

applies to taxable years ending on or after December 31, 1993.

(i) Section 1.475(c)-1(c)(3) (special rules for members of a consolidated group) is effective for taxable years beginning on or after December 24, 1996.

(ii) A taxpayer may rely on the rules set out in §1.475(c)-1T(b) (as contained in 26 CFR part 1 revised April 1, 1996) for taxable years beginning before January 23, 1997, provided the taxpayer applies that paragraph reasonably and consistently.

(4) Section 1.475(c)-1(d) (concerning the issuance of life insurance products) applies to taxable years beginning on or after January 1, 1995.

(i) Section 1.475(c)-2 (concerning the definition of security) applies to taxable years ending on or after December 31, 1993. By its terms, however, §1.475(c)-2(a)(3) applies only to residual interests or to interests or arrangements that are acquired on or after January 4, 1995; and the integrated transactions that are referred to in §§1.475(c)-2(a)(2) and 1.475(c)-2(b) exist only after August 13, 1996 (the effective date of §1.1275-6).

(j) Section 1.475(d)-1 (concerning the character of gain or loss) applies to taxable years ending on or after December 31, 1993.

[T.D. 8700, 61 FR 67725, Dec. 24, 1996]

#### ADJUSTMENTS

##### § 1.481-1 Adjustments in general.

(a)(1) Section 481 prescribes the rules to be followed in computing taxable income in cases where the taxable income of the taxpayer is computed under a method of accounting different from that under which the taxable income was previously computed. A change in method of accounting to which section 481 applies includes a change in the over-all method of accounting for gross income or deductions, or a change in the treatment of a material item. For rules relating to changes in methods of accounting, see section 446(e) and paragraph (e) of §1.446-1. In computing taxable income for the taxable year of the change, there shall be taken into account those adjustments which are determined to be necessary solely by reason of such change in order to prevent amounts

from being duplicated or omitted. The "year of the change" is the taxable year for which the taxable income of the taxpayer is computed under a method of accounting different from that used for the preceding taxable year.

(2) Unless the adjustments are attributable to a change in method of accounting initiated by the taxpayer, no part of the adjustments required by subparagraph (1) of this paragraph shall be based on amounts which were taken into account in computing income (or which should have been taken into account had the new method of accounting been used) for taxable years beginning before January 1, 1954, or ending before August 17, 1954 (hereinafter referred to as pre-1954 years).

(b) The adjustments specified in section 481(a) and this section shall take into account inventories, accounts receivable, accounts payable, and any other item determined to be necessary in order to prevent amounts from being duplicated or omitted.

(c)(1) The term "adjustments", as used in section 481, has reference to the net amount of the adjustments required by section 481(a) and paragraph (b) of this section. In the case of a change in the over-all method of accounting, such as from the cash receipts and disbursements method to an accrual method, the term "net amount of the adjustments" means the consolidation of adjustments (whether the amounts thereof represent increases or decreases in items of income or deductions) arising with respect to balances in various accounts, such as inventory, accounts receivable, and accounts payable, at the beginning of the taxable year of the change in method of accounting. With respect to the portion of the adjustments attributable to pre-1954 years, it is immaterial that the same items or class of items with respect to which adjustments would have to be made (for the first taxable year to which section 481 applies) do not exist at the time the actual change in method of accounting occurs. For purposes of section 481, only the net dollar balance is to be taken into account. In the case of a change in the treatment of a single material item, the amount of the adjustment shall be determined

with reference only to the net dollar balances in that particular account.

(2) If a change in method of accounting is voluntary (i.e., initiated by the taxpayer), the entire amount of the adjustments required by section 481(a) is generally taken into account in computing taxable income in the taxable year of the change, regardless of whether the adjustments increase or decrease taxable income. See, however, §§ 1.446-1(e)(3) and 1.481-4 which provide that the Commissioner may prescribe the taxable year or years in which the adjustments are taken into account.

(3) If the change in method of accounting is involuntary (i.e., not initiated by the taxpayer), then only the amount of the adjustments required by section 481(a) that is attributable to taxable years beginning after December 31, 1953, and ending after August 16, 1954, (hereinafter referred to as post-1953 years) is taken into account. This amount is generally taken into account in computing taxable income in the taxable year of the change, regardless of whether the adjustments increase or decrease taxable income. See, however, §§ 1.446-1(e)(3) and 1.481-4 which provide that the Commissioner may prescribe the taxable year or years in which the adjustments are taken into account. See also § 1.481-3 for rules relating to adjustments attributable to pre-1954 years.

(4) For any adjustments attributable to post-1953 years that are taken into account entirely in the year of change and that increase taxable income by more than \$3,000, the limitations on tax provided in section 481(b) (1) or (2) apply. See § 1.481-2 for rules relating to the limitations on tax provided by sections 481(b) (1) and (2).

(5) A change in the method of accounting initiated by the taxpayer includes not only a change which he originates by securing the consent of the Commissioner, but also a change from one method of accounting to another made without the advance approval of the Commissioner. A change in the taxpayer's method of accounting required as a result of an examination of the taxpayer's income tax return will not be considered as initiated by the taxpayer. On the other hand, a taxpayer who, on his own initiative,

changes his method of accounting in order to conform to the requirements of any Federal income tax regulation or ruling shall not, merely because of such fact, be considered to have made an involuntary change.

(d) Any adjustments required under section 481(a) that are taken into account during a taxable year must be properly taken into account for purposes of computing gross income, adjusted gross income, or taxable income in determining the amount of any item of gain, loss, deduction, or credit that depends on gross income, adjusted gross income, or taxable income.

[T.D. 6500, 25 FR 11731, Nov. 26, 1960, as amended by T.D. 8608, 60 FR 40078, Aug. 7, 1995]

#### § 1.481-2 Limitation on tax.

(a) *Three-year allocation.* Section 481(b)(1) provides a limitation on the tax under chapter 1 of the Internal Revenue Code for the taxable year of change that is attributable to the adjustments required under section 481(a) and § 1.481-1 if the entire amount of the adjustments is taken into account in the year of change. If such adjustments increase the taxpayer's taxable income for the taxable year of the change by more than \$3,000, then the tax for such taxable year that is attributable to the adjustments shall not exceed the lesser of the tax attributable to taking such adjustments into account in computing taxable income for the taxable year of the change under section 481(a) and § 1.481-1, or the aggregate of the increases in tax that would result if the adjustments were included ratably in the taxable year of the change and the two preceding taxable years. For the purpose of computing the limitation on tax under section 481(b)(1), the adjustments shall be allocated ratably to the taxable year of the change and the two preceding taxable years, whether or not the adjustments are in fact attributable in whole or in part to such years. The limitation on the tax provided in this paragraph shall be applicable only if the taxpayer used the method of accounting from which the change was made in computing taxable income for the two taxable years preceding the taxable year of the change.