

taking into account both P's and S's experience for the 3 immediately preceding taxable years. Thus, the initial opening balance of S's suspense account is \$170. S must also make an initial year adjustment of \$10 (\$170—\$160), which S must include in income for S's taxable year ending December 31, 1983. P is not entitled to a deduction or exclusion for merchandise received after the date of the transfer (December 31, 1982) attributable to sales made by the transferor before the date of transfer. Thus, P is not entitled to a deduction or exclusion for the \$160 of merchandise received by S during the first 4 months and 15 days of 1983.

(g) *Adjustment to inventory and cost of goods sold.* (1) If a taxpayer makes adjustments to gross receipts for a taxable year under the method of accounting described in section 458, the taxpayer, in determining excludable gross income, is also required to make appropriate correlative adjustments to purchases or closing inventory and to cost of goods sold for the same taxable year. Adjustments are appropriate, for example, where the taxpayer holds the merchandise returned for resale or where the taxpayer is entitled to receive a price adjustment from the person or entity that sold the merchandise to the taxpayer. Cost of goods sold must be properly adjusted in accordance with the provisions of §1.61-3 which provides, in pertinent part, that gross income derived from a manufacturing or merchandising business equals total sales less cost of goods sold.

(2) The provisions of this paragraph (g) may be illustrated by the following examples. These examples do not, however, reflect any required adjustments under paragraph (e)(3) of this section.

Example 1. (i) In 1986, P, a publisher, properly elects under section 458 of the Code not to include in its gross income in the year of sale, income attributable to qualified sales of paperback books returned within the specified statutory merchandise return period of 4 months and 15 days. P and D, a distributor, agree that P shall provide D with a full refund for paperback books that D purchases from P and is unable to resell, provided the merchandise is returned to P within four months following the original sale. The agreement constitutes a legal obligation. The agreement provides that D's return of the covers of paperback books within the first four months following their sale constitutes satisfactory evidence that D has not resold and will not resell the paperback books. During P's 1989 taxable year, pursuant

to the agreement, P sells D 500 paperback books for \$1 each. In 1990, during the merchandise return period, D returns covers from 100 unsold paperback books representing \$100 of P's 1989 sales of paperback books. P's cost attributable to the returned books is \$25. No adjustment to cost of goods sold is required under paragraph (g)(1) of this section because P is not holding returned merchandise for resale. P's proper amount excluded from its 1989 gross income under section 458 is \$100.

(ii) If D returns the paperback books, rather than the covers, to P and these same books are then held by P for resale to other customers, paragraph (g)(1) of this section applies. Under paragraph (g)(1), P is required to decrease its cost of goods sold by \$25, the amount of P's cost attributable to the returned merchandise. The proper amount excluded from P's 1989 gross income under section 458 is \$75, resulting from adjustments to sales and cost of sales [(100×\$1)—\$25].

Example 2. (i) In 1986, D, a distributor, properly elects under section 458 of the Code not to include in its gross income in the year of sale, income attributable to qualified sales of paperback books returned within the specified statutory merchandise return period of four months and 15 days. D and R, a retailer, agree that D shall provide a full refund for paperback books that R purchases from it and is unable to resell. D and R also have agreed that the merchandise must be returned to D within four months following the original sale. The agreement constitutes a legal obligation. D is similarly entitled to a full refund from P, the publisher, for the same paperback books. In 1990, during the merchandise return period, R returns paperback books to D representing \$100 of 1989 sales. D's cost relating to these sales is \$50. Under paragraph (g)(1) of this section, D must decrease its costs of goods sold by \$50. D's proper amount excluded from its 1989 gross income under section 458 is \$50 resulting from adjustments to sales and costs of sales (\$100—\$50).

(ii) If D is instead only entitled to a 50 percent refund from P, D is required under paragraph (g)(1) of this section to decrease its costs of goods sold by \$25, the amount of refund from P. D's proper amount excluded from its 1989 gross income under section 458 is \$75, resulting from adjustments to sales and cost of sales (\$100—\$25).

[T.D. 8426, 57 FR 38596, Aug. 26, 1992; 57 FR 45879, Oct. 5, 1992]

§ 1.458-2 Manner of and time for making election.

(a) *Scope.* For taxable years beginning after September 30, 1979, section 458 provides a special method of accounting for taxpayers who account for

sales of magazines, paperbacks, or records using an accrual method of accounting. In order to use the special method of accounting under section 458, a taxpayer must make an election in the manner prescribed in this section. The election does not require the prior consent of the Internal Revenue Service. The election is effective for the taxable year for which it is made and for all subsequent taxable years, unless the taxpayer secures the prior consent of the Internal Revenue Service to revoke such election.

(b) *Separate election for each trade or business.* An election is made with respect to each trade or business of a taxpayer in connection with which qualified sales (as defined in section 458(b)(5)) of a category of merchandise were made. Magazines, paperbacks, and records are each treated as a separate category of merchandise. If qualified sales of two or more categories of merchandise are made in connection with the same trade or business, then solely for purposes of section 458, each category is treated as a separate trade or business. For example, if a taxpayer makes qualified sales of both magazines and paperbacks in the same trade or business, then solely for purposes of section 458, the qualified sales relating to magazines are considered one trade or business and the qualified sales relating to paperbacks are considered a separate trade or business. Thus, if the taxpayer wishes to account under section 458 for the qualified sales of both magazines and paperbacks, such taxpayer must make a separate election for each category.

(c) *Manner of, and time for, making election.* An election is made under section 458 and this section by filing a statement of election containing the information described in paragraph (d) of this section with the taxpayer's income tax return for first taxable year for which the election is made. The election must be made no later than the time prescribed by law (including extensions) for filing the income tax return for the first taxable year for which the election is made. Thus, the election may not be filed with an amended income tax return after the prescribed date (including extensions)

for filing the original return for such year.

(d) *Required information.* The statement of election required by paragraph (c) of this section must indicate that an election is being made under section 458(c) and must set forth the following information:

(1) The taxpayer's name, address, and identification number;

(2) A description of each trade or business for which an election is made;

(3) The first taxable year for which an election is made for each trade or business;

(4) The merchandise return period (as defined in section 458(b)(7)) for each trade or business for which an election is made;

(5) With respect to an election that applies to magazines, the amount of the adjustment computed under section 481(a) resulting from the change to the method of accounting described in section 458; and

(6) With respect to an election that applies to paperbacks or records, the initial opening balance (computed in accordance with section 458(e)) in the suspense account for each trade or business for which an election is made.

The statement of election should be made on a Form 3115 which need contain no information other than that required by this paragraph.

[T.D. 7628, 44 FR 33398, June 11, 1979. Redesignated by T.D. 8426, 57 FR 38599, Aug. 26, 1992]

§ 1.460-0 Outline of regulations under section 460.

This section lists the paragraphs contained in § 1.460-1 through § 1.460-6.

§ 1.460-1 Long-term contracts.

- (a) Overview.
 - (1) In general.
 - (2) Exceptions to required use of PCM.
 - (i) Exempt construction contract.
 - (ii) Qualified ship or residential construction contract.
- (b) Terms.
 - (1) Long-term contract.
 - (2) Contract for the manufacture, building, installation, or construction of property.
 - (i) In general.
 - (ii) De minimis construction activities.
- (3) Allocable contract costs.
- (4) Related party.