

Name		Employer identification number	
1	Inventory at beginning of year	1	
2	Purchases	2	
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule)	5	
6	Total. Add lines 1 through 5	6	
7	Inventory at end of year	7	
8	Cost of goods sold. Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	8	
9a	Check all methods used for valuing closing inventory: (i) <input type="checkbox"/> Cost (ii) <input type="checkbox"/> Lower of cost or market (iii) <input type="checkbox"/> Other (Specify method used and attach explanation.) ▶		
b	Check if there was a writedown of subnormal goods		<input type="checkbox"/>
c	Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970)		<input type="checkbox"/>
d	If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO	9d	
e	If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions		<input type="checkbox"/> Yes <input type="checkbox"/> No
f	Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation		<input type="checkbox"/> Yes <input type="checkbox"/> No

Section references are to the Internal Revenue Code unless otherwise noted.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, 1065, or 1065-B, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. If you are a qualifying taxpayer or a qualifying small business taxpayer (defined below), you can adopt or change your accounting method to account for inventoriable items in the same manner as materials and supplies that are not incidental.

Under this accounting method, inventory costs for raw materials purchased for use in producing finished goods and merchandise purchased for resale are deductible in the year the finished goods or merchandise are sold (but not before the year you paid for the raw materials or merchandise, if you are also using the cash method).

If you account for inventoriable items in the same manner as materials and supplies that are not incidental, you can currently deduct expenditures for direct labor and all indirect costs that would otherwise be included in inventory costs. See the instructions for lines 2 and 7.

For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on adopting or changing to this method of accounting, see Form 3115, Application for Change in Accounting Method, and its instructions.

Qualifying taxpayer. A qualifying taxpayer is a taxpayer that, (a) for each prior tax year ending after December 16, 1998, has average annual gross receipts of \$1 million or less for the 3 prior tax years, and (b) its business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2001-10, 2001-2 I.R.B. 272.

Qualifying small business taxpayer. A qualifying small business taxpayer is a taxpayer that, (a) for each prior tax year

ending on or after December 31, 2000, has average annual gross receipts of \$10 million or less for the 3 prior tax years, (b) whose principal business activity is not an ineligible activity, and (c) whose business is not a tax shelter (as defined in section 448(d)(3)). See Rev. Proc. 2002-28, 2002-18 I.R.B. 815.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property by a corporation for use in its trade or business or in an activity engaged in for profit.

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

Specific Instructions

Line 1. Inventory at Beginning of Year

If you are changing your method of accounting for the current tax year, you must refigure last year's closing inventory using the new method of accounting. Enter the result on line 1. If there is a difference between last year's closing inventory and the refigured amount, attach an explanation and take it into account when figuring any section 481(a) adjustment.

Line 2. Purchases

If you account for inventoriable items in the same manner as materials and supplies that are not incidental, enter amounts paid for all raw materials and merchandise during the tax year on line 2. The amount you can deduct for the tax year is figured on line 8.

Reduce purchases by items withdrawn for personal use. For a partnership, the cost of these items should be shown on Schedule K and Schedule K-1 as distributions to partners.

Line 4. Additional Section 263A Costs

If you elected a simplified method of accounting, enter on line 4 the balance of section 263A costs paid or incurred during the tax year not includible on lines 2, 3, and 5.

If you elected the simplified production method, additional section 263A costs are generally those costs, other than interest, that were not capitalized under your method of accounting immediately prior to the effective date of section 263A, but are now required to be capitalized under section 263A. For details, see Regulations section 1.263A-2(b).

If you elected the simplified resale method, additional section 263A costs are generally those costs incurred with respect to the following categories.

- Off-site storage or warehousing.
- Purchasing.
- Handling, such as processing, assembling, repackaging, and transporting.
- General and administrative costs (mixed service costs).

Line 5. Other Costs

Enter on line 5 any costs paid or incurred during the tax year not entered on lines 2 through 4. Attach a statement listing details of the costs.

Special Rules for Cooperatives

Cooperatives are allowed to deduct certain per-unit retain allocations. Include these costs on line 5. Attach a statement listing details of per-unit retain allocations paid in:

- Qualified per-unit retain certificates,
- Money or other property (except nonqualified per-unit certificates), and
- Nonqualified per-unit retain certificates redeemed this year.

Per-unit retain allocations. A cooperative is allowed to deduct from its taxable income amounts paid during the payment period for the tax year as per-unit retain allocations to the extent paid in money, qualified per-unit retain certificates, or other property with respect to marketing occurring during the tax year. A per-unit retain allocation is any allocation from a cooperative to a patron for products marketed for him without reference to the cooperative net earnings. A qualified per-unit retain certificate is any per-unit retain certificate that the distributee has agreed to take into account at its stated dollar amount.

Nonqualified per-unit retain certificates redeemed this year. Include the amount paid in money or other property (except amounts already included as per-unit retain certificates) to patrons to redeem nonqualified per-unit retain certificates. No deduction is allowed at the time of issuance for a nonqualified per-unit retain certificate. However, the cooperative may take a deduction in the year the certificate is redeemed, subject to the stated dollar amount of the certificate. See section 1383. Also see the instructions for line 29h of Form 1120-C, U.S. Income Tax Return for Cooperative Associations, for a special rule for figuring the cooperative's tax in the year of redemption of a nonqualified per-unit retain certificate.

Line 7. Inventory at End of Year

See Regulations sections 1.263A-1 through 1.263A-3 for details on figuring the amount of additional section 263A costs to be included in ending inventory. If you account for inventoriable items in the same manner as materials and supplies that are not incidental, enter on line 7 the portion of your raw materials and merchandise purchased for resale that was included in the total on line 6 but was not sold during the year.

Line 8. Cost of Goods Sold

Enter the amount from line 8 on your tax return as follows. Filers of Form 1120, 1120-C, 1120S, 1065, and 1065-B, enter cost of goods sold on page 1, line 2. Filers of Form 1120-F, enter cost of goods sold on Section II, line 2.

Lines 9a Through 9f. Inventory Valuation Methods

Inventories can be valued at:

- Cost,
- Cost or market value (whichever is lower), or
- Any other method approved by the IRS that conforms to the requirements of the applicable regulations cited below.

However, if you are using the cash method of accounting, you are required to use cost.

Filers that use erroneous valuation methods must change to a method permitted for federal income tax purposes. Use Form 3115 to make this change.

For more information on inventory valuation methods, see Pub. 538. For more information on changes in the method of accounting for inventory, see Form 3115 and the Instructions for Form 3115.

Line 9a. Method of valuing closing inventory. On line 9a, check the method(s) used for valuing inventories. Under lower of cost or market, the term "market" (for normal goods) means the current bid price prevailing on the inventory valuation date for the particular merchandise in the volume usually purchased by the filer. For a manufacturer, market applies to the basic elements of cost—raw materials, labor, and burden. If section 263A applies, the basic elements of cost must reflect the current bid price of all direct costs and all indirect costs properly allocable to goods on hand at the inventory date.

Inventory may be valued below cost when the merchandise is unsalable at normal prices or unusable in the normal way because the goods are subnormal due to damage, imperfections, shopwear, change of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange. The goods may be valued at the bona fide selling price, minus the direct cost of disposition (but not less than scrap value). Bona fide selling price means actual offering of goods during a period ending not later than 30 days after inventory date.

Lines 9c and 9d. LIFO method. If this is the first year the Last-in, First-out (LIFO) inventory method was either adopted or extended to inventory goods not previously valued under the LIFO method provided in section 472, attach Form 970, Application To Use LIFO Inventory Method, or a statement with the information required by Form 970. Check the LIFO box on line 9c. On line 9d, enter the amount of total closing inventories computed under section 472. Estimates are acceptable.

If you changed or extended your inventory method to LIFO and had to write up the opening inventory to cost in the year of election, report the effect of the write-up as other income, on your applicable return, proportionately over a 3-year period that begins with the year of the LIFO election.

Note: Entities using the LIFO method that make an S corporation election or transfer LIFO inventory to an S corporation in a nonrecognition transaction may be subject to an additional tax attributable to the LIFO recapture amount. See the instructions for Form 1120, Schedule J, line 11.

Line 9e. If property is produced or acquired for resale and the rules of section 263A apply to the corporation, cooperative, partnership, or other applicable entity, check the "Yes" box on line 9e.

Paperwork Reduction Act Notice. We ask for the information on this form to carry out the Internal Revenue laws of the United States. You are required to give us the

information. We need it to ensure that you are complying with these laws and to allow us to figure and collect the right amount of tax.

You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file this form will vary depending on individual circumstances. The estimated burden for business taxpayers filing this form is approved under OMB control number 1545-0123 and is included in the estimates shown in the instructions for their business income tax return.

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. See the instructions for the tax return with which this form is filed.