

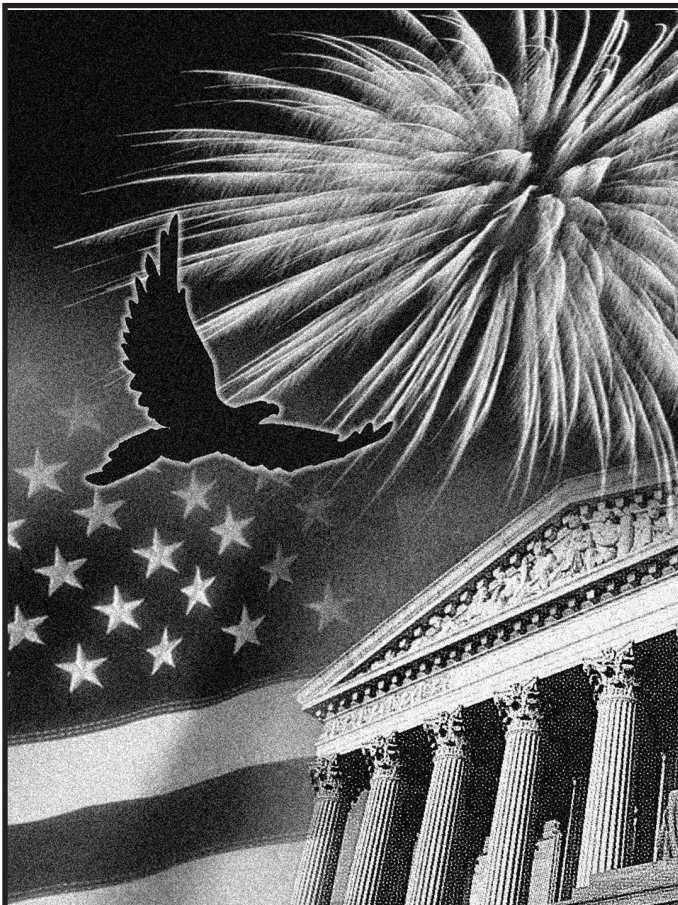


Publication 538

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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).

What's New

Small business taxpayers. Effective for tax years beginning after 2017, the Tax Cuts and Jobs Act (P.L. 115-97) expanded the eligibility of small business taxpayers to use the cash method of accounting. Qualifying small business taxpayers are also exempt from the following accounting rules.

- The requirement to keep inventories.
- The uniform capitalization rules.
- The requirement to use the percentage of completion method.

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 your suggestions for future editions.

You can send us comments through [IRS.gov/FormComments](https://www.irs.gov/FormComments). Or you can write to:

Internal Revenue Service
Tax Forms and Publications
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Although we can't respond individually to each comment received, we do appreciate your feedback and will consider your comments as we revise our tax forms, instructions, and publications.

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Tax Questions. If you have a tax question not answered by this publication, check [IRS.gov](https://www.irs.gov) and [How To Get Tax Help](#) at the end of this publication.

Photographs of Missing Children

The Internal Revenue Service is a proud partner with the [National Center for Missing & Exploited Children® \(NCMEC\)](#). 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.

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 Income Tax 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 Income Tax 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 Regulations.

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 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 Income Tax 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). The following discussions provide the rules for partnerships, S corporations, and PSCs.

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.

TIP *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	Year	Profits	Months	Interest
<u>12/31:</u>	<u>End</u>	<u>Interest</u>	<u>of</u>	<u>×</u>
			<u>Deferral</u>	<u>Deferral</u>
A	12/31	0.5	-0-	-0-
B	11/30	0.5	11	5.5
Total Deferral				<u>5.5</u>

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

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 section 1.444-2T of the regulations).
- 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.

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 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. See *Exceptions* under *Inventories*, 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 receive during the tax year. If you receive 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 2018. You did not withdraw it or enter it into your books until 2019. You must include the

amount in gross income for 2018, the year you constructively received the interest income.



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 2018 for a business insurance policy that is effective for three years (36 months), beginning on July 1, 2018. 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 2018, \$1,000 ($12/36 \times \$3,000$) is deductible in 2019, \$1,000 ($12/36 \times \$3,000$) is deductible in 2020, and the remaining \$500 is deductible in 2021.

Example 2. You are a calendar year taxpayer and pay \$10,000 on July 1, 2018, for a business insurance policy that is effective for only one year beginning on July 1, 2018. The 12-month rule applies. Therefore, the full \$10,000 is deductible in 2018.

Excluded Entities

The following entities cannot use the cash method, including any combination of methods that includes the cash method. (See *Special rules for farming businesses*, later.)

- A corporation (other than an S corporation) with average annual gross receipts for the 3 preceding tax

years exceeding \$25 million (indexed for inflation). See *Gross receipts test*, below.

- A partnership with a corporation (other than an S corporation) as a partner, with average annual gross receipts for the 3 preceding tax years exceeding \$25 million (indexed for inflation). See *Gross receipts test*, 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 preceding tax years were \$25 million or less (indexed for inflation).

Determine an entity's average annual gross receipts by:

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

See *Gross receipts test for qualifying taxpayers*, for more information. 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 qualified PSC is a corporation that meets the following function and ownership tests 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, 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 all events that fix your right to receive the income have occurred and you can determine the amount with reasonable accuracy. Under this rule, you report an

amount in your gross income on the earliest of the following dates.

- When you receive payment.
- When the income amount is due to you.
- When you earn the income.
- When title passes.

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.

Change in payment schedule. If you perform services for a basic rate specified in a contract, you must accrue the income at the basic rate, even if you agree to receive payments at a reduced rate. Continue this procedure until you complete the services, then account for the difference.

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.

For this purpose, advance payments must be:

- Includible in gross receipts under the method of accounting you use for tax purposes, and
- Included in income in your applicable financial statements (described in section 451(b)(1)).

See section 451(c) for more information. Also see Revenue Procedure 2004-34, 2004-22, I.R.B. 991 (or any successor) and Notice 2018-35, 2018-18 I.R.B. 520 (or any successor).

Financial Statement. 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 applicable financial statement (or other financial statement specified by the IRS. See section 451(b) for additional information and a list of applicable financial statements.

IRS approval. 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.

Advance Payment for Sales

Special rules apply to including income from advance payments on agreements for future sales or other dispositions of goods held primarily for sale to customers in the ordinary course of your trade or business. However, the rules do not apply to a payment (or part of a payment) for services that are not an integral part of the main activities

covered under the agreement. An agreement includes a gift certificate that can be redeemed for goods. Amounts due and payable are considered received.

Special rules apply to the deferral of advance payments from the sale of certain gift cards. See Revenue Procedure 2011-18, 2011-5 I.R.B. 443, as modified and clarified by Revenue Procedure 2013-29, 2013-33 I.R.B. 141 (or any successor).

How to report payments. Generally, include an advance payment in income in the year in which you receive it. However, you can use the alternative method, discussed next.

Alternative method of reporting. Under the alternative method, generally include an advance payment in income in the earlier tax year in which you:

- Include advance payments in gross receipts under the method of accounting you use for tax purposes, or
- Include any part of advance payments in income for financial reports under the method of accounting used for those reports. Financial reports include reports to shareholders, partners, beneficiaries, and other proprietors for credit purposes and consolidated financial statements.

Example. You are a retailer. You use an accrual method of accounting and account for the sale of goods when you ship the goods. You use this method for both tax and financial reporting purposes. You can include advance payments in gross receipts for tax purposes in either: **(a)** the tax year in which you receive the payments; or **(b)** the tax year in which you ship the goods. However, see *Exception for inventory goods*, later.

Information schedule. If you use the alternative method of reporting advance payments, you must attach a statement with the following information to your tax return each year.

- Total advance payments received in the current tax year.
- Total advance payments received in earlier tax years and not included in income before the current tax year.
- Total payments received in earlier tax years included in income for the current tax year.

Exception for inventory goods. If you have an agreement to sell goods properly included in inventory, you can postpone including the advance payment in income until the end of the second tax year following the year you receive an advance payment if, on the last day of the tax year, you meet the following requirements.

- You account for the advance payment under the alternative method (discussed earlier).
- You have received a substantial advance payment on the agreement (discussed next).

- You have enough substantially similar goods on hand, or available through your normal source of supply, to satisfy the agreement.

These rules also apply to an agreement, such as a gift certificate, that can be satisfied with goods that cannot be identified in the tax year you receive an advance payment.

If you meet these conditions, all advance payments you receive by the end of the second tax year, including payments received in prior years but not reported, must be included in income by the second tax year following the tax year of receipt of substantial advance payments. You must also deduct in that second year all actual or estimated costs for the goods required to satisfy the agreement. If you estimated the cost, you must take into account any difference between the estimate and the actual cost when the goods are delivered.

Note. You must report any advance payments you receive after the second year in the year received. No further deferral is allowed.

Substantial advance payments. Under an agreement for a future sale, you have substantial advance payments if, by the end of the tax year, the total advance payments received during that year and preceding tax years are equal to or more than the total costs reasonably estimated to be includible in inventory because of the agreement.

Example. You are a calendar year, accrual method taxpayer who accounts for advance payments under the alternative method. In 2013, you entered into a contract for the sale of goods properly includible in your inventory. The total contract price is \$50,000 and you estimate that your total inventoriable costs for the goods will be \$25,000. You receive the following advance payments under the contract.

2014	\$17,500
2015	10,000
2016	7,500
2017	5,000
2018	5,000
2019	5,000
Total contract price	<u><u>\$50,000</u></u>

Your customer asked you to deliver the goods in 2020. In your 2015 closing inventory, you had on hand enough of the type of goods specified in the contract to satisfy the contract. Since the advance payments you had received by the end of 2015 were more than the costs you estimated, the payments are substantial advance payments.

For 2017, include in income all payments you received by the end of 2017, the second tax year following the tax year in which you received substantial advance payments. You must include \$40,000 in sales for 2017 (the total amounts received from 2014 through 2017) and include in inventory the cost of the goods (or similar goods) on hand. If no such goods are on hand, then estimate the cost necessary to satisfy the contract.

No further deferral is allowed. You must include in gross income the advance payment you receive each

remaining year of the contract. Take into account the difference between any estimated cost of goods sold and the actual cost when you deliver the goods in 2020.

IRS approval. You must file Form 3115 to obtain IRS approval to change your method of accounting for advance payments for sales. See Form 3115 and the Instructions for Form 3115.

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 2016. You receive the supplies and the bill in December, but you pay the bill in January 2017. You can deduct the expense in 2016 because all events have occurred to fix the liability, the amount of the liability can be determined, and economic performance occurred in 2016.

Your office supplies may qualify as a recurring item, discussed later. If so, you can deduct them in 2016, even if the supplies are not delivered until 2017 (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 and Pub. 542, Corporations, 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 *Exceptions*, next. See also *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. If you choose not to keep an inventory, you will not be treated as failing to clearly reflect income if your method of accounting for inventory treats inventory as non-incidental material or supplies, or conforms to your financial accounting treatment for inventories. 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 \$25 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' gross receipts for the short tax years that are part of the 3 tax-year period.

Treating inventory as non-incident materials and supplies. If you account for inventories as materials and supplies that are not incidental, you deduct the amounts paid to acquire or produce the inventoriable items treated as materials and supplies in the year in which they are first used or consumed in your operations.

Financial accounting treatment of inventories. Your financial accounting treatment of inventories is determined with regard to the method of accounting you use in your applicable financial statement (as defined in section 451(b)(3)) or, if you do not have any applicable financial statement, with regard to the method of accounting you use in your books and records that have been prepared in accordance with your accounting procedures.

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.
- 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.

For more information, see section 474. 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
Total	\$950	\$800	\$600

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 (\$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. For more information, see Revenue Ruling 75-181 in Cumulative Bulletin 1975-1.

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, free-lance 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 free-lance (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 free-lance (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.

More information. For information about the uniform capitalization rules, see section 263A of the Internal Revenue Code and the related income tax regulations.

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).

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.

More information. For more information on making changes in accounting methods, see Form 3115 and the instructions for Form 3115. Also see Revenue Procedure 2018-31, 2018-22 I.R.B. 637 (or any successor).



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.

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 and find resources that can help you right away.

Tax reform. Major tax reform legislation impacting individuals, businesses, and tax-exempt entities was enacted in the Tax Cuts and Jobs Act on December 22, 2017. Go to [IRS.gov/TaxReform](https://www.irs.gov/TaxReform) for information and updates on how this legislation affects your taxes.

Preparing and filing your tax return. Find free options to prepare and file your return on IRS.gov or in your local community if you qualify.

The Volunteer Income Tax Assistance (VITA) program offers free tax help to people who generally make \$55,000 or less, persons with disabilities, and limited-English-speaking taxpayers who need help preparing their own tax returns. 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.

You can go to IRS.gov to see your options for preparing and filing your return which include the following.

- **Free File.** Go to [IRS.gov/FreeFile](https://www.irs.gov/FreeFile) to see if you qualify to use brand-name software to prepare and e-file your federal tax return for free.
- **VITA.** Go to [IRS.gov/VITA](https://www.irs.gov/VITA), download the free IRS2Go app, or call 800-906-9887 to find the nearest VITA location for free tax return preparation.
- **TCE.** Go to [IRS.gov/TCE](https://www.irs.gov/TCE), download the free IRS2Go app, or call 888-227-7669 to find the nearest TCE location for free tax return preparation.



Getting answers to your tax questions. On IRS.gov, get answers to your tax questions anytime, anywhere.

- Go to [IRS.gov/Help](https://www.irs.gov/Help) for a variety of tools that will help you get answers to some of the most common tax questions.
- Go to [IRS.gov/ITA](https://www.irs.gov/ITA) for the Interactive Tax Assistant, a tool that will ask you questions on a number of tax law topics and provide answers. You can print the entire interview and the final response for your records.
- Go to [IRS.gov/Pub17](https://www.irs.gov/Pub17) to get Pub. 17, Your Federal Income Tax for Individuals, which features details on tax-saving opportunities, 2018 tax changes, and thousands of interactive links to help you find answers to your questions. View it online in HTML, as a PDF, or download it to your mobile device as an eBook.
- You may also be able to access tax law information in your electronic filing software.

Getting tax forms and publications. Go to [IRS.gov/Forms](https://www.irs.gov/Forms) to view, download, or print all of the forms and publications you may need. You can also download and view popular tax publications and instructions (including the 1040 instructions) on mobile devices as an eBook at no charge. Or you can go to [IRS.gov/OrderForms](https://www.irs.gov/OrderForms) to place an order and have forms mailed to you within 10 business days.

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

- View the amount you owe, pay online, or set up an online payment agreement.
- Access your tax records online.
- Review the past 24 months of your payment history.

- Go to [IRS.gov/SecureAccess](https://www.irs.gov/SecureAccess) to review the required identity authentication process.

Using direct deposit. The fastest way to receive a tax refund is to combine direct deposit and IRS *e-file*. Direct deposit securely and electronically transfers your refund directly into your financial account. Eight in 10 taxpayers use direct deposit to receive their refund. The IRS issues more than 90% of refunds in less than 21 days.

Refund timing for returns claiming certain credits. The IRS can't issue refunds before mid-February 2019 for returns that claimed the earned income credit (EIC) or the additional child tax credit (ACTC). This applies to the entire refund, not just the portion associated with these credits.

Getting a transcript or copy 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, or
- Mail Form 4506-T or Form 4506T-EZ (both available on [IRS.gov](https://www.irs.gov)).

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 EIC.
- The [Online EIN Application \(IRS.gov/EIN\)](https://www.irs.gov/EIN) helps you get an employer identification number.
- The [IRS Withholding Calculator \(IRS.gov/W4App\)](https://www.irs.gov/W4App) estimates the amount you should have withheld from your paycheck for federal income tax purposes and can help you perform a "paycheck checkup."
- 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), choose not to claim state and local income taxes, and you didn't save your receipts showing the sales tax you paid.

Resolving tax-related identity theft issues.

- The IRS doesn't initiate contact with taxpayers by email or telephone to request personal or financial information. This includes any type of electronic communication, such as text messages and social media channels.
- Go to [IRS.gov/IDProtection](https://www.irs.gov/IDProtection) for information.
- If your SSN has been lost or stolen or you suspect you're a victim of tax-related identity theft, visit [IRS.gov/IdentityTheft](https://www.irs.gov/IdentityTheft) to learn what steps you should take.

Checking on the status of your refund.

- Go to [IRS.gov/Refunds](https://www.irs.gov/Refunds).
- The IRS can't issue refunds before mid-February 2019 for returns that claimed the EIC or the ACTC. This applies to the entire refund, not just the portion associated with these credits.
- Download the official IRS2Go app to your mobile device to check your refund status.
- Call the automated refund hotline at 800-829-1954.

Making a tax payment. The IRS uses the latest encryption technology to ensure your electronic payments are safe and secure. You can make electronic payments online, by phone, and from a mobile device using the IRS2Go app. Paying electronically is quick, easy, and faster than mailing in a check or money order. Go to [IRS.gov/Payments](https://www.irs.gov/Payments) 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, by phone, and by mobile device.
- **Electronic Funds Withdrawal:** Offered only 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.

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 \(IRS.gov/OPA\)](https://www.irs.gov/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 \(IRS.gov/OIC\)](https://www.irs.gov/OIC) to see if you can settle your tax debt for less than the full amount you owe.

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. Please note that it can take up to 3 weeks from the date you mailed 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.

Contacting your local IRS office. Keep in mind, many questions can be answered on [IRS.gov](https://www.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."

Watching IRS videos. The IRS Video portal ([IRSVideos.gov](https://www.irs.gov/IRSVideos)) contains video and audio presentations for individuals, small businesses, and tax professionals.

Getting tax information in other languages. For taxpayers whose native language isn't English, we have the following resources available. Taxpayers can find information on [IRS.gov](https://www.irs.gov) in the following languages.

- [Spanish \(IRS.gov/Spanish\)](https://www.irs.gov/Spanish).
- [Chinese \(IRS.gov/Chinese\)](https://www.irs.gov/Chinese).
- [Vietnamese \(IRS.gov/Vietnamese\)](https://www.irs.gov/Vietnamese).
- [Korean \(IRS.gov/Korean\)](https://www.irs.gov/Korean).
- [Russian \(IRS.gov/Russian\)](https://www.irs.gov/Russian).

The IRS TACs provide over-the-phone interpreter service in over 170 languages, and the service is available free to taxpayers.

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/TaxpayerBillOfRights).

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/TaxpayerAdvocate) 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/TaxpayerAdvocate). 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 also has a website, [Tax Reform Changes](https://www.irs.gov/TaxReformChanges), which shows you how the new tax law may change your future tax filings and helps you plan for these changes. The information is categorized by tax topic in the order of the IRS Form 1040. Go to [TaxChanges.us](https://www.irs.gov/TaxChanges) for more information.

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/LITCmap](https://www.irs.gov/TaxpayerAdvocate) or see IRS Pub. 4134, [Low Income Taxpayer Clinic List](https://www.irs.gov/LowIncomeTaxpayerClinicList).