

absorption method. The base cost and layers of increment previously computed shall be retained and treated as if such base cost and layers of increment had been computed under the method authorized by this section. The taxpayer shall use the year of change as the base year in applying the double extension method or other method approved by the Commissioner, instead of the earliest year for which he adopted the LIFO method for any items in the pool.

(4) *Transition to full absorption method of inventory costing from a method more inclusive of indirect production costs—*

(i) *Taxpayer has not previously changed to his present method pursuant to subparagraphs (1), (2), and (3) of this paragraph.* If a taxpayer wishes to change to the full absorption method of inventory costing (as prescribed by paragraph (a) of this section) from a method of inventory costing which is more inclusive of indirect production costs and he has not previously changed to his present method by use of the special transition rules provided by subparagraphs (1), (2) and (3) of this paragraph, he may elect on Form 3115 to change to the full absorption method of inventory costing and, in so doing, take into account any resulting section 481 adjustment generally over 10 taxable years commencing with the year of transition. The Commissioner's consent to such election will be evidenced by a letter of consent to the taxpayer setting forth the values of inventory, as provided by the taxpayer determined under the full absorption method of inventory costing, except to the extent that no determination of such values is necessary under subparagraph (3)(ii)(b) of this paragraph, the amount of the adjustments (if any) required to be taken into account by section 481, and the treatment to be accorded such adjustments, subject to terms and conditions specified by the Commissioner to prevent distortions of income. Such election must be made within the transition period described in subparagraph (1)(ii) of this paragraph. A change pursuant to this subparagraph shall be a change initiated by the taxpayer as provided by §1.481-1(c)(5). Thus, any of the taxpayers "pre-1954 inventory bal-

ances" will be taken into account as an adjustment under section 481.

(ii) *Taxpayer has previously changed to his present method pursuant to subparagraph (1), (2), and (3) of this paragraph or would satisfy all the requirements of subdivision (i) of this subparagraph but fails to elect within the transition period.* If a taxpayer wishes to change to the full absorption method of inventory costing (as prescribed by paragraph (a) of this section) from a method of inventory costing which is more inclusive of indirect production costs and he has previously changed to his present method pursuant to subparagraphs (1), (2), and (3) of this paragraph or he would satisfy the requirements of subdivision (i) of this subparagraph but he fails to elect within the transition period, he must secure the consent of the Commissioner prior to making such change.

[T.D. 7285, 38 FR 26185, Sept. 19, 1973, as amended by T.D. 8067, 51 FR 393, Jan. 6, 1986; T.D. 8131, 52 FR 10084, Mar. 30, 1987; T.D. 8482, 58 FR 42234, Aug. 9, 1993]

§ 1.472-1 Last-in, first-out inventories.

(a) Any taxpayer permitted or required to take inventories pursuant to the provisions of section 471, and pursuant to the provisions of §§1.471-1 to 1.471-9, inclusive, may elect with respect to those goods specified in his application and properly subject to inventory to compute his opening and closing inventories in accordance with the method provided by section 472, this section, and §1.472-2. Under this last-in, first-out (LIFO) inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being:

(1) Those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and

(2) Those acquired during the taxable year.

The LIFO inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand, and may be adopted by the taxpayer as of the close of any taxable year.

(b) If the LIFO inventory method is used by a taxpayer who regularly and

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consistently, in a manner similar to hedging on a futures market, matches purchases with sales, then firm purchases and sales contracts (i.e., those not legally subject to cancellation by either party) entered into at fixed prices on or before the date of the inventory may be included in purchases or sales, as the case may be, for the purpose of determining the cost of goods sold and the resulting profit or loss, provided that this practice is regularly and consistently adhered to by the taxpayer and provided that, in the opinion of the Commissioner, income is clearly reflected thereby.

(c) A manufacturer or processor who has adopted the LIFO inventory method as to a class of goods may elect to have such method apply to the raw materials only (including those included in goods in process and in finished goods) expressed in terms of appropriate units. If such method is adopted, the adjustments are confined to costs of the raw material in the inventory and the cost of the raw material in goods in process and in finished goods produced by such manufacturer or processor and reflected in the inventory. The provisions of this paragraph may be illustrated by the following examples:

Example 1. Assume that the opening inventory had 10 units of raw material, 10 units of goods in process, and 10 units of finished goods, and that the raw material cost was 6 cents a unit, the processing cost 2 cents a unit, and overhead cost 1 cent a unit. For the purposes of this example, it is assumed that the entire amount of goods in process was 50 percent processed.

	Raw material	Goods in process	Finished goods
Raw material	\$0.60	\$0.60	\$0.60
Processing cost	.....	.10	.20
Overhead	.....	.05	.10

In the closing inventory there are 20 units of raw material, 6 units of goods in process, and 8 units of finished goods and the costs were: Raw material 10 cents, processing cost 4 cents, and overhead 1 cent.

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	Raw material	Goods in process	Finished goods
Raw material	\$2.00	\$0.60	\$0.80
Processing costs12	.32
Overhead03	.08
Total	2.00	.75	1.20

There were 30 units of raw material in the opening inventory and 34 units in the closing inventory. The adjustment to the closing inventory would be as follows:

	Raw material	Goods in process	Finished goods
Raw material:			
20 at 6 cents	\$1.20	.....	.....
6 at 6 cents	.....	\$0.36	.....
4 at 6 cents	.....	.....	\$0.24
4 at 10 cents ¹	.....	.....	.40
Processing costs	.....	.12	.32
Overhead	.....	.03	.08
Total	1.20	.51	1.04

¹ This excess is subject to determination of price under section 472(b)(1) and § 1.472-2. If the excess falls in goods in process, the same adjustment is applicable.

The only adjustment to the closing inventory is the cost of the raw material; the processing costs and overhead cost are not changed.

Example 2. Assume that the opening inventory had 5 units of raw material, 10 units of goods in process, and 20 units of finished goods, with the same prices as in Example 1, and that the closing inventory had 20 units of raw material, 20 units of goods in process, and 10 units of finished goods, with raw material costs as in the closing inventory in Example 1. The adjusted closing inventory would be as follows in so far as the raw material is concerned:

Raw material, 20 at 6 cents	.....	\$1.20
Goods in process:		
15 at 6 cents	.....	.90
5 at 10 cents ¹	.....	.50
Finished goods:		
None at 6 cents	.....	0.00
10 at 10 cents ¹	.....	1.00

¹ This excess is subject to determination of price under section 472(b)(1) and § 1.472-2.

The 20 units of raw material in the raw state plus 15 units of raw material in goods in process make up the 35 units of raw material that were contained in the opening inventory.

(d) For the purposes of this section, raw material in the opening inventory must be compared with similar raw material in the closing inventory. There may be several types of raw materials, depending upon the character,

quality, or price, and each type of raw material in the opening inventory must be compared with a similar type in the closing inventory.

(e) In the cotton textile industry there may be different raw materials depending upon marked differences in length of staple, in color or grade of the cotton. But where different staple lengths or grades of cotton are being used at different times in the same mill to produce the same class of goods, such differences would not necessarily require the classification into different raw materials.

(f) As to the pork packing industry a live hog is considered as being composed of various raw materials, different cuts of a hog varying markedly in price and use. Generally a hog is processed into approximately 10 primal cuts and several miscellaneous articles. However, due to similarity in price and use, these may be grouped into fewer classifications, each group being classed as one raw material.

(g) When the finished product contains two or more different raw materials as in the case of cotton and rayon mixtures, each raw material is treated separately and adjustments made accordingly.

(h) Upon written notice addressed to the Commissioner of Internal Revenue, Attention T:R, Washington, D.C. 20224 by the taxpayer, a taxpayer who has heretofore adopted the LIFO inventory method in respect of any goods may adopt the method authorized in this section and limit the election to the raw material including raw materials entering into goods in process and in finished goods. If this method is adopted as to any specific goods, it must be used exclusively for such goods for any prior taxable year (not closed by agreement) to which the prior election applies and for all subsequent taxable years, unless permission to change is granted by the Commissioner.

(i) The election may also be limited to that phase in the manufacturing process where a product is produced that is recognized generally as a salable product as, for example, in the textile industry where one phase of the process is the production of yarn. Since yarn is generally recognized as a salable product, the election may be lim-

ited to that portion of the process when yarn is produced. In the case of copper and brass processors, the election may be limited to the production of bars, plates, sheets, etc., although these may be further processed into other products.

(j) The election may also apply to any one raw material, when two or more raw materials enter into the composition of the finished product; for example, in the case of cotton and rayon yarn, the taxpayer may elect to inventory the cotton only. However, a taxpayer who has previously made an election to use the LIFO inventory method may not later elect to exclude any raw materials that were covered by such previous election.

(k) If a taxpayer using the retail method of pricing inventories, authorized by §1.471-8, elects to use in connection therewith the LIFO inventory method authorized by section 472 and this section, the apparent cost of the goods on hand at the end of the year, determined pursuant to §1.471-8, shall be adjusted to the extent of price changes therein taking place after the close of the preceding taxable year. The amount of any apparent inventory increase or decrease to be eliminated in this adjustment shall be determined by reference to acceptable price indexes established to the satisfaction of the Commissioner. Price indexes prepared by the United States Bureau of Labor Statistics which are applicable to the goods in question will be considered acceptable to the Commissioner. Price indexes which are based upon inadequate records, or which are not subject to complete and detailed audit within the Internal Revenue Service, will not be approved.

(l) If a taxpayer uses consistently the so-called "dollar-value" method of pricing inventories, or any other method of computation established to the satisfaction of the Commissioner as reasonably adaptable to the purpose and intent of section 472 and this section, and if such taxpayer elects under section 472 to use the LIFO inventory method authorized by such section, the taxpayer's opening and closing inventories shall be determined under section 472 by the use of the appropriate

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adaptation. See § 1.472-8 for rules relating to the use of the dollar-value method.

[T.D. 6500, 25 FR 11727, Nov. 26, 1960, as amended by T.D. 6539, 26 FR 518, Jan. 20, 1961]

§ 1.472-2 Requirements incident to adoption and use of LIFO inventory method.

Except as otherwise provided in § 1.472-1 with respect to raw material computations, with respect to retail inventory computations, and with respect to other methods of computation established to the satisfaction of the Commissioner as reasonably adapted to the purpose and intent of section 472, and in § 1.472-8 with respect to the "dollar-value" method, the adoption and use of the LIFO inventory method is subject to the following requirements:

(a) The taxpayer shall file an application to use such method specifying with particularity the goods to which it is to be applied.

(b) The inventory shall be taken at cost regardless of market value.

(c) Goods of the specified type included in the opening inventory of the taxable year for which the method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the prior taxable year with the exception that restoration shall be made with respect to any writedown to market values resulting from the pricing of former inventories.

(d) Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices and regardless of specific cost accounting records, at costs determined pursuant to the provisions of subparagraph (1) or (2) of this paragraph, dependent upon the character of the transactions in which the taxpayer is engaged:

(1)(i) In the case of a taxpayer engaged in the purchase and sale of mer-

chandise, such as a retail grocer or druggist, or engaged in the initial production of merchandise and its sale without processing, such as a miner selling his ore output without smelting or refining, such costs shall be determined—

(a) By reference to the actual cost of the goods most recently purchased or produced;

(b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition;

(c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of section 472 as having been acquired all at the same time; or

(d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

(ii) Whichever of the several methods of valuing the inventory increase is adopted by the taxpayer and approved by the Commissioner shall be consistently adhered to in all subsequent taxable years so long as the LIFO inventory method is used by the taxpayer.

(iii) The application of subdivisions (i) and (ii) of this subparagraph may be illustrated by the following examples:

Example 1. Suppose that the taxpayer adopts the LIFO inventory method for the taxable year 1957 with an opening inventory of 10 units at 10 cents per unit, that it makes 1957 purchases of 10 units as follows:

January	1 at	\$0.11=	\$0.11
April	2 at	.12=	.24
July	3 at	.13=	.39
October	4 at	.14=	.56
Totals	10		1.30

and that it has a 1957 closing inventory of 15 units. This closing inventory, depending upon the taxpayer's method of valuing inventory increases, will be computed as follows:

(a) Most recent purchases—

October	10 at	\$0.10	\$1.00
July	4 at	.14	.56
July	1 at	.13	.13
Totals	15		1.69

(b) In order of acquisitions—

January	10 at	\$0.10	\$1.00
April	1 at	.11	.11
April	2 at	.12	.24