

LIFO Recapture

Notice 2003-4

This notice provides information concerning the federal income tax consequences of a taxpayer's failure to timely make an installment payment attributable to the last-in, first-out (LIFO) recapture requirement of § 1363(d) of the Internal Revenue Code.

Section 1363(d)(1) provides that a C corporation that accounts for its inventory using the LIFO method and elects S corporation status must include a "LIFO recapture amount" in gross income for the last taxable year before its S election becomes effective. Under § 1363(d)(3), the LIFO recapture amount is the excess of the inventory amount of the inventory assets under the first-in, first-out method over the inventory amount of the assets under the LIFO method. The inventory amounts are determined as of the close of the taxable year prior to the taxable year in which the taxpayer's S election becomes effective.

Section 1363(d)(2) requires payment of the additional tax that is attributable to the inclusion of the LIFO recapture amount in gross income in four equal installments. The first installment payment must be made on or before the due date of the electing corporation's last income tax return as a C corporation. An additional installment must be paid on or before the due date of the corporation's return for each of the 3 succeeding taxable years. No interest is payable with regard to any installment payment that is paid on or before the due date. Due dates are determined without regard to extensions.

A C corporation that accounts for its inventory using the LIFO method that elects S status but fails to include a LIFO recapture amount in gross income for the last taxable year before its S election becomes effective may be liable for a 20 percent accuracy-related penalty pursuant to § 6662. A corporation that fails to make a LIFO recapture installment payment by its required due date may be liable for a failure to pay penalty under § 6651.

A corporation that fails to make a LIFO recapture installment payment by its required due date is liable for interest un-

der § 6601, which requires payment of interest on the unpaid amount from the last date prescribed for payment to the date paid. When determining interest on underpayments, the "last date prescribed for payment" is generally ascertained without regard to any extension of time for payment or filing. However, under § 1363(d)(2)(C), no interest is payable with regard to a LIFO recapture installment payment that is paid by its due date.

Failure to pay, or late payment of, a LIFO recapture installment payment due under § 1363(d) does not cause any remaining unpaid installments to become due immediately. The authority in § 6159(b)(4) to alter or modify an installment agreement if the taxpayer fails to timely make an installment payment is limited to the specific installment payments described in that section and does not apply to installment payments under § 1363(d).

DRAFTING INFORMATION

The principal author of this notice is Scott Rabinowitz of the Office of the Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Mr. Rabinowitz at (202) 622-4970 (not a toll-free call).