

particular industry. Among such cases are:

- (1) Farmers and raisers of livestock (see §1.471-6);
- (2) Miners and manufacturers who by a single process or uniform series of processes derive a product of two or more kinds, sizes, or grades, the unit cost of which is substantially alike (see §1.471-7); and
- (3) Retail merchants who use what is known as the ‘retail method’ in ascertaining approximate cost (see §1.471-8).

Notwithstanding the other rules of this section, cost shall not include an amount which is of a type for which a deduction would be disallowed under section 162 (c), (f), or (g) and the regulations thereunder in the case of a business expense.

[T.D. 6500, 25 FR 11725, Nov. 26, 1960, as amended by T.D. 7285, 38 FR 26185, Sept. 19, 1973; T.D. 7345, 40 FR 7439, Feb. 20, 1975; T.D. 8131, 52 FR 10084, Mar. 30, 1987; T.D. 8482, 58 FR 42233, Aug. 9, 1993]

**§ 1.471-4 Inventories at cost or market, whichever is lower.**

(a) *In general*—(1) *Market definition.* Under ordinary circumstances and for normal goods in an inventory, *market* means the aggregate of the current bid prices prevailing at the date of the inventory of the basic elements of cost reflected in inventories of goods purchased and on hand, goods in process of manufacture, and finished manufactured goods on hand. The basic elements of cost include direct materials, direct labor, and indirect costs required to be included in inventories by the taxpayer (e.g., under section 263A and its underlying regulations for taxpayers subject to that section). For taxpayers to which section 263A applies, for example, the basic elements of cost must reflect all direct costs and all indirect costs properly allocable to goods on hand at the inventory date at the current bid price of those costs, including but not limited to the cost of purchasing, handling, and storage activities conducted by the taxpayer, both prior to and subsequent to acquisition or production of the goods. The determination of the current bid price of the basic elements of costs reflected in goods on hand at the inventory date

must be based on the usual volume of particular cost elements purchased (or incurred) by the taxpayer.

(2) *Fixed price contracts.* Paragraph (a)(1) of this section does not apply to any goods on hand or in process of manufacture for delivery upon firm sales contracts (i.e., those not legally subject to cancellation by either party) at fixed prices entered into before the date of the inventory, under which the taxpayer is protected against actual loss. Any such goods must be inventoried at cost.

(3) *Examples.* The valuation principles in paragraph (a)(1) of this section are illustrated by the following examples:

*Example 1.* (i) Taxpayer A manufactures tractors. A values its inventory using cost or market, whichever is lower, under paragraph (a)(1) of this section. At the end of 1994, the cost of one of A’s tractors on hand is determined as follows:

Direct materials .....	\$3,000
Direct labor .....	4,000
Indirect costs under section 263A ....	3,000
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Total section 263A costs (cost) .....	\$10,000

(ii) A determines that the aggregate of the current bid prices of the materials, labor, and overhead required to reproduce the tractor at the end of 1994 are as follows:

Direct materials .....	\$3,100
Direct labor .....	4,100
Indirect costs under section 263A ....	3,100
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Total section 263A costs (market) .....	\$10,300

(iii) In determining the lower of cost or market value of the tractor, A compares the cost of the tractor, \$10,000, with the market value of the tractor, \$10,300, in accordance with paragraph (c) of this section. Thus, under this section, A values the tractor at \$10,000.

*Example 2.* (i) Taxpayer B purchases and resells several lines of shoes and is subject to section 263A. B values its inventory using cost or market, whichever is lower, under paragraph (a)(1) of this section. At the end of 1994, the cost of one pair of shoes on hand is determined as follows:

Acquisition cost .....	\$200
Indirect costs under section 263A ....	10
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Total section 263A costs (cost) .....	\$210

(ii) B determines the aggregate current bid prices prevailing at the end of 1994 for the elements of cost (both direct costs and indirect costs incurred prior and subsequent to acquisition of the shoes) based on the volume

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of the elements usually purchased (or incurred) by B as follows:

Acquisition cost .....	\$178
Indirect costs under section 263A ....	12
	\$190
Total §263A costs (market) .....	\$190

(iii) In determining the lower of cost or market value of the shoes, B compares the cost of the pair of shoes, \$210, with the market value of the shoes, \$190, in accordance with paragraph (c) of this section. Thus, under this section, B values the shoes at \$190.

(b) *Inactive markets.* Where no open market exists or where quotations are nominal, due to inactive market conditions, the taxpayer must use such evidence of a fair market price at the date or dates nearest the inventory as may be available, such as specific purchases or sales by the taxpayer or others in reasonable volume and made in good faith, or compensation paid for cancellation of contracts for purchase commitments. Where the taxpayer in the regular course of business has offered for sale such merchandise at prices lower than the current price as above defined, the inventory may be valued at such prices less direct cost of disposition, and the correctness of such prices will be determined by reference to the actual sales of the taxpayer for a reasonable period before and after the date of the inventory. Prices which vary materially from the actual prices so ascertained will not be accepted as reflecting the market.

(c) *Comparison of cost and market.* Where the inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

(d) *Effective date.* This section applies to inventory valuations for taxable years beginning after December 31, 1993. For taxable years beginning before January 1, 1994, taxpayers must take reasonable positions on their federal income tax returns with respect to the application of section 263A, and must have otherwise complied with §1.471-4 (as contained in the 26 CFR part 1 edition revised April 1, 1993). For purposes of this paragraph (d), a rea-

sonable position as to the application of section 263A is a position consistent with the temporary regulations, revenue rulings, revenue procedures, notices, and announcements concerning section 263A applicable in taxable years beginning before January 1, 1994. (See §601.601(d)(2)(ii)(b) of this chapter.)

[T.D. 6500, 25 FR 11725, Nov. 26, 1960, as amended by T.D. 8482, 58 FR 42233, Aug. 9, 1993]

**§ 1.471-5 Inventories by dealers in securities.**

A dealer in securities who in his books of account regularly inventories unsold securities on hand either—

- (a) At cost,
- (b) At cost or market, whichever is lower, or
- (c) At market value,

may make his return upon the basis upon which his accounts are kept, provided that a description of the method employed is included in or attached to the return, that all the securities are inventoried by the same method, and that such method is adhered to in subsequent years, unless another method is authorized by the Commissioner pursuant to a written application therefor filed as provided in paragraph (e) of §1.446-1. A dealer in securities in whose books of account separate computations of the gain or loss from the sale of the various lots of securities sold are made on the basis of the cost of each lot shall be regarded, for the purposes of this section, as regularly inventorying his securities at cost. For the purposes of this section, a dealer in securities is a merchant of securities, whether an individual, partnership, or corporation, with an established place of business, regularly engaged in the purchase of securities and their resale to customers; that is, one who as a merchant buys securities and sells them to customers with a view to the gains and profits that may be derived therefrom. If such business is simply a branch of the activities carried on by such person, the securities inventoried as provided in this section may include only those held for purposes of resale and not for investment. Taxpayers who buy and sell or hold securities for investment or speculation, irrespective