Internal Revenue
bulletin

Bulletin No. 2002–5
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HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

T.D. 8972, page 443.
Final regulations under section 1301 of the Code provide guidance to individuals engaged in a farming business who may elect to income average and thereby reduce their regular tax liability by treating all or a portion of the current year's farming income as if it had been earned in equal portions over the prior three years.

T.D. 8976, page 421.
Final regulations under section 472 of the Code relate to accounting for inventories under the last-in, first-out (LIFO) method. The regulations provide guidance regarding methods of valuing dollar-value LIFO pools and affect persons who elect to use the dollar-value LIFO and inventory price index computation (IPIC) methods or who receive dollar-value LIFO inventories in certain nonrecognition transactions. Rev. Procs. 84–57 and 98–49 obsoleted. Rev. Rul. 89–29 obsoleted.

EMPLOYEE PLANS

Notice 2002–9, page 450 .
Weighted average interest rate update. The weighted average interest rate for January 2002 and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code are set forth.

EXCISE TAX

REG–125450–01, page 457 .
Proposed regulations under section 4374 of the Code contain amendments to the regulations relating to liability for the insurance premium excise tax. This document affects persons who make, sign, issue, or sell a policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer. A public hearing is scheduled for March 19, 2002.

ADMINISTRATIVE

Rev. Proc. 2002–14, page 450.
Automobile owners and lessees. This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2002 and the amounts to be included in income for automobiles first leased during calendar year 2002. In addition, it provides the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 2002 for which the vehicle cents-per-mile valuation rule provided under section 1.61–21(e) of the regulations may be applicable.

Announcement 2002–6, page 458.
This document contains a notice of public hearing on REGs–142299–01 and 209135–88 (2002–4 I.R.B. 418) relating to certain transactions or events that result in a Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT) owning property that has a basis determined by reference to a C corporation's basis in the property. A public hearing is scheduled for May 1, 2002.

Announcement 2002–7, page 459.
This document contains corrections to temporary regulations (REG–105344–01, 2002–2 I.R.B. 302) which permit the IRS to authorize federal, state, and local agencies with access to returns and return information to redisclose such information, with the Commissioner's approval, to any authorized recipient set forth in section 6103 of the Code, subject to the same conditions and restrictions, and for the same purposes, as if the recipient had received the information directly from the IRS.

Finding Lists begin on page ii.
Index for January begins on page iv.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The first Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the first Bulletin of the succeeding semiannual period, respectively.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

This procedure provides the maximum value of employer-provided automobiles first made available to employees for personal use in calendar year 2002 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. See Rev. Proc. 2002–14, page 450.

Section 280F.—Limitation on Depreciation for Luxury Automobiles; Limitation Where Certain Property Used for Personal Purposes

26 CFR 1.280F–7: Property leased after December 31, 1986.

This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2002 and the amounts to be included in income for automobiles first leased during calendar year 2002. See Rev. Proc. 2002–14, page 450.

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–8: Dollar-value method of pricing LIFO inventories.

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

T.D. 8976

Dollar-Value LIFO Regulations; Inventory Price Index Computation Method

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations under section 472 of the Internal Revenue Code that relate to accounting for inventories under the last-in, first-out (LIFO) method. The final regulations provide guidance regarding methods of valuing dollar-value LIFO pools and affect persons who elect to use the dollar-value LIFO and inventory price index computation (IPIC) methods or who receive dollar-value LIFO inventories in certain nonrecognition transactions.

DATES: *Effective Date*: These regulations are effective on December 31, 2001.

Applicability Date: For dates of applicability, see §§ 1.472–8(e)(3)(v) and 1.472–8(h)(4).

FOR FURTHER INFORMATION CONTACT: Leo F. Nolan II at (202) 622–4970 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information in this final rule have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545–1767.

The collections of information in this regulation are in § 1.472–8(e)(3)(iii)(B)(*3*) and (e)(3)(iv). To elect the IPIC method, a taxpayer must file Form 970, "*Application to Use LIFO Inventory Method.*" This information is required to inform the Commissioner regarding the taxpayer's elections under the IPIC method. This information will be used to determine whether the taxpayer is properly accounting for its dollar-value pools under the IPIC method. The collections of information are required if the taxpayer wants to obtain the tax benefits of the LIFO method. The likely respondents are business or other for-profit institutions, and/or small businesses or organizations.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The reporting burden contained in § 1.472–8(e)(3)(iii)(B)(*3*) and (e)(3)(iv) is reflected in the burden of Form 970.

Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 472 of the Internal Revenue Code (Code) permits a taxpayer to account for inventories using a last-in, first-out (LIFO) method of accounting. Section 472(f) directs the Secretary to prescribe regulations that permit the use of suitable published governmental price indexes for purposes of the LIFO method. The IRS and Treasury Department prescribed the inventory price index computation (IPIC) method in § 1.472–8(e)(3) (T.D. 7814, 1982–1 C.B. 84 [47 FR 11271]) (the current regulations), under the authority contained in sections 472 and 7805. A taxpayer using the IPIC method must base its inventory price indexes on the consumer price indexes or producer price indexes published by the United States Bureau of Labor Statistics (BLS). The IPIC method was intended to simplify the use of the dollar-value LIFO method, so that the LIFO method could be used by more taxpayers and so that taxpayers already using the dollar-value LIFO method would have a simpler alternative method of computing an index for their dollar-value pool.

On May 19, 2000, the IRS and Treasury Department published a notice of proposed rulemaking (REG–107644–98, 2000–23 I.R.B. 1229 [65 FR 31841]) (the proposed regulations) intended to simplify and clarify certain aspects of the

IPIC method. In addition, the proposed regulations provided rules for computing the LIFO value of a dollar-value pool when a taxpayer receives LIFO inventories in certain nonrecognition transactions. Comments responding to the notice were received, and a public hearing was held on September 15, 2000.

The IRS and Treasury Department received 16 comment letters concerning the proposed regulations. After considering the comments contained in these letters, the IRS and Treasury Department adopt the proposed regulations as revised by this Treasury decision. The comments and revisions are discussed below.

Explanation of Provisions and Summary of Comments

1. Overview

Under the last-in, first-out (LIFO) method, inventory on hand at the end of the year is treated as consisting of "layers," first of inventory on hand at the beginning of the year (in the order of acquisition), and then of any inventory acquired during the current year. Section 1.472–8 permits a taxpayer to use the dollar-value LIFO method, which accounts for all items in an inventory "pool" (dollar-value pool) in terms of dollars of cost rather than in terms of quantities and prices of specific goods. Specifically, the taxpayer annually determines the existence of an increase (increment) or decrease (liquidation) in a dollar-value pool by comparing inventory quantities measured in terms of equivalent-value dollars (base-year cost). The current-year cost of beginning and ending inventory is converted into base-year cost using an inflation index, which is the ratio of the dollar-value pool's total current-year cost to its total base-year cost. By subtracting the base-year cost of the dollar-value pool at the beginning of the taxable year from the base-year cost of the dollar-value pool at the end of the taxable year, the taxpayer determines the amount of any resulting increment or liquidation. Finally, the taxpayer computes the LIFO value of an increment (layer) by multiplying that increment's base-year cost by an inflation index.

The current regulations provide an alternative method for a taxpayer to determine an inflation index. Under the inventory price index computation (IPIC) method, the taxpayer computes an inventory price index (IPI) based on the consumer price indexes (CPI) or producer price indexes (PPI) published monthly by the United States Bureau of Labor Statistics (BLS) in the "CPI Detailed Report" and "PPI Detailed Report," respectively. See also *http://www.bls.gov.*

To facilitate a taxpayer's use of the IPIC method, the final regulations use new, more-descriptive terms for some IPIC method concepts. For example, *pool index* has been replaced with *IPI*, *appropriate index* has been replaced with *category inflation index*, and *index category* has been replaced with *BLS index category*. Within this preamble, the discussion of the current and proposed regulations uses both old and new terms, and the discussion of the final regulations generally uses the new terms.

2. Inventory Price Index — 20 percent reduction

The current regulations state that "[a]n inventory price index computed [under the IPIC method] shall be a stated percentage of the percent change in the selected consumer or producer price index or indexes for a specific category or categories of goods." For this purpose, "stated percentage" means "100 percent" in the case of an eligible small business, as defined in section 474 (*i.e.*, average annual gross receipts for the three preceding taxable years do not exceed $5,000,000), and "80 percent" in all other cases. The proposed regulations retained this 20 percent reduction for large taxpayers.

Several commentators objected to the continuing requirement that large taxpayers reduce the IPI by 20 percent. Some of these commentators opined that the IPIC method is effectively a safe harbor method that significantly simplifies the LIFO computation and reduces IRS and taxpayer controversy; however, the 20 percent reduction is a major deterrent to its use by large taxpayers. Others argued that the CPI and PPI are representative of true inflation and, therefore, the 20 percent reduction decreases the accuracy of the IPIC method. Other commentators recommended that the stated percentage not be decreased by 20 percent until the taxpayer's gross receipts exceed $10,000,000. In their view, a taxpayer's gross receipts are likely to exceed $5,000,000 by the time the taxpayer's business is profitable enough to benefit by changing to the LIFO method.

The 20 percent reduction contained in the current regulations represents a balance between two competing tax policies — simplification and prevention of adverse selection. The IPIC method was developed originally to simplify the LIFO rules so that small businesses that could not compute an internal inflation index could use the LIFO method. Nonetheless, availability of the method was provided to all taxpayers because it was believed to be too difficult to define the class of taxpayers for which the LIFO rules were unduly burdensome and inappropriate to prevent large taxpayers from using the simplified method. Allowing all taxpayers to use the CPI or PPI regardless of the rate of inflation they actually experienced, however, provided an opportunity for adverse selection whereby a sophisticated taxpayer would adopt the IPIC method only when the inflation reflected in the CPI or PPI exceeded the taxpayer's internal rate of inflation. The 20 percent reduction of the IPI was incorporated into the current regulations to reduce this potential for adverse selection.

The IRS and Treasury Department now believe that the benefits of simplification (and reduced controversy) obtained from the IPIC method outweigh the need to prevent adverse selection. Consequently, the final regulations eliminate the requirement to reduce the IPI by 20 percent. All taxpayers electing to use the IPIC method may use 100 percent of the IPI to compute the LIFO value of a dollar-value pool.

3. Use of 10 Percent Categories and BLS Weights

The current regulations provide rules for assigning the items in a dollar-value pool to the applicable categories listed in the "CPI Detailed Report" or the "PPI Detailed Report" for which the BLS publishes corresponding cumulative price indexes (BLS categories and BLS price indexes, respectively) for purposes of computing the IPI for a dollar-value pool. In very simple terms, taxpayers use a process of elimination to assign all the items in a dollar-value pool to BLS categories

that include at least 10 percent of the total inventory value (10 percent BLS categories) and then use the corresponding BLS weights to compute a weighted-average appropriate index for the items assigned to those 10 percent BLS categories.

The proposed regulations eliminate the requirements to use the 10 percent BLS categories and BLS weights to compute an appropriate index because it was believed that these requirements did not provide the intended simplicity but rather added unnecessary complexity to the IPIC method. Instead, the proposed regulations require the taxpayer to assign items in a dollar-value pool to the most-detailed BLS categories listed in the "CPI Detailed Report" or the "PPI Detailed Report," whichever is applicable, and to weight the BLS price indexes based on the relative current-year cost of the items assigned to those BLS categories.

Several commentators objected to the elimination of the requirement to use the 10 percent BLS categories and BLS weights to compute an appropriate index. They suggested that this regime does in fact provide simplification for some taxpayers and consequently should be retained as an option, particularly for retail grocers that would have to incur substantial administrative costs to have the items contained in their dollar-value pools assigned to numerous, most-detailed BLS categories. Other commentators supported the elimination of the requirement to use BLS weights, arguing that this will reduce both the complexity of the IPIC method and the potential for distortion caused by the use of the BLS weights. However, these commentators generally recommended retention of the 10 percent categories or, alternatively, modification of the proposed rule to permit a taxpayer to assign items in a dollar-value pool to less-detailed BLS categories (*e.g.*, using 6-digit or 4-digit commodity codes in the PPI). Another commentator suggested lowering the testing threshold from 10 percent to 8 percent.

The IRS and Treasury Department now understand that the requirement to use 10 percent BLS categories and BLS weights provides simplicity for some taxpayers but complexity for others. Accordingly, the final regulations retain the 10 percent BLS categories and BLS weights as an elective method (10 percent method) of determining the category inflation index of a 10 percent BLS category. The final regulations clarify, however, that to determine whether a BLS category may be selected under the 10 percent method, a taxpayer must compare the current-year cost of the items in that category to the total current-year cost of the items in the dollar-value pool, not to the total current-year cost of the items in the taxpayer's entire inventory.

4. Weighted Harmonic Mean for Computing Inventory Price Index

A pool index computed using the dollar-value LIFO method should reflect a weighted average of the inflation rates of the items contained in the ending inventory of the dollar-value pool. The current regulations state that the appropriate indexes are weighted according to the relative current-year costs of the items in each selected BLS category. However, the regulations do not state how a taxpayer computes a weighted average of the appropriate indexes using the amount of relative current-year costs in each selected BLS category. An example of IPIC weighting methodology is found in Rev. Proc. 84–57 (1984–2 C.B. 496), which shows the computation of an IPI based on a weighted arithmetic mean of the appropriate indexes. (Weighted Arithmetic Mean = [Sum of (Weight x Appropriate Index)] / Sum of Weights). In addition, an example found in Rev. Proc. 98–49 (1998–2 C.B. 320) uses a weighted arithmetic mean to compute a weighted-average percent change for a selected BLS category.

The proposed regulations provide that the pool index must be computed using a weighted harmonic mean, instead of a weighted arithmetic mean, based on the relative current-year costs in the dollar-value pool. (Weighted Harmonic Mean = Sum of Weights / Sum of (Weight / Appropriate Index)).

Using a weighted arithmetic mean of the category inflation indexes of the BLS categories represented in a dollar-value pool is not a mathematically correct method of computing the IPI for the pool when the corresponding weights are the relative current-year costs at the end of the taxable year. If a taxpayer's dollar-value pool has the same quantity of two items with identical base-year costs, the IPI should reflect the inflation rates of the two items equally. However, a weighted arithmetic mean of the category inflation indexes will assign more weight to the inflation rate of the item that has the higher current-year cost. Thus, the mean will be skewed in favor of BLS categories that experience higher rates of inflation, and the IPI will be overstated. This result also will occur when the items in the dollar-value pool experience deflation because too much weight will be assigned to the BLS categories that experience less deflation.

Several commentators objected to the mandatory use of the weighted harmonic mean when computing an IPI. Acknowledging that an IPI based on a weighted harmonic mean is mathematically correct, these commentators stated that the inaccuracy built into a weighted arithmetic mean is offset (in the case of larger taxpayers) by the 20 percent reduction of the "stated percentage." Thus, they recommended that taxpayers be permitted to continue computing IPIs based on a weighted arithmetic mean rather than be required to incur additional administrative costs to begin computing IPIs based on a weighted harmonic mean.

The IRS and Treasury Department did not adopt these suggestions because a weighted arithmetic mean based on relative current-year costs at the end of the period is not mathematically correct and the conversion from a weighted arithmetic mean to a weighted harmonic mean is not unduly burdensome. To assist taxpayers that need to change to a weighted harmonic mean, the final regulations include the formula for, and examples of, computing a weighted harmonic mean.

On the other hand, the use of a weighted arithmetic mean is mathematically correct when computing a weighted-average category inflation index based on relative costs at the beginning of the taxable year. The published BLS weights applicable for a taxable year are essentially based on relative costs at the beginning of the period. Therefore, whenever it is necessary to compute the category inflation index of a 10 percent BLS category using BLS weights, taxpayers must compute a weighted arithmetic mean. When computing the IPI for a dollar-value pool, however, even taxpayers electing to use the 10 percent method

must use the weighted harmonic mean based on the current-year cost of the items assigned to each 10 percent BLS category.

5. Selecting an Appropriate Month

The current regulations state that a taxpayer not using the retail method must select price indexes "as of the month or months" most appropriate to its method of determining current-year cost (appropriate month), or make a one-time binding election of an appropriate representative month (representative month). In the case of a retailer using the retail method, the appropriate month is the last month of the retailer's taxable year. The IRS has ruled that a month is a representative month if a nexus exists between the selected month, the taxpayer's method of determining current-year cost, and the taxpayer's historic experience of inventory purchases. Rev. Rul. 89–29 (1989–1 C.B. 168). In practice, many taxpayers have been confused about the meaning of "month or months most appropriate to the taxpayer's method of determining current-year cost."

The proposed regulations clarify that for each dollar-value pool, a taxpayer not using the retail method either must annually select an appropriate month or must make an election to use a representative month. The principles of Rev. Rul. 89–29, which have been incorporated into the final regulations, continue to apply for the purpose of determining whether a particular month is appropriate or representative.

Several commentators stated that taxpayers should be permitted to use two IPIs for each taxable year (dual indexes), so that they will not be denied the right to use the earliest acquisitions method of determining current-year costs. These commentators suggest that a taxpayer whose accounting system determines the current-year cost of ending inventory using a first-in, first-out (FIFO) method (*i.e.*, most recent purchases) could compute an IPI based on indexes selected from the CPI or PPI applicable to a month late in the taxable year to deflate the current-year cost of items in ending inventory for the purpose of determining whether an increment or liquidation has occurred during the taxable year. If there is an increment, the taxpayer would compute a second IPI based on indexes selected from the CPI or PPI applicable to a month early in the taxable year to inflate the base-year cost of the increment to its LIFO value based on its "pricing election" (*i.e.*, earliest acquisitions).

The IRS and Treasury Department did not adopt this suggestion for several reasons. First, the IPIC method and the earliest acquisitions method are not mutually exclusive. In fact, the current and proposed IPIC regulations clearly permit an electing taxpayer to use any method of determining current-year cost permitted under § 1.472–8(e)(2)(ii), including the earliest acquisitions method. A dual index IPIC method is not needed to ensure that an electing taxpayer will be able to use the earliest acquisitions method. However, the earliest acquisitions method is available under the IPIC method only to a taxpayer that actually computes the current-year cost of its ending inventory using the earliest acquisitions method because use of a dual index is inconsistent with the IPIC method's concept of an appropriate month. The appropriate month concept requires a taxpayer to select a month that correlates with its actual method of computing current-year cost and its experience with inventory purchases. As explained in Rev. Rul. 89–29, "[t]he timing of the index (and the month selected) must relate to the timing of the determination of current-year cost, otherwise distortion would occur." The determination of an appropriate month is not a choice between equally acceptable methods of determining current-year cost, but depends on the taxpayer's actual method of determining current-year cost and actual purchases. Thus, a taxpayer using a calendar tax year may select January as the appropriate month only if items represented in the ending inventory were purchased in January and the taxpayer determines the current-year cost of the ending inventory based on the cost of those January purchases.

Moreover, though a dual index IPIC method would eliminate the requirement to determine the actual earliest acquisitions cost of the items in a dollar-value pool, the method would not simplify a taxpayer's use of the dollar-value LIFO method. A dual index IPIC method will require an electing taxpayer to compute (and the IRS to examine) twice as many category inflation indexes because the taxpayer would need BLS price indexes that reflect its inflation experience under the most recent purchases method as well as under the earliest acquisitions method. Similarly, a dual index IPIC method would require a taxpayer to select twice as many appropriate or representative months for each taxable year. Not only does the requirement to select two appropriate months increase the complexity of the IPIC method, it also decreases the accuracy of the method as some accuracy is lost as a result of determining the appropriate month for the entire pool rather than for each inventory item or each BLS category.

In summary, the IPIC method was intended to simplify the dollar-value LIFO method, primarily so it could be used by taxpayers that were otherwise unable to use the method. The IPIC method was neither intended nor designed to serve as a surrogate for determining the earliest acquisitions cost of the items in a dollar-value pool. The prohibition on the use of dual indexes in connection with the IPIC method, however, does not necessarily mean that the use of dual indexes will be prohibited in the context of other LIFO methods.

Several commentators objected to the rule that requires a taxpayer using both the retail method and LIFO method to use the last month of the taxable year as its appropriate month. In their view, a month in the middle of the year would be more representative because the retail method produces an average cost for a group of goods based on purchases for an entire year.

The IRS and Treasury Department did not adopt this suggestion because they believe that the appropriate month for a taxpayer using the retail method is the last month of the taxable year. Section 1.471–8 generally requires that a taxpayer adjust retail selling prices of the goods on hand at the end of the year to cost based on the ratio of goods available for sale at cost to goods available for sale at retail (the cost complement percentage). While this ratio may reflect an average cost complement percentage for the year, it is applied to retail selling prices of the

goods on hand at the end of the taxable year rather than the average retail selling price of these goods during the year. Consequently, the approximate cost determined under the retail method is not necessarily equal to the average cost of the inventory.

One commentator suggested that the final regulations should include factors for determining an appropriate month. Other commentators requested an example showing how to determine an appropriate month when a short taxable year follows the first taxable year that a taxpayer uses the IPIC method. In response to these comments, the final regulations incorporate the guidance on an appropriate representative month (including three of the examples) found in Rev. Rul. 89–29.

6. Calculation of a Category Inflation Index

The proposed regulations generally provide that in the case of a taxpayer using the double-extension IPIC method, the inflation index for a selected BLS category is equal to the quotient of the BLS price index for the appropriate or representative month of the current taxable year and the month preceding the first day of the base year. In the case of a taxpayer using the link-chain IPIC method, the inflation index for a selected BLS category is equal to the BLS price index for the appropriate or representative month of the current taxable year divided by the appropriate or representative month used for the immediately preceding taxable year. However, if the first taxable year the taxpayer uses the IPIC method also is the first taxable year the taxpayer uses the dollar-value LIFO method, the inflation index is equal to the quotient of the published cumulative index for the appropriate or representative month for the current taxable year divided by the published cumulative index for the month immediately preceding the first day of the taxable year.

Several commentators argued that the prescribed calculation for the first taxable year a taxpayer uses both the dollar-value LIFO and IPIC methods is likely to overstate or understate inflation if the taxpayer has opening inventories, unless the opening inventories were purchased during the last month of the preceding taxable year. To address this concern, the commentators suggested that a taxpayer be permitted to compare the BLS price index for the appropriate month of the first LIFO taxable year with the BLS price index for the appropriate month of the taxpayer's last non-LIFO taxable year. Another commentator suggested that the denominator in this formula should be the BLS price index that reflects prices during the last inventory turn of the immediately preceding taxable year.

The IRS and Treasury Department agree with the commentators' concerns. In addition, the IRS and Treasury Department recognize that the same problem exists under the proposed regulations as a result of the requirement to use the month preceding the first day of the base year to compute an appropriate index under the double-extension IPIC method. Accordingly, the final regulations generally provide that a category inflation index should be computed with reference to the BLS price indexes for an appropriate month of the year preceding its LIFO election (in the case of the double-extension IPIC method) or of the preceding year (in the case of the link-chain IPIC method). In addition, the final regulations incorporate the general guidance of Rev. Proc. 98–49 concerning the computation of a category inflation index when a selected BLS category is revised for the taxable year.

7. Scope of an IPIC Method Election

The current regulations generally require a taxpayer using the IPIC method to use that method to account for all items accounted for using the LIFO method (LIFO inventory items). The current regulations also prohibit the use of the IPIC method by a taxpayer that is eligible to use BLS price indexes prepared for the purpose of valuing the LIFO inventory items of a specific industry. For example, a taxpayer eligible to use the BLS retail price indexes published in "Department Store Inventory Price Indexes" (DSIP indexes) may not use the IPIC method.

The proposed regulations liberalize the eligibility restrictions applicable to the IPIC method in two respects. First, a taxpayer must use the IPIC method for all items accounted for under the dollar-value LIFO method, but not for all items accounted for under the LIFO method. Second, a taxpayer eligible to use DSIP indexes may elect to use the IPIC method for all its LIFO inventory items or for those LIFO inventory items that do not fall within any of the 23 major groups listed in "Department Store Inventory Price Indexes."

Several commentators objected to the proposed general requirement that an electing taxpayer use the IPIC method for all its LIFO inventory items. In their view, section 446(d) permits a taxpayer to elect the IPIC method for each trade or business. The requirement to use the IPIC method for all LIFO inventory items, as originally promulgated, was designed to prevent adverse selection. The IRS and Treasury Department understand, however, that taxpayers often have valid business reasons for using the IPIC method in some businesses but not in others. For example, a taxpayer may have difficulty using the double-extension method in one of its trades or businesses but not in another. Accordingly, the final regulations permit a taxpayer to limit its IPIC election to one or more specific trades or businesses.

8. Selection of "CPI Detailed Report" or "PPI Detailed Report"

The current regulations state that a retailer may select price indexes from the "CPI Detailed Report" or the "PPI Detailed Report," but if equally appropriate price indexes may be selected from either, a retailer using the retail method must select from the "CPI Detailed Report," and a retailer not using the retail method must select from the "PPI Detailed Report."

The proposed regulations eliminate the requirement that retailers determine whether the "CPI Detailed Report" and "PPI Detailed Report" contain equally appropriate price indexes. Instead, the proposed regulations require retailers using the retail method to select price indexes from the "CPI Detailed Report" and require all other taxpayers using the IPIC method to select price indexes from the "PPI Detailed Report."

Several commentators suggested that the IRS and Treasury Department permit all retailers using the IPIC method to select price indexes from either the "CPI Detailed Report" or the "PPI Detailed Report." These commentators argue that many retailers selecting price indexes

from the CPI do not use the retail method and would be forced to change. This change would be particularly burdensome because the categories listed in the "PPI Detailed Report" are far more detailed (and less correlated) than those listed in the "CPI Detailed Report." In addition, these commentators argue that the proposed rule fails to recognize that the PPI does not necessarily reflect cost for retailers not using the retail method because the majority of retailers purchase their goods from wholesalers not producers. Finally, the commentators expressed concern that the proposed rule would preclude retailers that use the retail method at their stores and a cost method at their warehouses from using the price indexes listed in the "CPI Detailed Report" when retail price information is not ascertained or readily available for goods in warehouses.

The IRS and Treasury Department generally agree with the commentators' concerns. Accordingly, the final regulations permit all retailers using the IPIC method to assign items in dollar-value pools to the BLS categories listed in either the "CPI Detailed Report" or the "PPI Detailed Report," whichever is selected.

9. BLS Category for Work-in-Process

The proposed regulations provide that manufacturers and processors must assign all work-in-process (WIP) items in a dollar-value pool to the most-detailed index categories that include the finished goods into which the WIP item will be manufactured or processed. For this purpose, *finished good* means any good that is in a salable state.

Several commentators objected to the proposed requirement that a taxpayer compute a separate inflation index for a WIP item that is in a salable state but not regularly sold by the taxpayer.

The IRS and Treasury Department agree with the commentators' objection to the extent that the taxpayer's WIP items are merely salable. Accordingly, the final regulations provide that a taxpayer is not required to compute a separate category inflation index for a salable WIP item, unless the taxpayer regularly sells that WIP item.

10. Relocation and Clarification of Special Pooling Rules

The current regulations provide special, elective pooling rules for retailers, wholesalers, jobbers, and distributors that use the IPIC method. These taxpayers are permitted to establish a dollar-value pool for any group of goods included in one of the 11 general categories of consumer goods described in the "CPI Detailed Report." In addition, Rev. Proc. 84–57 provides that inventory pools may be established for any group of goods included within one of the 15 general categories of producer goods described in Table 6 of the "PPI Detailed Report." Finally, the regulations provide that dollar-value pools that comprise less than 5 percent of inventory value may be combined to form a single miscellaneous dollar-value pool. If the resulting miscellaneous dollar-value pool itself comprises less than 5 percent of inventory value, that pool may be combined with the largest dollar-value pool.

The proposed regulations retain the special, elective pooling rules for inventory items accounted for under the IPIC method contained in the current regulations and incorporate the special, elective pooling rules contained in Rev. Proc. 84–57.

Several commentators asked whether taxpayers must apply the 5 percent rules to a dollar-value pool annually and, if so, how they are to account for dollar-value pools that no longer satisfy the 5 percent threshold. One commentator suggested that the IRS and Treasury Department make these 5 percent rules optional, state whether these rules are methods of accounting, and require taxpayers to apply the principles of § 1.472–8(g)(2) when changing dollar-value pools because of these 5 percent rules. Another commentator recommended that taxpayers be permitted to include inventories not accounted for under the LIFO method in "inventory value" when determining whether the 5 percent rules apply.

The IRS and Treasury Department believe that both of the 5 percent rules for dollar-value pools have been, and remain, optional. Under the current and proposed regulations, a taxpayer may, but is not required to, combine two or more specific dollar-value pools into a single miscellaneous dollar-value pool when the cost of each specific dollar-value pool does not exceed 5 percent of the total cost of the taxpayer's LIFO inventory. In addition, a taxpayer may, but is not required to, combine the single miscellaneous dollar-value pool and the largest specific dollar-value pool when cost of the miscellaneous dollar-value pool does not exceed 5 percent of the total cost of the taxpayer's LIFO inventory. Furthermore, the IRS and Treasury Department believe that both of the 5 percent rules are methods of accounting within the broader IPIC pooling method, so a taxpayer may not change to, or cease using, either of the 5 percent rules without obtaining the Commissioner's prior consent. In addition, any change in pooling required by the taxpayer's proper use of the 5 percent rule(s) is a change in method of accounting. Thus, the final regulations require a taxpayer in these circumstances to combine and separate its dollar-value pools in accordance with § 1.472–8(g). Moreover, the final regulations require a taxpayer to determine whether to separate or combine the 5 percent pools every third taxable year based on current-year data rather than on average data.

11. New Base Year for IPIC Method Changes

The current regulations require a taxpayer that changes to the IPIC method from another dollar-value LIFO method to treat the year of change as the base year in determining the LIFO value of the dollar-value pool(s) for the year of change and later taxable years. The taxpayer is required to restate the base-year cost of the existing increments in terms of new base-year cost, which also requires the restatement of the IPI of each of the layers. This procedure is referred to alternatively as updating the base year or establishing a new base year.

One commentator suggested eliminating the reference to § 1.472–8(f)(2) in the case of a voluntary change from the specific goods LIFO method to the dollar-value LIFO method because taxpayers and tax practitioners have long questioned how to implement this change without updating the base year. The final regulations adopt this suggestion and require a taxpayer changing from the specific goods LIFO method to the IPIC

method to establish a new base year. Although guidance addressing taxpayers changing from the specific goods LIFO method to a dollar-value LIFO method other than the IPIC method is outside the scope of these regulations, the IRS and Treasury Department are considering whether to issue additional guidance to address the commentator's concerns regarding changes from the specific goods method to a dollar-value LIFO method.

The proposed regulations clarify that the base-year-updating procedure is mandatory for voluntary changes to the IPIC method. However, the proposed regulations authorized examining agents to require a change to the IPIC method in circumstances where the taxpayer's prior method does not clearly reflect income and to implement the change using a cut-off method in circumstances where the taxpayer's books and records lacked the information necessary to compute a section 481(a) adjustment. The latter provision was intended to provide examining agents with an alternative to LIFO termination in appropriate circumstances.

One commentator objected to giving examining agents the authority to require a taxpayer using a LIFO method to change to the double-extension IPIC method even when the taxpayer produces records that will allow the agent to calculate the effect of changing to a correct method other than the IPIC method. This commentator requested "clear-cut" published guidance on the types of records that taxpayers using a LIFO method must retain and the length of time that they must retain them. In addition, because of the administrative burden associated with record retention (particularly those records needed for LIFO methods not used by the taxpayer), this commentator requested that the IRS and Treasury Department create a shortcut procedure, similar to the three-year transition rule under § 1.263A–7(c)(2)(iv), to calculate the effect of changing the taxpayer's LIFO method. Finally, this commentator suggested that the IRS and Treasury Department, as a matter of fairness, permit a taxpayer to recompute each year's layer using the IPI for that year.

Several commentators urged the IRS and Treasury Department to withdraw the involuntary change provisions entirely or, alternatively, to modify them to give examining agents discretion to impose a change to the double-extension IPIC method with or without establishing a new base year. One of these commentators also urged the IRS and Treasury Department to give these examining agents discretion to impose a change to either the double-extension IPIC method or the link-chain IPIC method.

In response to these comments, the final regulations provide that an examining agent may change a taxpayer from a LIFO method that does not clearly reflect income to the IPIC method. If the agent decides to change the taxpayer to the IPIC method, and the taxpayer does not provide sufficient information from its books and records to compute an adjustment under section 481, the agent may implement the change using the simplified transition method. Under the simplified transition method, the agent makes certain assumptions regarding the composition of ending inventory in prior taxable years and recomputes the LIFO value of each dollar-value pool as of the beginning of the year of change using the IPIC method. The section 481(a) adjustment arising from the accounting method change is equal to the difference between that recomputed LIFO value and the LIFO value of the dollar-value pool determined under the taxpayer's former method. The IRS and Treasury Department are considering other simplified methods of computing a section 481(a) adjustment arising from a change from one LIFO method to another and may publish additional guidance in the future. The suggestion regarding the issuance of guidance on a taxpayer's recordkeeping requirement is beyond the scope of this project, but will be considered for possible future guidance.

12. Inventories Received in Certain Nonrecognition Transactions

An election to use the dollar-value LIFO method for LIFO inventories received in a nonrecognition transaction to which section 381 does not apply (non-section 381 transfer) may not continue the LIFO reserve of the transferor. If the mix of goods in the inventory changes significantly after the transfer, the mechanics of the dollar-value LIFO method may produce an artificial increment in the year the inventories are received that effectively eliminates the LIFO reserve established by the transferor. This artificial increment occurs because the base-year cost of new items are reconstructed to the transferee's base year (*i.e.*, the year it elects LIFO) and not to the transferor's base year. When a transferee elects the LIFO and IPIC methods for LIFO inventories received in a non-section 381 transfer, the transferee will have an artificial increment in the year the inventories are received even without a significant change in the mix of goods in its ending inventory. The IPIC method invariably produces an increment because the difference between the current-year cost and the carryover basis of the transferred inventories (*i.e.*, the base-year cost) reflects more than one year's inflation and the IPI used to convert the current-year cost of the dollar-value pool at the end of the taxable year to base-year cost will reflect only one year's inflation.

To prevent the recapture of a transferor's LIFO reserve in a non-section 381 transfer, the proposed regulations require the transferee to update its base-year cost if a transferee uses the dollar-value LIFO method for inventories received in a non-section 381 transfer and the transferor accounted for those inventories using the dollar-value LIFO method as follows. First, the transferee's base year for the inventories received from the transferor is the year of transfer. Second, the transferee's base-year cost for the inventories received from the transferor is equal to the transferor's current-year cost for those inventories. Finally, if the transferee owned inventories prior to the transfer, the new base-year cost of those inventories will be equal to their current-year cost. The proposed regulations do not affect either the ability of a newly formed transferee to elect new accounting methods or the holdings of Rev. Rul. 70–564 (1970–2 C.B. 109) and Rev. Rul. 70–565 (1970–2 C.B. 110). However, the proposed regulations do not apply to a non-section 381 transfer if its principal purpose is to avail the transferee of a method of accounting that is unavailable to the transferor (or is unavailable to the transferor without the Commissioner's consent).

One commentator asserted that when a taxpayer described in Rev. Rul. 70–564

(*i.e.*, no beginning LIFO inventories) applies the proposed rule to transferred inventories, the resulting IPI of the collapsed base-year layer will not equal 1. Because this result may cause some confusion, the commentator suggested including an example in the final regulations. The final regulations include an example demonstrating the computation of increments and liquidations after a new base year is established.

Several commentators asserted that the proposed rule may result in the creation of an artificial increment or liquidation when a transferee and transferor use different methods of determining current-year costs. Thus, the regulations should be changed to permit a transferee to establish (or reconstruct) the new base-year cost of the transferred inventories equal to the transferor's first-in, first-out cost for the year immediately preceding the year of transfer, or alternatively, if the final regulations continue to require the use of the transferor's current-year cost and current-year cost method, the regulations should be changed to provide that the period for measuring inflation for the base year is between the appropriate month for determining base-year cost and the appropriate month for determining current-year cost. In addition, one commentator suggested that the final regulations be changed to clarify that "beginning inventory, if any" refers only to inventory that the transferee actually owned before the nonrecognition transaction.

The IRS and Treasury Department agree with these commentator's concerns. Accordingly, the final regulations permit the transferee to compute the base-year cost of transferred inventories using its current-year cost and its method of determining current-year cost. The final regulations also clarify the meaning of beginning inventory.

Another commentator contended that the holding of Rev. Rul. 70–564 is incorrect and, thus, the average cost rule of section 472(b)(3) should not be applied to inventories received by a transferee without an existing LIFO election in a non-section 381 transfer. In addition, this commentator noted that the holding of Rev. Rul. 70–564 is inconsistent with § 1.1502–13 (concerning intercompany transactions), which generally provides that an intercompany transaction may not change the timing of the recognition of income or deductions. This commentator suggested that the holding of Rev. Rul. 70–565, which provides for a carryover of a transferor's LIFO layer history in a section 351 transfer to a transferee with an existing LIFO election, should be applied in all non-section 381 transfers.

The IRS and Treasury Department believe this comment is outside the scope of these final regulations. However, in response to this comment, the IRS and Treasury Department are reconsidering whether to continue to require different results upon the transfer of LIFO inventories in a non-section 381 transfer (as currently required by Rev. Rul. 70–564 and Rev. Rul. 70–565) depending upon whether the transferee has an existing LIFO election.

13. Effective Date of Final Regulations

The proposed regulations provide that proposed §§ 1.472–8(b)(4), (c)(2), and (e)(3) will apply to taxable years beginning on or after the date they are published in the **Federal Register** as final regulations. In addition, the proposed regulations provide that proposed § 1.472–8(h) will apply to transfers occurring on or after the date it is published in the **Federal Register** as a final regulation.

One commentator suggested that taxpayers be permitted, but not required, to apply §§ 1.472–8(b)(4), (c)(2), and (e)(3) for taxable years *ending* on or after the date the regulations are published in the **Federal Register** as final regulations. This commentator also suggested that taxpayers be permitted to apply § 1.472–8(h) to transfers occurring during the taxable year *ending* on or after the date the regulations are published in the **Federal Register** as final regulations. In addition, several commentators suggested that the transition period for an automatic change in method of accounting to comply with §§ 1.472–8(b)(4), (c)(2), and (e)(3) be extended to include the *second* taxable year ending on or after the date the regulations are published in the **Federal Register** as final regulations.

The IRS and Treasury Department agree with these suggestions. However, in order to ensure that taxpayers may implement these changes for taxable years ending December 31, 2001, as requested by the commentators, the final regulations are effective for taxable years ending on or after December 31, 2001.

Effect on Other Documents

Rev. Proc. 84–57, Rev. Rul. 89–29, and Rev. Proc. 98–49 are obsolete on January 9, 2002.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to section 7805(f) of the Code, the proposed regulations preceding this Treasury decision was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. It is hereby certified that the collections of information in this Treasury decision will not have a significant economic impact on a substantial number of small entities. First, only taxpayers that adopt, or change to, the IPIC method will be affected by the collections of information. Second, relatively few small entities are expected to adopt, or change to, the IPIC method. Third, the burden of the collections of information is not significant. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Drafting Information

The principal author of these regulations is Leo F. Nolan II of the Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

§ 1.472–8 also issued under 26 U.S.C. 472. * * *

Par. 2. Section 1.472–8 is amended as follows:

1. Paragraph (b)(4) is added.

2. The text of paragraph (c) following the paragraph heading is redesignated as paragraph (c)(1) and a paragraph heading for newly designated (c)(1) is added.

3. Paragraph (c)(2) is added.

4. Paragraph (e)(3) and (h) are revised.

5. The undesignated paragraph following paragraph (h) is removed.

The revisions and additions read as follows:

§1.472–8 Dollar-value method of pricing LIFO inventories.

* * * * *

(b) * * *

(4) *IPIC method pools.* A manufacturer or processor that elects to use the inventory price index computation method described in paragraph (e)(3) of this section (IPIC method) for a trade or business may elect to establish dollar-value pools for those items accounted for using the IPIC method based on the 2-digit commodity codes (*i.e.*, major commodity groups) in Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the "PPI Detailed Report" published monthly by the United States Bureau of Labor Statistics (available from New Orders, Superintendent of Documents, P.O. Box 371954, Pittsburgh, PA 15250–7954). A taxpayer electing to establish dollar-value pools under this paragraph (b)(4) may combine IPIC pools that comprise less than 5 percent of the total current-year cost of all dollar-value pools to form a single miscellaneous IPIC pool. A taxpayer electing to establish dollar-value pools under this paragraph (b)(4) may combine a miscellaneous IPIC pool that comprises less than 5 percent of the total current-year cost of all dollar-value pools with the largest IPIC pool. Each of these 5 percent rules is a method of accounting. A taxpayer may not change to, or cease using, either 5 percent rule without obtaining the Commissioner's prior consent. Whether a specific IPIC pool or the miscellaneous IPIC pool satisfies the applicable 5 percent rule must be determined in the year of adoption or year of change (whichever is applicable) and redetermined every third taxable year. Any change in pooling required or permitted as a result of a 5 percent rule is a change in method of accounting. A taxpayer must secure the consent of the Commissioner pursuant to § 1.446–1(e) before combining or separating pools and must combine or separate its IPIC pools in accordance with paragraph (g)(2) of this section.

(c) * * *(1) *In general.* * * *

(2) *IPIC method pools.* A retailer that elects to use the inventory price index computation method described in paragraph (e)(3) of this section (IPIC method) for a trade or business may elect to establish dollar-value pools for those items accounted for using the IPIC method based on either the general expenditure categories (*i.e.*, major groups) in Table 3 (Consumer Price Index for all Urban Consumers (CPI-U): U.S. city average, detailed expenditure categories) of the "CPI Detailed Report" or the 2–digit commodity codes (*i.e.*, major commodity groups) in Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the "PPI Detailed Report." A wholesaler, jobber, or distributor that elects to use the IPIC method for a trade or business may elect to establish dollar-value pools for any group of goods accounted for using the IPIC method and included within one of the 2-digit commodity codes (*i.e.*, major commodity groups) in Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the "PPI Detailed Report." The "CPI Detailed Report" and the "PPI Detailed Report" are published monthly by the United States Bureau of Labor Statistics (BLS) (available from New Orders, Superintendent of Documents, P.O. Box 371954, Pittsburgh, PA 15250–7954). A taxpayer electing to establish dollar-value pools under this paragraph (c)(2) may combine IPIC pools that comprise less than 5 percent of the total current-year cost of all dollar-value pools to form a single miscellaneous IPIC pool. A taxpayer electing to establish pools under this paragraph (c)(2) may combine a miscellaneous IPIC pool that comprises less than 5 percent of the total current-year cost of all dollar-value pools with the largest IPIC pool. Each of these 5 percent rules is a method of accounting. Thus, a taxpayer may not change to, or cease using, either 5 percent rule without obtaining the Commissioner's prior consent. Whether a specific IPIC pool or the miscellaneous IPIC pool satisfies the applicable 5 percent rule must be determined in the year of adoption or year of change (whichever is applicable) and redetermined every third taxable year. Any change in pooling required or permitted under a 5 percent rule is a change in method of accounting. A taxpayer must secure the consent of the Commissioner pursuant to section 1.446–1(e) before combining or separating pools and must combine or separate its IPIC pools in accordance with paragraph (g)(2) of this section.

* * * * *

(e) * * *

(3) *Inventory price index computation (IPIC) method*—(i) *In general.* The inventory price index computation method provided by this paragraph (e)(3) (IPIC method) is an elective method of determining the LIFO value of a dollar-value pool using consumer or producer price indexes published by the United States Bureau of Labor Statistics (BLS). A taxpayer using the IPIC method must compute a separate inventory price index (IPI) for each dollar-value pool. This IPI is used to convert the total current-year cost of the items in a dollar-value pool to base-year cost in order to determine whether there is an increment or liquidation in terms of base-year cost and, if there is an increment, to determine the LIFO inventory value of the current year's layer of increment (layer). Using one IPI to compute the base-year cost of a dollar-value pool for the current taxable year and using a different IPI to compute the LIFO inventory value of the current

taxable year's layer is not permitted under the IPIC method. The IPIC method will be accepted by the Commissioner as an appropriate method of computing an index, and the use of that index to compute the LIFO value of a dollar-value pool will be accepted as accurate, reliable, and suitable. The appropriateness of a taxpayer's computation of an IPI, which includes all the steps described in paragraph (e)(3)(iii) of this section, will be determined in connection with an examination of the taxpayer's federal income tax return. A taxpayer using the IPIC method may elect to establish dollar-value pools according to the special rules in paragraphs (b)(4) and (c)(2) of this section or the general rules in paragraphs (b) and (c) of this section. Taxpayers eligible to use the IPIC method are described in paragraph (e)(3)(ii) of this section. The manner in which an IPI is computed is described in paragraph (e)(3)(iii) of this section. Rules relating to the adoption of, or change to, the IPIC method are in paragraph (e)(3)(iv) of this section.

(ii) *Eligibility*. Any taxpayer electing to use the dollar-value LIFO method may elect to use the IPIC method. Except as provided in this paragraph (e)(3)(ii) or in other published guidance, a taxpayer that elects to use the IPIC method for a specific trade or business must use that method to account for all items of dollar-value LIFO inventory. A taxpayer that uses the retail price indexes computed by the BLS and published in "Department Store Inventory Price Indexes" (available from the BLS by calling (202) 606–6325 and entering document code 2415) may elect to use the IPIC method for items that do not fall within any of the major groups listed in "Department Store Inventory Price Indexes."

(iii) *Computation of an inventory price index*—(A) *In general*. The computation of an IPI for a dollar-value pool requires the following four steps, which are described in more detail in this paragraph (e)(3)(iii): First, selection of a BLS table and an appropriate month; second, assignment of items in a dollar-value pool to BLS categories (selected BLS categories); third, computation of category inflation indexes for selected BLS categories; and fourth, computation of the IPI. A taxpayer may compute the IPI for each dollar-value pool using either the double-extension method (double-extension IPIC method) or the link-chain method (link-chain IPIC method), without regard to whether the use of a double-extension method is impractical or unsuitable. The use of either the double-extension IPIC method or the link-chain IPIC method is a method of accounting, and the adopted method must be applied consistently to all dollar-value pools within a trade or business accounted for under the IPIC method. A taxpayer that wants to change from the double-extension IPIC method to the link-chain IPIC method, or vice versa, must secure the consent of the Commissioner under § 1.446–1(e). This change must be made with a new base year as described in paragraph (e)(3)(iv)(B)(*1*).

(B) *Selection of BLS table and appropriate month*—(*1*) *In general*. Under the IPIC method, an IPI is computed using the consumer or producer price indexes for certain categories (BLS price indexes and BLS categories, respectively) listed in the selected BLS table of the "CPI Detailed Report" or the "PPI Detailed Report" for the appropriate month.

(*2*) *BLS table selection*. Manufacturers, processors, wholesalers, jobbers, and distributors must select BLS price indexes from Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the "PPI Detailed Report", unless the taxpayer can demonstrate that selecting BLS price indexes from another table of the "PPI Detailed Report" is more appropriate. Retailers may select BLS price indexes from either Table 3 (Consumer Price Index for all Urban Consumers (CPI-U): U.S. city average, detailed expenditure categories) of the "CPI Detailed Report" or from Table 6 (or another more appropriate table) of the "PPI Detailed Report." The selection of a BLS table is a method of accounting and must be used for the taxable year of adoption and all subsequent years, unless the taxpayer obtains the Commissioner's consent under § 1.446–1(e) to change its table selection. A taxpayer that changes its BLS table must establish a new base year in the year of change as described in paragraph (e)(3)(iv)(B) of this section.

(*3*) *Appropriate month*. In the case of a retailer using the retail method, the appropriate month is the last month of the retailer's taxable year. In the case of all other taxpayers, the appropriate month is the month most consistent with the method used to determine the current-year cost of the dollar-value pool under paragraph (e)(2)(ii) of this section and the taxpayer's history of inventory production or purchases during the taxable year. A taxpayer not using the retail method may annually select an appropriate month for each dollar-value pool or make an election on Form 970, "*Application to Use LIFO Inventory Method*," to use a representative appropriate month (representative month). An election to use a representative month is a method of accounting and the month elected must be used for the taxable year of the election and all subsequent taxable years, unless the taxpayer obtains the Commissioner's consent under § 1.446–1(e) to change or revoke its election.

(*4*) *Examples*. The following examples illustrate the rules of this paragraph (e)(3)(iii)(B)(*3*):

Example 1. Determining an appropriate month. A wholesaler of seasonal goods timely files a Form 970, "*Application to Use LIFO Inventory Method*," for the taxable year ending December 31, 2001. The taxpayer indicates elections to use the dollar-value LIFO method, to determine the current-year cost using the earliest acquisitions method in accordance with paragraph (e)(2)(ii)(*b*) of this section, and to use the IPIC method under paragraph (e)(3) of this section. Although the taxpayer purchases inventory items regularly throughout the year, the items purchased vary according to the seasons. The seasonal items on hand at December 31, 2001, are purchased between October and December. Thus, based on the taxpayer's use of the earliest acquisitions method of determining current-year cost and its experience with inventory purchases, the appropriate month for the items represented in the ending inventory at December 31, 2001, is October.

Example 2. Electing a representative month. A retailer not using the retail method timely files a Form 970, "*Application to Use LIFO Inventory Method*," for the taxable year ending December 31, 2001. The taxpayer indicates elections to use the dollar-value LIFO method, the most recent purchases method of determining current-year cost under paragraph (e)(2)(ii)(*a*) of this section, the IPIC method under paragraph (e)(3) of this section, and December as its representative month under paragraph (e)(3)(iii)(B)(*3*) of this section. The items in the taxpayer's ending inventory are purchased fairly uniformly throughout the year, with the first purchases normally occurring in January and the last purchases normally occurring in December. The taxpayer's election to use December as its representative month is permissible because the taxpayer elected to use the most recent purchases method and

the taxpayer's last purchases of the taxable year normally occur during December, the last month of the taxpayer's taxable year.

Example 3. Changing representative month. The facts are the same as in *Example 2*, except the taxpayer files a Form 3115, "*Application for Change in Accounting Method*," requesting permission to change to the earliest acquisitions method of determining current-year cost in accordance with paragraph (e)(2)(ii)(*b*) of this section and to change its representative month from December to January beginning with the taxable year ending December 31, 2003. If the Commissioner consents to the taxpayer's request to change to the earliest acquisitions method, December will no longer be a permissible representative month for this taxpayer because of the absence of a nexus between the earliest acquisitions method, the month of December (the last month of the taxpayer's taxable year), and the taxpayer's experience with inventory purchases during the year. Thus, the Commissioner will permit the taxpayer to change its representative month to January, the first month of the taxpayer's taxable year.

Example 4. Changing representative month. The facts are the same as in *Example 2*. In 2002, the taxpayer changes its annual accounting period to a taxable year ending June 30, which requires the taxpayer to file a return for the short taxable year beginning January 1, 2002, and ending June 30, 2002. As a result, December is no longer a permissible representative month because of the absence of a nexus between the most recent purchases method, the month of December, and the taxpayer's experience with inventory purchases during the year. The taxpayer should file a Form 3115 requesting permission to change its representative month from December to June beginning with the short taxable year ending June 30, 2002. Because the taxpayer's last purchases of the taxable year now will occur in June, the Commissioner will consent to the taxpayer's request to change its representative month to June.

Example 5. Changing representative month. The facts are the same as in *Example 2*, except that the taxpayer elects to use January as its representative month. The taxpayer timely files a Form 3115 requesting permission to change its representative month from January to December beginning with the taxable year ending December 31, 2003. January is not a permissible representative month because of the absence of a nexus between the most recent purchases method, the taxpayer's history of inventory purchases, and the month of January, the first month in the taxpayer's taxable year. Because December is a permissible representative month, the Commissioner will permit the taxpayer to change its representative month to December.

(C) *Assignment of inventory items to BLS categories*—(*1*) *In general.* Except as provided in paragraph (e)(3)(iii)(C)(*2*) of this section, a taxpayer must assign each item in a dollar-value pool to the most-detailed BLS category of the selected BLS table that contains that item. For example, in Table 6 of the "PPI Detailed Report" for a given month, the commodity codes for the various BLS categories run from 2 to 8 digits, with the least-detailed BLS categories having a 2-digit code and the most-detailed BLS categories usually (but not always) having an 8-digit code. For purposes of assigning items to the most-detailed BLS category, manufacturers and processors must assign each raw material item to the most-detailed PPI category that includes that raw material and must assign each finished good item to the most-detailed PPI category that includes that finished good. In addition, manufacturers and processors must assign each work-in-process (WIP) item to the most-detailed PPI category that includes the finished good into which the item will be manufactured or processed. For this purpose, *finished good* means a salable item that the taxpayer regularly sells. For example, a gasoline-engine manufacturer that also manufactures the pistons used in those engines and regularly sells some of the pistons (*e.g.*, to retailers of replacement parts) must assign both finished pistons that have not been affixed to an engine block and piston WIP items to the most-detailed PPI category that includes pistons. Finished pistons that have been affixed to an engine block must be assigned to the most-detailed PPI category that includes gasoline engines. In contrast, if sales of these pistons occur infrequently, the taxpayer must assign both finished pistons and piston WIP items to the most-detailed PPI category that includes gasoline engines.

(*2*) *10 percent method.* Instead of assigning each item in a dollar-value pool to the most-detailed BLS categories, as described in paragraph (e)(3)(iii)(C)(*1*) of this section, a taxpayer may elect to use the 10 percent method described in this paragraph (e)(3)(iii)(C)(*2*). Under the 10 percent method, items are assigned to BLS categories using a three-step procedure. First, when the current-year cost of a specific item is 10 percent or more of the total current-year cost of the dollar-value pool, the taxpayer must assign that item to the most-detailed BLS category that includes that item (10 percent BLS category). Any other item that is includible in that 10 percent BLS category (other than an item that qualifies for its own 10 percent BLS category under the preceding sentence) must be assigned to that 10 percent BLS category. Second, if one or more items have not been assigned to BLS categories in the first step, the taxpayer must investigate successively less-detailed BLS categories and assign the unassigned item(s) to the first BLS category that contains unassigned items whose current-year cost, in the aggregate, is 10 percent or more of the total current-year cost of the dollar-value pool (also, 10 percent BLS categories). This step must be repeated until all the items in the dollar-value pool have been included in an appropriate 10 percent BLS category, the current-year cost of the unassigned items, in the aggregate, is less than 10 percent of the total current-year cost of the dollar-value pool, or the taxpayer determines that a single BLS category is not appropriate for the aggregate of the unassigned items. Third, if items in a dollar-value pool have not been assigned to a 10 percent BLS category because the current-year cost of those items, in the aggregate, is less than 10 percent of the total current-year cost of the dollar-value pool, the taxpayer must assign those items to the most-detailed BLS category that includes all those items (also, a 10 percent category). On the other hand, if items in a dollar-value pool have not been assigned to a 10 percent BLS category because the taxpayer determines that a single BLS category is not appropriate for the aggregate of those items, the taxpayer must assign each of those items to a single miscellaneous BLS category created by the taxpayer (also, a 10 percent category). In no event may a taxpayer assign items in a dollar-value pool to a BLS category that is less detailed than either the major groups of consumer goods described in Table 3 of the monthly "CPI Detailed Report" or the major commodity groups of producer goods described in Table 6 of the monthly "PPI Detailed Report." Principles similar to those described in paragraph (e)(3)(iii)(C)(*1*) apply for purposes of assigning raw material, work-in-process, and finished good items to the most-detailed BLS category under the 10 percent method.

(*3*) *Change in method of accounting.* The 10 percent method of assigning items in a dollar-value pool to BLS categories is a method of accounting. In addition, a taxpayer's selection of a BLS category for a specific item is a method of accounting. However, the assignment of

items to different BLS categories solely as a result of the application of the 10 percent method is a change in underlying facts and not a change in method of accounting. Likewise, the selection of a new BLS category for a specific item as a result of a revision to a BLS table is a change in underlying facts and not a change in method of accounting. A taxpayer that wants to change its method of selecting BLS categories (*i.e.*, to or from the 10-percent method) or of selecting a BLS category for a specific item must secure the Commissioner's consent in accordance with § 1.446–1(e). A taxpayer that voluntarily changes its method of selecting BLS categories or of selecting a BLS category for a specific item must establish a new base year in the year of change as described in paragraph (e)(3)(iv)(B) of this section.

(D) *Computation of a category inflation index—*(*1*) *In general*. As described in more detail in this paragraph (e)(3)(iii)(D), a category inflation index reflects the inflation that occurs in the BLS price indexes for a selected BLS category (or, if applicable, 10 percent BLS category) during the relevant measurement period.

(*2*) *BLS price indexes*. The BLS price indexes are the cumulative indexes published in the selected BLS table for the appropriate month. A taxpayer may elect to use either preliminary or final BLS price indexes for the appropriate month, provided that the selected BLS price indexes are used consistently. However, a taxpayer that elects to use final BLS price indexes for the appropriate month must use preliminary BLS price indexes for any taxable year for which the taxpayer files its original federal income tax return before the BLS publishes final BLS price indexes for the appropriate month. If a BLS price index for a most-detailed or 10 percent BLS category is not otherwise available for the appropriate or representative month (but not because the BLS categories in the BLS table have been revised), the taxpayer must use the BLS price index for the next most-detailed BLS category that includes the specific item(s) in the most-detailed or 10 percent BLS category. If a BLS price index is not otherwise available for the appropriate or representative month because the BLS categories in the BLS table have been revised, the rules of paragraph (e)(3)(iii)(D)(*4*) of this section apply.

(*3*) *Category inflation index*. (*i*) *In general*. Except as provided in paragraph (e)(3)(iii)(D)(*4*) of this section (concerning compound category inflation indexes) or (e)(3)(iii)(D)(*5*) of this section (concerning category inflation indexes for certain 10 percent BLS categories), a category inflation index for a selected BLS category (or, if applicable, 10 percent BLS category) is computed under the rules of this paragraph (e)(3)(iii)(D)(*3*).

(*ii*) *Double-extension IPIC method*. In the case of a taxpayer using the double-extension IPIC method, the category inflation index for a BLS category is the quotient of the BLS price index for the appropriate or representative month of the current year divided by the BLS price index for the appropriate month of the taxable year preceding the base year (base month). However, if the taxpayer did not have an opening inventory in the year that its election to use the dollar-value LIFO method and double-extension IPIC method became effective, the category inflation index for a BLS category is the quotient of the BLS price index for the appropriate or representative month of the current year divided by the BLS price index for the month immediately preceding the month of the taxpayer's first inventory production or purchase.

(*iii*) *Link-chain IPIC method*. In the case of a taxpayer using the link-chain IPIC method, the category inflation index for a BLS category is the quotient of the BLS price index for the appropriate or representative month of the current year divided by the BLS price index for the appropriate month used for the immediately preceding taxable year. However, if the taxpayer did not have an opening inventory in the year that its election to use the dollar-value LIFO method and link-chain IPIC method became effective, the category inflation index for a BLS category for the year of election is the quotient of the BLS price index for the appropriate or representative month of the current year divided by the BLS price index for the month immediately preceding the month of the taxpayer's first inventory production or purchase.

(*iv*) *Special rules concerning representative months*. A taxpayer electing to use a representative month under paragraph (e)(3)(iii)(B)(*3*) of this section must use an appropriate month, rather than the representative month, to determine category inflation indexes in the circumstances described in this paragraph (e)(3)(iii)(D)(*3*)(*iv*) and in other similar circumstances. For example, in the case of a short taxable year, the category inflation index should reflect the inflation that occurs from the base month (in the case of the double-extension IPIC method), or the appropriate or representative month used for the preceding taxable year (in the case of the link-chain IPIC method), and the appropriate month for the short taxable year. Similarly, if a taxpayer using the link-chain IPIC method is granted consent to change both its method of determining the current-year cost of a dollar-value pool and its representative month, the category inflation index for the year of change should reflect the inflation that occurs between the old representative month used for the preceding taxable year and the new representative month used for the year of change.

(*4*) *Compound category inflation index for revised BLS categories or price indexes—*(*i*) *In general*. Periodically, the BLS revises a BLS table to add one or more new BLS categories, eliminate one or more previously reported BLS categories, or reset the base-year BLS price index of one or more BLS categories. If the BLS has revised the applicable BLS table for a taxable year, a taxpayer must compute the category inflation index for each BLS category for which the taxpayer cannot compute a category inflation index in accordance with paragraph (e)(3)(iii)(D)(*3*) of this section (affected BLS category) using a reasonable method, provided the method is used consistently for all affected BLS categories within a particular taxable year. For example, if the BLS revised the CPI by adding new BLS categories as of January 2001, and eliminating some previously reported BLS categories as of December 2000, January 2002 would be the first month for which it would be possible to compute a category inflation index for a 12–month period using the BLS price indexes for any affected category. The compound category inflation index described in paragraph (e)(3)(iii)(D)(*4*)(*ii*) of this section is a reasonable method of

computing the category inflation index for an affected BLS category.

(*ii*) *Computation of compound category inflation index*. When the applicable BLS table is revised as described in paragraph (e)(3)(iii)(D)(*4*)(*i*) of this section, a taxpayer may use the procedure described in this paragraph (e)(3)(iii)(D)(*4*)(*ii*) to compute a compound category inflation index for each affected BLS category represented in the taxpayer's ending inventory. For this purpose, a compound category inflation index is the product of the category inflation index for the "first portion" multiplied by the corresponding category inflation index for the "second portion." The category inflation index for the first portion must reflect the inflation that occurs between the end of the base month (in the case of the double-extension IPIC method), or the preceding year's appropriate or representative month (in the case of the link-chain IPIC method), and the end of the last month covered by the unrevised BLS table based on the old BLS category. The corresponding category inflation index for the second portion must reflect the inflation that occurs between the beginning of the first month covered by the revised BLS table based on the new BLS category and the end of the current year's appropriate or representative month. First, using the revised BLS table for the current-year's appropriate or representative month, the taxpayer assigns items in the dollar-value pool using its method of assigning items to BLS categories as described in paragraph (e)(3)(iii)(C) of this section. Second, for each affected BLS category represented in the ending inventory, the taxpayer computes the category inflation index for the second portion using this formula: [A / B], where A equals the BLS price index for the current year's appropriate or representative month and B equals the BLS price index for the last month covered by the unrevised BLS table (as published for the first month of the revised BLS table). Third, using the unrevised BLS table for the base month (in the case of the double extension IPIC method) or the preceding year's appropriate or representative month (in the case of the link-chain IPIC method), the taxpayer assigns each of the items in the dollar-value pool using its method of assigning items to BLS categories. Fourth, for each affected BLS category represented in the ending inventory, the taxpayer computes the category inflation index for the first portion using this formula: [C / D], where C equals the BLS price index for the last month covered by the unrevised BLS table (as published for the last month of the unrevised BLS table) and D equals the BLS price index for the base month (in the case of the double-extension IPIC method) or the preceding year's appropriate or representative month (in the case of the link-chain IPIC method). Fifth, for each affected BLS category represented in the ending inventory, the taxpayer computes the compound category inflation index using this formula: [X * Y], where X equals the category inflation index for the second portion, and Y equals the corresponding category inflation index for the first portion. For the purpose of computing the compound category inflation index for each affected BLS category, the corresponding category inflation index for the first portion is the category inflation index for the unrevised BLS category that includes the specific inventory item(s) included in the revised BLS category. If items included in a single revised BLS category had been included in separate BLS categories before the revision of the BLS table, the corresponding category inflation index for the first portion is the weighted harmonic mean of the category inflation indexes for these unrevised BLS categories. See paragraph (e)(3)(iii)(E)(*1*) of this section for a formula of the weighted harmonic mean. When computing this weighted-average category inflation index, a taxpayer must use the current-year costs (or in the case of a retailer using the retail method, the retail selling prices) in ending inventory as the weights.

(*iii*) *New base year*. A taxpayer may establish a new base year in the year following the taxable year for which the taxpayer computed a compound category inflation index under this paragraph (e)(3)(iii)(D)(*4*) for one or more affected BLS categories in a dollar-value pool. See paragraph (e)(3)(iv)(B) of this section for the procedures and computations incident to establishing a new base year.

(*iv*) *Examples*. The following examples illustrate the rules of this paragraph (e)(3)(iii)(D)(*4*):

Example 1. BLS categories eliminated. (i) A retailer, whose taxable year ends January 31, elected to account for its inventories using the dollar-value LIFO method and double-extension IPIC method (based on the CPI), beginning with the taxable year ending January 31, 1997. The taxpayer does not use the retail method, but elected to use January as its representative month. On January 31, 1999, the taxpayer's only dollar-value pool contains only two items — lemons and peaches. The total current-year cost of these items is as follows: lemons, $40, and peaches, $30.

(ii) The CPI was revised in October of 1998 to eliminate the "Citrus fruits" subcategory of "Other fresh fruits." In addition, the base-year BLS price index for "Other fresh fruits" was reset to 100.00 as of October 1, 1998. In relevant part, the January 1999 CPI permits the assignment of both lemons and peaches to "Other fresh fruits." The January 1999 BLS price indexes for "Citrus fruits" and "Other fresh fruits" are 96.6 and 105.6, respectively. In relevant part, the September 1998 CPI permits the assignment of lemons to "Citrus fruits" and peaches to "Other fresh fruits." The September 1998 BLS price indexes for "Citrus fruits" and "Other fresh fruits" are 194.9 and 294.9, respectively, and the January 1997 BLS price indexes for "Citrus fruits" and "Other fresh fruits" are 190.2 and 290.2, respectively.

(iii) Because the BLS eliminated the category, "Citrus fruits," as of October 1998, it did not publish a BLS price index for that category in the January 1999 CPI. Thus, the taxpayer cannot compute a category inflation index for "Citrus fruits" under the normal procedures, but may compute a compound category inflation index for that affected BLS category using the procedures described in paragraph (e)(3)(iii)(D)(*4*)(*ii*) of this section.

(iv) The taxpayer computes a compound category inflation index for the two BLS categories that formerly included lemons and peaches. The taxpayer first assigns lemons and peaches to "Other fresh fruits," the most-detailed index in the January 1999 CPI, and then computes the category inflation index for the second portion as follows:

Item	1999 Category	Jan. 1999 index / Sept. 1998 index (as published in Oct. 1998)	Category inflation index
Lemons & Peaches	Other fresh fruits	105.6 / 100.0	1.0560

(v) The taxpayer assigns the lemons and peaches to the most-detailed BLS categories in the January 1998 CPI as follows: lemons to "Citrus fruits" and peaches to "Other fresh fruits." Then, the taxpayer computes the category inflation index for the first portion as follows:

Item	1998 Category	Sept. 1998 index (as published in Sept. 1998) / Jan. 1997	Category inflation index
Lemons	Citrus fruits	194.9 / 190.2	1.0247
Peaches	Other fresh Fruits	294.9 / 290.2	1.0162

(vi) Because lemons and peaches, which are included together in the revised "Other fresh fruits" category, had been included in separate BLS categories before the BLS table was revised, the taxpayer must compute a single corresponding category inflation index for the affected BLS categories for the first portion. This corresponding category inflation index is the weighted harmonic mean of the separate corresponding category inflation indexes for the first portion using the cost of the items in ending inventory as the weights. The taxpayer computes the corresponding category inflation index for "Other fresh fruits" for the first portion as follows:

Item	(I) Weight (Cost of Item)	(II) Category Inflation Index	(III) Quotient: (I) / (II)
Lemons	$40.00	1.0247	$39.04
Peaches	30.00	1.0162	29.52
Total	$70.00		$68.56

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Weighted Harmonic Mean of Other Fresh Fruits: (IV) / (V)
$70.00	$68.56	1.0210

(vii) Finally, the taxpayer computes the compound category inflation index for Other fresh fruits as follows:

Item	(I) Category Inflation Index (Second Portion)	(II) Category Inflation Index (First Portion)	(III) Compound Category Inflation Index: (I) * (II)
Other fresh fruits	1.0560	1.0210	1.0782

(viii) The taxpayer may establish a new base year for the taxable year ending January 31, 2000.

Example 2. BLS categories separated. (i) The facts are the same as in *Example 1*, except prior to October 1998, both lemons and peaches were assigned to "Other fresh fruits" and in the October 1998 CPI, the BLS created a new category, "Citrus fruits," for citrus fruits, such as lemons. Moreover, the BLS reset the base-year BLS price index for "Other fresh fruits" to 100.0 as of October 1, 1998. As a result of these changes, the taxpayer may no longer assign lemons to "Other fresh fruits."

(ii) Because "Citrus fruits" is new as of October 1998, the BLS did not publish a BLS price index for this BLS category in the January 1999 CPI. Thus, because the taxpayer cannot compute a category inflation index for "Citrus fruits" under the normal procedures, the taxpayer may compute a compound category inflation index for the affected BLS category using the procedures described in paragraph (e)(3)(iii)(D)(*4*)(*ii*) of this section.

(iii) Based on the January 1999 CPI, the taxpayer assigns lemons to "Citrus fruits" and peaches to "Other fresh fruits." Then, the taxpayer computes a compound category inflation index for each of the two BLS categories. The computation of the category inflation index for the second portion is as follows:

Item	1999 Category	Jan. 1999 index / Sept. 1998 index (as published in Oct. 1998)	Category Inflation Index
Lemons	Citrus fruits	96.6 / 100	0.9660
Peaches	Other fresh fruits	105.6 / 100	1.0560

(iv) Then, the taxpayer computes the category inflation index for the first portion as follows:

Item	1998 Category	Sept. 1998 index (as published in Sept. 1998) / Jan. 1997	Category Inflation Index
Lemons & Peaches	Other fresh fruits	294.9 / 290.2	1.0162

(v) Finally, the taxpayer computes the compound category inflation index for "Citrus fruits" and "Other fresh fruits":

Item	(I) Category Inflation Index (Second Portion)	(II) Category Inflation Index (First Portion)	(III) Compound Category Inflation Index: (I) * (II)
Citrus fruits	0.9660	1.0162	0.9816
Other fresh fruits	1.0560	1.0162	1.0731

(vi) The taxpayer may establish a new base year for the taxable year ending January 31, 2000.

(*5*) *10 percent method*. (*i*) *Applicability*. A taxpayer that elects to use the 10 percent method described in paragraph (e)(3)(iii)(C)(*2*) of this section must compute a category inflation index for a less-detailed 10 percent BLS category as provided in this paragraph (e)(3)(iii)(D)(*5*). A less-detailed 10 percent category is a BLS category that—

(*A*) subsumes two or more BLS categories;

(*B*) does not have a single assigned item whose current-year cost is 10 percent or more of the current-year cost of all the items in the dollar-value pool;

(*C*) has at least one item in at least one of the subsumed BLS categories; and

(*D*) has at least one subsumed BLS category that either does not have any assigned items or is a separate 10 percent BLS category.

(*ii*) *Determination of category inflation index*. If the rules of this paragraph (e)(3)(iii)(D)(*5*) apply, the category inflation index for the less-detailed 10 percent BLS category is equal to the weighted arithmetic mean of the category inflation index (or, compound category inflation index, if applicable) for each of the subsumed BLS categories that have been assigned at least one item from the taxpayer's dollar-value pool (excluding any item that is properly assigned to a separate 10 percent BLS category). [Weighted Arithmetic Mean = Sum of (Weight x Category Inflation Index)] / Sum of Weights]. The appropriate weight for each of the most-detailed BLS categories referenced in the preceding sentence is the corresponding BLS weight. Currently, in January of each year, the BLS publishes the BLS weights determined for December of the preceding year. In the case of a taxpayer using the double-extension IPIC method, the BLS weights for December of the taxable year preceding the base year are to be used for all taxable years. In the case of a taxpayer using the link-chain IPIC method, the BLS weights for December of a given calendar year are to be used for taxable years that end during the 12-month period that begins on July 1 of the following calendar year. However, if the BLS weights are not published for all of the most-detailed BLS categories referenced above, the taxpayer may use the current-year cost (or in the case of a retailer using the retail method, the retail selling prices) of all items assigned to a specific most-detailed BLS category as the appropriate weight for that category, but must compute a weighted harmonic mean. See paragraph (e)(3)(iii)(E)(*1*) of this section for a formula of the weighted harmonic mean.

(E) *Computation of Inventory Price Index (IPI)*—(*1*) *Double-extension IPIC method*. Under the double-extension IPIC method, the IPI for a dollar-value pool is the weighted harmonic mean of the category inflation indexes (or, if applicable, compound category inflation indexes) determined under paragraph (e)(3)(iii)(D) of this section for each selected BLS category (or, if applicable 10 percent BLS category) represented in the taxpayer's dollar-value pool at the end of the taxable year. The formula for computing the weighted harmonic mean of the category inflation indexes is: [Sum of Weights / Sum of (Weight / Category Inflation Index)]. The weights to be used when computing this weighted harmonic mean are the current-year costs (or, in the case of a retailer using the retail method, the retail selling prices) in each selected BLS category represented in the dollar-value pool at the end of the taxable year.

(*2*) *Link-chain IPIC method*. Under the link-chain IPIC method, the IPI for a dollar-value pool is the product of the weighted harmonic mean of the category inflation indexes (or, if applicable, the compound category inflation indexes) determined under paragraph (e)(3)(iii)(D)

of this section for each selected BLS category (or, if applicable, 10 percent BLS category) represented in the taxpayer's dollar-value pool at the end of the taxable year multiplied by the IPI for the immediately preceding taxable year. The formula for computing the weighted harmonic mean of the category inflation indexes is: [Sum of Weights / Sum of (Weight / Category Inflation Index)]. The weights to be used when computing this weighted harmonic mean are the current-year costs (or, in the case of a retailer using the retail method, the retail selling prices) in each selected BLS category represented in the dollar-value pool at the end of the taxable year.

(3) *Examples*. The following examples illustrate the rules of this paragraph (e)(3)(iii)(E):

Example 1. Double-extension method. (i) *Introduction*. R is a retail furniture merchant that does not use the retail method. For the taxable year ending December 31, 2000, R used the first-in, first-out method of identifying inventory and valued its inventory at cost. The total cost of R's inventory on December 31, 2000, was $850,000. R elected to use the dollar-value LIFO and double-extension IPIC methods for its taxable year ending December 31, 2001. R does not elect to use the 10 percent method described in paragraph (e)(3)(iii)(C)(*2*) of this section. R determines the current-year cost of the items using the actual cost of the most recently purchased goods. R elected to pool its inventory based on the major groups in Table 6 of the monthly "PPI Detailed Report" in accordance with the special IPIC pooling rules of paragraph (b)(4) of this section. All items in R's inventories fall within the 2-digit commodity code in Table 6 of the monthly "PPI Detailed Report" for "furniture and household durables." Therefore, R will maintain a single dollar-value pool.

(ii) *Select a BLS table and appropriate month for 2001*. R determines that the appropriate month for 2001 is October. R also determines that the appropriate month for 2000 would have been December if R had used the IPIC method for that year.

(iii) *Assign inventory items to BLS categories for 2001*. For 2001, R assigns all items in the dollar-value pool to the most-detailed BLS categories listed in Table 6 of the October 2001 "PPI Detailed Report" that contain those items. The BLS categories and the current-year cost of the items assigned to them are summarized as follows:

Commodity Code	Category	Current-Year Cost
12120101	Living Room Table	$111,924.00
12120211	Dining Room Table	159,578.00
12120216	Dining Room Chairs	98,639.00
12130101	Upholstered Sofas	332,488.00
12130111	Upholstered Chairs	218,751.00
Total		$921,380.00

(iv) *Compute category inflation indexes for 2001*. Because R elected to use the double-extension IPIC method and did not elect the 10 percent method, the category inflation indexes are computed in accordance with paragraph (e)(3)(iii)(D)(*3*)(*ii*) of this section (BLS price indexes for October 2001 divided by BLS price indexes for December 2000). R computes the category inflation indexes for 2001 as follows:

Category	(I) Oct. 2001 Index	(II) Dec. 2000 Index	(III) Category Inflation Index: (I) / (II)
Living Room Table	172.4	169.2	1.018913
Dining Room Table	171.9	168.1	1.022606
Dining Room Chairs	172.8	169.7	1.018268
Upholstered Sofas	142.2	140.9	1.009226
Upholstered Chairs	134.1	132.5	1.012075

(v) *Compute IPI for 2001*. R must compute the IPI for 2001, which is the weighted harmonic mean of the category inflation indexes for 2001. The formula for the weighted harmonic mean provided in paragraph (e)(3)(iii)(E)(*1*) of this section is [Sum of Weights / Sum of (Weight / Category Inflation Index)]. The IPI for 2001 is computed as follows:

Category	(I) Weight	(II) Category Inflation Index	(III) Quotient: (I) / (II)
Living Room Table	$111,924.00	1.018913	$109,846.47
Dining Room Table	159,578.00	1.022606	156,050.33
Dining Room Chairs	98,639.00	1.018268	96,869.39
Upholstered Sofas	332,488.00	1.009226	329,448.51
Upholstered Chairs	218,751.00	1.012075	216,141.10
Total	$921,380.00		$908,355.80

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Inventory Price Index: (IV) / (V)
$921,380.00	$908,355.80	1.01433821

(vi) *Determine the LIFO value of the dollar-value pool for 2001*. For 2001, R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the items in the dollar-value pool by the IPI for 2001. The total base-year cost of R's ending inventory is $908,355.80 ($921,380 / 1.01433821). Comparing the base-year cost of the ending inventory to the base-year cost of the beginning inventory, R determines that the base-year cost of the 2001 increment is $58,355.80 ($908,355.80 - $850,000.00). R multiplies the base-year cost of the 2001 increment by the IPI for 2001 and determines that the LIFO value of the 2001 layer is $59,192.52 ($58,355.80 * 1.01433821). Thus, the LIFO value of R's total inventory at the end of 2001 is $909,192.52 ($850,000.00 (opening inventory) + $59,192.52 (2001 layer)).

(vii) *Select a BLS table and appropriate month for 2002*. For 2002, R must compute a new IPI under the double-extension IPIC method to determine the LIFO value of its dollar-value pool. R determines that the appropriate month for 2002 is November.

(viii) *Assign inventory items to BLS categories for 2002*. For 2002, R assigns all items in the dollar-value pool to the most-detailed BLS categories listed in Table 6 of the November 2002 "PPI Detailed Report" that contain those items. The BLS categories and the current-year cost of the items assigned to them are summarized as follows:

Commodity Code	Category	Current-Year Cost
12120103	Living Room Desks	$125,008.00
12120211	Dining Room Table	136,216.00
12120216	Dining Room Chairs	113,569.00
12130101	Upholstered Sofas	343,900.00
12130111	Upholstered Chairs	233,050.00
Total		$951,743.00

(ix) *Compute category inflation indexes for 2002*. Because R uses the double-extension IPIC method and did not elect the 10 percent method, the category inflation indexes are computed in accordance with paragraph (e)(3)(iii)(D)(*3*)(*ii*) of this section (BLS price indexes for November 2002 divided by BLS price indexes for December 2000). R computes the category inflation indexes for 2002 as follows:

Category	(I) Nov. 2002 Index	(II) Dec. 2002 Index	(III) Category Inflation Index (I) / (II)
Living Room Desks	172.6	160.3	1.076731
Dining Room Table	174.8	168.1	1.039857
Dining Room Chairs	177.0	169.7	1.043017
Upholstered Sofas	144.9	140.9	1.028389
Upholstered Chairs	136.6	132.5	1.030943

(x) *Compute IPI for 2002*. R must compute the IPI for 2002, which is the weighted harmonic mean [Sum of Weights / Sum of (Weight / Category Inflation Index)] of the category inflation indexes for 2002. The IPI for 2002 is computed as follows:

Category	(I) Weight	(II) Category Inflation Index	(III) Quotient: (I) / (II)
Living Room Desks	$125,008.00	1.076731	$116,099.56
Dining Room Table	136,216.00	1.039857	130,994.93
Dining Room Chairs	113,569.00	1.043017	108,885.09
Upholstered Sofas	343,900.00	1.028389	334,406.53
Upholstered Chairs	233,050.00	1.030943	226,055.17
Total	$951,743.00		$916,441.28

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Inventory Price Index: (IV) / (V)
$951,743.00	$916,441.28	1.03852044

(xi) *Determine the LIFO value of the pool for 2002*. For 2002, R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the items in the dollar-value pool by the IPI for 2002. The total base-year cost of the ending inventory is $916,441.28 ($951,743.00 / 1.03852044). Comparing the base-year cost of the ending inventory to the base-year cost of the beginning inventory, R determines that the base-year cost of the 2002 increment is $8,085.48 ($916,441.28 - $908,355.80). R multiplies the base-year cost of the 2002 increment by the IPI for 2002 and determines that the LIFO value of the 2002 layer is $8,396.94 ($8,085.48 * 1.03852044). Thus, the LIFO value of R's total inventory at the end of 2002 is $917,589.46 ($850,000.00 (opening inventory) + $59,192.52 (2001 layer) + $8,396.94 (2002 layer)).

Example 2. Link-chain method. (i) *Introduction*. The facts are the same as *Example 1*, except that R uses the link-chain IPIC method. The double-extension IPIC method and the link-chain IPIC method yield the same results for the first taxable year in which the dollar-value LIFO and IPIC methods are used. Therefore, this example illustrates only how R will compute the IPI for, and determine the LIFO value of, its dollar-value pool for 2002.

(ii) *Select a BLS table and appropriate month for 2002*. R determines that the appropriate month for 2002 is November.

(iii) *Assign inventory items to BLS categories for 2002*. For 2002, R assigns all items in the dollar-value pool to the most-detailed BLS categories listed in Table 6 of the November 2002 "PPI Detailed Report" that contain those items. The BLS categories and the current-year cost of the items assigned to them are summarized as follows:

Commodity Code	Category	Current-Year Cost
12120103	Living Room Desks	$125,008.00
12120211	Dining Room Table	136,216.00
12120216	Dining Room Chairs	113,569.00
12130101	Upholstered Sofas	343,900.00
12130111	Upholstered Chairs	233,050.00
Total		$951,743.00

(iv) *Compute category inflation indexes for 2002*. Because R uses the link-chain IPIC method and did not elect the 10 percent method, the category inflation indexes are computed in accordance with paragraph (e)(3)(iii)(D)(*3*)(*iii*) of this section (BLS price indexes for November 2002 divided by BLS price indexes for October 2001). R computes the category inflation indexes for 2002 as follows:

Category	(I) Nov. 2002 Index	(II) Oct. 2001 Index	(III) Category Inflation Index (I) / (II)
Living Room Desks	172.6	162.0	1.065432
Dining Room Table	174.8	171.9	1.016870
Dining Room Chairs	177.0	172.8	1.024306
Upholstered Sofas	144.9	142.2	1.018987
Upholstered Chairs	136.6	134.1	1.018643

(v) *Compute IPI for 2002*. As provided in paragraph (e)(3)(iii)(E)(*2*) of this section, R must compute the IPI for 2002 by multiplying the weighted harmonic mean of the category inflation indexes for 2002 by the IPI for 2001. The IPI for 2002 is computed as follows:

Category	(I) Weight	(II) Category Inflation Index	(III) Quotient: (I) / (II)
Living Room Desks	$125,008.00	1.065432	$117,330.81
Dining Room Table	136,216.00	1.016870	133,956.16
Dining Room Chairs	113,569.00	1.024306	110,874.09
Upholstered Sofas	343,900.00	1.018987	337,492.04
Upholstered Chairs	233,050.00	1.018643	228,784.77
Total	$951,743.00		$928,437.87

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Weighted Harmonic Mean of Category Inflation Indexes for 2002: (IV) / (V)	(VII) Inventory Price Index for 2001	(VIII) Inventory Price Index for 2002: (VI) * (VII)
$951,743.00	$928,437.87	1.02510144	1.01433821	1.03979956

(vi) *Determine the LIFO value of the pool for 2002*. R determines the total base-year cost of its ending inventory by dividing the total current-year cost of the items in the dollar-value pool by the IPI for 2002. The total base-year cost of the ending inventory is $915,313.91 ($951,743.00 / 1.03979956). Comparing the base-year cost of the ending inventory to the base-year cost of the beginning inventory, R determines that the base-year cost of the 2002 layer is $6,958.11 ($915,313.91 - $908,355.80). R multiplies the base-year cost of the 2002 layer by the IPI for 2002 and determines that the LIFO value of the 2002 layer is $7,235.04 ($6,958.11 * 1.03979956). Thus, the LIFO value of R's total inventory at the end of 2002 is $916,427.56 ($850,000.00 (opening inventory) + $59,192.52 (2001 layer) + $7,235.04 (2002 layer)).

(iv) *Adoption or change of method*—(A) *Adoption or change to IPIC method*. The use of an inventory price index computed under the IPIC method is a method of accounting. A taxpayer permitted to adopt the dollar-value LIFO method without first securing the Commissioner's consent also may adopt the IPIC method without first securing the Commissioner's consent. The IPIC method may be adopted and used, however, only if the taxpayer provides the following information on a Form 970, "*Application to Use LIFO Inventory Method*," or in another manner as may be acceptable to the Commissioner: A complete list of dollar-value pools (including a description of the items in each dollar-value pool); the BLS table (*i.e.*, CPI or PPI) selected for each dollar-value pool; the representative month, if applicable, elected for each dollar-value pool; the BLS categories to which the items in each dollar-value pool will be assigned; the method of assigning items to BLS categories (*e.g.*, the 10 percent method) for each dollar-value pool; and the method of computing the IPI (*i.e.*, double-extension IPIC method or link-chain IPIC method) for each dollar-value pool. In the case of a taxpayer permitted to adopt the IPIC method without requesting the Commissioner's consent, the Form 970 must be attached to the taxpayer's income tax return for the taxable year of adoption. In all other cases, a taxpayer may change to the IPIC method only after securing the Commissioner's consent as provided in § 1.446–1(e). In these latter cases, the Form 970 containing the information described in this paragraph (e)(3)(iv)(A) must be attached to a Form 3115, "*Application for Change in Accounting Method*," filed as required by § 1.446–1(e). A taxpayer that simultaneously changes to the dollar-value LIFO and IPIC methods from another LIFO method must apply the rules of paragraph (f)(2) of this section before applying the rules of paragraph (e)(3)(iv)(B)(*1*) of this section. To satisfy the requirements of § 1.472–2(h), taxpayers must maintain adequate books and records, including those concerning the use of the IPIC method and necessary computations. Notwithstanding the rules in paragraph (e)(1) of this section, a taxpayer that adopts, or changes to, the link-chain IPIC method is not required to demonstrate that the use of any other method of determining the LIFO value of a dollar-value pool is impractical.

(B) *New base year*—(*1*) *Voluntary change*—(*i*) *In general*. In the case of a taxpayer using a non-IPIC method to determine the LIFO value of inventory, the layers previously determined under that method, if any, and the LIFO values of those layers are retained if the taxpayer voluntarily changes to the IPIC method. Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the dollar-value pool, the year of change is used as the new base year for the purpose of determining the amount of increments and liquidations, if any, for the year of change and subsequent taxable years. The base-year cost of the layers in a dollar-value pool at the beginning of the year of change must be restated in terms of new base-year cost using the year of change as the new base year and, if applicable, the indexes for the previously determined layers must be recomputed accordingly. The recomputed indexes will be used to determine the LIFO value of subsequent liquidations. For purposes of computing an IPI under paragraph (e)(3)(iii)(E) of this section, the IPI for the immediately preceding year is 1.00. The new total base-year cost of the items in a dollar-value pool for the purpose of determining future increments and liquidations is equal to the total current-year cost of the items in the dollar-value pool (determined using the taxpayer's method of determining the total current-year cost of the items in the dollar-value pool under paragraph (e)(2)(ii) of this section). A taxpayer must allocate this new total base-year cost to each layer based on the ratio of the old base-year cost of the layer to the old total base-year cost of the dollar-value pool.

(*ii*) *Example*. The following example illustrates the rules of this paragraph (e)(3)(iv)(B)(*1*):

Example. (i) In 1990, X elected to use a dollar-value LIFO method (other than the IPIC method) for its single dollar-value pool. X is granted permission to change to the link-chain IPIC method, beginning with the taxable year ending December 31, 2001. X will continue using a single dollar-value pool. X's beginning inventory as of January 1, 2001, computed using its former inventory method, is as follows:

Layer	(I) Base-Year Cost	(II) Inflation Index	(III) LIFO Value: (I) * (II)
Base layer	$135,000	1.00	$135,000
1991 layer	20,000	1.43	28,600
1994 layer	60,000	1.55	93,000
1995 layer	13,000	1.59	20,670
1997 layer	2,000	1.61	3,220
Total	$230,000		$280,490

(ii) Under X's method of determining the current-year cost of items in a dollar-value pool, the current-year cost of the beginning inventory is $391,000. Thus, X's new base-year cost as of January 1, 2001, is $391,000. X allocates this new base-year cost to each layer based on the ratio of old base-year cost of the layer to the total old base-year cost of the dollar-value pool. To recompute the inflation indexes for each of its layers, X divides the LIFO value of each layer by the new base-year cost attributable to the layer. The new base-year cost, recomputed inflation indexes, and LIFO value of X's layers as of January 1, 2001, are as follows:

	(I) Base-Year	(II) Inflation	(III) LIFO Value:
Layer	Cost	Index	(I) * (II)
Base layer	$229,500	0.588235	$135,000
1991 layer	34,000	0.841176	28,600
1994 layer	102,000	0.911765	93,000
1995 layer	22,100	0.935294	20,670
1997 layer	3,400	0.947059	3,220
Total	$391,000		$280,490

(iii) In 2001, the current-year cost of X's ending inventory is $430,139. The weighted harmonic mean of the category inflation indexes applicable to X's ending inventory is 1.075347, and in accordance with paragraph (e)(3)(iv)(B)(*1*)(*i*) of this section, the inflation index for the immediately preceding taxable year is 1.00. Thus, X's IPI for 2001 is 1.075347 (1.00 * 1.075347). The total base-year cost of X's ending inventory is $400,000 ($430,139 / 1.075347). The base-year cost, IPI, and LIFO value of X's layers as of December 31, 2001, are as follows:

	(I) Base-Year	(II) Inflation	(III) LIFO Value:
Layer	Cost	Index	(I) * (II)
Base layer	$229,500	0.588235	$135,000
1991 layer	34,000	0.841176	28,600
1994 layer	102,000	0.911765	93,000
1995 layer	22,100	0.935294	20,670
1997 layer	3,400	0.947059	3,220
2001 layer	9,000	1.075347	9,678
Total	$400,000		$290,168

(iv) In 2002, the current-year cost of X's ending inventory is $418,000. The weighted harmonic mean of the category inflation indexes applicable to X's ending inventory is 1.02292562, and the IPI for the immediately preceding year is 1.075347. Thus, X's IPI for 2001 is 1.10 (1.075347 * 1.02292562). The total base-year cost of X's ending inventory is $380,000 ($418,000 / 1.10), which results in a liquidation of $20,000 ($400,000 - $380,000) in terms of base-year cost. This liquidation eliminates the 2001 layer ($9,000 base-year cost), the 1997 layer ($3,400 base-year cost), and part of the 1995 layer ($7,600 base-year cost). The base-year cost, indexes, and LIFO value of X's layers as of December 31, 2002, are as follows:

	(I) Base-Year	(II) Inflation	(III) LIFO Value:
Layer	Cost	Index	(I) * (II)
Base layer	$229,500	0.588235	$135,000
1991 layer	34,000	0.841176	28,600
1994 layer	102,000	0.911765	93,000
1995 layer	14,500	0.935294	13,562
Total	$380,000		$270,162

(*2*) *Involuntary change*—(*i*) *In general*. If a taxpayer uses a non-IPIC method to compute the LIFO value of a dollar-value pool, and if the Commissioner determines that the taxpayer's method does not clearly reflect income, the Commissioner may require the taxpayer to change to the IPIC method. If the Commissioner requires a taxpayer to change to the IPIC method, and the taxpayer does not provide sufficient information from its books and records to compute an adjustment under section 481, the Commissioner may implement the change using the simplified transition method described in paragraph (e)(3)(iv)(B)(*2*)(*ii*) of this section.

(*ii*) *Simplified Transition Method*. Under the simplified transition method, the Commissioner will recompute the LIFO value of each dollar-value pool as of the beginning of the year of change using the double-extension IPIC method or the link-chain IPIC method. The adjustment under section 481 is equal to the difference between the recomputed LIFO value and the LIFO value of the pool determined under the taxpayer's former method. The Commissioner will compute an IPI using the double-extension IPIC method or link-chain IPIC method for each taxable year in which the LIFO method was used by the taxpayer

based on the assumptions that the ending inventory of the pool in each taxable year was comprised of items that fall into the same BLS categories as the items in the ending inventory of the year of change and that the relative weights of those BLS categories in all prior years were the same as the relative weights of those BLS categories in the ending inventory of the year of change. The base-year cost of the items in a dollar-value pool at the end of a taxable year will be determined by dividing the IPI computed for the taxable year into the current-year cost of the items in that pool determined in accordance with paragraph (e)(2)(ii) of this section. If the comparison of the base-year cost of the beginning and ending inventory produces a current-year increment, the base-year cost of that increment will be multiplied by the IPI computed for that taxable year to determine the LIFO value of that layer.

(*iii*) *Example*. The following example illustrates the rules of this paragraph (e)(3)(iv)(B)(*2*)(*ii*).

Example. (i) Z began using a dollar-value LIFO method other than the IPIC method in the taxable year ending December 31, 1998, and maintains a single dollar-value pool. Z's beginning inventory as of January 1, 2000, computed using its method of accounting, was as follows:

Layer	(I) Base-Year Cost	(II) Inflation Index	(III) LIFO Value: (I) * (II)
Base layer	$105,000	1.00	$105,000
1998 layer	3,000	1.40	4,200
Total	$108,000		$109,200

(ii) Upon examining Z's federal income tax return for the taxable year ending December 31, 2000, the examining agent determines that Z's dollar-value LIFO method does not clearly reflect income. The examining agent chooses to change Z to the double-extension IPIC method for 2000 and implements the change using the simplified transition method as follows. First, the inventory in Z's dollar-value pool at the end of 2000 is assigned to the most-detailed categories in the CPI or PPI, whichever is appropriate. Assume that 80 percent of the current-year cost of Z's inventory as of December 31, 2000, is assigned to Category 1, 10 percent is assigned to Category 2, and 10 percent is assigned to Category 3. Assume further that the current-year cost of the inventory in Z's dollar-value pool at the end of 1998 and 1999 was $133,000 and $145,000, respectively.

(iii) The category inflation indexes for 1998 computed under the double-extension IPIC method are 1.17 for Category 1, 1.26 for Category 2, and 1.19 for Category 3. The weights to be used in computing the IPI for 1998 are $106,400 ($133,000 * 80 percent) for Category 1, $13,300 ($133,000 * 10 percent) for Category 2, and $13,300 ($133,000 * 10 percent) for Category 3. The IPI for 1998 is computed as follows:

Category	(I) Weight	(II) Category Inflation Index	(III) Quotient: (I) / (II)
1	$106,400	1.17	90,940
2	13,300	1.26	10,556
3	13,300	1.19	11,176
Total	$133,000		$112,672

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Inventory Price Index: (IV) / (V)
$133,000	$112,672	1.180417

(iv) The base-year cost of the inventory in Z's pool at the end of 1998 is $112,672 ($133,000 / 1.180417), and the base-year cost of the 1998 increment is $7,672 ($112,672 - $105,000). The LIFO value of the 1998 layer is $9,056 ($7,672 * 1.180417).

(v) The category inflation indexes for 1999 computed under the double-extension IPIC method were 1.21 for Category 1, 1.29 for Category 2 and 1.23 for Category 3. The weights to be used in computing the IPI for 1999 are $116,000 ($145,000 * 80 percent) for Category 1, $14,500 ($145,000 * 10 percent) for Category 2, and $14,500 ($145,000 * 10 percent) for Category 3. The IPI for 1999 is computed as follows:

Category	(I) Weight	(II) Category Inflation Index	(III) Quotient: (I) / (II)
1	$116,000	1.21	$ 95,868
2	14,500	1.29	11,240
3	14,500	1.23	11,789
Total	$145,000		$118,897

(IV) Sum of Weights	(V) Sum of (Weight / Category Inflation Index)	(VI) Inventory Price Index: (IV) / (V)
$145,000	$118,897	1.219543

(vi) The base-year cost of the inventory in Z's pool at the end of 1999 is $118,897 ($145,000 / 1.219543), and the base-year cost of the 1999 layer is $6,225 ($118,897 - $112,672). The LIFO value of the 1999 layer is $7,592 ($6,225 * 1.219543).

(vii) The LIFO value of Z's dollar-value pool at the end of 1999 computed under the double-extension IPIC method is as follows:

Layer	(I) Base-Year Cost	(II) Inventory Price Index	(III) LIFO Value: (I) * (II)
Base layer	$105,000	1.000000	$105,000
1998 layer	7,672	1.180417	9,056
1999 layer	6,225	1.219542	7,592
Total	$118,897		$121,648

(viii) The section 481(a) adjustment is equal to the difference between the LIFO value of the inventory at the beginning of 2000 computed under Z's former method of accounting and recomputed by the examining agent under the double-extension IPIC method, or $12,448 ($121,648 - $109,200).

(ix) Finally, the examining agent will recompute Z's taxable income for 2000 and succeeding taxable years using the double-extension IPIC method.

(v) *Effective date*—(A) *In general*. The rules of this paragraph (e)(3) and paragraphs (b)(4) and (c)(2) of this section are applicable for taxable years ending on or after December 31, 2001.

(B) *Change in method of accounting*. Any change in a taxpayer's method of accounting necessary to comply with this paragraph (e)(3) or with paragraphs (b)(4) or (c)(2) of this section is a change in method of accounting to which the provisions of section 446 and the regulations thereunder apply. For the first or second taxable year ending on or after December 31, 2001, a taxpayer is granted the consent of the Commissioner to change its method of accounting to a method required or permitted by this paragraph (e)(3) and paragraphs (b)(4) and (c)(2) of this section. A taxpayer that wants to change its method of accounting under this paragraph (e)(3)(v) must follow the automatic consent procedures in Rev. Proc. 2002–9 (2002–3 I.R.B. 327) (see § 601.601(d)(2) of this chapter). However, the scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply, and the five-year limitation on the readoption of the LIFO method under section 10.01(2) of the Appendix is waived. In addition, if the taxpayer's method of accounting for its LIFO inventories is an issue under consideration at the time the application is filed with the national office, the audit protection of section 7 of Rev. Proc. 2002–9 does not apply. If a taxpayer changing its method of accounting under this paragraph (e)(3)(v)(B) is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the application to the examining agent(s), appeals officer or counsel for the government, as appropriate, at the same time it files the application with the national office. Any change under this paragraph (e)(3)(v)(B) must be made using a cut-off method and new base year as required by paragraph (e)(3)(iv)(B)(*1*) of this section. Because a change under this paragraph (e)(3)(v)(B) is made using a cut-off method, a section 481(a) adjustment is not permitted. However, a taxpayer changing its method of accounting under this paragraph (e)(3)(v)(B) must comply with the requirements of section 10.06(3) of the APPENDIX of Rev. Proc. 2002–9 (concerning bargain purchases).

* * * * *

(h) *LIFO inventories received in certain nonrecognition transactions*—(1) *In general*. Except as provided in paragraph (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.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In § 602.101, the table in paragraph (b) is amended by revising the entry for 1.472–8 to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.472–8	1545–0028
	1545–0042
	1545–1767
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 21, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 8, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 9, 2002, 67 F.R. 1075)

Section 1301.—Averaging of Farm Income

26 CFR 1.1301–1: Averaging of farm income.

T.D. 8972

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

Averaging of Farm Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the election to average farm income in computing tax liability. The regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, as amended by the Tax and Trade Relief Extension Act of 1998, and provide guidance to individuals engaged in a farming business.

DATES: *Effective Date*: These regulations are effective January 8, 2002.

Applicability Date: These regulations apply to taxable years beginning after December 31, 2001. However, taxpayers may rely on the rules in these final regulations in computing tax liability for taxable years beginning on or before December 31, 2001.

FOR FURTHER INFORMATION CONTACT: John M. Moran (202) 622–4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1662. Taxpayers provide the information on Schedule J, "*Farm Income Averaging,*" which is attached to Form 1040, "*U.S. Individual Income Tax Return,*" for the taxable year in which income averaging is elected.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget.

The burden for this requirement is reflected in the burden estimate for Schedule J. The estimated burden for the 2000 Schedule J is 2 hours per respondent.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR: MP:FP:S:O, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

Section 1301 was added to the Internal Revenue Code (the Code) by section 933(a) of the Taxpayer Relief Act of 1997 (Public Law 105–34; (111 Stat. 788, 881–82)), as amended by section 2011 of the Tax and Trade Relief Extension Act of 1998 (Division J of H.R. 4328, Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999) (Public Law 105–277 (112 Stat. 2681, 2681–886, 2681–902)). On October 8, 1999, a notice of proposed rulemaking (REG–121063–97, 1999–2 C.B. 540) containing proposed regulations under section 1301 was published in the **Federal Register** (64 FR 54836). A number of comments responding to the notice were received and a public hearing was held on February 15, 2000. After consideration of the comments, the proposed regulations are adopted as revised by this Treasury decision.

Explanation of Provisions

Treatment of Wages

The income averaging election is available only to individuals engaged in a farming business and only with respect to income from that business. The proposed regulations provide that farm income does not include wages but the notice of proposed rulemaking invited public comment on whether a different rule should apply to wages paid to a shareholder of an S corporation. Several comments on this issue supported a rule that would permit wages paid by an S corporation to a shareholder to qualify as income from a farming business, and the final regulations adopt this rule.

This change results in comparable treatment for S corporation shareholders, partners, and sole proprietors. A sole proprietor's Schedule F income, whether attributable to capital or labor, is treated as income from the business conducted through the proprietorship. In the case of a partnership engaged in a farming business, income earned by the partners that is attributable to the farming business is similarly treated as farm income for purposes of the income averaging rules whether the income takes the form of a distributive share or a guaranteed payment.

S corporations, like partnerships, are passthrough entities for Federal income tax purposes. In an S corporation, amounts paid to shareholders as wages would, if retained by the corporation, increase the shareholders' income qualifying for the income averaging election. There is no indication in the legislative history of section 1301 that Congress intended disparate treatment of S corporation shareholders depending on whether amounts are paid to the shareholders as wages or allocated to shareholders as a *pro rata* share of the corporation's income. Accordingly, the final regulations provide consistent treatment for shareholders in S corporations and partners in partnerships. Thus, a shareholder's income that is attributable to the S corporation's farming business qualifies as farm income for purposes of the income averaging rules whether paid to the shareholder as wages or allocated to the shareholder as a *pro rata* share.

In contrast, a C corporation is not a passthrough entity for Federal income tax purposes. Accordingly, the final regulations do not treat any amounts paid by a C corporation to its shareholder-employees as farm income.

Treatment of Rental Income

The proposed regulations contain no provision for treating rental income as income from a farming business. This is consistent with the general principle that lessors of farmland are not ordinarily treated as engaged in a farming business with respect to the leased land. Commentators were divided over whether rental income based on a tenant's production (*e.g.*, a crop share) should be treated as income from a farming business for purposes of section 1301. The final regulations provide that income from such arrangements is treated, subject to an anti-abuse rule, as income from a farming business. This rule is consistent with the policy underlying section 1301 of limiting the adverse effects of a progressive rate structure on farmers whose income varies significantly from year to year in response to fluctuations in the farm economy. A landlord's income from a crop-share lease or similar arrangement is affected by fluctuations in the farm economy to the same extent as that of any other farmer. Moreover, regulations under other Code sections provide precedent for the rule in the final regulations. For example, a similar rule in the regulations under section 175 (relating to the deduction for certain soil and water conservation expenditures) treats a landlord who receives rent (either cash or in kind)

based on farm production as engaged in the business of farming.

Under the final regulations, a landlord's crop share income reported on Form 4835, "*Farm Rental Income and Expenses*," Schedule F, "*Profit or Loss From Farming*," or Part II of Schedule E, "*Supplemental Income or Loss*," is eligible for income averaging if the landlord's share of a tenant's production is set in a written rental agreement before the tenant begins significant activities on the land. If a landlord receives a fixed rent or a share of a tenant's production that is set after the tenant begins significant activities, the landlord is not considered to be engaged in a farming business with respect to the leased land, and the rental income is not eligible for income averaging, even if the landlord materially participates in the tenant's farming business.

Treatment of Income from Partnerships

A commentator asked whether income attributable to a farming business carried on by a partnership is farm income without regard to the size of a partner's interest in the partnership or the activities of the partner. The commentator also asked how the farm income of a partnership may be allocated. Farm income is allocated under the partnership rules in Subchapter K of the Code, and these regulations do not modify those rules. The final regulations, like the proposed regulations, permit income attributable to a farming business carried on by a partnership to be averaged without regard to the partner's level of participation in the partnership or size of ownership interest.

Effect of Adjustments

A commentator requested that the final regulations expressly require an amended return if there is a change to a base year return as a result of either an IRS or taxpayer initiated adjustment. The IRS and Treasury do not believe that a special rule in the final regulations is necessary to address this point, as the situation is not unique to section 1301. If the election year tax liability is changed as a result of an adjustment to a base year, then, as with any correction, an amended return should be made for the election year if the statute of limitations is open.

Making, Changing, or Revoking an Election

Under the proposed regulations an individual may not make a late election, change an election, or revoke an election unless there has been an adjustment to taxable income or tax liability or the Commissioner has consented. One comment suggested that these limitations on a taxpayer's ability to make, change, or revoke an election should be eliminated. This suggestion has been adopted. Under the final regulations, a taxpayer may make a late election, change an election, or revoke an election subject only to the generally applicable rules on the period of limitations on filing a claim for credit or refund.

Negative Taxable Income

A number of commentators criticized the computational rules contained in Schedule J, *Farm Income Averaging*, for 1999 and earlier years. These rules prohibited the use of a negative amount for a base year's taxable income. The commentators suggested that taxpayers should be permitted to use a negative amount if appropriate adjustments are made for amounts, such as net operating losses, that may provide a tax benefit in another taxable year.

The final regulations adopt this suggestion. Thus, a base year's taxable income may be negative but amounts, such as a net operating loss or certain capital losses, that may be deducted in one or more other taxable years in the form of a carryover or carryback must be added back in computing negative taxable income. The Schedule J for years after 1999 includes worksheets and instructions for determining negative taxable income for purposes of the income averaging computation.

Calculation of Section 1 Tax

The proposed regulations provide that the tax is computed by reducing the election year taxable income by the applicable amount and increasing taxable income for the base years by one-third of that amount. One commentator suggested that taxable income for the election year should be computed by excluding the elected amount from the taxpayer's gross income. This would reduce adjusted gross income, which in turn might reduce the effect of limitations and phase-outs based on adjusted gross income. The statutory language unambiguously provides, however, that any election-year decrease (or base-year increase) must be made to taxable income. Moreover, consistent application of the rule suggested in the comment would require recomputation of adjusted gross income and all related limitations and phase-outs in base years. This would substantially increase the complexity of the income averaging computation. Accordingly, the final regulations do not adopt this suggestion.

Farm Income

A commentator suggested that the final regulations list specific items of income and deductions to clarify which items are attributable to a farming business under section 1301. The regulations are not a suitable format for providing the comprehensive guidance requested because of the difficulty in identifying the myriad items of income and expense that may be attributable to a farming business and because, in each case, a determination based on specific facts and circumstances is necessary. Taxpayers are encouraged to raise questions they may have concerning any specific types of income so that guidance can be given by revenue ruling, instructions, or other appropriate means.

The proposed regulations treat gain from the sale or other disposition of property (other than land) as attributable to a farming business if, taking into account all the facts and circumstances, the property was regularly used in the farming business for a substantial period of time. A commentator asked that the final regulations provide more specific guidance on what constitutes a substantial period of time. The final regulations provide that property that has always been used solely in the farming business by the individual is deemed to meet both the regularly used and substantial period tests. For property not used solely in the farming business, what constitutes regular use or a substantial period of time is likely to vary significantly, depending upon the facts of the taxpayer's business. Accordingly, the final regulations retain the facts-and-circumstances test for such property.

The proposed regulations establish a presumption that sales or dispositions of property used in a farming business are attributable to that business if they occur within one year of its cessation. One comment expressed concern that this presumption may be construed as establishing a contrary presumption for sales or dispositions occurring after that one-year period. The comment suggested extending the period to two years, arguing that it is not uncommon for sales or dispositions of farm property to continue for more than one year after the cessation of the farming business, particularly in economically depressed areas.

The final regulations do not adopt this suggestion. The regulatory presumption is, however, only a safe harbor for sales or dispositions of property occurring within the one-year period; no contrary presumption is stated or implied for sales or dispositions occurring after that period. Rather, the determination of whether those sales or dispositions are attributable to a farming business appropriately depends upon all the facts and circumstances.

One commentator proposed an example to illustrate that elected farm income may not exceed taxable income, using a gross farm income amount reduced by farming deductions and the standard deduction. The regulations illustrate, as simply as possible, that elected farm income cannot exceed taxable income. These computations are illustrated in greater detail in Pub. 225, "*Farmer's Tax Guide*," which provides a sample tax return including a Schedule J.

Similarly, one commentator requested examples demonstrating calculations involving capital gains. Although no such examples are provided in the final regulations, Pub. 225 does provide an example, and the IRS will consider including other examples in future guidance.

Married Taxpayers

Several comments were received regarding the application of the rules to married taxpayers. Two commentators asked how farm income reported on a joint return is associated with the proper spouse in a noncommunity property state. Two other commentators asked about the application of community property laws.

The final regulations do not provide specific guidance on these issues. As a general matter, however, an individual's filing status does not affect determinations regarding whether the individual is engaged in a farming business or the amount of profit or loss from that business reported on the individual's Schedule F, *Profit or Loss From Farming*, or Schedule K–1, *Partner's (Shareholder's) Share of Income, Credits, Deductions, etc.* Thus, if only one spouse engages in farming in the election year, only that spouse may have elected farm income, and if both spouses engage in farming, each spouse may have elected farm income from the business in which that spouse is engaged. Similarly, as a general matter, community property laws determine income and property ownership for Federal income tax purposes. Although the Code may provide otherwise in specific instances, there are no such exceptions in either section 1301 or the final regulations.

Alternative Minimum Tax

One commentator requested that the final regulations provide an example showing that the alternative minimum tax limits the benefits of an income averaging election. Although the final regulations do not provide an example of the application of the alternative minimum tax, they continue to note that the income averaging election does not apply for purposes of determining the alternative minimum tax in the election year or any base year, except to the extent the election is taken into account in determining the regular tax offset to the tentative minimum tax. There is no exception in the Code provisions relating to the alternative minimum tax that would permit the minimum tax to be computed without regard to the effect of farm income averaging on the regular tax.

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collection of information imposed by these regulations is not significant as reflected in the estimated burden of information collection for Schedule J, which is 2 hours per respondent. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the IRS submitted the notice of proposed rulemaking to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is John M. Moran of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.1301–1 also issued under 26 U.S.C. 1301(c). * * *

Par. 2. An undesignated center heading and §1.1301–1 are added immediately following the center heading "Readjustment of Tax Between Years and Special Limitations" to read as follows:

INCOME AVERAGING

§ 1.1301–1 Averaging of farm income.

(a) *Overview.* An individual engaged in a farming business may elect to compute current year (election year) income tax liability under section 1 by averaging,

over the prior three-year period (base years), all or a portion of the individual's current year electible farm income as defined in paragraph (e) of this section. To average farm income, the individual—

(1) Designates all or a portion of his or her electible farm income for the election year as elected farm income; and

(2) Determines the election year section 1 tax by determining the sum of—

(i) The section 1 tax that would be imposed for the election year if taxable income for the year were reduced by elected farm income; plus

(ii) For each base year, the amount by which the section 1 tax would be increased if taxable income for the year were increased by one-third of elected farm income.

(b) *Individual engaged in a farming business*—(1) *In general. Farming business* has the same meaning as provided in section 263A(e)(4) and the regulations thereunder. An individual engaged in a farming business includes a sole proprietor of a farming business, a partner in a partnership engaged in a farming business, and a shareholder of an S corporation engaged in a farming business. Services performed as an employee are disregarded in determining whether an individual is engaged in a farming business for purposes of section 1301. An individual is not required to have been engaged in a farming business in any of the base years in order to make a farm income averaging election.

(2) *Certain landlords*. A landlord is engaged in a farming business for purposes of section 1301 with respect to rental income that is based on a share of production from a tenant's farming business and, with respect to amounts received on or after January 1, 2003, is determined under a written agreement entered into before the tenant begins significant activities on the land. A landlord is not engaged in a farming business for purposes of section 1301 with respect to either fixed rent or, with respect to amounts received on or after January 1, 2003, rental income based on a share of a tenant's production determined under an unwritten agreement or a written agreement entered into after the tenant begins significant activities on the land. Whether the landlord materially participates in the tenant's farming business is irrelevant for purposes of section 1301.

(c) *Making, changing, or revoking an election*—(1) *In general*. A farm income averaging election is made by filing Schedule J, "*Farm Income Averaging*," with an individual's Federal income tax return for the election year (including a late or amended return if the period of limitations on filing a claim for credit or refund has not expired).

(2) *Changing or revoking an election*. An individual may change the amount of the elected farm income in a previous election or revoke a previous election if the period of limitations on filing a claim for credit or refund has not expired for the election year.

(d) *Guidelines for calculation of section 1 tax*—(1) *Actual taxable income not affected*. Under paragraph (a)(2) of this section, a determination of the section 1 tax for the election year involves a computation of the section 1 tax that would be imposed if taxable income for the election year were reduced by elected farm income and taxable income for each of the base years were increased by one-third of elected farm income. The reduction and increases required for purposes of this computation do not affect the actual taxable income for either the election year or the base years. Thus, for each of those years, the actual taxable income is taxable income determined without regard to any hypothetical reduction or increase required for purposes of the computation under paragraph (a)(2) of this section. The following illustrates this principle:

(i) Any reduction or increase in taxable income required for purposes of the computation under paragraph (a)(2) of this section is disregarded in determining the taxable year in which a net operating loss carryover or net capital loss carryover is applied.

(ii) The net section 1231 gain or loss and the character of any section 1231 items for the election year is determined without regard to any reduction in taxable income required for purposes of the computation under paragraph (a)(2) of this section.

(iii) The section 68 overall limitation on itemized deductions for the election year is determined without regard to any reduction in taxable income required for purposes of the computation under paragraph (a)(2) of this section. Similarly, the section 68 limitation for a base year is not recomputed to take into account any allocation of elected farm income to the base year for such purposes.

(iv) If a base year had a partially used capital loss, the remaining capital loss may not be applied to reduce the elected farm income allocated to the year for purposes of the computation under paragraph (a)(2) of this section.

(v) If a base year had a partially used credit, the remaining credit may not be applied to reduce the section 1 tax attributable to the elected farm income allocated to the year for purposes of the computation under paragraph (a)(2) of this section.

(2) *Computation in base years*—(i) *In general*. As provided in paragraph (a)(2)(ii) of this section, the election year section 1 tax includes the amounts by which the section 1 tax for each base year would be increased if taxable income for the year were increased by one-third of elected farm income. For this purpose, all allowable deductions (including the full amount of any net operating loss carryover) are taken into account in determining the taxable income for the base year even if the deductions exceed gross income and the result is negative. If the result is negative, however, any amount that may provide a benefit in another taxable year is added back in determining base year taxable income. Amounts that may provide a benefit in another year include—

(A) The net operating loss (as defined in section 172(c)) for the base year;

(B) The net operating loss for any other year to the extent carried forward from the base year under section 172(b)(2); and

(C) The capital loss deduction allowed for the base year under section 1211(b)(1) or (2) to the extent such deduction does not reduce the capital loss carryover from the base year because it exceeds adjusted taxable income (as defined in section 1212(b)(2)(B)).

(ii) *Example*. The rules of this paragraph (d)(2)are illustrated by the following example:

Example. In 2001, F and F's spouse on their joint return elect to average $24,000 of income attributable to a farming business. One-third of the elected farm income, $8,000, is added to the 1999

base year income. In 1999, F and F's spouse reported adjusted gross income of $7,300 and claimed a standard deduction of $7,200 and a deduction for personal exemptions of $8,250. Therefore, their 1999 base year taxable income is -$8,150 [$7,300-($7,200+$8,250)]. After adding the elected farm income to the negative taxable income, their 1999 base year taxable income would be zero [$8,000+(-$8,150)=-$150]. If F and F's spouse elected to income average in 2002, and made the adjustments described in paragraph (d)(3) of this section to account for the 2001 election, their 1999 base year taxable income for the 2002 election would be -$150.

(3) *Effect on subsequent elections*—(i) *In general*. The reduction and increases in taxable income assumed in computing the election year section 1 tax (within the meaning of paragraph (a)(2) of this section) for an election year are treated as having actually occurred for purposes of computing the election year section 1 tax for any subsequent election year. Thus, if a base year for a farm income averaging election is also an election year for another farm income averaging election, the increase in the section 1 tax for that base year is determined after reducing taxable income by the elected farm income from the earlier election year. Similarly, if a base year for a farm income averaging election is also a base year for another farm income averaging election, the increase in the section 1 tax for that base year is determined after increasing taxable income by elected farm income allocated to the year from the earlier election year.

(ii) *Example*. The rules of this paragraph (d)(3) are illustrated by the following example:

Example. (i) In each of years 1998, 1999, and 2000, T had taxable income of $20,000. In 2001, T had taxable income of $30,000 (prior to any farm income averaging election) and electible farm income of $10,000. T makes a farm income averaging election with respect to $9,000 of his electible farm income for 2001. Thus, for purposes of the computation under paragraph (a)(2) of this section, $3,000 of elected farm income is allocated to each of years 1998, 1999, and 2000. T's 2001 tax liability is the sum of—

(A) The section 1 tax on $21,000 (2001 taxable income minus elected farm income); plus

(B) For each of years 1998, 1999, and 2000, the section 1 tax on $23,000 minus the section 1 tax on $20,000 (the amount by which section 1 tax would be increased if one-third of elected farm income were allocated to such year).

(ii) In 2002, T has taxable income of $50,000 and electible farm income of $12,000. T makes a farm income averaging election with respect to all $12,000 of his electible farm income for 2002. Thus, for purposes of the computation under paragraph (a)(2) of this section, $4,000 of elected farm income is allocated to each of years 1990, 2000, and 2001. T's 2002 tax liability is the sum of—

(A) The section 1 tax on $38,000 (2002 taxable income minus elected farm income); plus

(B) For each of years 1999 and 2000, the section 1 tax on $27,000 minus the section 1 tax on $23,000 (the amount by which section 1 tax would be increased if one-third of elected farm income were allocated to such years after increasing taxable income for such years by the elected income allocated to such years from the 2001 election year); plus

(C) For year 2001, the section 1 tax on $25,000 minus the section 1 tax on $21,000 (the amount by which section 1 tax would be increased if one-third of elected farm income were allocated to such year after reducing taxable income for such year by the 2001 elected farm income).

(e) *Electible farm income*—(1) *Identification of items attributable to a farming business*—(i) *In general*. Farm income includes items of income, deduction, gain, and loss attributable to the individual's farming business. Farm losses include a net operating loss carryover or carryback, or a net capital loss carryover, to an election year that is attributable to a farming business. Income, gain, or loss from the sale of development rights, grazing rights, and other similar rights is not treated as attributable to a farming business. In general, farm income does not include compensation received by an employee. However, a shareholder of an S corporation engaged in a farming business may treat compensation received from the corporation that is attributable to the farming business as farm income.

(ii) *Gain or loss on sale or other disposition of property*—(A) *In general*. Gain or loss from the sale or other disposition of property that was regularly used in the individual's farming business for a substantial period of time is treated as attributable to a farming business. For this purpose, the term *property* does not include land, but does include structures affixed to land. Property that has always been used solely in the farming business by the individual is deemed to meet both the regularly used and substantial period tests. Whether property not used solely in the farming business was regularly used in the farming business for a substantial period of time depends on all of the facts and circumstances.

(B) *Cessation of a farming business*. If gain or loss described in paragraph (e)(1)(ii)(A) of this section is realized after cessation of a farming business, such gain or loss is treated as attributable to a farming business only if the property is sold within a reasonable time after cessation of the farming business. A sale or other disposition within one year of cessation of the farming business is presumed to be within a reasonable time. Whether a sale or other disposition that occurs more than one year after cessation of the farming business is within a reasonable time depends on all of the facts and circumstances.

(2) *Determination of amount that may be elected farm income*—(i) *Electible farm income*. The maximum amount of income that an individual may elect to average (electible farm income) is the sum of any farm income and gains minus any farm deductions or losses (including loss carryovers and carrybacks) that are allowed as a deduction in computing the individual's taxable income. However, electible farm income may not exceed taxable income. In addition, electible farm income from net capital gain attributable to a farming business cannot exceed total net capital gain. Subject to these limitations, an individual who has both ordinary and net capital gain farm income may elect to average any combination of such ordinary and net capital gain farm income.

(ii) *Examples*. The rules of paragraph (e)(2)(i) of this section are illustrated by the following examples:

Example 1. A has farm gross receipts of $200,000 and farm ordinary deductions of $50,000. A's taxable income is $150,000 ($200,000-$50,000). A's electible farm income is $150,000, all of which is ordinary income.

Example 2. B has ordinary farm income of $200,000 and ordinary nonfarm losses of $50,000. B's taxable income is $150,000 ($200,000-$50,000). B's electible farm income is $150,000, all of which is ordinary income.

Example 3. C has a farm capital gain of $50,000 and a nonfarm capital loss of $40,000. C also has ordinary farm income of $60,000. C has taxable income of $70,000 ($50,000-$40,000+$60,000). C's electible farm income is $70,000. C can elect to average up to $10,000 of farm capital gain and up to $60,000 of farm ordinary income.

Example 4. D has a nonfarm capital gain of $40,000 and a farm capital loss of $30,000. D also has ordinary farm income of $100,000. D has taxable income of $110,000 ($40,000-$30,000+$100,000). D's electible farm income is $70,000 ($100,000 ordinary farm income minus $30,000 farm capital loss), all of which is ordinary income.

Example 5. E has a nonfarm capital gain of $20,000 and a farm capital loss of $30,000. E also has ordinary farm income of $100,000. E has taxable income of $97,000 ($20,000-$23,000 ($30,000

loss limited by section 1211(b))+$100,000). E has a farm capital loss carryover of $7,000 ($30,000-$23,000 allowed as a deduction). E's electible farm income is $77,000 ($100,000 ordinary farm income minus $23,000 farm capital loss), all of which is ordinary income.

(f) *Miscellaneous rules*—(1) *Short taxable year*—(i) *In general*. If a base year or an election year is a short taxable year, the rules of section 443 and the regulations thereunder apply for purposes of calculating the section 1 tax.

(ii) *Base year is a short taxable year*. If a base year is a short taxable year, elected farm income is allocated to such year for purposes of paragraph (a)(2) of this section after the taxable income for such year has been annualized.

(iii) *Election year is a short taxable year*. In applying paragraph (a)(2) of this section for purposes of determining tax computed on the annual basis (within the meaning of section 443(b)(1)) for an election year that is a short taxable year—

(A) The taxable income and the electible farm income for the year are annualized; and

(B) The taxpayer may designate all or any part of the annualized electible farm income as elected farm income.

(2) *Changes in filing status*. An individual is not prohibited from making a farm income averaging election solely because the individual's filing status is not the same in an election year and the base years. For example, an individual who files married filing jointly in the election year, but filed as single in one or more of the base years, may still elect to average farm income using the single filing status used in the base year.

(3) *Employment tax*. A farm income averaging election has no effect in determining the amount of wages for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), and the Collection of Income Tax at Source on Wages (Federal income tax withholding), or the amount of net earnings from self-employment for purposes of the Self-Employment Contributions Act (SECA).

(4) *Alternative minimum tax*. A farm income averaging election does not apply in determining the section 55 alternative minimum tax for any base year or the section 55(b) tentative minimum tax for the election year or any base year. The election does, however, apply in determining the regular tax under sections 53(c) and 55(c) for the election year.

(5) *Unearned income of minor child*. In an election year, if a minor child's investment income is taxable under section 1(g) and a parent makes a farm income averaging election, the tax rate used for purposes of applying section 1(g) is the rate determined after application of the election. In a base year, however, the tax on a minor child's investment income is not affected by a farm income averaging election.

(g) *Effective date*. The rules of this section apply to taxable years beginning after December 31, 2001, except with respect to the written agreement requirement of paragraph (b)(2) of this section.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1301–1	1545–1662
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved December 12, 2001.

Mark Weinberger,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 7, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 8, 2002, 67 F.R. 817)

Part III. Administrative, Procedural, and Miscellaneous

Weighted Average Interest Rate Update

Notice 2002–9

Notice 88–73 provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act, Pub. L. 103–465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for December 2001 is 5.48 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
January	2002	5.71	5.14 to 6.00	5.14 to 6.28

Drafting Information

The principal author of this notice is Todd Newman of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please call Mr. Newman at (202) 283–9888 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, § 61, 280F; 1.61–21, 1.280F–7.)

Rev. Proc. 2002–14

SECTION 1. PURPOSE

This revenue procedure provides: (1) limitations on depreciation deductions for owners of passenger automobiles first placed in service during calendar year 2002, including separate limitations on passenger automobiles designed to be propelled primarily by electricity and built by an original equipment manufacturer (electric automobiles); (2) the amounts to be included in income by lessees of passenger automobiles first leased during calendar year 2002, including separate inclusion amounts for electric automobiles; and (3) the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 2002 for which the vehicle cents-per-mile valuation rule provided under § 1.61–21(e) of the Income Tax Regulations may be applicable. The tables detailing these depreciation limitations and lessee inclusion amounts reflect the automobile price inflation adjustments required by § 280F(d)(7) of the Internal Revenue Code. The maximum allowable automobile value for applying the vehicle cents-per-mile valuation rule reflects the automobile price inflation adjustment of § 280F(d)(7) as required by § 1.61–21(e)(1)(iii)(A).

SECTION 2. BACKGROUND

For owners of automobiles, § 280F(a) imposes dollar limitations on the depreciation deduction for the year that the automobile is placed in service and each succeeding year. In the case of electric automobiles placed in service after August 5, 1997, and before January 1, 2005, § 280F(a)(1)(C) requires tripling of these limitation amounts. Section 280F(d)(7) requires the amounts allowable as depreciation deductions to be increased by a price inflation adjustment amount for passenger automobiles placed in service after 1988.

For leased automobiles, § 280F(c) requires a reduction in the deduction allowed to the lessee of the automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of automobiles. Under § 1.280F–7(a), this reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. There is a table for lessees of electric automobiles and a table for all other passenger automobiles. Each table shows inclusion amounts for a range of fair market values for each tax year after the automobile is first leased.

For automobiles first provided by employers to employees that meet the requirements of § 1.61–21(e)(1), the value to the employee of the use of the automobile may be determined under the vehicle cents-per-mile valuation rule of § 1.61–21(e). Section 1.61–21(e)(1)(iii)(A) provides that for an automobile first made available after 1988 to any employee of the employer for personal use, the value of the use of the automobile may not be determined under the vehicle cents-per-mile valuation rule for a calendar year if the fair market value of the automobile (determined pursuant to § 1.61–21(d)(5)(i) through (iv)) on the first date the automobile is made available to the employee exceeds $12,800 as adjusted by § 280F(d)(7).

SECTION 3. SCOPE AND OBJECTIVE

01. The limitations on depreciation deductions in section 4.02 of this revenue procedure apply to automobiles (other than leased automobiles) that are placed in service in calendar year 2002 and continue to apply for each tax year that the automobile remains in service.

02. The tables in section 4.03 of this revenue procedure apply to leased automobiles for which the lease term begins in calendar year 2002. Lessees of such automobiles must use these tables to

determine the inclusion amount for each tax year during which the automobile is leased.

03. See Rev. Proc. 96–25 (1996–1 C.B. 681) for information on determining inclusion amounts for automobiles first leased before January 1, 1997; Rev. Proc. 97–20 (1997–1 C.B. 647) for automobiles first leased during calendar year 1997, including electric automobiles first leased on or after January 1, 1997, and before August 6, 1997; Rev. Proc. 98–24 (1998–1 C.B. 663) for electric automobiles first leased after August 5, 1997, and before January 1, 1998; Rev. Proc. 98–30 (1998–1 C.B. 930) for all automobiles first leased in calendar year 1998; Rev. Proc. 99–14 (1999–1 C.B. 413) for all automobiles first leased in calendar year 1999; Rev. Proc. 2000–18 (2000–9 I.R.B. 722) for all automobiles first leased in calendar year 2000, and Rev. Proc. 2001–19 (2001–9 I.R.B. 732) for all automobiles first leased in calendar year 2001.

04. The maximum fair market value figure in section 4.04(2) of this revenue procedure applies to employer-provided automobiles first made available to any employee for personal use in calendar year 2002. *See* Rev. Proc. 97–20, for the maximum fair market value figure for automobiles first made available in calendar year 1997; Rev. Proc. 98–30, for the maximum fair market value figure for automobiles first made available in calendar year 1998; Rev. Proc. 99–14, for the maximum fair market value figure for automobiles first made available in calendar year 1999; Rev. Proc. 2000–18, for the maximum fair market value figure for automobiles first made available in calendar year 2000; and Rev. Proc. 2001–19, for the maximum fair market value figure for automobiles first made available in calendar year 2001.

SECTION 4. APPLICATION

01. A taxpayer placing an automobile in service for the first time during calendar year 2002 is limited to the depreciation deduction shown in Table 1 of section 4.02(2) of this revenue procedure or, in the case of an electric automobile, Table 2 of this revenue procedure. A taxpayer first leasing an automobile in calendar year 2002 must determine the inclusion amount that is added to gross income using Table 3 of section 4.03 of this revenue procedure or, in the case of an electric automobile, Table 4 of this revenue procedure. In addition, the procedures of § 1.280F–7(a) must be followed. An employer providing an automobile for the first time in calendar year 2002 for the personal use of any employee may determine the value of the use of the automobile by using the cents-per-mile valuation rule in § 1.61–21(e) if the fair market value of the automobile does not exceed the amount specified in section 4.04(2) of this revenue procedure. If the fair market value of the automobile exceeds the amount specified in section 4.04(2) of this revenue procedure, the employer may determine the value of the use of the automobile under the general valuation rules of § 1.61–21(b) or under the special valuation rules of § 1.61–21(d) (Automobile lease valuation) or § 1.61–21(f) (Commuting valuation) if the applicable requirements are met.

02. *Limitations on Depreciation Deductions for Certain Automobiles*.

(1) *Amount of the Inflation Adjustment*. Under § 280F(d)(7)(B)(i), the automobile price inflation adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. The term "CPI automobile component" is defined in § 280F(d)(7)(B)(ii) as the "automobile component" of the Consumer Price Index for all Urban Consumers published by the Department of Labor (the CPI). The new car component of the CPI was 115.2 for October 1987 and 137.7 for October 2001. The October 2001 index exceeded the October 1987 index by 22.5. The Internal Revenue Service has, therefore, determined that the automobile price inflation adjustment for 2002 is 19.53125 percent (22.5/115.2 x 100%). This adjustment is applicable to all automobiles that are first placed in service in calendar year 2002. The dollar limitations in § 280F(a) must therefore be multiplied by a factor of 0.1953125, and the resulting increases, after rounding to the nearest $100, are added to the 1988 limitations to give the depreciation limitations applicable to passenger automobiles (other than electric automobiles) for calendar year 2002. To determine the dollar limitations applicable to an electric automobile first placed in service during calendar year 2002, the dollar limitations in § 280F(a) are tripled in accordance with § 280F(a)(1)(C) and are then multiplied by a factor of 0.1953125; the resulting increases, after rounding to the nearest $100, are added to the tripled 1988 limitations to give the depreciation limitations for calendar year 2002.

(2) *Amount of the Limitation*. For automobiles (other than electric automobiles) placed in service in calendar year 2002, Table 1 of this revenue procedure contains the dollar amount of the depreciation limitations for each tax year. For electric automobiles placed in service in calendar year 2002, Table 2 of this revenue procedure contains these amounts.

REV. PROC. 2002–14 TABLE 1

DEPRECIATION LIMITATIONS FOR AUTOMOBILES
(OTHER THAN ELECTRIC AUTOMOBILES)
FIRST PLACED IN SERVICE IN CALENDAR YEAR 2002

Tax Year	*Amount*
1st Tax Year	$3,060
2nd Tax Year	$4,900
3rd Tax Year	$2,950
Each Succeeding Year	$1,775

REV. PROC. 2002–14 TABLE 2

DEPRECIATION LIMITATIONS FOR ELECTRIC AUTOMOBILES
FIRST PLACED IN SERVICE IN CALENDAR YEAR 2002

Tax Year	*Amount*
1st Tax Year	$ 9,180
2nd Tax Year	$14,700
3rd Tax Year	$ 8,750
Each Succeeding Year	$ 5,325

03. *Inclusions in Income of Lessees of Automobiles*.

The inclusion amounts for automobiles first leased in calendar year 2002 are calculated under the procedures described in § 1.280F–7(a). Lessees of automobiles other than electric automobiles should use Table 3 of this revenue procedure in applying these procedures, while lessees of electric automobiles should use Table 4 of this revenue procedure.

REV. PROC. 2002–14 TABLE 3

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN
ELECTRIC AUTOMOBILES)
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2002

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
$15,500	15,800	2	3	5	6	6
15,800	16,100	3	7	9	11	13
16,100	16,400	4	10	14	17	19
16,400	16,700	6	13	18	22	26
16,700	17,000	7	16	23	28	31
17,000	17,500	9	20	29	35	40
17,500	18,000	11	25	37	44	50
18,000	18,500	14	30	44	53	61
18,500	19,000	16	35	52	62	72
19,000	19,500	18	40	60	71	82

REV. PROC. 2002–14 TABLE 3—CONTINUED

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2002

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
19,500	20,000	21	45	67	80	93
20,000	20,500	23	50	75	89	103
20,500	21,000	25	56	82	98	114
21,000	21,500	28	60	90	108	123
21,500	22,000	30	66	97	117	134
22,000	23,000	33	74	108	130	150
23,000	24,000	38	84	123	149	171
24,000	25,000	43	94	139	166	192
25,000	26,000	47	104	154	185	213
26,000	27,000	52	114	169	203	234
27,000	28,000	57	124	185	220	255
28,000	29,000	61	135	199	239	276
29,000	30,000	66	145	214	258	296
30,000	31,000	71	155	230	275	318
31,000	32,000	75	165	245	294	338
32,000	33,000	80	175	260	312	360
33,000	34,000	85	185	276	329	381
34,000	35,000	89	196	290	348	402
35,000	36,000	94	206	305	367	422
36,000	37,000	99	216	321	384	443
37,000	38,000	103	226	336	403	464
38,000	39,000	108	236	351	421	485
39,000	40,000	112	247	366	439	506
40,000	41,000	117	257	381	457	527
41,000	42,000	122	267	396	475	549
42,000	43,000	126	278	411	493	570
43,000	44,000	131	288	426	512	590
44,000	45,000	136	298	441	530	611
45,000	46,000	140	308	457	548	632
46,000	47,000	145	318	472	566	653
47,000	48,000	150	328	487	584	674
48,000	49,000	154	339	502	602	695
49,000	50,000	159	349	517	620	717
50,000	51,000	164	359	532	639	737
51,000	52,000	168	369	548	657	758
52,000	53,000	173	379	563	675	779
53,000	54,000	177	390	578	693	800
54,000	55,000	182	400	593	711	821

REV. PROC. 2002–14 TABLE 3—CONTINUED

DOLLAR AMOUNTS FOR AUTOMOBILES (OTHER THAN ELECTRIC AUTOMOBILES) WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2002

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
55,000	56,000	187	410	608	729	842
56,000	57,000	191	420	624	747	863
57,000	58,000	196	430	639	766	883
58,000	59,000	201	440	654	784	905
59,000	60,000	205	451	669	802	925
60,000	62,000	212	466	692	829	957
62,000	64,000	222	486	722	866	999
64,000	66,000	231	507	752	902	1,041
66,000	68,000	240	527	783	938	1,083
68,000	70,000	250	547	813	974	1,125
70,000	72,000	259	568	843	1,011	1,166
72,000	74,000	268	589	873	1,047	1,208
74,000	76,000	277	609	904	1,083	1,250
76,000	78,000	287	629	934	1,120	1,292
78,000	80,000	296	650	964	1,156	1,334
80,000	85,000	312	686	1,017	1,219	1,408
85,000	90,000	335	737	1,092	1,311	1,512
90,000	95,000	359	787	1,169	1,401	1,617
95,000	100,000	382	838	1,245	1,491	1,722
100,000	110,000	417	915	1,358	1,627	1,880
110,000	120,000	463	1,017	1,509	1,810	2,089
120,000	130,000	510	1,119	1,660	1,991	2,299
130,000	140,000	556	1,221	1,812	2,172	2,509
140,000	150,000	603	1,323	1,963	2,354	2,718
150,000	160,000	649	1,425	2,115	2,535	2,928
160,000	170,000	696	1,527	2,266	2,717	3,137
170,000	180,000	742	1,629	2,418	2,898	3,347
180,000	190,000	789	1,731	2,569	3,080	3,556
190,000	200,000	835	1,833	2,720	3,262	3,766
200,000	210,000	881	1,935	2,872	3,443	3,976
210,000	220,000	928	2,037	3,023	3,625	4,185
220,000	230,000	974	2,139	3,175	3,806	4,395
230,000	240,000	1,021	2,241	3,326	3,988	4,604
240,000	250,000	1,067	2,343	3,478	4,169	4,814

REV. PROC. 2002–14 TABLE 4

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2002

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
$46,000	47,000	3	6	10	11	12
47,000	48,000	7	16	26	29	33
48,000	49,000	12	26	41	47	54
49,000	50,000	17	36	56	66	74
50,000	51,000	21	47	71	83	96
51,000	52,000	26	57	86	102	117
52,000	53,000	31	67	101	120	138
53,000	54,000	35	77	117	138	159
54,000	55,000	40	87	132	156	180
55,000	56,000	45	98	146	174	201
56,000	57,000	49	108	161	193	222
57,000	58,000	54	118	177	211	242
58,000	59,000	59	128	192	229	264
59,000	60,000	63	139	206	248	284
60,000	62,000	70	154	229	275	316
62,000	64,000	79	174	260	311	358
64,000	66,000	89	195	290	347	400
66,000	68,000	98	215	320	384	442
68,000	70,000	107	236	350	420	484
70,000	72,000	117	256	381	456	525
72,000	74,000	126	276	411	493	567
74,000	76,000	135	297	441	529	609
76,000	78,000	145	317	472	564	652
78,000	80,000	154	337	502	602	693
80,000	85,000	170	373	555	665	767
85,000	90,000	193	424	631	756	871
90,000	95,000	217	475	706	847	976
95,000	100,000	240	526	782	937	1,081
100,000	110,000	275	602	896	1,073	1,239
110,000	120,000	321	705	1,047	1,255	1,448
120,000	130,000	368	806	1,199	1,436	1,658
130,000	140,000	414	909	1,350	1,617	1,868
140,000	150,000	460	1,011	1,501	1,800	2,076
150,000	160,000	507	1,113	1,652	1,981	2,287
160,000	170,000	553	1,215	1,804	2,163	2,496
170,000	180,000	600	1,317	1,955	2,344	2,706
180,000	190,000	646	1,419	2,107	2,525	2,916

REV. PROC. 2002–14 TABLE 4—CONTINUED

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2002

Fair Market Value of Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
190,000	200,000	693	1,521	2,258	2,707	3,125
200,000	210,000	739	1,623	2,410	2,888	3,335
210,000	220,000	786	1,725	2,561	3,070	3,544
220,000	230,000	832	1,827	2,712	3,252	3,754
230,000	240,000	879	1,929	2,863	3,434	3,963
240,000	250,000	925	2,031	3,015	3,615	4,173

04. *Maximum Automobile Value for Using the Cents-per-mile Valuation Rule*.

(1) *Amount of Adjustment*. Under § 1.61–21(e)(1)(iii)(A), the limitation on the fair market value of an employer-provided automobile first made available to any employee for personal use after 1988 is to be adjusted in accordance with § 280F(d)(7). Accordingly, the adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. *See*, section 4.02(1) of this revenue procedure. The new car component of the CPI was 115.2 for October 1987 and 137.7 for October 2000. The October 2000 index exceeded the October 1987 index by 22.5. The Internal Revenue Service has, therefore, determined that the adjustment for 2002 is 19.53125 percent (22.5/115.2 x 100%). This adjustment is applicable to all employer-provided automobiles first made available to any employee for personal use in calendar year 2002. The maximum fair market value specified in § 1.61–21(e)(1)(iii)(A) must therefore be multiplied by a factor of 0.1953125, and the resulting increase, after rounding to the nearest $100, is added to $12,800 to give the maximum value for calendar year 2002.

(2) *The Maximum Automobile Value*. For automobiles first made available in calendar year 2002 to any employee of the employer for personal use, the vehicle cents-per-mile valuation rule may be applicable if the fair market value of the automobile on the date it is first made available does not exceed $15,300.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to automobiles (other than leased automobiles) that are first placed in service during calendar year 2002, to leased automobiles that are first leased during calendar year 2002, and to employer-provided automobiles first made available to employees for personal use in calendar year 2002.

DRAFTING INFORMATION

The principal author of this revenue procedure is Bernard P. Harvey of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding the depreciation limitations and lessee inclusion amounts in this revenue procedure, contact Mr. Harvey at (202) 622–3110; for further information regarding the maximum automobile value for applying the vehicle cents-per-mile valuation rule, contact Dan E. Boeskin of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622–6040 (not toll-free calls).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Liability for Insurance Premium Excise Tax

REG–125450–01

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed amendments to the regulations relating to liability for the insurance premium excise tax. This document affects persons who make, sign, issue, or sell a policy of insurance, indemnity bond, annuity contract, or policy of reinsurance issued by any foreign insurer or reinsurer. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments, requests to speak and outlines of topics to be discussed at the public hearing scheduled for March 19, 2002, at 10 a.m. must be received by February 26, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–125450–01), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG–125450–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html*. The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Amanda Ehrlich, (202) 622–3880; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, Treena Garrett, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The insurance premium excise tax imposed by section 4371 originated as a stamp tax on certain insurance policies in the Act of February 24, 1919, Title IX, section 1100. This provision was re-enacted unchanged in the Revenue Act of 1924, as section 800; in the Revenue Act of 1926, as section 800; and in the Internal Revenue Code of 1939 (1939 Code), as section 1804. Section 1809(a) of the 1939 Code required the tax imposed by section 1804 to be paid "by any person who makes, signs, issues, [or] sells ... any of the documents [or] instruments ... [including insurance policies subject to tax] ... or for whose use or benefit the same are made, signed, issued, [or] sold ...." Section 1809(b)(1) of the 1939 Code required the tax to be paid by the purchase of stamps to be affixed to taxable documents.

The insurance premium excise tax imposed by section 1804 of the 1939 Code was reenacted in the Internal Revenue Code of 1954 (1954 Code) as section 4371. Section 1809(a) and (b)(1) of the 1939 Code (relating to who is liable for the tax and how it is to be paid) were reenacted as sections 4383 and 4374 of the 1954 Code, respectively. Section 4383 of the 1954 Code was renumbered as section 4384 by the Excise Technical Changes Act of 1958.

Section 4374 was amended in 1965 to authorize the Secretary or the Secretary's delegate to provide by regulations that the tax imposed by section 4371 shall be paid on the basis of a return, instead of by stamp. Excise Tax Reduction Act of 1965, Public Law 89–44, section 804(a), 79 Stat. 136, 160 (1965). Pursuant to this statutory authorization, the Secretary promulgated 26 CFR § 46.4374–1 in 1970, which provides that the tax imposed by section 4371 shall be paid on the basis of a return and remitted by the person who pays the premium to a foreign insurer or reinsurer. T.D. 7023 (1970–1 C.B. 233, 236). For these purposes, the person who makes payment of the premium is the resident person who actually transferred the money, check, or its equivalent to the foreign insurer or reinsurer. The regulation further provided a reference to section 4384 for purposes of determining the persons liable for the tax. § 46.4374–1(a).

The Tax Reform Act of 1976 (1976 Act) combined sections 4374 and 4384 into a single Code section, and eliminated any references therein to the payment of the tax by stamps. Tax Reform Act of 1976, Public Law 94–455, section 1904(a)(12), 90 Stat. 1520, 1812–14 (1976). The 1976 Act repealed section 4374, which had required payment of the tax by stamps or by return pursuant to regulations. It renumbered section 4384 as section 4374, which imposes liability for the tax. Finally, the 1976 Act amended the new section 4374 to require payment of the tax by return. The regulations under section 4374 have not been changed to reflect the 1976 statutory amendments.

Some taxpayers have taken the position, contrary to the statute, that § 46.4374–1 (which does not reflect the 1976 legislative changes) imposes liability and requires payment of tax only if a premium is paid by a resident of the United States. This interpretation ignores the cross-reference in § 46.4374–1(a) to prior Code section 4384 for purposes of determining the persons who are liable for the tax. The proposed regulations revise § 46.4374–1(a) to conform the regulations to the 1976 statutory amendments by providing that any person who makes, signs, issues, or sells any of the documents and instruments subject to the tax, or for whose use or benefit the same are made, signed, issued, or sold, is liable for the tax imposed by section 4371. Section 46.4374–1(c) also provides that the tax imposed by section 4371 shall be paid on the basis of a return by the person who makes payment of the premium to a foreign insurer or reinsurer or to any nonresident agent, solicitor, or broker. If the tax is not paid by the person who paid the premium, the tax imposed by section

4371 shall be paid on the basis of a return by any person who makes, signs, issues, or sells any of the documents or instruments subject to the tax imposed by section 4371, or for whose use or benefit such document or instrument is made, signed, issued, or sold.

Proposed Effective Date

These regulations are proposed to apply to premiums paid on or after the date final regulations are published in the **Federal Register**.

Special Analysis

It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) that are submitted timely to the IRS. Treasury and the IRS request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be made available for public inspection and copying.

A public hearing has been scheduled for March 19, 2002, at 10 a.m., in room 4718, Internal Revenue Building, 1111 Constitution Ave., NW, Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to this hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by February 26, 2002. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Amanda Ehrlich of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 46 is proposed to be amended as follows:

PART 46 — EXCISE TAX ON POLICIES ISSUED BY FOREIGN INSURERS AND OBLIGATIONS NOT IN REGISTERED FORM

Paragraph 1. The authority citation for part 46 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 2. Section 46.4374–1 is revised to read as follows:

§ 46.4374–1 Liability for tax.

(a) *In general*. Any person who makes, signs, issues, or sells any of the documents and instruments subject to the tax, or for whose use or benefit the same are made, signed, issued, or sold, shall be liable for the tax imposed by section 4371.

(b) *When liability for tax attaches*. The liability for the tax imposed by section 4371 shall attach at the time the premium payment is transferred to the foreign insurer or reinsurer (including transfers to any bank, trust fund, or similar recipient, designated by the foreign insurer or reinsurer), or to any nonresident agent, solicitor, or broker. A person required to pay tax under this section may remit such tax before the time the tax attaches if he keeps records consistent with such practice.

(c) *Payment of tax*. The tax imposed by section 4371 shall be paid on the basis of a return by the person who makes payment of the premium to a foreign insurer or reinsurer or to any nonresident agent, solicitor, or broker. If the tax is not paid by the person who paid the premium, the tax imposed by section 4371 shall be paid on the basis of a return by any person who makes, signs, issues, or sells any of the documents or instruments subject to the tax imposed by section 4371, or for whose use or benefit such document or instrument is made, signed, issued, or sold.

(d) *Penalty for failure to pay tax*. Any person who fails to comply with the requirements of this section with intent to evade the tax shall, in addition to other penalties provided therefor, pay a fine of double the amount of tax. (See section 7270.)

(e) *Effective date*. This section is applicable for premiums paid on or after the date final regulations are published in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on January 4, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 7, 2002, 67 F.R. 707)

Certain Transfers of Property to Regulated Investment Companies and Real Estate Investment Trusts; Hearing

Announcement 2002–6

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of Public Hearing on proposed rulemaking by cross-reference to temporary regulations (REG–142299–01 and REG–209135–88, 2002–4 I.R.B. 417).

SUMMARY: This document contains a notice of public hearing on proposed rulemaking by cross-reference to temporary regulations relating to certain transfers of property to regulated investment companies and real estate investment trusts.

DATES: The public hearing is being held on May 1, 2002, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by April 10, 2002.

ADDRESSES: The public hearing is being held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Main entrance, located on Constitution Avenue, NW. In addition, all visitors must present photo identification to enter the building.

Mail outlines to: CC:IT&A:RU (REG–142299–01), Room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Hand deliver outlines Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:IT&A:RU (REG–142299–01), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Submit outlines electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting them directly to the IRS Internet site at *http://www.irs.gov/tax_regs/regslist.html.*

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Lisa Fuller (202), 622–7750; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Donna Poindexter (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is the notice of proposed rulemaking by cross-reference to temporary regulations (REG–142299–01) that was published in the **Federal Register** on Wednesday, January 2, 2002 (67 FR 48).

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who have submitted written comments and wish to present oral comments at the hearing, must submit an outline of the topics to be discussed and the amount of time to be devoted to each topic (signed original and eight (8) copies) by April 10, 2002.

A period of 10 minutes is allotted to each person for presenting oral comments.

After the deadline for receiving outlines has passed, the IRS will prepare an agenda containing the schedule of speakers. Copies of the agenda will be made available, free of charge, at the hearing.

Because of access restrictions, the IRS will not admit visitors beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this document.

LaNita VanDyke,
Acting Chief, Regulations Unit,
Associate Chief Counsel (Income Tax and Accounting).

(Filed by the Office of the Federal Register on January 11, 2002, 8:45 a.m., and published in the issue of the Federal Register for January 14, 2002, 67 F.R. 1672)

Disclosure of Returns and Return Information by Other Agencies; Correction

Announcement 2002–7

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: This document contains corrections to proposed regulations (REG–105344–01, 2002–2 I.R.B. 302) which were published in the **Federal Register** on Thursday, December 13, 2001 (66 FR 64386). These regulations relate to the disclosure of returns and return information by other agencies.

DATES: These corrections are effective December 13, 2001.

FOR FURTHER INFORMATION CONTACT: Julie C. Schwartz (202) 622–4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The proposed rulemaking by cross-reference to temporary regulations that are the subject of this correction is under section 6103 of the Internal Revenue Code.

Need for Correction

As published, proposed rulemaking by cross-reference to temporary regulations (REG–105344–01) contain errors which may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of notice of proposed rulemaking by cross-reference to temporary regulations (REG–105344–01), which are the subject of FR Doc. 01–30620, is corrected as follows:

1. On page 64386, column 2, in the preamble, under the paragraph heading "Paperwork Reduction Act," paragraph 3, line 4, the language "Internal revenue Service, including" is corrected to read "Internal Revenue Service, including".

2. On page 64386, column 3, in the preamble, under the paragraph heading "Paperwork Reduction Act," line 11, the language "recordkeepers are federal agencies and" is corrected to read "recordkeepers are Federal agencies and".

LaNita VanDyke,
Acting Chief, Regulations Unit,
Associate Chief Counsel (Income Tax and Accounting).

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as"rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Intemal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

INCOME TAX—Cont.