Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Concept Unit

Unit Name	IRC 481(a) Adjustments for IRC 263A Accounting Method Changes	
Primary UIL Code	263A.07-00	Change in Method of Accounting under Section 263A

Library Level	**Title**
Knowledge Base	Corporate/Business Issues & Credits
Shelf	Inventory and IRC 263A
Book	UNICAP 263A
Chapter	263A General

Document Control Number (DCN)	COR-C-011 (formerly INV/C/202_01-01)
Date of Last Update	03/11/20

Table of Contents

(View this PowerPoint in "Presentation View" to click on the links below)

General Overview

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

In general, an accounting method is a set of rules used to determine when and how a taxpayer takes income and expenses into account for federal income tax purposes. A method of accounting must involve timing. If an accounting practice for an item does not permanently affect the taxpayer's lifetime taxable income, but does or could change the year in which taxable income is reported (or in which deductions are claimed), the accounting practice for the item involves timing and is therefore considered a method of accounting.

A Service-imposed change in accounting method (CAM) requires specific written notification to the taxpayer. If the Service does not provide written notice to the taxpayer that it is treating an accounting method issue as a CAM, then the taxpayer's accounting method has not been changed. It is important to properly identify change in accounting method issues and properly compute the IRC 481(a) adjustment. A change to the tax treatment of IRC 263A costs, methods, allocations, etc. may be a CAM.

If multiple change in accounting methods occur in the same year, then method change procedures generally deem the IRC 263A CAM to occur before any other CAM for that tax year. However, there are some changes that do not follow this general rule. See Treas. Reg. 1.263A-7(b).

First, if there is a change to a taxpayer's overall method of accounting, such as from the cash receipts and disbursements method to the accrual method, in the same tax year a change to the method of accounting for costs subject to IRC 263A, the change to the accrual method must occur before the change to the method of accounting for IRC 263A costs. Second, if there are changes to a taxpayer's method of accounting for depreciation in the same year a change to the method of accounting for IRC 263A costs and any portion of the depreciation is subject to IRC 263A, the change in the method for depreciation must occur before the IRC 263A method change.

General Overview (cont’d)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
In addition, there are a few other exceptions to this general rule. Certain LIFO changes made in the same year as changes to a method of accounting for IRC 263A costs are not required to follow this rule. For example, if there is a change to terminate the use of LIFO method or a change from using the specific goods LIFO method to using the dollar value LIFO inventory method in the same year a change to the method of accounting for IRC 263A costs, the changes to the LIFO method may occur before the IRC 263A changes.

Facts of Concept

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Facts of Concept
A change to the treatment of IRC 263A costs is a change in accounting method if the taxpayer adopted the method. It requires the Service to compute an IRC 481(a) adjustment and notify taxpayer that it is treating the accounting method issue as a change in accounting method. Some common examples of IRC 263A CAMs include a change from expensing to capitalizing costs or vice versa. A change to the treatment of costs to comply with IRC 263A requires a CAM. Another common example requiring a CAM is a change in the method of allocating costs to ending inventory including the change to or from one of the simplified methods. See Treas. Reg. 1.263A-7(a)(5). A taxpayer's method of accounting must clearly reflect income. A permissible method of accounting is a method that clearly reflects income because it complies with the Code, regulations, or other published guidance. If the taxpayer's method does not clearly reflect income or if the taxpayer does not consistently use a method, then the Service will compute taxable income in a manner that does clearly reflect income. An impermissible method of accounting does not comply with the Code, regulations, or other published guidance. In other words, an impermissible method is a method of accounting that does not clearly reflect income.

Detailed Explanation of the Concept

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Analysis	Resources
You must determine if a taxpayer has adopted a method of accounting. This is important because once a taxpayer adopts a method of accounting, even an impermissible method, it may not change to a different method of accounting without first obtaining the Commissioner’s consent. A taxpayer adopts a method of accounting by using a consistent pattern of treatment. A taxpayer adopts a permissible method of accounting by using the method to compute taxable income on its first tax return or the first tax return that reflects the material item. A taxpayer adopts an impermissible method of accounting for a material item by treating the item in the same way on two or more consecutively filed tax returns (see Rev. Rul. 90-38 and Rev. Rul. 72-491). A material item is any item of income, deduction, gain or loss that involves timing (e.g., IRC 263A costs). If you determine a taxpayer adopted an impermissible accounting method for its IRC 263A costs or did not properly obtain the Commissioner’s consent before changing its accounting method for IRC 263A costs, you should propose a Service-imposed change in accounting method. Rev. Proc. 2002-18 provides the procedures for a Service-imposed change in accounting method.	▪ IRC 446(e) ▪ IRC 481 ▪ Rev. Rul. 90-38 ▪ Rev. Rul. 72-491 ▪ Rev. Proc. 2002-18 ▪ Rev. Proc. 2015-13 ▪ Rev. Proc. 2019-43

Detailed Explanation of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes	
Analysis	**Resources**
You can find additional information on Service-imposed method change issues in the Servicewide Virtual Library (VL) by going to the Examination floor, then the Corporate/Business Issues & Credits Knowledge Base (KB), and selecting the Change in Methods book on the Methods of Accounting and Timing shelf. In general, a taxpayer requesting a change in accounting method must file an application for change in accounting method (Form 3115) prospectively, using either the automatic or the non-automatic (advance) method change consent procedures in Rev. Proc. 2015-13. You can find additional information on voluntary method change procedures in the Change in Methods book. If you determine a taxpayer adopted an IRC 263A method of accounting that does not clearly reflect income (i.e., impermissible method), you should initiate an involuntary change in accounting method by calculating an IRC 481(a) adjustment and a current year adjustment. Do this by recalculating the taxpayer's beginning and ending capitalized IRC 263A costs under the new method of accounting. Generally, propose the CAM adjustment in the first year under examination. There is no spread of the IRC 481(a) adjustment – you must include the entire amount of the IRC 481(a) adjustment in the first year of change.	▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 4 - *Voluntary Change in Method (Taxpayer-Initiated)* ▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 - *Involuntary Change in Method (Service-Initiated)* ▪ IRC 263A ▪ IRC 481 ▪ Treas. Reg. 1.263A-7(c)(1) ▪ Rev. Proc. 2015-13

Examples of the Concept

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Below is an example of an IRC 263A CAM with an IRC 481(a) adjustment and a current year adjustment.

IRC 481(a) Adjustment – Beginning Inventory:	Amounts:
Beginning Inventory per Examination	6,550,000
Less: Beginning Inventory per Return	(5,725,000)
IRC 481(a) Adjustment to Beginning Inventory	825,000

Adjustment – Ending Inventory:	Amounts:
Ending Inventory per Examination	7,875,000
Less: Ending Inventory per Return	(6,325,000)
Total Adjustment to Ending Inventory	1,550,000

Current Year Adjustment:	Amounts:
Total Adjustment to Ending Inventory	1,550,000
Less: IRC 481(a) Adjustment	(825,000)
Current Year Adjustment	725,000

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

The total adjustment:

- Includes the amount of additional IRC 263A costs added to beginning inventory ($825,000)
- Includes the amount of additional IRC 263A costs added to ending inventory less the adjustment to beginning inventory ($725,000)
- The total is the difference between ending inventory computed under the old method and ending inventory computed under the new method of accounting ($1,550,000)

With an IRC 263A CAM, you must restate beginning inventory using the new method. The IRC 481(a) adjustment is the difference between the beginning inventory computed under the old method and the beginning inventory computed under the new method. You must compute the current year adjustment by computing the adjustment to ending inventory using the new method of accounting and reversing (deducting) the adjustment to the beginning inventory amount (i.e., IRC 481(a) adjustment). The IRC 481(a) adjustment plus the current year adjustment are equal to the total adjustment to ending inventory.

The beginning inventory must be revalued. Three methods are available to revalue the inventory.

Inventory Revaluation Methods

1. Facts and Circumstances Method
2. Weighted Average Method
3. 3-year Average Method

Back to Table of Contents

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Examples
<u>Inventory Revaluation Methods (cont'd)</u> All three methods are available regardless of whether the taxpayer elects a simplified method to capitalize costs under IRC 263A. Examples of the three methods follow. <u>Facts and Circumstances Method</u> All taxpayers may use the facts and circumstances method. Under this method, taxpayers must revalue inventory by applying the rules of IRC 263A to production and resale activities. The rules must be applied with the same degree of specificity as required of inventory manufacturers under the law immediately prior to the Tax Reform Act of 1986. The taxpayer must analyze production and resale activities and apply the rules of IRC 263A for any prior year that is relevant in determining the total amount of revalued cost beginning in the year of changes. For example, a LIFO taxpayer's inventory includes layers from prior years. Therefore, they must evaluate prior years IRC 263A information and apply that information in order to determine the revalued costs. A taxpayer may utilize reasonable estimates and procedures when valuing inventory costs under certain circumstances. This Practice Unit will discuss those circumstances next. A taxpayer may use reasonable estimates and procedures to value inventory if the taxpayer cannot reconstruct from its books and records the actual financial and accounting data required to properly apply IRC 263A. If the total amount of costs estimated are not significant in comparison to the total restated value of the items or costs for the period in question (including costs previously capitalized under the old method), then the taxpayer can use available information from more recent years to estimate the amount and nature of costs applicable to earlier years and use available information for comparable items of inventory produced or acquired during the same year to estimate costs.

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Examples
<u>Weighted Average Method</u> A taxpayer using the FIFO method or the specific goods LIFO method can use the weighted average method. This method estimates the change in the amount of costs allocated to prior years' inventories. This method is only available if a taxpayer lacks sufficient data to use the facts and circumstances method. If a taxpayer qualifies to use this method, it can only be used for those items or costs for which they lack sufficient information to use the facts and circumstances method. If sufficient information is not available to apply this method, then the taxpayer must use reasonable estimates and procedures to whatever extent is necessary to allow for the application of this method. The following example applies to both a reseller and a producer. A FIFO taxpayer manufactures widgets and makes a method change in 20x8. The taxpayer did not capitalize all costs required by IRC 263A. The taxpayer maintains inventories of widgets; however, they no longer produce some types. Widget A is no longer produced. The last production year was 20x5. The revaluation of the IRC 263A costs for widget A for those produced in 20x5 is a 15% increase in the costs for widget A. A portion of the inventory was produced in 20x4, however the taxpayer does not have data for this year. The taxpayer may apply the 15% increase found for 20x5 to revalue the 20x4 inventory for widget A. Widget B was last produced in 20x2. No data is available to revalue the inventory of widget B. Information for all other widgets is available for 20x4 and 20x5. Using data available for these widgets for these years results in an average increase of 20% in the 20x4 production costs. The overall 20% increase may be used to revalue widget B. <u>3-Year Average Method</u> 3-year average method is available to all taxpayers using the dollar value LIFO method regardless of whether the taxpayer lacks sufficient data to revalue its inventory costs under the facts and circumstances revaluation method.

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

<u>3-Year Average Method (cont'd)</u>

Under this method, the taxpayer revalues all existing LIFO layers of a trade or business. The method is based on the average percentage change (the three-year revaluation factor) in the current costs of inventory for each LIFO pool. The change is based on the three most recent taxable years for which the taxpayer has sufficient information available. The three-year revaluation factor applies to all layers for each pool that exist in beginning inventory in the year of the change. The method must be applied to all inventory in a taxpayer's trade or business. Taxpayers are not allowed to use the method for some, but not all, inventory costs on the basis of pools, business units, or other measures of inventory that are not a separate trade or business. Generally, if a taxpayer uses this method, they must establish a new base year. However, a dollar-value LIFO taxpayer using this method and either the simplified production method or simplified resale method to revalue inventory, is permitted, but not required, to establish a new base year. If a new base year is established, then the beginning inventory for the year of change becomes the new base year for determining the LIFO index in future years.

Under this method, if the taxpayer has sufficient data to calculate the revaluation factor for more than three years, then it may use that data to determine the average percentage increase or decrease. However, this can only be done if the additional years are consecutive and prior to the year of change. The requirement for consecutive years applies under this method regardless of whether any inventory costs in beginning inventory as of the year of change are viewed as incurred in, or attributable to, those consecutive years under the LIFO inventory method. This could result in using data from a year in which no increment occurred.

For example, if a taxpayer changes its method of accounting in 20x8 and has sufficient data to revalue its inventory for the years 20x2 through 20x7, then the taxpayer may calculate the revaluation factor using all six prior years. If sufficient data exists for 20x1 through 20x3 and 20x5 through 20x7, then only the three prior consecutive years can be used to compute the revaluation factor, i.e., the years 20x5 through 20x7. If the taxpayer has LIFO increments in 20x6, 20x4 and 20x3, the taxpayer may not use those years alone; they must use available information for consecutive years.

A comprehensive example is shown as part of the example for a LIFO taxpayer in example #3.

Examples of the Concept (cont’d)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Examples
Next there are four examples of situations which require a change in method and a corresponding IRC 481(a) adjustment: 1. IRC 481(a) adjustment for a FIFO (First In-First Out) taxpayer with no prior IRC 263A adjustment. 2. IRC 481(a) adjustment for a FIFO taxpayer with a prior IRC 263A adjustment. 3. IRC 481(a) adjustment for a LIFO taxpayer. 4. IRC 481(a) adjustment for non-inventory property.

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #1: IRC 481(a) Adjustment for a FIFO Taxpayer That Did Not Capitalize Any Costs Under IRC 263A

For the first exam year (the year of change), Exam will split the total IRC 263A adjustment between the IRC 481(a) adjustment and the current year adjustment.

Example of Computation

Facts

Exam Years = 20x7, 20x8

Tax Year	12/31/20x6	12/31/20x7	12/31/20x8
IRC 263A Amount Capitalized per Return	0	0	0
IRC 263A Amount Capitalized per Exam	400,000	430,000	465,000

Computation:

IRC 481(a) Adjustment	12/31/20x7
IRC 263A per Return at 12/31/20x6	0
IRC 263A per Exam at 12/31/20x6	400,000
Difference is 481(a) Adjustment	400,000

Exam makes the change in accounting method in the earliest year under examination. It computes the IRC 481(a) adjustment as of the beginning of the year of change. The adjustment is based on the 20x7 corrected beginning inventory, which is the 20x6 ending inventory amount.

Back to Table of Contents

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #1: IRC 481(a) Adjustment for a FIFO Taxpayer That Did Not Capitalize Any Costs Under IRC 263A (cont'd)

Current Year Adjustments:	12/31/20x7	12/31/20x8
Corrected IRC 263A as of 12/31/20x7	430,000	465,000
Less: Corrected IRC 263A as of 12/31/20x6	400,000	430,000
Difference is Current Year Adjustment	30,000	35,000

Check Figure:

IRC 263A Amount Capitalized per Return at 12/31/20x8	0
IRC 263A Amount Capitalized per Audit at 12/31/20x8 (Last year of Exam)	465,000
Total Adjustment	465,000

Revenue Agent Report (RAR) Presentation:

Change in Accounting Method – IRC 263A	12/31/20x7	12/31/20x8
IRC 481(a) Adjustment	400,000	0
Current Year Adjustment(s)	30,000	35,000
Total Adjustment(s)	430,000	35,000

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #1: IRC 481(a) Adjustment for a FIFO Taxpayer That Did Not Capitalize Any Costs Under IRC 263A (cont'd)

Total Adjustment = 465,000 = (430,000 + 35,000)

Example #2: IRC 481(a) Adjustment for a FIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A

For the first exam year (the year of change), exam will split the total IRC 263A adjustment between the IRC 481(a) adjustment and the current year adjustment.

Example of Computation

Facts

Exam Years = 20x7, 20x8

IRC 263A Information:	12/31/20x6	12/31/20x7	12/31/20x8
IRC 263A Amount Capitalized per Return	247,000	263,000	292,000
IRC 263A Amount Capitalized per Exam	400,000	430,000	465,000

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #2: IRC 481(a) Adjustment for a FIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Computations:

IRC 481(a) Adjustment	12/31/20x7
IRC 263A per Return at 12/31/20x6	247,000
IRC 263A per Audit at 12/31/20x6	400,000
Difference is IRC 481(a) Adjustment	153,000

Exam makes the change in accounting method in the earliest year under examination. It computes the IRC 481(a) adjustment as of the beginning of the year of change. The adjustment is based on the 20x7 corrected beginning inventory, which is based on the 20x6 ending inventory amount.

Current Year Adjustment	12/31/20x7	12/31/20x8
IRC 263A per Return – Beginning	247,000	263,000
IRC 263A per Audit – Beginning	(400,000)	(430,000)
IRC 263A per Return – Ending	(263,000)	(292,000)
IRC 263A per Audit – Ending	430,000	465,000
Current Year Adjustment	14,000	6,000

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #2: IRC 481(a) Adjustment for a FIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Check Adjustment:

IRC 263A per Return at 12/31/20x8 (Last Exam Year)	292,000
IRC 263A per Audit at 12/31/20x8 (Last Exam Year)	465,000
Total Adjustment for All Years	173,000

RAR Presentation:

Change in Accounting-IRC 263A	12/31/20x7	12/31/20x8
IRC 481(a) Adjustment	153,000	0
Current Year Adjustment(s)	14,000	6,000
Total Adjustment(s)	167,000	6,000

Total Adjustment = 173,000 = (167,000 + 6,000)

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Examples
<u>Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A</u> For a specific goods LIFO taxpayer, Exam can use either the weighted average method or the 3-year average method to compute the revaluation factor needed to calculate the IRC 481(a) adjustment. For a dollar value LIFO taxpayer, Exam may use the 3-year average method to compute the revaluation factor needed to calculate the IRC 481(a) adjustment. <u>Example of Computation</u> <u>Facts</u> The taxpayer is a reseller using the dollar value LIFO double extension method with a single pool. The taxpayer does not use a simplified method for computing additional IRC 263A costs. The taxpayer adopted LIFO in 20x1. Exam has identified additional costs to capitalize under IRC 263A. The year of change is 20x7. The taxpayer has sufficient information from the previous three years and Exam uses the 3-year average method to recompute the IRC 263A costs.

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Facts (cont'd)

Layer Year	Base Year Costs	Index	LIFO Value
Base Layer	10,000	1.00	10,000
20x1	5,000	1.30	6,500
20x2	6,000	1.40	8,400
20x3	3,000	1.45	4,350
20x4	0	1.50	0
20x5	5,000	1.60	8,000
20x6	6,000	1.70	10,200
Total	35,000		47,450

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

The LIFO computation for 20x7 is as follows:

Step 1: Compute the Percentage Change in IRC 263A Costs for the Prior Three Years

Year	Current IRC 263A Costs (Old Method)	Current IRC 263A Costs (New Method)	Change	Percentage Change
20x4 (3rd previous year)	45,000	58,500	13,500	.30
20x5 (2nd previous year)	53,500	68,480	14,980	.28
20x6 (1st previous year)	64,400	81,144	16,744	.26
Total	162,900	208,124		

Revaluation Factor (Average Change) = (.30 + .28 + .26) divided by 3 = .28

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Step 2: Restate the Base Year Using the Revaluation Factor

Year	Original Base Year Costs	Factor	Addition to Base Year Layer	(Original + Addition) Restated Layer
Base Layer	10,000	.28	2,800	12,800
20x1	5,000	.28	1,400	6.400
20x2	6,000	.28	1,680	7.680
20x3	3,000	.28	840	3,840
20x4	0	.28	0	0
20x5	5,000	.28	1,400	6,400
20x6	6,000	.28	1,680	7,680
	35,000		9,800	44,800

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Step 2: Restate the Base Year Using the Revaluation Factor (cont'd)

Year	Restated Layers	Index	Restated LIFO Value
Base layer	12,800	1.00	12,800
20x1	6,400	1.30	8,320
20x2	7,680	1.40	10,752
20x3	3,840	1.45	5,568
20x4	0	1.50	0
20x5	6,400	1.60	10,240
20x6	7,680	1.70	10,056
	44,800		60,736

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Step 3: Compute the IRC 481(a) adjustment (2 computations)

Computation 1 uses the prior LIFO value, or the LIFO value before the IRC 263A changes. Multiply this value by the revaluation factor found in Step 1 to find the amount of the IRC 481(a) adjustment. You can use computation 2 to calculate the IRC 481(a) adjustment amount or you can use it as a check figure. Computation 2 subtracts the prior LIFO value or the LIFO value before the IRC 263A changes from the restated LIFO value found in Step 2.

Method 1	Amounts:
Prior LIFO Value	47,450
x Revaluation Factor	.28
IRC 481(a) Adjustment	13,286

Method 2	Amounts:
Restated LIFO Value	60,736
(-) Prior LIFO Value	47,450
IRC 481(a)	13,286

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #3: IRC 481(a) Adjustment for a LIFO Taxpayer That Capitalized Incorrect Costs Under IRC 263A (cont'd)

Step 4: Restate Layers Based on the New Base Year Index

	Restated Base Year Costs	Percent of Total	Total New Costs *	Restate Layers	Restated LIFO Value	New Index
	(From Step 3)	(a) x	(b) =	(c)	(d)	(d)/(c)
Base Layer	12,800	.286	81,444	23,207	12,800	.552
20x1	6,400	.143	81,444	11,604	8,320	.717
20x2	7,680	.171	81,444	13,876	10,752	.775
20x3	3,840	.086	81,444	6,978	5,568	.798
20x4	0	.000	81,444	0	0	0
20x5	6,400	.143	81,444	11,604	10,240	.882
20x6	7,680	.171	81,444	13,875	13,056	.941
	44,800	1.000		81,444	60,736	

*20x6 Current IRC 263A Costs (New Method)

Back to Table of Contents

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
Examples
Example #4: IRC 481(a) Adjustment for Capitalization of IRC 263A Costs for Non-Inventory Property If you determine a taxpayer did not capitalize all costs subject to IRC 263A for non-inventory property, then you must revalue the property on hand at the beginning of the year. If the property is depreciable, then allow depreciation on the additional capitalized amount. You must compute an adjustment under IRC 481(a). Calculate the IRC 481(a) adjustment by computing the difference between the adjusted basis of the property under the new method and the adjusted basis of the property under the prior method. You must revalue the non-inventory property as of the beginning of the year of the change in accounting method. You must use the facts and circumstances revaluation method, described earlier, to revalue the property. In revaluing non-inventory property however, the only additional IRC 263A costs you or the taxpayer must take into account are those additional IRC 263A costs incurred after the later of December 31, 1986, or the date the taxpayer first becomes subject to IRC 263A, in taxable years ending after that date. Example of Computation Facts Exam year is 20x7. The taxpayer built a new facility in 20x5 and did not capitalize all the indirect costs required by IRC 263A. The additional amount of IRC 263A costs not capitalized in 20x5 was $50,000. The original amount capitalized was $500,000 when the taxpayer placed the asset in service in 20x5. The depreciation deducted for 20x5 was $12,500, and $25,000 for 20x6 and 20x7. The depreciation deduction on the corrected basis should be $13,750 for 20x5, and $27,500 for 20x6 and 20x7.

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #4: IRC 481(a) Adjustment for Capitalization of IRC 263A Costs for Non-Inventory Property (cont'd)

IRC 481(a) Adjustment

Prior Method	Adjusted Basis
Original Basis	$500,000
Less Depreciation: 20x5	($12,500)
Less Depreciation: 20x6	($25,000)
Adjusted Basis Prior Method	$462,500

New Method	Adjusted Basis
Original Basis	$500,000
Plus: Additional IRC 263A Costs	$50,000
Corrected Basis	$550,000
Less Depreciation 20x5	($13,750)
Less Depreciation 20x6	($27,500)
Adjusted Basis New Method	$508,750

Examples of the Concept (cont'd)

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes

Examples

Example #4: IRC 481(a) Adjustment for Capitalization of IRC 263A Costs for Non-Inventory Property (cont'd):

IRC 481(a) Adjustment (cont'd)

IRC 481(a) Adjustment = $508,750 minus $462,500 = $46,250

Current Adjustment	Amount
20x7 Depreciation Prior Method	$25,000
Less: 20x7 Depreciation New Method	$27,500
Current Year Adjustment	($2,500)

Change in Accounting Method – IRC 263A	Amount
IRC 481(a) Adjustment	$46,250
Current Year Adjustment	($2,500)
Total Adjustment	$43,250

Index of Referenced Resources

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes
IRC 263A - Capitalization and Inclusion in Inventory Costs of Certain Expenses
IRC 446(e) - General Rule for Methods of Accounting
IRC 481 - Adjustments Required by Changes in Method of Accounting
Treas. Reg. 1.263A-7 - Changing a Method of Accounting Under Section 263A
Rev. Rul. 90-38 - Taxpayer May Not Request, or Otherwise Make a Retroactive Change in Accounting Method
Rev. Rul. 72-491 - Taxpayer May Amend First Year Return to Use a Proper Method Prior to Filing Succeeding Year's Return
Rev. Proc. 2015-13 (or Successor) - Procedures to Obtain the Consent of the Commissioner to Change an Accounting Method
Rev. Proc. 2018-31 (or Successor) - List of Automatic Method Changes
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 4 - *Voluntary Change in Method (Taxpayer-Initiated)*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 - *Involuntary Change in Method (Service-Initiated)*

Training and Additional Resources

IRC 481(a) Adjustments for IRC 263A Accounting Method Changes	
Type of Resource	**Description(s)**
Saba Meeting Sessions	▪ *Interest Capitalization under 263A - Part 1* - 2017 Saba Meeting ▪ *Interest Capitalization under 263A - Part 2* - 2017 Saba Meeting
Issue Toolkits	▪ Issue Snapshot - *263A UNICAP for LIFO Taxpayers* ▪ Issue Snapshot - *Identifying and Allocating Costs Under the Uniform Capitalization Rules of IRC 263A*
Other Training Materials	▪ Comprehensive IRC 263A CPE Part I PPT - 2016-02 ▪ Comprehensive IRC 263A CPE Part II PPT - 2016-03 ▪ Interest Cap Under 263A - PPT - 2017-08

Glossary of Terms and Acronyms

Term/Acronym	Definition
CAM	Change in Accounting Method
FIFO	First In First Out
IRC	Internal Revenue Code
KB	Knowledge Base
LIFO	Last In First Out
RAR	Revenue Agent Report
Rev. Rul.	Revenue Ruling
Rev. Proc.	Revenue Procedure
Treas. Reg.	Treasury Regulation
UNICAP	Uniform Capitalization
VL	Virtual Library

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
0263A.08-00	*Interest Capitalization for Self-Constructed Assets*