do so, subject to the provisions of paragraph (g) of this section.

(Sec. 381(c)(5) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 381(c)(5) and 7805))

[T.D. 7344, 40 FR 2684, Jan. 15, 1975]

§ 1.381(c)(6)-1 Depreciation method.

(a) *Carryover requirement*—(1) *Distributions in taxable years ending before July 25, 1969.* (i) Section 381(c)(6) provides that if, in a transaction in a taxable year which ends before July 25, 1969, to which section 381(a) applies, an acquiring corporation acquires depreciable property from a distributor or transferor corporation which computes its allowance for the depreciation of the property under section 167(b)(2), (3), or (4), the acquiring corporation shall compute its depreciation allowance by the same method used by the distributor or transferor corporation with respect to such property. Thus, if the distributor or transferor corporation used the sum of the years-digits method under section 167(b)(3) with respect to an asset distributed or transferred to an acquiring corporation, the acquiring corporation will be required to use the sum of the years-digits method with respect to such asset acquired. The computation of the depreciation allowance with respect to the property acquired shall be made under the provisions of section 167 and the regulations thereunder.

(ii) The rules provided in section 381(c)(6) and subdivision (i) of this subparagraph will apply only with respect to that part or all of the basis of the property in the hands of the acquiring corporation immediately after the date of distribution or transfer as does not exceed the basis of the property in the hands of the distributor or transferor corporation on the date of the distribution or transfer. For this purpose, the basis of the property in the hands of the distributor or transferor corporation shall be the adjusted basis provided in section 1011 for the purpose of determining gain on the sale or other

disposition of such property. For provisions defining the date of distribution or transfer see § 1.381(b)-1(b).

(2) *Distributions in taxable years ending after July 24, 1969.* (i) Section 381(c)(6) provides that if, in a transaction in a taxable year ending after July 24, 1969, to which section 381(a) applies, an acquiring corporation acquires depreciable property from a distributor or transferor corporation which computes its allowances for the depreciation of the property under subsection (b), (j), or (k) of section 167, the acquiring corporation shall compute its depreciation allowance by the same method used by the distributor or transferor corporation with respect to such property. Thus, if the distributor or transferor corporation used the straight line method under section 167(b)(1) with respect to an asset distributed or transferred to an acquiring corporation, the acquiring corporation will be required to use the straight line method with respect to such asset. Similarly, if the distributor or transferor corporation elected to compute depreciation under section 167(k) with respect to property attributable to rehabilitation expenditures, and such property is transferred to an acquiring corporation, the acquiring corporation will be required to compute depreciation under section 167(k) with respect to the property acquired. The computation of the depreciation allowance with respect to the property acquired shall be made under the provisions of section 167 and the regulations thereunder.

(ii) The rules provided in section 381(c)(6) and subdivision (i) of this subparagraph shall apply only with respect to that part or all of the basis of the property in the hands of the acquiring corporation immediately after the date of distribution or transfer as does not exceed the basis of the property in the hands of the distributor or transferor corporation on the date of the distribution or transfer. For this purpose, the basis of the property in the hands of the distributor or transferor corporation shall be the adjusted basis provided in section 1011 for the purpose of determining gain on the sale or other disposition of such property. For provisions defining the date of distribution or transfer see § 1.381(b)-1(b).