

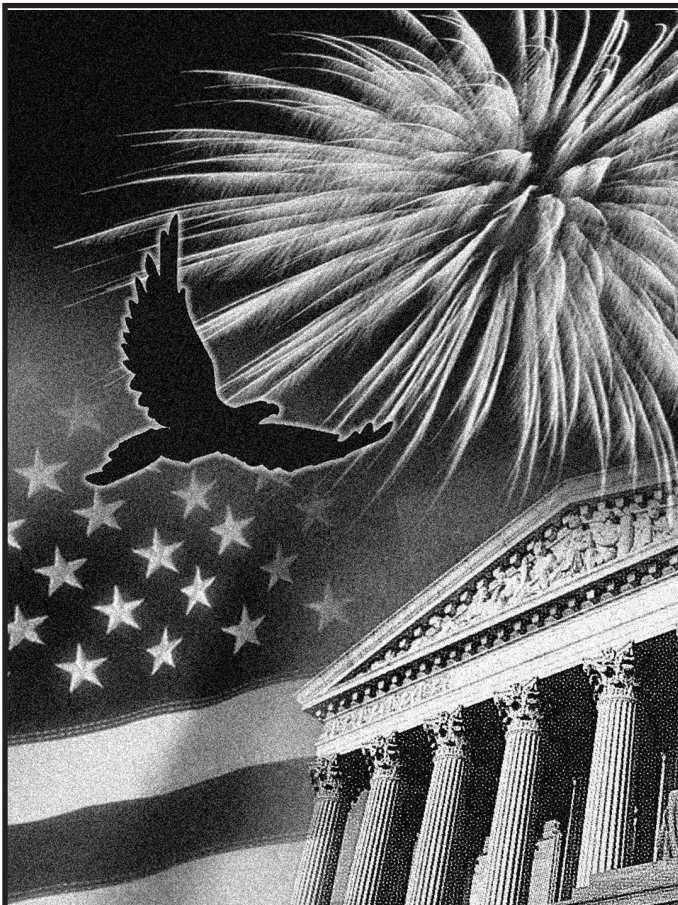


## Publication 538

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# Accounting Periods and Methods



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## Future Developments

For the latest information about developments related to Pub. 538, such as legislation enacted after it was published, go to [IRS.gov/Pub538](https://www.irs.gov/Pub538).

## Introduction

Every taxpayer (individuals, business entities, etc.) must figure taxable income for an annual accounting period called a tax year. The calendar year is the most common tax year. Other tax years include a fiscal year and a short tax year.

Each taxpayer must use a consistent accounting method, which is a set of rules for determining when to report income and expenses. The most commonly used accounting methods are the cash method and the accrual method.

Under the cash method, you generally report income in the tax year you receive it, and deduct expenses in the tax year in which you pay the expenses.

Under the accrual method, you generally report income in the tax year you earn it, regardless of when payment is received. You deduct expenses in the tax year you incur them, regardless of when payment is made.



*This publication explains some of the rules for accounting periods and accounting methods. In some cases, you may have to refer to other sources for a more in-depth explanation of the topic.*

**Comments and suggestions.** We welcome your comments about this publication and suggestions for future editions.

You can send us comments through [IRS.gov/FormComments](https://www.irs.gov/FormComments). Or you can write to the Internal Revenue Service, Tax Forms and Publications, 1111 Constitution Ave. NW, IR-6526, Washington, DC 20224.

Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments and suggestions as we revise our tax forms, instructions, and publications. **Don't** send tax questions, tax returns, or payments to the above address.

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## Photographs of Missing Children

The Internal Revenue Service is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](https://www.nccmec.org/). Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 1-800-THE-LOST (1-800-843-5678) if you recognize a child.

### Useful Items

You may want to see:

#### Publication

- 537** Installment Sales
- 541** Partnerships
- 542** Corporations

#### Form (and Instructions)

- 1128** Application To Adopt, Change, or Retain a Tax Year
- 2553** Election by a Small Business Corporation
- 3115** Application for Change in Accounting Method

- 8716** Election To Have a Tax Year Other Than a Required Tax Year

See *Ordering forms and publications*, earlier, for information about getting these publications and forms.

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## Accounting Periods

You must use a tax year to figure your taxable income. A tax year is an annual accounting period for keeping records and reporting income and expenses. An annual accounting period does not include a short tax year (discussed later). You can use the following tax years:

- A calendar year; or
- A fiscal year (including a 52-53-week tax year).

Unless you have a required tax year, you adopt a tax year by filing your first income tax return using that tax year. A required tax year is a tax year required under the Internal Revenue Code or the Treasury Regulations. You cannot adopt a tax year by merely:

- Filing an application for an extension of time to file an income tax return;
- Filing an application for an employer identification number (Form SS-4); or
- Paying estimated taxes.

This section discusses:

- A calendar year.
- A fiscal year (including a period of 52 or 53 weeks).
- A short tax year.
- An improper tax year.
- A change in tax year.
- Special situations that apply to individuals.
- Restrictions that apply to the accounting period of a partnership, S corporation, or personal service corporation.
- Special situations that apply to corporations.

## Calendar Year

A calendar year is 12 consecutive months beginning on January 1st and ending on December 31st.

If you adopt the calendar year, you must maintain your books and records and report your income and expenses from January 1st through December 31st of each year.

If you file your first tax return using the calendar tax year and you later begin business as a sole proprietor, become a partner in a partnership, or become a shareholder in an S corporation, you must continue to use the calendar year unless you obtain approval from the IRS to change it, or are otherwise allowed to change it without IRS approval. See [Change in Tax Year](#), later.

Generally, anyone can adopt the calendar year. However, you must adopt the calendar year if:

- You keep no books or records;
- You have no annual accounting period;
- Your present tax year does not qualify as a fiscal year; or
- You are required to use a calendar year by a provision in the Internal Revenue Code or Treasury Regulations.

## Fiscal Year

A fiscal year is 12 consecutive months ending on the last day of any month except December 31st. If you are allowed to adopt a fiscal year, you must consistently maintain your books and records and report your income and expenses using the time period adopted.

## 52-53-Week Tax Year

You can elect to use a 52-53-week tax year if you keep your books and records and report your income and expenses on that basis. If you make this election, your 52-53-week tax year must always end on the same day of the week. Your 52-53-week tax year must always end on:

- Whatever date this same day of the week last occurs in a calendar month, or
- Whatever date this same day of the week falls that is nearest to the last day of the calendar month.

**Election.** To make the election for the 52-53-week tax year, attach a statement with the following information to your tax return.

1. The month in which the new 52-53-week tax year ends.
2. The day of the week on which the tax year always ends.
3. The date the tax year ends. It can be either of the following dates on which the chosen day:
  - a. Last occurs in the month in (1), above, or
  - b. Occurs nearest to the last day of the month in (1), above.

When you figure depreciation or amortization, a 52-53-week tax year is generally considered a year of 12 calendar months.

To determine an effective date (or apply provisions of any law) expressed in terms of tax years beginning, including, or ending on the first or last day of a specified calendar month, a 52-53-week tax year is considered to:

- Begin on the first day of the calendar month beginning nearest to the first day of the 52-53-week tax year, and
- End on the last day of the calendar month ending nearest to the last day of the 52-53-week tax year.

**Example.** Assume a tax provision applies to tax years beginning on or after July 1, which (for purposes of this example) happens to be a Sunday. For this purpose, a 52-53-week tax year that begins on the last Tuesday of June, which (for purposes of this example) falls on June 25, is treated as beginning on July 1.

## Short Tax Year

A short tax year is a tax year of less than 12 months. A short period tax return may be required when you (as a taxable entity):

- Are not in existence for an entire tax year, or
- Change your accounting period.

Tax on a short period tax return is figured differently for each situation.

## Not in Existence Entire Year

Even if a taxable entity was not in existence for the entire year, a tax return is required for the time it was in existence. Requirements for filing the return and figuring the tax are generally the same as the requirements for a return for a full tax year (12 months) ending on the last day of the short tax year.

**Example 1.** XYZ Corporation was organized on July 1. It elected the calendar year as its tax year. The corporation's first tax return will cover the short period from July 1 through December 31.

**Example 2.** A calendar year corporation dissolved on July 23. The corporation's final return will cover the short period from January 1 through July 23.

**Death of individual.** Although the return of the decedent is a return for the short period beginning with the first day of his last taxable year and ending with the date of his death, the filing of a return and the payment of tax for the decedent may be made as though the decedent had lived throughout his last taxable year. The decedent's tax return must be filed for the decedent by the 15th day of the 4th month after the close of the individual's regular tax year. If the due date falls on a Saturday, Sunday, or legal holiday, file by the next business day. The decedent's final return will be a short period tax return that begins on January 1st, and ends on the date of death. In the case of a decedent who dies on December 31st, the last day of the regular tax year, a full calendar-year tax return is required.

## Figuring Tax for Short Year

If the IRS approves a change in your tax year or if you are required to change your tax year, you must figure the tax and file your return for the short tax period. The short tax period begins on the first day after the close of your old tax year and ends on the day before the first day of your new tax year.

Figure tax for a short year under the general rule, explained below. You may then be able to use a relief



procedure, explained later, and claim a refund of part of the tax you paid.

**General rule.** Income tax for a short tax year must be annualized. However, self-employment tax is figured on the actual self-employment income for the short period.

**Individuals.** An individual must figure income tax for the short tax year as follows.

1. Determine your adjusted gross income (AGI) for the short tax year and then subtract your actual itemized deductions for the short tax year. You must itemize deductions when you file a short period tax return.
2. Multiply the dollar amount of your exemptions by the number of months in the short tax year and divide the result by 12. **Note.** For tax years beginning after 2017 and before 2026, the dollar amount of your exemption is zero (-0-).
3. Subtract the amount in (2) from the amount in (1). The result is your modified taxable income.
4. Multiply the modified taxable income in (3) by 12, then divide the result by the number of months in the short tax year. The result is your annualized income.
5. Figure the total tax on your annualized income using the appropriate tax rate schedule.
6. Multiply the total tax by the number of months in the short tax year and divide the result by 12. The result is your tax for the short tax year.

**Relief procedure.** You can use a relief procedure to figure the tax for the short tax year. It may result in less tax. Under this procedure, the tax is figured by two separate methods. If the tax figured under both methods is less than the tax figured under the general rule, you can file a claim for a refund of part of the tax you paid. For more information, see section 443(b)(2) of the Internal Revenue Code and the related Treasury Regulation.

**Alternative minimum tax.** Individuals, to figure the alternative minimum tax (AMT) due for a short tax year:

1. Figure the annualized alternative minimum taxable income (AMTI) for the short tax period by completing the following steps.
  - a. Multiply the AMTI by 12.
  - b. Divide the result by the number of months in the short tax year.
2. Multiply the annualized AMTI by the appropriate rate of tax under section 55(b)(1) of the Internal Revenue Code. The result is the annualized AMT.
3. Multiply the annualized AMT by the number of months in the short tax year and divide the result by 12.

For information on the AMT for individuals, see the Instructions for Form 6251, Alternative Minimum Tax—Individuals.

**Tax withheld from wages.** You can claim a credit against your income tax liability for federal income tax

withheld from your wages. Federal income tax is withheld on a calendar year basis. The amount of tax withheld in any calendar year is allowed as a credit for the tax year beginning in the calendar year.

## Improper Tax Year

Taxpayers that have adopted an improper tax year must change to a proper tax year. For example, if a taxpayer began business on March 15 and adopted a tax year ending on March 14 (a period of exactly 12 months), this would be an improper tax year. See [Accounting Periods](#), earlier, for a description of permissible tax years.

To change to a proper tax year, you must do one of the following.

- If you are requesting a change to a calendar tax year, file an amended income tax return based on a calendar tax year that corrects the most recently filed tax return that was filed on the basis of an improper tax year. Attach a completed Form 1128 to the amended tax return. Write “FILED UNDER REV. PROC. 85-15” at the top of Form 1128 and file the forms with the Internal Revenue Service Center where you filed your original return.
- If you are requesting a change to a fiscal tax year, file Form 1128 in accordance with the form instructions to request IRS approval for the change.

## Change in Tax Year

Generally, you must file Form 1128 to request IRS approval to change your tax year. See the Instructions for Form 1128 for exceptions. If you qualify for an automatic approval request, a user fee is not required.

## Individuals

Generally, individuals must adopt the calendar year as their tax year. An individual can adopt a fiscal year if the individual maintains his or her books and records on the basis of the adopted fiscal year.

## Partnerships, S Corporations, and Personal Service Corporations (PSCs)

Generally, partnerships, S corporations (including electing S corporations), and PSCs must use a required tax year. A required tax year is a tax year that is required under the Internal Revenue Code and Treasury Regulations. The entity does not have to use the required tax year if it receives IRS approval to use another permitted tax year or makes an election under section 444 of the Internal Revenue Code (discussed later).

## Partnership

A partnership must conform its tax year to its partners' tax years unless any of the following apply.

- The partnership makes an election under section 444 of the Internal Revenue Code to have a tax year other than a required tax year by filing Form 8716.
- The partnership elects to use a 52-53-week tax year that ends with reference to either its required tax year or a tax year elected under section 444.
- The partnership can establish a business purpose for a different tax year.

The rules for the required tax year for partnerships are as follows.

- If one or more partners having the same tax year own a majority interest (more than 50%) in partnership profits and capital, the partnership must use the tax year of those partners.
- If there is no majority interest tax year, the partnership must use the tax year of all its principal partners. A principal partner is one who has a 5% or more interest in the profits or capital of the partnership.
- If there is no majority interest tax year and the principal partners do not have the same tax year, the partnership generally must use a tax year that results in the least aggregate deferral of income to the partners.



*If a partnership changes to a required tax year because of these rules, it can get automatic approval by filing Form 1128.*

**Least aggregate deferral of income.** The tax year that results in the least aggregate deferral of income is determined as follows.

1. Figure the number of months of deferral for each partner using one partner's tax year. Find the months of deferral by counting the months from the end of that tax year forward to the end of each other partner's tax year.
2. Multiply each partner's months of deferral figured in step (1) by that partner's share of interest in the partnership profits for the year used in step (1).
3. Add the amounts in step (2) to get the aggregate (total) deferral for the tax year used in step (1).
4. Repeat steps (1) through (3) for each partner's tax year that is different from the other partners' years.

The partner's tax year that results in the lowest aggregate (total) number is the tax year that must be used by the partnership. If the calculation results in more than one tax year qualifying as the tax year with the least aggregate deferral, the partnership can choose any one of those tax years as its tax year. However, if one of the tax years that qualifies is the partnership's existing tax year, the partnership must retain that tax year.

**Example.** A and B each have a 50% interest in partnership P, which uses a fiscal year ending June 30. A

uses the calendar year and B uses a fiscal year ending November 30. P must change its tax year to a fiscal year ending November 30 because this results in the least aggregate deferral of income to the partners, as shown in the following table.

| Year End<br>12/31:       | Year<br>End | Profits<br>Interest | Months<br>of<br>Deferral | Interest<br>×<br>Deferral |
|--------------------------|-------------|---------------------|--------------------------|---------------------------|
| A                        | 12/31       | 0.5                 | -0-                      | -0-                       |
| B                        | 11/30       | 0.5                 | 11                       | 5.5                       |
| Total Deferral . . . . . |             |                     |                          | 5.5                       |

| Year End<br>11/30:       | Year<br>End | Profits<br>Interest | Months<br>of<br>Deferral | Interest<br>×<br>Deferral |
|--------------------------|-------------|---------------------|--------------------------|---------------------------|
| A                        | 12/31       | 0.5                 | 1                        | 0.5                       |
| B                        | 11/30       | 0.5                 | -0-                      | -0-                       |
| Total Deferral . . . . . |             |                     |                          | 0.5                       |

**When determination is made.** The determination of the tax year under the least aggregate deferral rules must generally be made at the beginning of the partnership's current tax year. However, the IRS can require the partnership to use another day or period that will more accurately reflect the ownership of the partnership. This could occur, for example, if a partnership interest was transferred for the purpose of qualifying for a particular tax year.

**Short period return.** When a partnership changes its tax year, a short period return must be filed. The short period return covers the months between the end of the partnership's prior tax year and the beginning of its new tax year.

If a partnership changes to the tax year resulting in the least aggregate deferral, it must file a Form 1128 with the short period return showing the computations used to determine that tax year. The short period return must indicate at the top of page 1, "FILED UNDER SECTION 1.706-1."

**More information.** For more information about changing a partnership's tax year, and information about ruling requests, see the Instructions for Form 1128.

## S Corporation

All S corporations, regardless of when they became an S corporation, must use a permitted tax year. A permitted tax year is any of the following.

- The calendar year.
- A tax year elected under section 444 of the Internal Revenue Code. See [Section 444 Election](#), below, for details.
- A 52-53-week tax year ending with reference to the calendar year or a tax year elected under section 444.
- Any other tax year for which the corporation establishes a business purpose.

If an electing S corporation wishes to adopt a tax year other than a calendar year, it must request IRS approval using Form 2553, instead of filing Form 1128. For information about changing an S corporation's tax year

and information about ruling requests, see the Instructions for Form 1128.

## Personal Service Corporation (PSC)

A PSC must use a calendar tax year unless any of the following apply.

- The corporation makes an election under section 444 of the Internal Revenue Code. See [Section 444 Election](#), below, for details.
- The corporation elects to use a 52-53-week tax year ending with reference to the calendar year or a tax year elected under section 444.
- The corporation establishes a business purpose for a fiscal year.

See the Instructions for Form 1120 and Pub. 542 for general information about PSCs. For information on adopting or changing tax years for PSCs and information about ruling requests, see the Instructions for Form 1128.

## Section 444 Election

A partnership, S corporation, electing S corporation, or PSC can elect under section 444 of the Internal Revenue Code to use a tax year other than its required tax year. Certain restrictions apply to the election. A partnership or an S corporation that makes a section 444 election must make certain required payments and a PSC must make certain distributions (discussed later). The section 444 election does not apply to any partnership, S corporation, or PSC that establishes a business purpose for a different period, explained later.

A partnership, S corporation, or PSC can make a section 444 election if it meets all the following requirements.

- It is not a member of a tiered structure (defined in Treasury Regulations section 1.444-2T).
- It has not previously had a section 444 election in effect.
- It elects a year that meets the deferral period requirement.

**Deferral period.** The determination of the deferral period depends on whether the partnership, S corporation, or PSC is retaining its tax year or adopting or changing its tax year with a section 444 election.

**Retaining tax year.** Generally, a partnership, S corporation, or PSC can make a section 444 election to retain its tax year only if the deferral period of the new tax year is 3 months or less. This deferral period is the number of months between the beginning of the retained year and the close of the first required tax year.

**Adopting or changing tax year.** If the partnership, S corporation, or PSC is adopting or changing to a tax year other than its required year, the deferral period is the number of months from the end of the new tax year to the end of the required tax year. The IRS will allow a section 444

election only if the deferral period of the new tax year is less than the shorter of:

- Three months, or
- The deferral period of the tax year being changed. This is the tax year immediately preceding the year for which the partnership, S corporation, or PSC wishes to make the section 444 election.

If the partnership, S corporation, or PSC's tax year is the same as its required tax year, the deferral period is zero.

**Example 1.** BD Partnership uses a calendar year, which is also its required tax year. BD cannot make a section 444 election because the deferral period is zero.

**Example 2.** E, a newly formed partnership, began operations on December 1. E is owned by calendar year partners. E wants to make a section 444 election to adopt a September 30 tax year. E's deferral period for the tax year beginning December 1 is 3 months, the number of months between September 30 and December 31.

**Making the election.** Make a section 444 election by filing Form 8716 with the Internal Revenue Service Center where the entity will file its tax return. See the instructions for Form 8716 for information on when to file.

Attach a copy of Form 8716 to Form 1065, Form 1120S, or Form 1120 for the first tax year for which the election is made.

**Terminating the election.** The section 444 election remains in effect until it is terminated. If the election is terminated, another section 444 election cannot be made for any tax year.

The election ends when any of the following applies to the partnership, S corporation, or PSC.

- The entity changes to its required tax year.
- The entity liquidates.
- The entity becomes a member of a tiered structure.
- The IRS determines that the entity willfully failed to comply with the required payments or distributions.

The election will also end if either of the following events occur.

- An S corporation's S election is terminated. However, if the S corporation immediately becomes a PSC, the PSC can continue the section 444 election of the S corporation.
- A PSC ceases to be a PSC. If the PSC elects to be an S corporation, the S corporation can continue the election of the PSC.

**Required payment for partnership or S corporation.** A partnership or an S corporation must make a required payment for any tax year:

- The section 444 election is in effect.
- The required payment for that year (or any preceding tax year) is more than \$500.

This payment represents the value of the tax deferral the owners receive by using a tax year different from the required tax year.

Form 8752, Required Payment or Refund Under Section 7519, must be filed each year the section 444 election is in effect, even if no payment is due. If the required payment is more than \$500 (or the required payment for any prior year was more than \$500), the payment must be made when Form 8752 is filed. If the required payment is \$500 or less and no payment was required in a prior year, Form 8752 must be filed showing a zero amount. See Form 8752 and its instructions for more information.

**Applicable election year.** Any tax year a section 444 election is in effect, including the first year, is called an applicable election year. Form 8752 must be filed and the required payment made (or zero amount reported) by May 15th of the calendar year following the calendar year in which the applicable election year begins.

**Required distribution for PSC.** A PSC with a section 444 election in effect must distribute certain amounts to employee-owners by December 31 of each applicable year. If it fails to make these distributions, it may be required to defer certain deductions for amounts paid to owner-employees. The amount deferred is treated as paid or incurred in the following tax year.

For information on the minimum distribution, see the instructions for Part I of Schedule H (Form 1120), Section 280H Limitations for a Personal Service Corporation (PSC).

**Back-up election.** A partnership, S corporation, or PSC can file a back-up section 444 election if it requests (or plans to request) permission to use a business purpose tax year, discussed later. If the request is denied, the back-up section 444 election must be activated (if the partnership, S corporation, or PSC otherwise qualifies).

**Making back-up election.** The general rules for making a section 444 election, as discussed earlier, apply. When filing Form 8716, type or print “BACK-UP ELECTION” at the top of the form. However, if Form 8716 is filed on or after the date Form 1128 (or Form 2553) is filed, type or print “FORM 1128 (or FORM 2553) BACK-UP ELECTION” at the top of Form 8716.

**Activating election.** A partnership or S corporation activates its back-up election by filing the return required and making the required payment with Form 8752. The due date for filing Form 8752 and making the payment is the later of the following dates.

- May 15 of the calendar year following the calendar year in which the applicable election year begins.
- 60 days after the partnership or S corporation has been notified by the IRS that the business year request has been denied.

A PSC activates its back-up election by filing Form 8716 with its original or amended income tax return for the tax year in which the election is first effective and printing on the top of the income tax return, “ACTIVATING BACK-UP ELECTION.”

## 52-53-Week Tax Year

A partnership, S corporation, or PSC can use a tax year other than its required tax year if it elects a 52-53-week tax year (discussed earlier) that ends with reference to either its required tax year or a tax year elected under section 444 (discussed earlier).

A newly formed partnership, S corporation, or PSC can adopt a 52-53-week tax year ending with reference to either its required tax year or a tax year elected under section 444 without IRS approval. However, if the entity wishes to change to a 52-53-week tax year or change from a 52-53-week tax year that references a particular month to a non-52-53-week tax year that ends on the last day of that month, it must request IRS approval by filing Form 1128.

## Business Purpose Tax Year

A partnership, S corporation, or PSC establishes the business purpose for a tax year by filing Form 1128. See the Instructions for Form 1128 for details.

## Corporations (Other Than S Corporations and PSCs)

A new corporation establishes its tax year when it files its first tax return. A newly reactivated corporation that has been inactive for a number of years is treated as a new taxpayer for the purpose of adopting a tax year. An S corporation or a PSC must use the required tax year rules, discussed earlier, to establish a tax year. Generally, a corporation that wants to change its tax year must obtain approval from the IRS under either the: **(a)** automatic approval procedures; or **(b)** ruling request procedures. See the Instructions for Form 1128 for details.

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## Accounting Methods

An accounting method is a set of rules used to determine when and how income and expenses are reported on your tax return. Your accounting method includes not only your overall method of accounting, but also the accounting treatment you use for any material item.

You choose an accounting method when you file your first tax return. If you later want to change your accounting method, you must generally get IRS approval. See [Change in Accounting Method](#), later.

No single accounting method is required of all taxpayers. You must use a system that clearly reflects your income and expenses and you must maintain records that will enable you to file a correct return. In addition to your permanent accounting books, you must keep any other records necessary to support the entries on your books and tax returns.

You must use the same accounting method from year to year. An accounting method clearly reflects income



only if all items of gross income and expenses are treated the same from year to year.

If you do not regularly use an accounting method that clearly reflects your income, your income will be refigured under the method that, in the opinion of the IRS, does clearly reflect income.

**Methods you can use.** Generally, you can figure your taxable income under any of the following accounting methods.

- Cash method.
- Accrual method.
- Special methods of accounting for certain items of income and expenses.
- A hybrid method which combines elements of two or more of the above accounting methods.

**Special methods.** This publication does not discuss special methods of accounting for certain items of income or expenses. For information on reporting income using one of the long-term contract methods, see section 460 of the Internal Revenue Code and the related regulations. The following publications also discuss special methods of reporting income or expenses.

- Publication 225, *Farmer's Tax Guide*.
- Publication 535, *Business Expenses*.
- Publication 537, *Installment Sales*.
- Publication 946, *How To Depreciate Property*.

**Hybrid method.** Generally, you can use any combination of cash, accrual, and special methods of accounting if the combination clearly reflects your income and you use it consistently. However, the following restrictions apply.

- If an inventory is necessary to account for your income, you must use an accrual method for purchases and sales. However, see [Exception for Small Business Taxpayers](#), later. Generally, you can use the cash method for all other items of income and expenses. See [Inventories](#), later.
- If you use the cash method for reporting your income, you must use the cash method for reporting your expenses.
- If you use an accrual method for reporting your expenses, you must use an accrual method for figuring your income.
- Any combination that includes the cash method is treated as the cash method for purposes of section 448 of the Internal Revenue Code.

**Business and personal items.** You can account for business and personal items using different accounting methods. For example, you can determine your business income and expenses under an accrual method, even if you use the cash method to figure personal items.

**Two or more businesses.** If you operate two or more separate and distinct businesses, you can use a different

accounting method for each business. No business is separate and distinct, unless a complete and separate set of books and records is maintained for each business.

**Note.** If you use different accounting methods to create or shift profits or losses between businesses (for example, through inventory adjustments, sales, purchases, or expenses) so that income is not clearly reflected, the businesses will not be considered separate and distinct.

## Cash Method


Most individuals and many small businesses (as explained under [Excluded Entities](#) and [Exceptions](#), later) use the cash method of accounting. Generally, if you produce, purchase, or sell merchandise, you must keep an inventory and use an accrual method for sales and purchases of merchandise. See [Inventories](#), later, for exceptions to this rule.

## Income

Under the cash method, you include in your gross income all items of income you actually or constructively received during the tax year. If you received property and services, you must include their fair market value (FMV) in income.

**Constructive receipt.** Income is constructively received when an amount is credited to your account or made available to you without restriction. You do not need to have possession of it. If you authorize someone to be your agent and receive income for you, you are considered to have received it when your agent receives it. Income is not constructively received if your control of its receipt is subject to substantial restrictions or limitations.

**Example.** You are a calendar year taxpayer. Your bank credited, and made available, interest to your bank account in December 2021. You did not withdraw it or enter it into your books until 2022. You must include the amount in gross income for 2021, the year you constructively received the interest income.

 **TIP** You cannot hold checks or postpone taking possession of similar property from one tax year to another to postpone paying tax on the income. You must report the income in the year the property is received or made available to you without restriction.

## Expenses

Under the cash method, generally, you deduct expenses in the tax year in which you actually pay them. This includes business expenses for which you contest liability. However, you may not be able to deduct an expense paid in advance. Instead, you may be required to capitalize certain costs, as explained later under [Uniform Capitalization Rules](#).

**Expense paid in advance.** An expense you pay in advance is deductible only in the year to which it applies, unless the expense qualifies for the 12-month rule.



Under the 12-month rule, a taxpayer is not required to capitalize amounts paid to create certain rights or benefits for the taxpayer that do not extend beyond the earlier of the following.

- 12 months after the right or benefit begins, or
- The end of the tax year after the tax year in which payment is made.

If you have not been applying the general rule (an expense paid in advance is deductible only in the year to which it applies) and/or the 12-month rule to the expenses you paid in advance, you must obtain approval from the IRS before using the general rule and/or the 12-month rule. See [Change in Accounting Method](#), later.

**Example 1.** You are a calendar year taxpayer and pay \$3,000 in 2021 for a business insurance policy that is effective for 3 years (36 months), beginning on July 1, 2021. The general rule that an expense paid in advance is deductible only in the year to which it applies is applicable to this payment because the payment does not qualify for the 12-month rule. Therefore, only \$500 ( $6/36 \times \$3,000$ ) is deductible in 2021, \$1,000 ( $12/36 \times \$3,000$ ) is deductible in 2022, \$1,000 ( $12/36 \times \$3,000$ ) is deductible in 2023, and the remaining \$500 is deductible in 2024.

**Example 2.** You are a calendar year taxpayer and pay \$10,000 on July 1, 2021, for a business insurance policy that is effective for only 1 year beginning on July 1, 2021. The 12-month rule applies. Therefore, the full \$10,000 is deductible in 2021.

## Excluded Entities

The following entities generally cannot use the cash method, including any combination of methods that includes the cash method. (However, see [Special rules for farming businesses](#), later.)

- A corporation (other than an S corporation). However, see [Exceptions](#) below.
- A partnership with a corporation (other than an S corporation) as a partner. However, see [Exceptions](#) below.
- A tax shelter, as defined in section 448(d)(3).

## Exceptions

The following entities can use the cash method of accounting.

- Any corporation or partnership, other than a tax shelter, that meets the gross receipts test explained below.
- A qualified personal service corporation (PSC).

**Gross receipts test.** A corporation or partnership, other than a tax shelter, that meets the gross receipts test can generally use the cash method. A corporation or a partnership meets the test if its average annual gross receipts for the 3 prior tax years were \$26 million or less (indexed for inflation).

Determine an entity's average annual gross receipts by:

1. Adding the gross receipts for the 3 prior tax years; and
2. Dividing the total by 3.

Generally, a partnership applies the test at the partnership level. Gross receipts for a short tax year are annualized.

**Aggregation rules.** Organizations that are members of an affiliated service group or a controlled group of corporations treated as a single employer for tax purposes must aggregate their gross receipts to determine whether the gross receipts test is met.

**Change to accrual method.** A corporation or partnership that fails to meet the gross receipts test for any tax year cannot use the cash method and must change to an accrual method of accounting, effective for the tax year in which the entity fails to meet this test. The entity must file Form 3115 to request the change. See the Instructions for Form 3115.

**Special rules for farming businesses.** Generally, a taxpayer engaged in the trade or business of farming is allowed to use the cash method for its farming business. However, certain corporations (other than S corporations) and partnerships that have a partner that is a corporation must use an accrual method for their farming business, unless they meet the gross receipts test discussed above.

See chapter 2 of Pub. 225, *Farmer's Tax Guide*, for more information.

**Qualified Personal Service Corporation (PSC).** A corporation that meets the function and ownership tests below is a qualified PSC and can use the cash method.

**Function test.** A corporation meets the function test if at least 95% of its activities are in the performance of services in the fields of health (including veterinary services), law, engineering (including surveying and mapping), architecture, accounting, actuarial science, performing arts, or consulting.

**Ownership test.** A corporation meets the ownership test if substantially all of its stock is owned, directly or indirectly, at all times during the year by one or more of the following.

1. Employees performing services for the corporation in a field qualifying under the function test.
2. Retired employees who had performed services in those fields.
3. The estate of an employee described in (1) or (2).
4. Any other person who acquired the stock by reason of the death of an employee referred to in (1) or (2), but only for the 2-year period beginning on the date of death.

Indirect ownership is generally taken into account if the stock is owned indirectly through one or more partnerships, S corporations, or qualified PSCs. Stock owned by one of these entities is considered owned by the entity's

owners in proportion to their ownership interest in that entity. Other forms of indirect stock ownership, such as stock owned by family members, are generally not considered when determining if the ownership test is met.

For purposes of the ownership test, a person is not considered an employee of a corporation unless that person performs more than minimal services for the corporation.

**Change to accrual method.** A corporation that fails to meet the function test for any tax year; or fails to meet the ownership test at any time during any tax year must change to an accrual method of accounting, effective for the year in which the corporation fails to meet either test. A corporation that fails to meet the function test or the ownership test is not treated as a qualified PSC for any part of that tax year.

## Accrual Method

Under an accrual method of accounting, you generally report income in the year it is earned and deduct or capitalize expenses in the year incurred. The purpose of an accrual method of accounting is to match income and expenses in the correct year.

## Income

Generally, you include an amount in gross income for the tax year in which the all events test is met. This test is met when all events have occurred which fix your right to receive the income and you can determine the amount with reasonable accuracy. However, if you have an applicable financial statement (AFS), you include the amount in income no later than when the item of income is reported in your applicable financial statement (AFS). This is known as the AFS income inclusion rule, discussed next.

**AFS income inclusion rule.** Under this rule, you report an amount in your gross income on the earliest of the following events.

- When you receive payment.
- When the income amount is due to you.
- When you earn the income.
- When title passes.
- When included as revenue in your AFS if you have an AFS.

See Regulations section 1.451-3(a)(5) for a hierarchical list of financial statements. See Regulations section 1.451-3(b) for guidance in determining the appropriate AFS income amount when applying the inclusion rule. If your financial results are reported on the AFS for a group of entities, use the group's AFS to apply the AFS income inclusion rule. Generally, the AFS income inclusion rule is not applicable to you if you use a special method of accounting to report an item of income. See Regulations section 1.451-3(a)(13) for examples of special methods of accounting to which the AFS income inclusion rule generally does not apply.

**AFS cost offset method.** If you are required to account for income from the sale of inventory under the AFS income inclusion rule, you may be eligible to elect the AFS cost offset method. This method allows you to reduce the reported amount of income accelerated under this rule. See Regulations section 1.451-3(c) for more information on the application of this method. If you receive advance payments for the sale of inventory, you may elect to use the advance payment cost offset method. See [Advance Payments](#) below.

**Estimated income.** If you include a reasonably estimated amount in gross income and later determine the exact amount is different, take the difference into account in the tax year you make that determination.

## Advance Payments

Generally, you report an advance payment for goods, services, or other items as income in the year you receive the payment. However, if you use an accrual method of accounting, you can elect to postpone including the advance payment in income until the next year. However, you cannot postpone including any payment beyond that tax year.

To be eligible for the deferral method, advance payments must meet the following requirements:

- Full inclusion of the payment in gross income in the year of receipt is a permissible method of accounting;
- A portion of the advance payment is included in revenue in your applicable financial statement (AFS) for a subsequent tax year, or if you do not have an AFS, you earn a portion of the payment in a subsequent tax year; and
- You received the advance payment for goods, services, or such other items that the Secretary has identified.

You are considered to receive an item of gross income if you actually or constructively receive it or it is due and payable to you.

Certain gift card sales are considered advance payments and eligible for the deferral method. Certain types of prepayments are excluded from the definition of advance payments and are ineligible for this deferral method such as some types of rent or insurance premiums. See section 451(c)(B) for exclusions to the term "advance payment."

See section 451(c) and Regulations section 1.451-8 for more information.

**How to report payments.** Generally, include an advance payment in income in the year in which you receive it. However, you may use the deferral method described above for qualifying advance payments.

**Deferral method with AFS.** Any advance payment you include in gross receipts on your tax return must be included no later than when the income is included on an

AFS (or other financial statement specified by the IRS in the year of receipt). The remaining portion of the advance payment is included as gross income for the subsequent tax year independent of how it is treated on your AFS.

**Non-AFS deferral method.** If you do not have an AFS and elect to use this deferral method, you must include the advance payment in gross income in the year received, to the extent you have earned the amount. The remaining portion of the advance payment is included in gross income in the subsequent tax year.

**IRS approval.** The election to defer advance payments is effective for the tax year that it is first made and for all subsequent tax years unless you receive consent to revoke the election. You must file Form 3115 to obtain IRS approval to change your method of accounting for advance payment for services. See Form 3115 and the Instructions for Form 3115.

**Acceleration of advance payments.** If you have elected the deferral method for advance payments, certain conditions may occur that require you to accelerate inclusion of the advance payments into gross income. Examples include if you cease to exist, or if your obligation for the advance payment is satisfied. See Regulations sections 1.451-8(c)(4) and 1.451-8(d).

## Advance Payment Cost Offset Method

If you receive advance payments for the sale of inventory, you may elect to use the advance payment cost offset method. If elected, this method of accounting applies to all advance payments received in your trade or business that satisfy the criteria. See Regulations section 1.451-8(e) for the criteria and other information related to this optional cost offset method.

## Specified Goods Exception

The specified goods exception is for a taxpayer that receives prepayments but does not deliver the good for several years in the future. This exclusion applies if you require a customer to make an upfront payment under a contract in which all the following apply:

1. The contracted delivery month and year of the good occurs at least 2 tax years after an upfront payment;
2. You do not have the good or a substantially similar good on hand at the end of the year the upfront payment is received; and
3. You recognized all of the revenue from the sale of the good in your AFS in the year of delivery.

See Regulations section 1.451-8(f).

**How to report payments.** If you receive a prepayment that satisfies the specified goods exception, it is excluded from the treatment afforded to advance payments and instead is analyzed under sections 451(a) and (b), including the all events test and existing case laws that address the

all events test. Under this analysis, the prepayment could be includible in the year of receipt.

If you are subject to this exception, you have the option to treat upfront payments that satisfy the criteria for the specified good exception as a typical advance payment under section 451(c). Under section 451(c), the advance payment is included in gross income under the full inclusion method or the 1-year deferral method.

## Expenses

Under an accrual method of accounting, you generally deduct or capitalize a business expense when both the following apply.

1. The all-events test has been met. The test is met when:
  - a. All events have occurred that fix the fact of liability, and
  - b. The liability can be determined with reasonable accuracy.
2. Economic performance has occurred.

## Economic Performance

Generally, you cannot deduct or capitalize a business expense until economic performance occurs. If your expense is for property or services provided to you, or for your use of property, economic performance occurs as the property or services are provided or the property is used. If your expense is for property or services you provide to others, economic performance occurs as you provide the property or services.

**Example.** You are a calendar year taxpayer. You buy office supplies in December 2020. You receive the supplies and the bill in December, but you pay the bill in January 2021. You can deduct the expense in 2020 because all events have occurred to fix the liability, the amount of the liability can be determined, and economic performance occurred in 2020.

Your office supplies may qualify as a recurring item, discussed later. If so, you can deduct them in 2020, even if the supplies are not delivered until 2021 (when economic performance occurs).

**Workers' compensation and tort liability.** If you are required to make payments under workers' compensation laws or in satisfaction of any tort liability, economic performance occurs as you make the payments. If you are required to make payments to a special designated settlement fund established by court order for a tort liability, economic performance occurs as you make the payments.

**Taxes.** Economic performance generally occurs as estimated income tax, property taxes, employment taxes, etc. are paid. However, you can elect to treat taxes as a recurring item, discussed later. You can also elect to ratably accrue real estate taxes. See chapter 5 of Pub. 535 for information about real estate taxes.



**Other liabilities.** Other liabilities for which economic performance occurs as you make payments include liabilities for breach of contract (to the extent of incidental, consequential, and liquidated damages), violation of law, rebates and refunds, awards, prizes, jackpots, insurance, and warranty and service contracts.

**Interest.** Economic performance occurs with the passage of time (as the borrower uses, and the lender forgoes use of, the lender's money) rather than as payments are made.

**Compensation for services.** Generally, economic performance occurs as an employee renders service to the employer. However, deductions for compensation or other benefits paid to an employee in a year subsequent to economic performance are subject to the rules governing deferred compensation, deferred benefits, and funded welfare benefit plans. For information on employee benefit programs, see Pub. 15-B, Employer's Tax Guide to Fringe Benefits.

**Vacation pay.** You can take a current deduction for vacation pay earned by your employees if you pay it during the year or, if the amount is vested, within 2½ months after the end of the year. If you pay it later than this, you must deduct it in the year actually paid. An amount is vested if your right to it cannot be nullified or cancelled.

**Exception for recurring items.** An exception to the economic performance rule allows certain recurring items to be treated as incurred during the tax year even though economic performance has not occurred. The exception applies if all the following requirements are met.

1. The all-events test, discussed earlier, is met.
2. Economic performance occurs by the earlier of the following dates.
  - a. 8½ months after the close of the year.
  - b. The date you file a timely return (including extensions) for the year.
3. The item is recurring in nature and you consistently treat similar items as incurred in the tax year in which the all-events test is met.
4. Either:
  - a. The item is not material, or
  - b. Accruing the item in the year in which the all-events test is met results in a better match against income than accruing the item in the year of economic performance.

This exception does not apply to workers' compensation or tort liabilities.

**Amended return.** You may be able to file an amended return and treat a liability as incurred under the recurring item exception. You can do so if economic performance for the liability occurs after you file your tax return for the year, but within 8½ months after the close of the tax year.

**Recurrence and consistency.** To determine whether an item is recurring and consistently reported, consider the frequency with which the item and similar items are incurred (or expected to be incurred) and how you report these items for tax purposes. A new expense or an expense not incurred every year can be treated as recurring if it is reasonable to expect that it will be incurred regularly in the future.

**Materiality.** Factors to consider in determining the materiality of a recurring item include the size of the item (both in absolute terms and in relation to your income and other expenses) and the treatment of the item on your financial statements.

An item considered material for financial statement purposes is also considered material for tax purposes. However, in certain situations an immaterial item for financial accounting purposes is treated as material for purposes of economic performance.

**Matching expenses with income.** Costs directly associated with the revenue of a period are properly allocable to that period. To determine whether the accrual of an expense in a particular year results in a better match with the income to which it relates, generally accepted accounting principles (GAAP) are an important factor.

For example, if you report sales income in the year of sale, but you do not ship the goods until the following year, the shipping costs are more properly matched to income in the year of sale than the year the goods are shipped. Expenses that cannot be practically associated with income of a particular period, such as advertising costs, should be assigned to the period the costs are incurred. However, the matching requirement is considered met for certain types of expenses. These expenses include taxes, payments under insurance, warranty, and service contracts, rebates, refunds, awards, prizes, and jackpots.

## Expenses Paid in Advance

An expense you pay in advance is deductible only in the year to which it applies, unless the expense qualifies for the 12-month rule. Under the 12-month rule, a taxpayer is not required to capitalize amounts paid to create certain rights or benefits for the taxpayer that do not extend beyond the earlier of the following.

- 12 months after the right or benefit begins, or
- The end of the tax year after the tax year in which payment is made.

If you have not been applying the general rule (an expense paid in advance is deductible only in the year to which it applies) and/or the 12-month rule to the expenses you paid in advance, you must get IRS approval before using the general rule and/or the 12-month rule. See [Change in Accounting Method](#), later, for information on how to get IRS approval. See [Expense paid in advance](#) under *Cash Method*, earlier, for examples illustrating the application of the general and 12-month rules.

## Related Persons

Business expenses and interest owed to a related person who uses the cash method of accounting are not deductible until you make the payment and the corresponding amount is includable in the related person's gross income. Determine the relationship for this rule as of the end of the tax year for which the expense or interest would otherwise be deductible. See section 267 of the Internal Revenue Code for the definition of related person.

## Inventories

An inventory is necessary to clearly show income when the production, purchase, or sale of merchandise is an income-producing factor. If you must account for an inventory in your business, you must use an accrual method of accounting for your purchases and sales. However, see [Exception for Small Business Taxpayers](#), below. Also, see [Accrual Method](#), earlier.

To figure taxable income, you must value your inventory at the beginning and end of each tax year. To determine the value, you need a method for identifying the items in your inventory and a method for valuing these items. See [Identifying Cost](#) and [Valuing Inventory](#), later.

The rules for valuing inventory are not the same for all businesses. The method you use must conform to generally accepted accounting principles for similar businesses and must clearly reflect income. Your inventory practices must be consistent from year to year.



*The rules discussed here apply only if they do not conflict with the uniform capitalization rules of section 263A and the mark-to-market rules of section 475.*

## Exception for Small Business Taxpayers

If you are a small business taxpayer (defined below), you can choose not to keep an inventory, but you must still use a method of accounting for inventory that clearly reflects income. A small business taxpayer can account for inventory by (a) treating the inventory as non-incidentals and supplies, or (b) conforming to its treatment of inventory in an applicable financial statement (as defined in section 451(b)(3)). If it does not have an applicable financial statement, it can use the method of accounting used in its books and records prepared according to its accounting procedures. See Regulations section 1.471-1(b). If, however, you choose to keep an inventory, you generally must use an accrual method of accounting and value the inventory each year to determine your cost of goods sold.

**Small business taxpayer.** You qualify as a small business taxpayer if you:

- Have average annual gross receipts of \$26 million or less (indexed for inflation) for the 3 prior tax years, and
- Are not a tax shelter (as defined in section 448(d)(3)).

If your business has not been in existence for all of the 3 tax-year period used in figuring average gross receipts, base your average on the period it has existed. If your business has a predecessor entity, include the gross receipts of the predecessor entity from the 3 tax-year period when figuring average gross receipts. If your business (or predecessor entity) had short tax years for any of the 3 tax-year period, annualize your business's gross receipts for the short tax years that are part of the 3 tax-year period.

### **Changing your method of accounting for inventory.**

If you want to change your method of accounting for inventory, you must file Form 3115. See the Instructions for Form 3115.

## Items Included in Inventory

Your inventory should include all of the following.

- Merchandise or stock in trade.
- Raw materials.
- Work in process.
- Finished products.
- Supplies that physically become a part of the item intended for sale.

**Merchandise.** Include the following merchandise in inventory.

- Purchased merchandise if title has passed to you, even if the merchandise is in transit or you do not have physical possession for another reason.
- Goods under contract for sale that you have not yet segregated and applied to the contract.
- Goods out on consignment.
- Goods held for sale in display rooms, merchandise mart rooms, or booths located away from your place of business.

**C.O.D. mail sales.** If you sell merchandise by mail and intend payment and delivery to happen at the same time, title passes when payment is made. Include the merchandise in your closing inventory until the buyer pays for it.

**Containers.** Containers such as kegs, bottles, and cases, regardless of whether they are on hand or returnable, should be included in inventory if title has not passed to the buyer of the contents. If title has passed to the buyer, exclude the containers from inventory. Under certain circumstances, some containers can be depreciated. See Pub. 946.

**Merchandise not included.** Do not include the following merchandise in inventory.

- Goods you have sold, but only if title has passed to the buyer.
- Goods consigned to you.

- Goods ordered for future delivery if you do not yet have title.

**Assets.** Do not include the following in inventory.

- Land, buildings, and equipment used in your business.
- Notes, accounts receivable, and similar assets.
- Real estate held for sale by a real estate dealer in the ordinary course of business.
- Supplies that do not physically become part of the item intended for sale.



*Special rules apply to the cost of inventory or property imported from a related person. See the regulations under section 1059A of the Internal Revenue Code.*

## Identifying Cost

You can use any of the following methods to identify the cost of items in inventory.

### Specific Identification Method

Use the specific identification method when you can identify and match the actual cost to the items in inventory.

Use the FIFO or LIFO method, explained next, if:

- You cannot specifically identify items with their costs, or
- The same type of goods are intermingled in your inventory and they cannot be identified with specific invoices.

### FIFO Method

The FIFO (first-in first-out) method assumes the items you purchased or produced first are the first items you sold, consumed, or otherwise disposed of. The items in inventory at the end of the tax year are matched with the costs of similar items that you most recently purchased or produced.

### LIFO Method

The LIFO (last-in first-out) method assumes the items of inventory you purchased or produced last are the first items you sold, consumed, or otherwise disposed of. Items included in closing inventory are considered to be from the opening inventory in the order of acquisition and from those acquired during the tax year.

**LIFO rules.** The rules for using the LIFO method are very complex. Two are discussed briefly here. For more information on these and other LIFO rules, see sections 472 through 474 of the Internal Revenue Code and the related income tax regulations.

**Dollar-value method.** Under the dollar-value method of pricing LIFO inventories, goods and products must be

grouped into one or more pools (classes of items), depending on the kinds of goods or products in the inventories. See Regulations section 1.472-8.

**Simplified dollar-value method.** Under this method, you establish multiple inventory pools in general categories from appropriate government price indexes. You then use changes in the price index to estimate the annual change in price for inventory items in the pools.

An eligible small business (average annual gross receipts of \$5 million or less for the 3 preceding tax years) can elect the simplified dollar-value LIFO method. See section 474(c).

Taxpayers who cannot use the method under section 474 should see Regulations section 1.472-8(e)(3) for a similar simplified dollar-value method.

**Adopting LIFO method.** File Form 970, Application To Use LIFO Inventory Method, or a statement with all the information required on Form 970 to adopt the LIFO method. You must file the form (or the statement) with your timely filed tax return for the year in which you first use LIFO.

## Differences Between FIFO and LIFO

Each method produces different income results, depending on the trend of price levels at the time. In times of inflation, when prices are rising, LIFO will produce a larger cost of goods sold and a lower closing inventory. Under FIFO, the cost of goods sold will be lower and the closing inventory will be higher. However, in times of falling prices, the opposite will hold.

## Valuing Inventory

The value of your inventory is a major factor in figuring your taxable income. The method you use to value the inventory is very important.

The following methods, described below, are those generally available for valuing inventory.

- Cost.
- Lower of cost or market.
- Retail.

**Goods that cannot be sold.** These are goods you cannot sell at normal prices or they are unusable in the usual way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes. You should value these goods at their bona fide selling price minus direct cost of disposition, no matter which method you use to value the rest of your inventory. If these goods consist of raw materials or partly finished goods held for use or consumption, you must value them on a reasonable basis, considering their usability and condition. Do not value them for less than scrap value. For more information, see Regulations section 1.471-2(c).



## Cost Method

To properly value your inventory at cost, you must include all direct and indirect costs associated with it. The following rules apply.

- For merchandise on hand at the beginning of the tax year, cost means the ending inventory price of the goods.
- For merchandise purchased during the year, cost means the invoice price minus appropriate discounts plus transportation or other charges incurred in acquiring the goods. It can also include other costs that have to be capitalized under the uniform capitalization rules of section 263A of the Internal Revenue Code.
- For merchandise produced during the year, cost means all direct and indirect costs that have to be capitalized under the uniform capitalization rules.

**Discounts.** A trade discount is a discount allowed regardless of when the payment is made. Generally, it is for volume or quantity purchases. You must reduce the cost of inventory by a trade (or quantity) discount.

A cash discount is a reduction in the invoice or purchase price for paying within a prescribed time period. You can choose either to deduct cash discounts or include them in income, but you must treat them consistently from year to year.

## Lower of Cost or Market Method

Under the lower of cost or market method, compare the market value of each item on hand on the inventory date with its cost and use the lower of the two as its inventory value.

This method applies to the following.

- Goods purchased and on hand.
- The basic elements of cost (direct materials, direct labor, and certain indirect costs) of goods being manufactured and finished goods on hand.

This method does not apply to the following. They must be inventoried at cost.

- Goods on hand or being manufactured for delivery at a fixed price on a firm sales contract (that is, not legally subject to cancellation by either you or the buyer).
- Goods accounted for under the LIFO method.

**Example.** Under the lower of cost or market method, the following items would be valued at \$600 in closing inventory.

| Item                   | Cost         | Market       | Lower        |
|------------------------|--------------|--------------|--------------|
| R . . . . .            | \$300        | \$500        | \$300        |
| S . . . . .            | 200          | 100          | 100          |
| T . . . . .            | 450          | 200          | 200          |
| <b>Total</b> . . . . . | <b>\$950</b> | <b>\$800</b> | <b>\$600</b> |

You must value each item in the inventory separately. You cannot value the entire inventory at cost (\$950) and at market (\$800) and then use the lower of the two figures.

**Market value.** Under ordinary circumstances for normal goods, market value means the usual bid price on the date of inventory. This price is based on the volume of merchandise you usually buy. For example, if you buy items in small lots at \$10 an item and a competitor buys identical items in larger lots at \$8.50 an item, your usual market price will be higher than your competitor's.

**Lower than market.** When you offer merchandise for sale at a price lower than market in the normal course of business, you can value the inventory at the lower price, minus the direct cost of disposition. Determine these prices from the actual sales for a reasonable period before and after the date of your inventory. Prices that vary materially from the actual prices will not be accepted as reflecting the market.

**No market exists.** If no market exists, or if quotations are nominal because of an inactive market, you must use the best available evidence of fair market price on the date or dates nearest your inventory date. This evidence could include the following items.

- Specific purchases or sales you or others made in reasonable volume and in good faith.
- Compensation amounts paid for cancellation of contracts for purchase commitments.

## Retail Method

Under the retail method, the total retail selling price of goods on hand at the end of the tax year in each department or of each class of goods is reduced to approximate cost by using an average markup expressed as a percentage of the total retail selling price.

To figure the average markup, apply the following steps in order.

1. Add the total of the retail selling prices of the goods in the opening inventory and the retail selling prices of the goods you bought during the year (adjusted for all markups and markdowns).
2. Subtract from the total in (1) the cost of goods included in the opening inventory plus the cost of goods you bought during the year.
3. Divide the balance in (2) by the total selling price in (1). The result is the average markup percentage.

Then determine the approximate cost in three steps.

1. Subtract the sales at retail from the total retail selling price. The result is the closing inventory at retail.
2. Multiply the closing inventory at retail by the average markup percentage. The result is the markup in closing inventory.

3. Subtract the markup in (2) from the closing inventory at retail. The result is the approximate closing inventory at cost.

**Closing inventory.** The following example shows how to figure your closing inventory using the retail method.

**Example.** Your records show the following information on the last day of your tax year.

| Item                        | Cost     | Retail Value |
|-----------------------------|----------|--------------|
| Opening inventory . . . . . | \$52,000 | \$60,000     |
| Purchases . . . . .         | 53,000   | 78,500       |
| Sales . . . . .             |          | 98,000       |
| Markups . . . . .           |          | 2,000        |
| Markdowns . . . . .         |          | 500          |

Using the retail method, determine your closing inventory as follows.

| Item                                                 | Cost      | Retail Value |
|------------------------------------------------------|-----------|--------------|
| Opening inventory . . . . .                          | \$52,000  | \$60,000     |
| Plus: Purchases . . . . .                            | 53,000    | 78,500       |
| Net markups<br>(\$2,000 – \$500 markdowns) . . . . . |           | 1,500        |
| Total . . . . .                                      | \$105,000 | \$140,000    |
| Minus: Sales . . . . .                               |           | 98,000       |
| Closing inventory at retail . . . . .                |           | \$42,000     |
| Minus: Markup* (.25 × \$42,000) . . . . .            |           | 10,500       |
| Closing inventory at cost . . . . .                  |           | \$31,500     |

\* See *Markup percentage*, next, for an explanation of how the markup percentage (25%) was figured for this example.

**Markup percentage.** The markup (\$35,000) is the difference between cost (\$105,000) and the retail value (\$140,000). Divide the markup by the total retail value to get the markup percentage (25%). You cannot use arbitrary standard percentages of purchase markup to determine markup. You must determine it as accurately as possible from department records for the period covered by your tax return.

**Markdowns.** When determining the retail selling price of goods on hand at the end of the year, markdowns are recognized only if the goods were offered to the public at the reduced price. Markdowns not based on an actual reduction of retail sales price, such as those based on depreciation and obsolescence, are not allowed.

**Retail method with LIFO.** If you use LIFO with the retail method, you must adjust your retail selling prices for markdowns as well as markups.

**Price index.** If you are using the retail method and LIFO, adjust the inventory value, determined using the retail method, at the end of the year to reflect price changes since the close of the preceding year. Generally, to make this adjustment, you must develop your own retail price index based on an analysis of your own data under a method acceptable to the IRS. However, a department store using LIFO that offers a full line of merchandise for

sale can use an inventory price index provided by the Bureau of Labor Statistics. Other sellers can use this index if they can demonstrate the index is accurate, reliable, and suitable for their use.

**Retail method without LIFO.** If you do not use LIFO and have been determining your inventory under the retail method except that, to approximate the lower of cost or market, you have followed the consistent practice of adjusting the retail selling prices of goods for markups (but not markdowns), you can continue that practice. The adjustments must be bona fide, consistent, and uniform and you must also exclude markups made to cancel or correct markdowns. The markups you include must be reduced by markdowns made to cancel or correct the markups.

If you do not use LIFO and you previously determined inventories without eliminating markdowns in making adjustments to retail selling prices, you can continue this practice only if you first get IRS approval. You can adopt and use this practice on the first tax return you file for the business, subject to IRS approval on examination of your tax return.

**Figuring income tax.** Resellers who use the retail method of pricing inventories can determine their tax on that basis.

To use this method, you must do all of the following.

- State that you are using the retail method on your tax return.
- Keep accurate records.
- Use this method each year unless the IRS allows you to change to another method.

You must keep records for each separate department or class of goods carrying different percentages of gross profit. Purchase records should show the firm name, date of invoice, invoice cost, and retail selling price. You should also keep records of the respective departmental or class accumulation of all purchases, markdowns, sales, stock, etc.

## Perpetual or Book Inventory

You can figure the cost of goods on hand by either a perpetual or book inventory if inventory is kept by following sound accounting practices. Inventory accounts must be charged with the actual cost of goods purchased or produced and credited with the value of goods used, transferred, or sold. Credits must be determined on the basis of the actual cost of goods acquired during the year and their inventory value at the beginning of the tax year.

**Physical inventory.** You must take a physical inventory at reasonable intervals and the book amount for inventory must be adjusted to agree with the actual inventory.

## Loss of Inventory

You claim a casualty or theft loss of inventory, including items you hold for sale to customers, through the increase in the cost of goods sold by properly reporting your

opening and closing inventories. You cannot claim the loss again as a casualty or theft loss. Any insurance or other reimbursement you receive for the loss is taxable.

You can choose to claim the loss separately as a casualty or theft loss. If you claim the loss separately, adjust opening inventory or purchases to eliminate the loss items and avoid counting the loss twice.

If you claim the loss separately, reduce the loss by the reimbursement you receive or expect to receive. If you do not receive the reimbursement by the end of the year, you cannot claim a loss for any amounts you reasonably expect to recover.

**Forgiveness of indebtedness by creditors or suppliers.** If your creditors or suppliers forgive part of what you owe them because of your inventory loss, this amount is treated as taxable income.

**Disaster loss.** If your inventory loss is due to a disaster in an area determined by the President of the United States to be eligible for federal assistance, you can choose to deduct the loss on your return for the immediately preceding year. However, you must also decrease your opening inventory for the year of the loss so the loss will not show up again in inventory.

## Uniform Capitalization Rules

Under the uniform capitalization rules, you must capitalize the direct costs and part of the indirect costs for production or resale activities. Include these costs in the basis of property you produce or acquire for resale, rather than claiming them as a current deduction. You recover the costs through depreciation, amortization, or cost of goods sold when you use, sell, or otherwise dispose of the property.



*Special uniform capitalization rules apply to a farming business. See chapter 6 in Pub. 225.*

**Activities subject to the rules.** You are subject to the uniform capitalization rules if you do any of the following, unless the property is produced for your use other than in a trade or business or an activity carried on for profit.

- Produce real or tangible personal property.
- Acquire property for resale. However, see the exception for certain small taxpayers, discussed later.

**Producing property.** You produce property if you construct, build, install, manufacture, develop, improve, create, raise, or grow the property. Property produced for you under a contract is treated as produced by you to the extent you make payments or otherwise incur costs in connection with the property.

**Tangible personal property.** Tangible personal property includes films, sound recordings, video tapes, books, artwork, photographs, or similar property containing words, ideas, concepts, images, or sounds. However,

freelance authors, photographers, and artists are exempt from the uniform capitalization rules if they qualify.

**Exceptions.** The uniform capitalization rules do not apply to the following.

- A small business taxpayer that meets the gross receipts test under section 448(c) and that is not a tax shelter.
- Property produced to use as personal or nonbusiness property or for uses not connected with a trade or business or an activity conducted for profit.
- Research and experimental expenditures deductible under section 174.
- Intangible drilling and development costs of oil and gas or geothermal wells or any amortization deduction allowable under section 59(e) for intangible drilling, development, or mining exploration expenditures.
- Property produced under a long-term contract, except for certain home construction contracts. See section 460(e).
- Timber and certain ornamental trees raised, harvested, or grown, and the underlying land.
- Qualified creative expenses paid or incurred as a freelance (self-employed) writer, photographer, or artist that are otherwise deductible on your tax return.
- Costs allocable to natural gas acquired for resale to the extent these costs would otherwise be allocable to cushion gas stored underground.
- Property produced if substantial construction occurred before March 1, 1986.
- Property provided to customers in connection with providing services. It must be de minimus in amount and not be included in inventory in the hands of the service provider.
- Loan origination.
- The costs of certain producers who use a simplified production method and whose total indirect costs are \$200,000 or less. See Regulations section 1.263A-2(b)(3)(iv) for more information.

**Qualified creative expenses.** Qualified creative expenses are expenses paid or incurred by a freelance (self-employed) writer, photographer, or artist whose personal efforts create (or can reasonably be expected to create) certain properties. These expenses do not include expenses related to printing, photographic plates, motion picture films, video tapes, or similar items.

These individuals are defined as follows.

- A writer is an individual who creates a literary manuscript, a musical composition (including any accompanying words), or a dance score.
- A photographer is an individual who creates a photograph or photographic negative or transparency.
- An artist is an individual who creates a picture, painting, sculpture, statue, etching, drawing, cartoon, graphic design, or original print item. The originality



and uniqueness of the item created and the predominance of aesthetic value over utilitarian value of the item created are taken into account.

**Personal service corporation.** The exemption for writers, photographers, and artists also applies to an expense of a personal service corporation that directly relates to the activities of the qualified employee-owner. A qualified employee-owner is a writer, photographer, or artist who owns, with certain members of his or her family, substantially all the stock of the corporation.

**Inventories.** If you must adopt the uniform capitalization rules, revalue the items or costs included in beginning inventory for the year of change as if the capitalization rules had been in effect for all prior periods. When revaluing inventory costs, the capitalization rules apply to all inventory costs accumulated in prior periods. An adjustment is required under section 481(a). It is the difference between the original value of the inventory and the revalued inventory.

If you must capitalize costs for production and resale activities, you are required to make this change. If you make the change for the first tax year you are subject to the uniform capitalization rules, it is an automatic change of accounting method that does not need IRS approval. Otherwise, IRS approval is required to make the change.

## Change in Accounting Method

Generally, you can choose any permitted accounting method when you file your first tax return. You do not need to obtain IRS approval to choose the initial accounting method. You must, however, use the method consistently from year to year and it must clearly reflect your income. See [Accounting Methods](#), earlier.

Once you have set up your accounting method and filed your first return, generally, you must receive approval from the IRS before you change the method. A change in your accounting method includes a change not only in your overall system of accounting but also in the treatment of any material item. A material item is one that affects the proper time for inclusion of income or allowance of a deduction. Although an accounting method can exist without treating an item consistently, an accounting method is not established for that item, in most cases, unless the item is treated consistently.

**Approval required.** The following are examples of changes in accounting method that require IRS approval.

- A change from the cash method to an accrual method or vice versa.
- A change in the method or basis used to value inventory.
- A change in the depreciation or amortization method (except for certain permitted changes to the straight-line method).

- A change involving the adoption, use, or discontinuance of any other specialized method of computing taxable income.
- A change where the Internal Revenue Code and Treasury Regulations specifically require that the consent of the IRS must be obtained before adopting such a change.

**Approval not required.** The following are examples of types of changes that are not changes in accounting methods and do not require IRS approval.

- Correction of a math or posting error.
- Correction of an error in figuring tax liability (such as an error in figuring a credit).
- An adjustment of any item of income or deduction that does not involve the proper time for including it in income or deducting it.
- Certain adjustments in the useful life of a depreciable or amortizable asset.

**Form 3115.** In general, you must file a current Form 3115 to request a change in either an overall accounting method or the accounting treatment of any item. There are some instances when you can obtain automatic consent from the IRS to change to certain accounting methods. In other instances, you can file Form 3115 using the non-automatic change request procedures to request an accounting method change.

**More information.** For more information on making changes in accounting methods, see Form 3115 and the Instructions for Form 3115. See Revenue Procedure 2021-34, 2021-35 I.R.B. 337 (or any successor), available at [IRS.gov/irb/2021-35\\_IRB#REV-PROC-2021-34](https://www.irs.gov/irb/2021-35_IRB#REV-PROC-2021-34), for additional procedures that may apply for obtaining automatic consent to change methods of accounting for revenue recognition and certain other methods of accounting that may affect the accounting for revenue recognition. Also see Revenue Procedure 2022-09, 2022-02 I.R.B. 310 (or any successor) available at [IRS.gov/irb/2022-02\\_IRB#REV-PROC-2022-9](https://www.irs.gov/irb/2022-02_IRB#REV-PROC-2022-9), for additional procedures that may apply for obtaining automatic consent to change certain methods of accounting related to small businesses.



*When making changes in accounting methods or when filing Form 3115, you must determine if the IRS has issued any new published guidance which includes revenue procedures, revenue rulings, notices, regulations, or other relevant guidance in the Internal Revenue Bulletin. For the latest information, visit [IRS.gov](https://www.irs.gov).*

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## How To Get Tax Help

If you have questions about a tax issue; need help preparing your tax return; or want to download free publications, forms, or instructions, go to [IRS.gov](https://www.irs.gov) and find resources that can help you right away.

**Preparing and filing your tax return.** After receiving all your wage and earnings statements (Forms W-2, W-2G, 1099-R, 1099-MISC, 1099-NEC, etc.); unemployment compensation statements (by mail or in a digital format) or other government payment statements (Form 1099-G); and interest, dividend, and retirement statements from banks and investment firms (Forms 1099), you have several options to choose from to prepare and file your tax return. You can prepare the tax return yourself, see if you qualify for free tax preparation, or hire a tax professional to prepare your return.



*For 2021, if you received an Economic Impact Payment (EIP), refer to your Notice 1444-C, Your 2021 Economic Impact Payment. If you received Advance Child Tax Credit payments, refer to your Letter 6419.*

**Free options for tax preparation.** Go to [IRS.gov](https://www.irs.gov) to see your options for preparing and filing your return online or in your local community, if you qualify, which include the following.

- **Free File.** This program lets you prepare and file your federal individual income tax return for free using brand-name tax-preparation-and-filing software or Free File fillable forms. However, state tax preparation may not be available through Free File. Go to [IRS.gov/FreeFile](https://www.irs.gov/FreeFile) to see if you qualify for free online federal tax preparation, e-filing, and direct deposit or payment options.
- **VITA.** The Volunteer Income Tax Assistance (VITA) program offers free tax help to people with low-to-moderate incomes, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. Go to [IRS.gov/VITA](https://www.irs.gov/VITA), download the free IRS2Go app, or call 800-906-9887 for information on free tax return preparation.
- **TCE.** The Tax Counseling for the Elderly (TCE) program offers free tax help for all taxpayers, particularly those who are 60 years of age and older. TCE volunteers specialize in answering questions about pensions and retirement-related issues unique to seniors. Go to [IRS.gov/TCE](https://www.irs.gov/TCE), download the free IRS2Go app, or call 888-227-7669 for information on free tax return preparation.
- **MilTax.** Members of the U.S. Armed Forces and qualified veterans may use MilTax, a free tax service offered by the Department of Defense through Military OneSource. For more information, go to [MilitaryOneSource \(MilitaryOneSource.mil/Tax\)](https://www.militaryonesource.com/MilitaryOneSource.mil/Tax).

Also, the IRS offers Free Fillable Forms, which can be completed online and then filed electronically regardless of income.

**Using online tools to help prepare your return.** Go to [IRS.gov/Tools](https://www.irs.gov/Tools) for the following.

- The [Earned Income Tax Credit Assistant \(IRS.gov/EITCAssistant\)](https://www.irs.gov/EITCAssistant) determines if you're eligible for the earned income credit (EIC).
- The [Online EIN Application \(IRS.gov/EIN\)](https://www.irs.gov/EIN) helps you get an employer identification number (EIN) at no cost.
- The [Tax Withholding Estimator \(IRS.gov/W4app\)](https://www.irs.gov/W4app) makes it easier for everyone to pay the correct amount of tax during the year. The tool is a convenient, online way to check and tailor your withholding. It's more user-friendly for taxpayers, including retirees and self-employed individuals. The features include the following.
  - ▶ Easy to understand language.
  - ▶ The ability to switch between screens, correct previous entries, and skip screens that don't apply.
  - ▶ Tips and links to help you determine if you qualify for tax credits and deductions.
  - ▶ A progress tracker.
  - ▶ A self-employment tax feature.
  - ▶ Automatic calculation of taxable social security benefits.
- The [First-Time Homebuyer Credit Account Look-up \(IRS.gov/HomeBuyer\)](https://www.irs.gov/HomeBuyer) tool provides information on your repayments and account balance.
- The [Sales Tax Deduction Calculator \(IRS.gov/SalesTax\)](https://www.irs.gov/SalesTax) figures the amount you can claim if you itemize deductions on Schedule A (Form 1040).



**Getting answers to your tax questions.** On [IRS.gov](https://www.irs.gov), you can get up-to-date information on current events and changes in tax law.

- [IRS.gov/Help](https://www.irs.gov/Help): A variety of tools to help you get answers to some of the most common tax questions.
- [IRS.gov/ITA](https://www.irs.gov/ITA): The Interactive Tax Assistant, a tool that will ask you questions and, based on your input, provide answers on a number of tax law topics.
- [IRS.gov/Forms](https://www.irs.gov/Forms): Find forms, instructions, and publications. You will find details on 2021 tax changes and hundreds of interactive links to help you find answers to your questions.
- You may also be able to access tax law information in your electronic filing software.

**Need someone to prepare your tax return?** There are various types of tax return preparers, including tax preparers, enrolled agents, certified public accountants (CPAs), attorneys, and many others who don't have professional credentials. If you choose to have someone prepare your tax return, choose that preparer wisely. A paid tax preparer is:

- Primarily responsible for the overall substantive accuracy of your return,
- Required to sign the return, and

- Required to include their preparer tax identification number (PTIN).

Although the tax preparer always signs the return, you're ultimately responsible for providing all the information required for the preparer to accurately prepare your return. Anyone paid to prepare tax returns for others should have a thorough understanding of tax matters. For more information on how to choose a tax preparer, go to [Tips for Choosing a Tax Preparer](#) on IRS.gov.

**Advance child tax credit payments.** From July through December 2021, advance payments were sent automatically to taxpayers with qualifying children who met certain criteria. The advance child tax credit payments were early payments of up to 50% of the estimated child tax credit that taxpayers may properly claim on their 2021 returns. Go to [IRS.gov/AdvCTC](#) for more information about these payments and how they can affect your taxes.

**Coronavirus.** Go to [IRS.gov/Coronavirus](#) for links to information on the impact of the coronavirus, as well as tax relief available for individuals and families, small and large businesses, and tax-exempt organizations.

**Employers can register to use Business Services Online.** The Social Security Administration (SSA) offers online service at [SSA.gov/employer](#) for fast, free, and secure online W-2 filing options to CPAs, accountants, enrolled agents, and individuals who process Form W-2, Wage and Tax Statement, and Form W-2c, Corrected Wage and Tax Statement.

**IRS social media.** Go to [IRS.gov/SocialMedia](#) to see the various social media tools the IRS uses to share the latest information on tax changes, scam alerts, initiatives, products, and services. At the IRS, privacy and security are our highest priority. We use these tools to share public information with you. **Don't** post your social security number (SSN) or other confidential information on social media sites. Always protect your identity when using any social networking site. The following IRS YouTube channels provide short, informative videos on various tax-related topics in English, Spanish, and ASL.

- [Youtube.com/irsvideos](#).
- [Youtube.com/irsvideosmultilingua](#).
- [Youtube.com/irsvideosASL](#).

**Watching IRS videos.** The IRS Video portal ([IRSVideos.gov](#)) contains video and audio presentations for individuals, small businesses, and tax professionals.

**Online tax information in other languages.** You can find information on [IRS.gov/MyLanguage](#) if English isn't your native language.

**Free Over-the-Phone Interpreter (OPI) Service.** The IRS is committed to serving our multilingual customers by offering OPI services. The OPI service is a federally funded program and is available at Taxpayer Assistance Centers (TACs), other IRS offices, and every VITA/TCE

return site. OPI service is accessible in more than 350 languages.

**Accessibility Helpline available for taxpayers with disabilities.** Taxpayers who need information about accessibility services can call 833-690-0598. The Accessibility Helpline can answer questions related to current and future accessibility products and services available in alternative media formats (for example, braille, large print, audio, etc.).

**Getting tax forms and publications.** Go to [IRS.gov/Forms](#) to view, download, or print all of the forms and publications you may need. Or, you can go to [IRS.gov/OrderForms](#) to place an order.

**Getting tax publications and instructions in eBook format.** You can also download and view popular tax publications and instructions (including the Instructions for Form 1040) on mobile devices as eBooks at [IRS.gov/eBooks](#).

**Note.** IRS eBooks have been tested using Apple's iBooks for iPad. Our eBooks haven't been tested on other dedicated eBook readers, and eBook functionality may not operate as intended.

**Access your online account (individual taxpayers only).** Go to [IRS.gov/Account](#) to securely access information about your federal tax account.

- View the amount you owe and a breakdown by tax year.
- See payment plan details or apply for a new payment plan.
- Make a payment or view 5 years of payment history and any pending or scheduled payments.
- Access your tax records, including key data from your most recent tax return, your EIP amounts, and transcripts.
- View digital copies of select notices from the IRS.
- Approve or reject authorization requests from tax professionals.
- View your address on file or manage your communication preferences.

**Tax Pro Account.** This tool lets your tax professional submit an authorization request to access your individual taxpayer [IRS online account](#). For more information, go to [IRS.gov/TaxProAccount](#).

**Using direct deposit.** The fastest way to receive a tax refund is to file electronically and choose direct deposit, which securely and electronically transfers your refund directly into your financial account. Direct deposit also avoids the possibility that your check could be lost, stolen, or returned undeliverable to the IRS. Eight in 10 taxpayers use direct deposit to receive their refunds. If you don't have a bank account, go to [IRS.gov/DirectDeposit](#) for more information on where to find a bank or credit union that can open an account online.



**Getting a transcript of a return.** The quickest way to get a copy of your tax transcript is to go to [IRS.gov/Transcripts](https://www.irs.gov/Transcripts). Click on either "Get Transcript Online" or "Get Transcript by Mail" to order a copy of your transcript. If you prefer, you can order your transcript by calling 800-908-9946.

### Reporting and resolving your tax-related identity theft issues.

- Tax-related identity theft happens when someone steals your personal information to commit tax fraud. Your taxes can be affected if your SSN is used to file a fraudulent return or to claim a refund or credit.
- The IRS doesn't initiate contact with taxpayers by email, text messages, telephone calls, or social media channels to request personal or financial information. This includes requests for personal identification numbers (PINs), passwords, or similar information for credit cards, banks, or other financial accounts.
- Go to [IRS.gov/IdentityTheft](https://www.irs.gov/IdentityTheft), the IRS Identity Theft Central webpage, for information on identity theft and data security protection for taxpayers, tax professionals, and businesses. If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, you can learn what steps you should take.
- Get an Identity Protection PIN (IP PIN). IP PINs are six-digit numbers assigned to taxpayers to help prevent the misuse of their SSNs on fraudulent federal income tax returns. When you have an IP PIN, it prevents someone else from filing a tax return with your SSN. To learn more, go to [IRS.gov/IPPIN](https://www.irs.gov/IPPIN).

### Ways to check on the status of your refund.

- Go to [IRS.gov/Refunds](https://www.irs.gov/Refunds).
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.

**Note.** The IRS can't issue refunds before mid-February 2022 for returns that claimed the EIC or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.

**Making a tax payment.** Go to [IRS.gov/Payments](https://www.irs.gov/Payments) for information on how to make a payment using any of the following options.

- **IRS Direct Pay:** Pay your individual tax bill or estimated tax payment directly from your checking or savings account at no cost to you.
- **Debit or credit card:** Choose an approved payment processor to pay online or by phone.
- **Electronic Funds Withdrawal:** Schedule a payment when filing your federal taxes using tax return preparation software or through a tax professional.
- **Electronic Federal Tax Payment System:** Best option for businesses. Enrollment is required.

- **Check or money order:** Mail your payment to the address listed on the notice or instructions.
- **Cash:** You may be able to pay your taxes with cash at a participating retail store.
- **Same-Day Wire:** You may be able to do same-day wire from your financial institution. Contact your financial institution for availability, cost, and time frames.

**Note.** The IRS uses the latest encryption technology to ensure that the electronic payments you make online, by phone, or from a mobile device using the IRS2Go app are safe and secure. Paying electronically is quick, easy, and faster than mailing in a check or money order.

**What if I can't pay now?** Go to [IRS.gov/Payments](https://www.irs.gov/Payments) for more information about your options.

- Apply for an **online payment agreement (OPA)** to meet your tax obligation in monthly installments if you can't pay your taxes in full today. Once you complete the online process, you will receive immediate notification of whether your agreement has been approved.
- Use the **Offer in Compromise Pre-Qualifier** to see if you can settle your tax debt for less than the full amount you owe. For more information on the Offer in Compromise program, go to [IRS.gov/OIC](https://www.irs.gov/OIC).

**Filing an amended return.** You can now file Form 1040-X electronically with tax filing software to amend 2019 or 2020 Forms 1040 and 1040-SR. To do so, you must have e-filed your original 2019 or 2020 return. Amended returns for all prior years must be mailed. Go to [IRS.gov/Form1040X](https://www.irs.gov/Form1040X) for information and updates.

**Checking the status of an amended return.** Go to [IRS.gov/WMAR](https://www.irs.gov/WMAR) to track the status of Form 1040X amended returns.

**Note.** It can take up to 3 weeks from the date you filed your amended return for it to show up in our system, and processing it can take up to 16 weeks.

**Understanding an IRS notice or letter.** Go to [IRS.gov/Notices](https://www.irs.gov/Notices) to find additional information about responding to an IRS notice or letter.

You can use Schedule LEP, Request for Change in Language Preference, to state a preference to receive notices, letters, or other written communications from the IRS in an alternative language, when these are available. Once your Schedule LEP is processed, the IRS will determine your translation needs and provide you translations when available. If you have a disability requiring notices in an accessible format, see Form 9000.

**Contacting your local IRS office.** Keep in mind, many questions can be answered on IRS.gov without visiting an IRS Tax Assistance Center (TAC). Go to [IRS.gov/LetUsHelp](https://www.irs.gov/LetUsHelp) for the topics people ask about most. If you still need help, IRS TACs provide tax help when a tax issue can't be handled online or by phone. All TACs now provide service by appointment so you'll know in advance

that you can get the service you need without long wait times. Before you visit, go to [IRS.gov/TACLocator](https://www.irs.gov/TACLocator) to find the nearest TAC, check hours, available services, and appointment options. Or, on the IRS2Go app, under the Stay Connected tab, choose the Contact Us option and click on “Local Offices.”

## The Taxpayer Advocate Service (TAS) Is Here To Help You

### What is TAS?

TAS is an *independent* organization within the IRS that helps taxpayers and protects taxpayer rights. Their job is to ensure that every taxpayer is treated fairly and that you know and understand your rights under the [Taxpayer Bill of Rights](https://www.irs.gov/advocate/bill-of-rights).

### How Can You Learn About Your Taxpayer Rights?

The Taxpayer Bill of Rights describes 10 basic rights that all taxpayers have when dealing with the IRS. Go to [TaxpayerAdvocate.IRS.gov](https://www.irs.gov/advocate) to help you understand what these rights mean to you and how they apply. These are *your* rights. Know them. Use them.

### What Can TAS Do For You?

TAS can help you resolve problems that you can't resolve with the IRS. And their service is free. If you qualify for their assistance, you will be assigned to one advocate who will work with you throughout the process and will do everything possible to resolve your issue. TAS can help you if:

- Your problem is causing financial difficulty for you, your family, or your business;
- You face (or your business is facing) an immediate threat of adverse action; or

- You've tried repeatedly to contact the IRS but no one has responded, or the IRS hasn't responded by the date promised.

### How Can You Reach TAS?

TAS has offices *in every state, the District of Columbia, and Puerto Rico*. Your local advocate's number is in your local directory and at [TaxpayerAdvocate.IRS.gov/Contact-Us](https://www.irs.gov/advocate/contact-us). You can also call them at 877-777-4778.

### How Else Does TAS Help Taxpayers?

TAS works to resolve large-scale problems that affect many taxpayers. If you know of one of these broad issues, please report it to them at [IRS.gov/SAMS](https://www.irs.gov/SAMS).

### TAS for Tax Professionals

TAS can provide a variety of information for tax professionals, including tax law updates and guidance, TAS programs, and ways to let TAS know about systemic problems you've seen in your practice.

### Low Income Taxpayer Clinics (LITCs)

LITCs are independent from the IRS. LITCs represent individuals whose income is below a certain level and need to resolve tax problems with the IRS, such as audits, appeals, and tax collection disputes. In addition, clinics can provide information about taxpayer rights and responsibilities in different languages for individuals who speak English as a second language. Services are offered for free or a small fee. To find a clinic near you, visit [TaxpayerAdvocate.IRS.gov/about-us/Low-Income-Taxpayer-Clinics-LITC](https://www.irs.gov/advocate/about-us/low-income-taxpayer-clinics-litc) or see IRS Pub. 4134, [Low Income Taxpayer Clinic List](https://www.irs.gov/advocate/about-us/low-income-taxpayer-clinic-list).