

(h)(3) of this section, if inventory items accounted for under the LIFO method are received in a transaction described in paragraph (h)(2) of this section, then, for the purpose of determining future increments and liquidations, the transferee must use the year of transfer as the base year and must use its current-year cost (computed under the transferee's method of accounting) of those items as their new base-year cost. If the transferee had opening inventories in the year of transfer, then, for the purpose of determining future increments and liquidations, the transferee must use its current-year cost (computed under the transferee's method of accounting) of those inventories as their new base-year cost. For this purpose, "opening inventory" refers to all items owned by the transferee before the transfer for which the transferee uses, or elects to use, the LIFO method. The total new base-year cost of the transferee's inventory as of the beginning of the year of transfer is equal to the new base-year cost of the inventory received from the transferor and the new base-year cost of the transferee's opening inventory. The index (or, the cumulative index in the case of the link-chain method) for the year immediately preceding the year of transfer is 1.00. The base-year cost of any layers in the dollar-value pool, as determined after the transfer, must be recomputed accordingly. See paragraph (e)(3)(iv)(B)(1) of this section for an example of this computation.

(2) *Transactions to which this paragraph (h) applies.* The rules in this paragraph (h) apply to a transaction in which—

(i) The transferee determines its basis in the inventories, in whole or in part, by reference to the basis of the inventories in the hands of the transferor;

(ii) The transferor used the dollar-value LIFO method to account for the transferred inventories;

(iii) The transferee uses the dollar-value LIFO method to account for the inventories in the year of the transfer; and

(iv) The transaction is not described in section 381(a).

(3) *Anti-avoidance rule.* The rules in this paragraph (h) do not apply to a

transaction entered into with the principal purpose to avail the transferee of a method of accounting that would be unavailable to the transferor (or would be unavailable to the transferor without securing consent from the Commissioner). In determining the principal purpose of a transfer, consideration will be given to all of the facts and circumstances. However, a transfer is deemed made with the principal purpose to avail the transferee of a method of accounting that would be unavailable to the transferor without securing consent from the Commissioner if the transferor acquired inventory in a bargain purchase within the five taxable years preceding the year of the transfer and used a dollar-value LIFO method to account for that inventory that did not treat the bargain purchase inventory and physically identical inventory acquired at market prices as separate items. Inventory is deemed acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was less than or equal to 50 percent of the replacement cost of physically identical inventory. Inventory is not considered acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was greater than or equal to 75 percent of the replacement cost of physically identical inventory.

(4) *Effective date.* The rules of this paragraph (h) are applicable for transfers that occur during a taxable year ending on or after December 31, 2001.

[T.D. 6539, 26 FR 518, Jan. 20, 1961, as amended by T.D. 7814, 47 FR 11272, Mar. 16, 1982; T.D. 8976, 67 FR 1082, Jan. 9, 2002; 67 FR 5062, 5148, Feb. 4, 2002]

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§§ 1.475(a)-1—1.475(a)-2 [Reserved]

§ 1.475(a)-3 *Acquisition by a dealer of a security with a substituted basis.*

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(b) Rules.

**§ 1.475-0**

**26 CFR Ch. I (4-1-02 Edition)**

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- (a) Securities never held in connection with the taxpayer's activities as a dealer in securities.
- (b) Ordinary treatment for notional principal contracts and derivatives held by dealers in notional principal contracts and derivatives.

**Internal Revenue Service, Treasury**

**§ 1.475(b)-1**

*§ 1.475(e)-1 Effective dates.*

[T.D. 8700, 61 FR 67719, Dec. 24, 1996]

**§ 1.475(a)-1—1.475(a)-2 [Reserved]**

**§ 1.475(a)-3 Acquisition by a dealer of a security with a substituted basis.**

(a) *Scope.* This section applies if—

(1) A dealer in securities acquires a security that is subject to section 475(a) and the dealer's basis in the security is determined, in whole or in part, by reference to the basis of that security in the hands of the person from whom the security was acquired; or

(2) A dealer in securities acquires a security that is subject to section 475(a) and the dealer's basis in the security is determined, in whole or in part, by reference to other property held at any time by the dealer.

(b) *Rules.* If this section applies to a security—

(1) Section 475(a) applies only to changes in value of the security occurring after the acquisition; and

(2) Any built-in gain or loss with respect to the security (based on the difference between the fair market value of the security on the date the dealer acquired it and its basis to the dealer on that date) is taken into account at the time, and has the character, provided by the sections of the Internal Revenue Code that would apply to the built-in gain or loss if section 475(a) did not apply to the security.

[T.D. 8700, 61 FR 67720, Dec. 24, 1996]

**§ 1.475(b)-1 Scope of exemptions from mark-to-market requirement.**

(a) *Securities held for investment or not held for sale.* Except as otherwise provided by this section and subject to the identification requirements of section 475(b)(2), a security is held for investment (within the meaning of section 475(b)(1)(A)) or not held for sale (within the meaning of section 475(b)(1)(B)) if it is not held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business.

(b) *Securities deemed identified as held for investment—*(1) *In general.* The following items held by a dealer in securities are per se held for investment

within the meaning of section 475(b)(1)(A) and are deemed to be properly identified as such for purposes of section 475(b)(2)—

(i) Except as provided in paragraph (b)(3) of this section, stock in a corporation, or a partnership or beneficial ownership interest in a widely held or publicly traded partnership or trust, to which the taxpayer has a relationship specified in paragraph (b)(2) of this section; or

(ii) A contract that is treated for federal income tax purposes as an annuity, endowment, or life insurance contract (see sections 72, 817, and 7702).

(2) *Relationships—*(i) *General rule.* The relationships specified in this paragraph (b)(2) are—

(A) Those described in section 267(b)(2), (3), (10), (11), or (12); or

(B) Those described in section 707(b)(1)(A) or (B).

(ii) *Attribution.* The relationships described in paragraph (b)(2)(i) of this section are determined taking into account sections 267(c) and 707(b)(3), as appropriate.

(iii) *Trusts treated as partnerships.* For purposes of this paragraph (b)(2), the phrase partnership or trust is substituted for the word *partnership* in sections 707(b)(1) and (3), and a reference to beneficial ownership interest is added to each reference to capital interest or profits interest in those sections.

(3) *Securities traded on certain established financial markets.* Paragraph (b)(1)(i) of this section does not apply to a security if—

(i) The security is actively traded within the meaning of § 1.1092(d)-1(a) taking into account only established financial markets identified in § 1.1092(d)-1(b)(1) (i) or (ii) (describing national securities exchanges and interdealer quotation systems);

(ii) Less than 15 percent of all of the outstanding shares or interests in the same class are held by the taxpayer and all persons having a relationship to the taxpayer that is specified in paragraph (b)(2) of this section; and

(iii) If the security was acquired (e.g., on original issue) from a person having a relationship to the taxpayer that is