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A Periodic Update of Essential Tax Information

DEALER TAX WATCH

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DEALER TAX WATCH *OUT*

If you had called me personally to ask, "What's happening lately with IRS audits of dealers and dealerships that I need to know about?" ... Here's what I'd say:

#1. 2008 ... THE YEAR IN REVIEW. On page 3, you'll find a timeline of the various developments covered in the Mid-Year issue and in this issue of the *Dealer Tax Watch*.

All in all, 2008 heralded two major Revenue Procedures. Rev. Proc. 2008-23 is basically of interest for dealerships on LIFO, and Rev. Proc. 2008-52 (discussed in this issue) is a major update of the IRS procedures for automatic changes in methods of accounting.

There were three court decisions of note - none of them out of the Tax Court. There were also three *Automotive Alerts* and several IRS Administrative or Internal Announcements and Memos.

We've also included a few other developments in the timeline because they involve matters we track in the *Dealer Tax Watch*.

Regrettably, as noted below, the guidance from the IRS on dealer cost capitalization issues that we were hoping for a year ago still has not materialized.

IRS audits. Conversations with various CPAs lead me to conclude that there isn't much IRS audit activity going on currently. The few dealership audits of which I'm aware have been pretty much routine and Section 263A was not even prominently involved. IRS budget restrictions and personnel cutbacks seem to be involved with this lesser degree of audit activity.

#2. UPDATE ON SECTION 263A ... IRS "NON-GUIDANCE" ON COST CAPITALIZATION FOR AUTO DEALERSHIPS. Ironically, the only action the IRS seems to be able to bring to bear on this subject is to keep moving it further down or around on its "to do lists" - all with special names, of course - that hint at some future official pronouncements.

Again at this year's 2008 AICPA Auto Dealership Conference, Ms. Terri Harris (the IRS MVTA) couldn't really add anything new to what we have already covered at length in previous issues of the *Dealer Tax Watch*.

So, for the time being, you're on your own in finalizing dealership tax returns for 2008. When the IRS does *finally* come out with something *precedential*, we plan to analyze it fully for you.

In the meantime, again this year, it's probably best to not make any changes in anticipation of what the IRS *might* say. Maybe we'll have more to report on this in 2009.

Meanwhile, NADA has continued its efforts to convince the IRS to expand its Section 263A guidance beyond the "producer" issue and to cover many of the other, broader Section 263A (i.e., the non-

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LOOKING FOR ADDITIONAL & "VALUE ADDED" SERVICES FOR DEALER CLIENTS?

Look no further... Just use the *Dealer Tax Watch* for a head start in golden consulting opportunities and activities to help dealer clients—and, in the process, to help yourself.

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producer) cost capitalization issues affecting dealerships.

Although there has been no formal statement of policy by the IRS, it appears that, in effect, the IRS has agreed to "stand down" on cost cap audits involving non-producer issues, many of which surfaced in TAM 200736026. My discussions with a few CPAs have indicated that the IRS has not really intensively audited cost capitalization practices in some of the audits going on this year. And, Ms. Harris' comments, discussed elsewhere, suggest other reasons for this result.

#3. LIFO TIDBITS. LIFO matters covering auto dealerships have been fully covered in both issues of the *LIFO Lookout* this year. Briefly, for non-subscribers to that publication, here's a quick rundown.

We're expecting considerably more inflation in the LIFO indexes this year, with the Detroit Big 3 having the highest inflation in their prices for 2008.

Although we're not sure how long LIFO will be around ... everything to date about its demise is speculative.

We believe that any dealer not on LIFO should not be crying about how hard it is to get a line of credit. After all, using LIFO gives the dealer an interest-free loan from the U.S. Treasury, and we know hundreds (probably thousands, if we really had to count them) of dealers who have borrowed funds from the U.S. / IRS and used them wisely.

Earlier in the year, the IRS gave dealers a real gift when it announced that they could opt to combine their LIFO pools into a single pool. Mid-year, the IRS issued informal guidance on how dealers implementing the change to the Vehicle-Pool Method should combine their pools. The Year-End issue of the *LIFO Lookout* discussed this guidance (Chief Counsel Memo 200825044) and demonstrates that some dealerships may wish they had not made the change if the IRS' method for combining is the only satisfactory approach. A very brief discussion of this can be found as part of the information reproduced from my Year-End Tax Update Outline.

Dealers who did not elect to combine their pools for 2007 may want to consider this option for 2008 and, if so, they should at least consider the potential results in their year-end projections.

Finally, the IRS has now made it easier for dealerships to terminate their LIFO elections under the new automatic consent procedures. This is discussed in our coverage of Revenue Procedure 2008-52 in this issue.

#4. MANY CHANGES IN ACCOUNTING METHODS ARE NOW EASIER TO MAKE. After reviewing its procedures for taxpayers making automatic changes in accounting methods, the IRS issued Revenue Procedure 2008-52 in August of 2008. This Revenue Procedure supersedes its previous guidance and procedures for taxpayers who are voluntarily making changes in accounting methods that the IRS favors under its "automatic consent process."

These procedures affect all taxpayers and include many changes in accounting methods that affect auto dealerships. One of the presentations at the AICPA Dealership Conference in October discussed many practices that dealerships may want to review in connection with valuing their used vehicle inventories. The automatic changes incorporated into Rev. Proc. 2008-52 are of special interest in this respect, especially if dealers are using inconsistent hybrid-judgment methods in applying lower of cost or market and/or Black, Blue or Yellow official industry guide book approaches to value their used vehicle inventories.

Rather than trying to "cherry pick" only those provisions that might be of interest to readers of the *Dealer Tax Watch*, we have included our complete analysis of Revenue Procedure 2008-52 in this issue.

#5. BY THE WAY, DON'T BLOW OFF FILING A COPY OF FORM 3115 WITH THE IRS NATIONAL OFFICE. One of the requirements that continues in place is that when a Form 3115 is filed with an income tax return for the year of change in which an "automatic" change in accounting method becomes effective, the taxpayer is required to file a copy of that Form 3115 with the National Office of the IRS in Washington, DC.

Occasionally, this requirement may be overlooked or blown off by a practitioner. Just in case you think the IRS doesn't (at least spot) check on this, consider Letter Ruling 200838012. In this situation, the taxpayer timely filed its Federal income tax return with an original Form 3115 included in it to notify the IRS that a change in method of accounting (for bad debts) was being made. However, a duplicate of the Form 3115 was not filed with the IRS National Office until a much later date, way beyond ... one day(!) ... after the deadline contained in Section 6.02(3)(a) of Rev. Proc. 2002-9.

The Letter Ruling states that "this delay was due to inadvertence and circumstances beyond taxpayer's control." Someone has to accept the blame for this in order for the taxpayer to obtain an extension of time to file the copy of the Form 3115 with the National

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2008 Timeline	JAN. 1 TO DEC. 31, 2008 ... THE YEAR IN REVIEW
January	• Several new *Automotive Alerts*, all dated January 2008, are issued by the office of the IRS Motor Vehicle Technical Advisor ... ◆ ***IRC Section 263A** TAM 200736026 Addresses Dealership UNICAP Issues* ◆ ***Electronic Records Retention Requirements** for Auto Dealerships ... Rev. Proc. 98-25* ◆ ***Alternative Motor Vehicle Credit** for Qualified Hybrid Vehicles & Alternative Fuel Vehicles*
January 30	• General Alert issued on IRS Cross-Divisional Team re: ***Employee Tool & Equipment Plans***
Feb. 8 - 12	• At NADA Convention in San Francisco, CA, Ms. Terri Harris (IRS Motor Vehicle Technical Advisor - MVTA) presents a workshop on dealership Federal income tax issues.
Feb. 25	• Cost Segregation (depreciable asset lives) for dealerships is addressed comprehensively in a new chapter added to IRS *Audit Technique Guide*.
March 4	• U.S. Court of Appeals for the 6th Circuit affirmed Tax Court decision in *Huffman, et al.*, allowing IRS to change accountant's errors in LIFO calculations by making a Section 481(a) adjustment to the dealership's earliest open year.
March 8	• ***Revenue Procedure 2008-23.*** IRS permits dealerships to use a single, combined LIFO pool for all new vehicles ... and/or for all used vehicles (Rev. Proc. 2008-23). ◆ Alternatively, IRS clarifies how new and/or used crossover vehicles should be treated by dealerships if they do not elect to use the single, combined LIFO pool method.
March 26	• Sec. 263A ... NADA submission to the IRS requests that non-producer dealership cost capitalization issues be considered for guidance under the IIR Program.
April 2	• In *Irwin Muskat v. U.S.A.*, IRS prevails in District Court, and taxpayers who sold their business are not able to prove that $1 million of the proceeds received under a non-compete agreement were really allocable to goodwill that they sold in connection with their business.
April 16	• In *Solomon v. Comm.*, IRS prevails in Tax Court, and the individual sellers of a portion of their business are not successful in claiming that a portion of the proceeds received were received for the sale of customer lists (which should have been taxed as long-term capital gain). Instead, amounts received were attributable to the sellers' covenants not to compete.
April 24	• De Filipps seminar ... *How Auto Dealership LIFO Inventories Can Benefit by Using the New Single Pool Method* (a 2-hour CCH audio seminar)
May 7	• IRS Chief Counsel's Office issues Memo No. 200825044 ... Guidance on Combining Pools Under Rev. Proc. 2008-23 Vehicle-Pool Method ... potential problems with IRS approach
May 8	• NADA seminar ... *Recent Tax Issues Affecting Auto Dealers* presented by Mr. Paul Metrey (NADA) and Ms. Terri Harris (IRS Motor Vehicle Technical Advisor) (a 2-hour web seminar)
Various	• De Filipps seminar ... *Mid-Year 2008 Dealer Tax Update Tax Strategies & IRS Activities* ... various dates & locations
July 2	• ***Employee tool & equipment plans*** ... IRS issues Coordinated Issue Paper for the Motor Vehicle Industry (based upon Chief Counsel Advice issued in late 2007) ... LMSB-04-0608-037
August	• ***Revenue Procedure 2008-52.*** IRS revises and updates procedures for taxpayers to secure designated automatic changes in accounting methods (Rev. Proc. 2008-52). The revenue procedure includes an updated list of all changes eligible for "automatic change" treatment. Effective for Forms 3115 (*Change in Accounting Method*) filed after August 18, 2008.
October 22	• ***Red Flag Suspension.*** The Federal Trade Commission announced a 6-month suspension of enforcement of the "Red Flags" rule requiring creditors and financial institutions to have identity theft prevention programs in place. This delay in enforcement (which otherwise would have begun on November 1, 2008) will end on May 1, 2009.
October 23-24	• ***AICPA Dealership Conference.*** At the Annual AICPA National Auto Dealership Conference in Las Vegas (at Caesars Palace), a broad range of subjects and speakers attracted individuals from dealerships and CPAs with auto dealership practices. Presentations included an update on IRS tax developments by Ms. Terri Harris (the IRS Motor Vehicle Technical Advisor) and on several other tax subjects.
October 28	• ***S Corp Shareholder Loss Deduction Limitations.*** Final regulations were issued to limit the amount of basis attributable to open account indebtedness that a shareholder in an S Corporation can use to absorb losses from that S corp. in his or her individual income tax return. (Reg. Sec. 1.1367-2)
Various	• De Filipps seminar ... *Year-End 2008 Dealer Tax Update Tax Strategies & IRS Activities* ... various dates & locations

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Office. Because of this inadvertence, the taxpayer had to incur considerable time and expense in order to apply for relief - in the form of an extension of the filing date - under the special provisions in Reg. Sec. 301.9100-1(c).

Requesting an extension under this relief provision costs a pretty penny, not to mention embarrassment over failing to follow the procedure in the first place.

Consider this LTR a reminder that you can't even let up on doing "the little things."

#6. AICPA NATIONAL AUTO DEALERSHIP CONFERENCE. The AICPA Annual National Auto Dealership Conference was held October 23-24, 2008 at Caesars Palace in Las Vegas, NV. The broad range of subjects and speakers was intended to attract individuals from dealerships and CPAs with auto dealership practices.

We've included summaries of several of the presentations. Richard Sox's update on dealer legal/ franchise issues was excellent, as usual. Mr. Sox's 90-minute presentation included discussions of implications of bankruptcy proceedings for the dealer body at large. He also allocated a considerable amount of his time to discuss the problems and pressures that are now being created by floorplan lenders and what dealers might be able to do to protect themselves when these lenders seek to capitalize on the almost daily out-of-trust position many dealers are experiencing. See page 13 for details.

Throughout his presentation, Mr. Sox discussed various protections that he and his firm have been able to help write into various state laws for dealers. From this portion of his presentation, we've developed the Suggested Franchise Protections checklist on page 5.

Incidentally, the *Automotive News* recently reported (Dec. 8, 2008) the end of a five-year battle one Chevrolet dealership in Ohio successfully fought with GM over GM's planned relocation of another dealership that was too close for comfort.

The attorney for the dealership said that the decision of the Court supports a trend in board rulings that a dealership's sales performance is not necessarily best measured against a state-wide average of sales per dealership, which is the measure manufacturers typically use. And in this case, GM used an Ohio average. The attorney had successfully argued that it was more reasonable to measure the economic impact of a relocation locally. As part of the settlement, GM is reported to have paid more than $400,000 in that dealership's attorneys fees and expert witness costs.

At the AICPA Conference, a session on buy-here, pay-here (BHPH) operations was presented by Ken Shilson. Ken is a good friend and frequent contributor of materials on this subject to the *Dealer Tax Watch*. His presentation contains a wealth of information, including operating statistics and guidelines drawn from Ken's enormous database.

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At-A-Glance	***AICPA ANNUAL NATIONAL AUTO DEALERSHIP CONFERENCE OCTOBER 23-24, 2008 ... LAS VEGAS, NV***
Tax & Dealer-Factory Issue Presentations	• ***IRS Update*** presented by Terri Harris, IRS Motor Vehicle Technical Advisor • ***Practical Tax Applications for Dealerships*** presented by Sid Tobiason & Kelly Porter, Moss Adams LLP • ***Reinsurance Programs: the Good, the Bad and the Confusing*** presented by Andrew Weill, Benjamin, Weill & Mazer, APC • ***Latest Manufacturer Initiatives Threatening Dealership Viability*** presented by Richard Sox, Esq. Myers & Fuller, P.A. • ***Riding the Regulatory Title Wave*** presented by Paul Metrey, NADA
Other Sessions of Note	• ***Buy-Here, Pay-Here*** presented by Ken Shilson, Shilson, Goldberg, Cheung & Assoc. • ***Increased Dealership Profitability Through Expense Reductions*** • ***Expense Management ... Top Ten Expense Controls*** • ***Key Ratios to Help You Manage Your Business*** • ***Best Ideas From NADA 20 Groups*** • ***Mining the Gold Out of Parts Management Reports*** • ***Practical A&A (Accounting & Auditing) Applications for Dealerships*** ... discussions on FIN 48 and International Financial Reporting Standards
Excellent Resource	• You can purchase a multi-media CD-ROM of the Conference presentations directly from the AICPA, Auto Dealers Conference, 220 Leigh Farm Road, Durham, NC 27707.

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Checklist	*CHECKLIST OF SUGGESTED DEALER FRANCHISE PROTECTION PROVISIONS*		
PROVISIONS THAT STATE DEALER PROTECTION LAWS CAN OR SHOULD INCLUDE TO BEST PROTECT THE DEALER *(Dealer protection laws vary from state to state. Dealers should check their state law to see if, or how adequately, they are protected.)*	**What Does Your State Dealer Protection Law Say?**	**Could Absence of Provision Create (Major) Problem or Issue Here?**	**Does Dealer's Franchise Agreement Include Anything On This?**
Re: Manufacturers Efforts to Consolidate Dealer Network • Codify the "constructive termination" concept • Require manufacturer to pay fair market value to the dealer for termination • Limit the reasons manufacturer can give to support turning down a transfer request • Require new distributors/manufacturers to offer substantially similar franchise agreements to all dealers • Comments ____			
Re: Agreements with the manufacturer (in general) • Define "franchise" as all agreements with manufacturers • Insure all prohibitions are "notwithstanding the terms of the franchise" • Require notice and right to protest change in dealer agreement • Comments ____			
Re: Facility/image program issues • Prohibit any facility upgrade or renovation that is not economically justified • Require manufacturer to provide sales and service revenue projections in writing • Require manufacturers to provide sufficient supply of (popular) vehicles • Prohibit manufacturer from withholding allocations of vehicles or any per car incentive bonus payments if the dealer does not participate in the program • Comments ____			
Re: Factory incentive program issues • Prohibit any incentive that is not equally available to all dealers • Prohibit any per car incentive that is tied to facility or image upgrade programs • Require manufacturer to pay treble damages, attorneys fees and costs where the dealer prevails in litigation or arbitration proceedings • Comments ____			
Re: Factory audits and vehicle export chargebacks • Prohibit any chargeback without right to protest and stay • Prohibit export chargeback unless the manufacturer can show that the dealer had actual knowledge of the customer's intent to export the vehicle • No "actual knowledge" where vehicle is registered or titled in the United States • Comments ____			
Re: Floorplan financing issues • Insure that a controlled finance company is treated as an agent of the manufacturer • Comments ____			

In General — ***Causes for Termination of a Dealer's Selling Agreement***
Actions by a Dealer that Can Result in the Loss of the Franchise

A manufacturer cannot arbitrarily (i.e., without "good cause") terminate its Selling Agreement with a dealer unless the dealer has...

- Bad moral character (i.e., this usually applies if the dealer has a felony conviction),
- Insufficient business experience, and/or
- Insufficient capital (financing).

Circumstances (that are essentially within the dealer's control) which can result in the dealer's loss of the franchise include...

- Poor sales performance
- Failure to meet/maintain minimum capital requirements
- Failure to meet/maintain minimum facility requirements
- Filing of bankruptcy by the dealer
- Commission of a fraud related to warranty or sales incentive program claim submissions

Based on a presentation by Richard Sox, Esq. (Myers & Fuller, PA) at the 2008 AICPA National Auto Dealership Conference

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#7. EMPLOYEE TOOL & EQUIPMENT PLANS. Since so much of the last issue of the *Dealer Tax Watch* (pages 48-62) was devoted to tool plans and the IRS Coordinated Issue Paper that was released in July, it seems appropriate to report that Ms. Harris (during her IRS Update presentation at the AICPA Conference) repeated the same dire warnings.

She basically said that although most CPAs know better than to get their dealership clients involved with these plans, there are many dealerships and dealers out there who don't seem to know better and who have jumped at the chance to use these plans. Apparently, her review of the "promoter" lists of clients which the IRS has accessed in some of its enforcement activities has made a strong impression.

It does seem that the mid-year Coordinated Issue Paper released by the IRS has accomplished its purpose in scaring less aggressive taxpayers and their advisors away from these plans.

#8. DEALER PORCs. Another excellent presentation at the Conference of special interest to DTW readers was an update on dealer producer owned reinsurance companies, or PORCs, by Andrew Weill.

Mr. Weill is a strong proponent of the opinion that the term "PORC" is a misnomer. He prefers the term ARC (Affiliated Reinsurance Company) to PORC because the latter is always viewed with suspicion by the IRS and it is not descriptive of the actual operating relationships that are involved.

Mr. Weill represented the taxpayers who were involved with TAMs 200453012 and -013. These TAMs were covered in detail in the March 2005 issue of the *Dealer Tax Watch*. These TAMs, in which the IRS finally capitulated after making a big deal over nothing, provide much guidance on how PORC/ARC arrangements can be structured to withstand IRS suspicion and scrutiny.

Mr. Weill's presentation was entitled *Reinsurance Programs: The Good, the Bad and the Confusing*. The "confusing" aspect related to the question ... Why is the IRS now trying to apply the rules for international transfer pricing (under Sections 482 and 485) to ARC reinsurance transactions? This development was reported in our Mid-Year DTW Update. It seems that the IRS is having some difficulty with how dealers are pricing their transactions between their related ARC entities. Mr. Weill indicated his belief that the IRS is probably barking up the wrong tree here, as it has done before in prior attacks on perceived PORC/ARC abuses. However, it may take a long time before all of this is resolved.

#9. WATCH BASIS IN S CORPs FOR PURPOSES OF DEDUCTING LOSSES IN 2008. Many dealers this year are experiencing extraordinarily large operating losses. For dealerships operating as S Corporations, one of the factors limiting how much of the "flow through" losses that a shareholder can deduct in his or her individual income tax return is the amount of his or her adjusted tax basis in the S Corp. This basis includes the dealer's adjusted tax basis for the S Corp. stock basis plus the amount of any indebtedness by the S Corp. to the shareholder at yearend.

There are two classes of indebtedness related to loans by shareholders to S Corps. They are (1) open account debt and (2) indebtedness evidenced by separate written instruments, usually notes. Where there is multiple indebtedness of an S Corp to a shareholder, there are differences in the basis adjustments resulting from the reductions of and restorations of basis as the debt levels change.

The basis adjustments under these final Regulations apply to all indebtedness of an S Corporation to a shareholder, whether the indebtedness is evidenced by a written instrument or is 'open account debt' (i.e., shareholder advances not evidenced by separate written instruments).

Informal loans to an S Corporation by a shareholder that do not involve formal contracts for repayment are treated as open account debt.

The final Regulations addressing the treatment of open account debt transactions involving S Corporations and their shareholders became effective October 20, 2008 (Treasury Decision TD 9428). These Regulations now may limit the amount of basis available to absorb losses if there is open account debt transactions (i.e., in-and-out shareholder loans to the S corp. during the year).

Previously proposed Regulations would have limited such open account debt treatment in cases where the outstanding principal amount was not more than $10,000 on any day during the year. The final Regulations increased the aggregate principal threshold amount per shareholder for open account debt from $10,000 to $25,000.

The final Regulations permit a single determination as of the last day of the S Corporation's tax year (rather than requiring a daily determination) of whether the open account debt threshold amount for each shareholder exceeds the $25,000 limitation amount.

Now, for shareholder open account loan advances or repayments to an S Corp on or after October 20, 2008, the open account indebtedness

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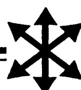

will be treated as if it were indebtedness evidenced by a separate written instrument, and the resulting different adjustments to basis for this class of indebtedness could limit the amount of losses that the shareholder will be able to currently absorb against his or her basis in the debt.

These changes in the regulations under Section 1367-2 are intended to overturn the result - which the IRS obviously disliked - in the Tax Court Memo decision involving *Brooks v. Comm.* a few years ago (TCM 2005-204).

#10. STANDARD FOR TAX RETURN PREPARER PENALTIES IS RELAXED ... BUT ... THERE'S MORE. On page 24 of the December, 2007 *Dealer Tax Watch* we discussed the uncomfortable position that tax return preparers have been put in as a result of a change in the law which increased the tax return preparer penalty standards. This article also included two examples of commonly encountered situations where real conflict could easily arise between a CPA/return preparer and his/her dealer or dealership/taxpayer client.

Mercifully, one provision in the recently enacted *Tax Extenders & Alternative Minimum Tax Relief Act of 2008* has relaxed the standard for imposing preparer penalties for undisclosed positions taken in tax returns. The standard has been reduced ***from*** "Milton" - an acronym for MLTN or the "more-likely-than-not" (i.e., a greater than 50% chance of success) standard ***to*** the somewhat lesser standard of "substantial authority" for the position taken in the tax return. This relaxation of this standard is retroactive back to May 25, 2007.

Thus, if the position taken on an issue is not adequately disclosed in the tax return, then the standard for the conduct of the preparer is met if there is "substantial authority" for the position taken in the tax return. If the position taken on an issue is adequately disclosed in the tax return, then the standard for the conduct of the preparer is "reasonable possibility of

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PREPARER STANDARDS	*STANDARD FOR UNDISCLOSED POSITIONS TAKEN IN TAX RETURNS BY TAX RETURN PREPARER*
Sources That Constitute "Substantial Authority"	Only the sources listed in Reg. Sec. 1.6662-4(d)(3)(iii) are authority for purposes of determining whether there is "substantial authority" for the tax treatment of an item in a tax return. These sources are: • Applicable provisions of the Internal Revenue Code and other statutory provisions • Proposed, temporary and final regulations construing such statutes • Revenue rulings • Revenue procedures • Tax treaties and related regulations and Treasury or other official explanations of such treaties • Court cases • Congressional intent as reflected in committee reports and other enumerated like sources • Private letter rulings and technical advice memoranda issued after October 31, 1976 • Actions on decisions • General counsel memoranda issued after March 12, 1981 and certain other GCMs • Internal Revenue Service information or press releases • Notices, announcements and other administrative pronouncements published by the Service in the Internal Revenue Bulletin
	Note: Conclusions reached in treatises, legal periodicals, legal opinions or opinions rendered by tax professionals are not authority.
Chances of Success Probability Terminology	• ***More-likely-than-not (MLTN)*** ... more than a 50% chance of prevailing on the merits of the issue ... more than 1 out of 2 chance. • ***Substantial authority*** ... something less than MLTN (i.e., less than a 1 out of 2 chance of prevailing) but greater than a realistic possibility of success. Some say: a 40% or better chance. • ***Realistic possibility of success*** ... something greater than a 1 out of 3 chance of success of being upheld on the merits of the issue. • ***Reasonable basis*** ... significantly higher than frivolous or not patently improper (Reg. Sec. 1.6662-3(b)(3)). Some say: this would be somewhere in the range of a 1 out of 4 or a 1 out of 5 chance of success (20%-25%) of being upheld on the merits of the issue. • ***Frivolous*** ... a position that is patently improper.

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success" (i.e., the position taken has a one-in-three chance of success of being sustained).

These liberalized standards do not apply where tax shelters and/or reportable transactions (involving "transactions of interest") are involved. For these tax avoidance situations, the more-likely-than-not or over 50% chance of success standard continues to apply.

Two thoughts to keep in mind in this regard. First, the preparer conduct standard applies on a position-by-position basis to each tax return. Second, some states may not recognize the lower threshold (i.e., the substantial authority standard) and still apply the more stringent more-likely-than-not standard to the reporting of all transactions.

Interrogating the Taxpayer About the Return Preparer's Conduct. Large and Mid-Size Business (LMSB) Memorandum (LMSB-04-0308-009), dated April 13, 2008, discusses procedures for tax return preparer penalty cases. This Memo states that it is the examiner's responsibility to assert penalties if return preparer violations are found to exist. This determination is to be made by the IRS auditor based on oral testimony and/or written evidence gathered during the examination process.

When facts and circumstances in the examination give rise to the development of a penalty issue, the examiner must secure the Team Manager's approval to begin the return preparer examination. If a preparer's misconduct appears to be pervasive and wide-spread, consideration will be given to opening a Program Action Case (PAC). A PAC is a preparer investigation where clients of an allegedly questionable tax return preparer are examined to determine whether preparer penalties and/or injunctive actions against the preparer are warranted.

Each income tax examination is separate and distinct from the tax preparer violation case relating to the income tax examination case. Therefore, examiners are not to propose or discuss conduct penalties per se in the presence of the taxpayer.

There are at least ten questions that an examining agent might ask a taxpayer in a given situation to obtain information relating to whether penalties should be considered against the return preparer. These questions include ... (1) Did you meet with the preparer? (2) What documentation was provided to the preparer? (3) Did you receive a copy of the return or claim? (4) How was the preparer compensated? (5) Are you aware of any errors, omissions or mistakes on the return under examination? (6) Did you disclose this transaction on your return? Why? Why not? (7) Were there any concerns about how the transaction was reported? (8) What sort of process was used to address those concerns, and on what basis were decisions made? (9) Was there any discussion regarding potential penalties? (10) Was there any discussion regarding whether the transaction is subject to disclosure under Revenue Procedure 94-69?

#11. DE FILIPPS' YEAR-END DEALER TAX <u>UPDATE SEMINAR</u>. Since mid-year, I've made several year-end update presentations to different dealer-CPA groups. Once again, my outline includes some of the items that were not included by Ms. Harris during her presentation at the AICPA Dealership Conference. See page 45.

Several of the topics in my year-end presentation are discussed more fully in this issue of the DTW. However, there are two items (a brief discussion of the IRS' guidance on combining LIFO pools and the two cases discussed below) which are not and I've included these discussions from my outline on pages 46-52 in case you are interested.

#12. PERSONAL/INDIVIDUAL GOODWILL IN <u>BUSINESS SALE SITUATIONS</u>. My Mid-Year *Dealer Tax Update* outline referred to two cases that were both decided in April bearing on the question of whether there can be individual goodwill (or the sale of other assets resulting in long-term capital gain treatment) in connection with the sale of a business by its individual owner employees.

Neither of these cases - *Solomon v. Commissioner* and *Irwin Muskat v. U.S.A.* - involved the sale of an automobile dealership. However, each is instructive, in its own way, on the question of the sale of personal goodwill.

In *Solomon*, the individual shareholders were not required to include monies they received from the buyer as a dividend, nor was the company required to include the amount as income when such amounts were payable to the shareholders. The individual shareholders had reported the amounts in their personal returns as (long-term) capital gains for personal goodwill. The Tax Court recharacterized these amounts as ordinary income payments received from the buyer for the individuals' restrictive covenants not to compete.

Both *Solomon* and *Muskat* are discussed more fully in the portion of my Year-End Update Outline included at the end of this issue.

#13. YEAR-END PLANNING ... CONSIDER TAX <u>RATES ON QUALIFIED INCOME AFTER 2008</u>. Now that we know who the members of Congress are for next year, we can probably expect that after 2008 ... some time in the very near future ... the income tax

see **DEALER TAX WATCH OUT**, page 10

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MAJOR INCOME TAX PLANNING OPPORTUNITY IS STILL AVAILABLE FOR DEALERS

15-18% RATES

The *Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA)* enacted significantly lower tax rates for individuals on income from investments, including so-called ***"qualified dividends"*** and long-term capital gains. Before this change, individuals were taxed on all dividend income at their highest marginal tax rates, and long-term capital gains were generally taxed at a flat 20%.

For an individual, these preferential lower tax rates for qualified dividends and long-term capital gain were applied as follows ...

(1) ***A flat 5% tax rate*** is applied to that portion of the qualified dividend income and long-term capital gain that would otherwise be taxed in either the 10% or in the 15% tax rate brackets.

(2) ***A flat 15% tax rate*** is applied to the remaining portion of any such income that would otherwise be taxed in the higher-than-15% tax rate brackets (i.e., that would have fallen into the 25%, 28%, 33% or 35% tax brackets).

(3) The beneficial tax treatment for both qualified dividends and long-term capital gains is also available in computing an individual's income tax liability under the Alternative Minimum Tax.

Planning & projections. In connection with planning for a large dividend distribution, it is necessary to project the taxes resulting from both (1) the regular income rates and (2) the Alternative Minimum Tax (AMT) rates. Although the flat rate of tax on the qualifying income will be 15%, the ***effective rate of tax*** probably will be a little higher because of the interplay with the AMT on Form 6251.

Before year-end, there are many variables to be estimated. This prevents knowing exactly what the effective tax rate on the contemplated dividend will be. After yearend, the effective rate of tax on that dividend can be easily be computed. In several cases in the past, the effective rate has been between 17.5% and 18%. Although this is slightly more than 15%, it is still low enough to be attractive as the tax cost for taking out a large dividend.

Proactive Planning for the Lower Rates. Many planners have seen opportunities to take advantage of the seemingly "too-good-to-be-true" low rates on investment income and gains which are effectively ***slightly more than 15% and less than 20%.***

Some dealers have built up accumulated *earnings and profits* (somewhat similar - but for tax purposes, not technically the same as - *retained earnings*) in their regular C corporations or in years before their C Corporations switched over from being taxed as C Corps. to S Corps.

Even now, in 2008, the lower tax rates are still considered by some to be a "take-it-while-you-can-get-it" invitation to withdraw earnings accumulated in their C Corporations at minimum tax cost. After all, who knows how long these lower tax rates are going to remain in effect?

This planning scenario could be especially attractive to individuals whose C Corporations have accumulated assets that are not really needed in the business operations (toys - not necessarily cash) and who now want to take some of that accumulation out of the corporation at minimal tax rates. In business continuity planning situations, relieving the corporation of these unneeded assets may also make it easier for the next generation of successors to pay for the stock they are acquiring in the dealership/business.

In this case, when a C Corporation distributes this property as a (non-liquidating) dividend, it will have to pay tax at the corporate level because that distribution is treated as if it were a sale of the property by the corporation.

However, if the amount of tax at the corporate tax level on the distribution will not be significant (because the property being distributed has a depressed value or a high tax basis relative to its fair market value), then the payment of a small amount of tax at the corporate rates will be worth it to "simplify" things and reduce exposure to the IRS questioning the ownership and use of these assets by the corporation.

In this case, the shareholder benefits from the low rates on qualified dividend income since the property distribution is pulling out accumulated earnings and profits. And, after the distribution, the corporation's balance sheet will be a lot "cleaner."

Borrow funds to pay the dividend? In some cases, the C Corporation may have earnings and profits, but it may not have adequate cash on hand to pay out a large dividend to take advantage of these lower rates. As a final thought ... The corporation might consider borrowing the money to fund the dividend payment.

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 (Continued from page 8)

rate on dividend income will increase from 15% to nearly 40% (39.6%). This is the full hit on taxing dividends paid by corporations to individual shareholders as ordinary income.

Also, many expect that the rates on long-term capital gains will increase by at least one-third from 15% to 20%.

If you haven't explored the possibility of taking advantage of this situation with your corporate clients, there is still time. Just to make it easier for you to follow up, the article on page 9 is reprinted from our mid-year 2008 *DTW*.

#14. "RED FLAGS" PROGRAM ... 6-MONTH DELAY OF ENFORCEMENT. The identity theft Regulations and guidelines were promulgated pursuant to the Fair and Accurate Credit Transactions Act of 2003 (FACTA) and require financial institutions and creditors to develop and implement written "identity theft prevention programs." Dealerships, of course, are required to comply with these provisions and rules.

Essentially, a "Red Flags" program must do four things ... (1) Identify *red flags* which are patterns, practices or specific activities that indicate the possible existence of identity theft. (2) Detect red flags that exist in the dealership's environment. (3) Respond appropriately to any red flags that are detected. (4) Be periodically changed and updated to reflect changes in risks from identity theft.

In general, a dealership is required to appoint a "Red Flags" Manager and to have its senior management and/or board of directors review the program. The FTC "Red Flags" program rules were covered in depth by Paul D. Metrey, Director of Regulatory Affairs, NADA, in his presentation entitled "Riding the Regulatory Tidal Wave" at the AICPA Dealership Conference.

The final rules became effective on January 1, 2008, but full compliance with them was not required until November 1, 2008.

Reprieve. However, the Federal Trade Commission, in a release dated October 22, 2008, said that it will briefly suspend enforcement of the "Red Flags" rules. This delay in its enforcement has been extended for six months, and it will end on May 1, 2009.

#15. GOOD, FREE INFORMATION ON DEALER FACTORY PROBLEMS. There are two excellent newsletters that you may not be aware of that can help you stay up-to-date on dealer-franchise activities. Both are available at no cost.

The first one is the *Myers & Fuller Newsletter*. This is published quarterly by Rich Sox's firm. You can request to have your name added to their mailing list by contacting Richard N. Sox, Jr. at rsox@dealerlawyer.com (2822 Remington Green Circle, Tallahassee, Fla., 32308).

The second newsletter is written by Ronald L. Coleman. Ron also is a frequent speaker for dealer and CPA groups and he is a partner in Davies, Pearson, PC, a legal firm headquartered in Tacoma, Washington. The newsletter is called the *Automotive Dealer Update* and it is published by the Automotive Dealer Practice Group of Davies, Pearson, PC. To request to receive this newsletter, you can e-mail msmith@dpearson.com.

#16. DISCLOSURE OF TAXPAYER INFORMATION BY PREPARERS. In the December 2005 issue of the *Dealer Tax Watch*, under Watch Out #4 ("The Most Disturbing Development on the Horizon"), I commented on the groans of agony that accompanied the discussion of IRS Notice 2005-93 at a seminar I attended in late 2005.

In that issue of the *DTW* on pages 6-7, this Notice was analyzed under the heading "Before Disclosing Any Tax Return Information, You'd Better Read Notice 2005-93 First."

The chickens have now come home to roost.

On January 3, 2008, the IRS released the final Regulations under Sections 6713 and 7216 of the Code on the handling and release of taxpayer information by tax return preparers. Treasury Decision 9375 contains a full text of the IRS' response to practitioner comments that were offered in this regard.

In Revenue Procedure 2008-12, the IRS issued guidance regarding the format and content of consents to disclose and consents to use tax information involving individual (Form 1040) returns. The ink on this revenue procedure was hardly dry when it was superseded and modified by Revenue Procedure 2008-35, which contains the new rules that become effective on January 1, 2009.

Accordingly, we would repeat the same warning about the need for you to read Revenue Procedure 2008-35 and mention it to your staff before you release any income tax return information relating to any individual's personal 1040.

#17. NEXT TIME YOU SIGN A POWER OF ATTORNEY (FORM 2848) ... CONSIDER THIS. Let's close with a bang!

Here's something to think about over the next few months when you are preparing all those Forms 3115 for automatic changes in accounting method ***and***

attaching a Power of Attorney ***signed by you*** as part of the filing.

The IRS recently announced that tax practitioners who file a Power of Attorney (Form 2848) will automatically undergo a tax check to ensure that they have timely filed and paid their own taxes.

This announcement was made by Mr. Michael Chesman, Director of the IRS Office of Professional Responsibility (OPR) when he spoke during the week of October 20 in Boston at the 63rd Annual Conference of the Tax Executives Institute.

Mr. Chesman stated "one of the issues that we take very seriously for tax practitioners is that a tax practitioner timely files and pays his or her own taxes." While a tax check has been standard procedure for enrolled agents, either at the time of application or at the time of renewal, this new approach "will now soon start applying to anybody who does a Power of Attorney." This was reported in *Tax Notes*, October 27, 2008 (page 397).

Have a good filing season ... and I'll catch up with you again soon.

XYZ Dealership in the Real World, Inc. - Combined Single LIFO Pool for all New Vehicles
Difference in the Contributions to the LIFO Reserve by Layer
Depending on Sequence of Calculations Used in Combining Separate LIFO Pools
As of December 31, 2006 (the End of the Year Immediately Preceding the Year of Change)

Analysis of Year-End LIFO Inventory Layers	(A) Pool #1 Separate Pool for New Automobiles — Composition of LIFO Reserve by Layer	(B) Pool #2 Separate Pool for New Light-Duty Trucks — Composition of LIFO Reserve by Layer	(C) = (A) + (B) Result by Layer ... Pools Rebased, Then Combined — Total LIFO Reserves Both Pools Combined	(D) Result by Layer ... Pools Combined, Then Rebased — Total LIFO Reserves Both Pools Combined	(E) = (C) - (D) Amount of LIFO Reserve Shifted Between Layers — Difference in Contribution to LIFO Reserve by Layer
Base Inventory - January 1, 1980	2,276,805	2,559,464	4,836,269	4,952,318	(116,049)
1981 Increment	213,115	372,323	585,438	588,667	(3,228)
1982 Increment	210,463	155,077	365,541	385,224	(19,683)
1985 Increment	176,125	639,448	815,573	807,318	8,255
1986 Increment	228,291	293,656	521,948	543,151	(21,204)
1987 Increment	881,466	417,886	1,299,352	1,471,513	(172,161)
1988 Increment	-	860,798	860,798	780,540	80,258
1989 Increment	-	1,777,429	1,777,429	1,624,335	153,095
1990 Increment	-	1,791,339	1,791,339	1,619,127	172,212
1991 Increment	-	26,673	26,673	23,279	3,395
1992 Increment	-	664,546	664,546	573,084	91,463
1994 Increment	-	1,958,722	1,958,722	1,649,189	309,532
1995 Increment	-	294,040	294,040	232,707	61,333
1996 Increment	-	1,310,617	1,310,617	1,001,719	308,898
1999 Increment	-	171,184	171,184	104,049	67,135
2002 Increment	136,726	-	136,726	617,103	(480,377)
2004 Increment	14,912	-	14,912	67,685	(52,773)
2005 Increment	2,253	-	2,253	169,369	(167,116)
2006 Increment	-	-	-	222,983	(222,983)
	-	-	-	-	-
LIFO Reserve Totals	4,140,157	13,293,203	17,433,360	17,433,360	(0)

Dealership Facts
LIFO election was made for new vehicles in 1980 using the link-chain dollar-value method.
In 1992, election was made to change to the Alternative LIFO Method for New Vehicles.
Year of change to the Vehicle-Pool Method (under Rev. Proc. 2008-23) is 2007.
Separate pools for New Automobiles (Pool #1) and New Light-Duty Trucks (Pool #2) are to be combined as of Dec. 31, 2006.
LIFO computation for Pool #1 for 2006 reflected an increment of more than $2.3 million base dollars (before rebasing), for which there was no contribution to that pool's LIFO reserve as of Dec. 31, 2006.

As of Dec. 31, 2006, over the span of the LIFO election for Pool #1, there are 9 layers of increment contributing to its LIFO reserve of over $4 million.
As of Dec. 31, 2006, over the span of the LIFO election for Pool #2, there are 15 layers of increment contributing to its LIFO reserve of over $13 million.
There are only 6 layers represented in the layer history of both pools.
There are 9 years' layers in Pool #2 that are not in Pool #1 and all of these cluster in the middle years.
There are 3 years' layers in Pool #1 that are not represented in Pool #2 and these layers represent the more recent years (including 2006).

Note: Extensive detail schedules supporting the above calculations are not included with the summary above.

Column (C) data is based on the computation sequence of first rebasing the two separate pools to 1.000, followed by combining (i.e., by adding) the rebased results.
This result is the same as adding the amounts in columns (A) and (B) and it retains the integrity of the contribution to the LIFO reserve made by each year's layer.
Column (D) data is based on the computation sequence of first combining the two separate pools, followed by rebasing the combined results to 1.0000.
This result is obtained by following the sequence of computations (first combine the pools, then rebase the result) set forth in CCM 200825044.

Observation
It can be seen from the above that under the CCM approach, if there is a decrement in the pool in the year of change (2007 in this case study) that is large enough to eliminate the increments experienced in 2006 and 2005, the LIFO reserve will significantly decrease because of the creation of a contribution to the LIFO reserve of $222,983 with respect to the increment for 2006 and the creation of a contribution to the LIFO reserve of almost $170,000 for 2005.

Under the alternative sequence approach of rebasing the pools to 1.0000 first, then combining the pools, the maximum LIFO reserve recapture for the repayment due to the decrement experienced in the combined pool in 2007 would be limited to only $2,253 - the amount of the contribution with respect to the year 2005 layer in Pool #1.

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IRS Update from the IRS Motor Vehicle Technical Advisor

For many years, Ms. Terri Harris (the IRS Motor Vehicle Technical Advisor) has been one of the featured speakers at this Conference. The Mid-Year 2008 issue of the *Dealer Tax Watch* (pages 5-13) contains a detailed comparison of three of Ms. Harris' recent presentations (October 2007, February 2008 and May of 2008).

In her 50-minute presentation at the Conference in October, Ms. Harris devoted about 35 minutes to discussing four major areas: (1) Section 263A or UNICAP, (2) LIFO terminations, (3) employee tool and equipment plans and (4) the Vehicle-Pool Method for LIFO inventories. The remaining 15 minutes of her time was devoted to answering questions from several attendees.

The technical content in her presentation and slides is very similar to her recent presentations. Accordingly, you can basically refer to the material in the Mid-Year 2008 issue of the *DTW* for these details.

Due to IRS resource limitations, Ms. Harris is now the only individual in the Motor Vehicle Technical Advisory Group. She is "the Team."

Ms. Harris briefly reviewed various Section 263A issues and said that unfortunately, due to many other things that were going on in Treasury, the dealers' Section 263A problems and issues were not accepted into the Industry Issue Resolution Program but that these problems may be considered in the Chief Counsel's Business Priority Guidance Plan for 2009. She added that three things might happen: (1) a revenue ruling or revenue procedure might be issued, (2) the regulations might be changed or (3) nothing might happen. She advised that if you haven't read TAM 200736026 recently, you ought to take a look at it again to refresh your memory on the technical issues.

The IRS recently designated Section 263A issues as Tier III issues. This means these 263A issues have a fairly low priority on the totem pole and they are not mandatory audit items. They are items that probably should be considered by an examiner during the audit of a dealership, but an IRS auditor is not required to examine them and cannot be forced to examine them.

Ms. Harris explained that a Tier III Team is being formed, sort of a Field Guidance Team. This group will not have authority to issue any guidance. However, it may develop some audit guidelines and possibly develop some audit guides or material for the IRS Audit Technique Guide handbook.

To report what she said about LIFO terminations and the Vehicle-Pool Method would be to repeat what has been dealt with more exhaustively elsewhere. Her comments on employee tool and equipment plans were essentially to warn CPAs and dealerships away from becoming even remotely involved in them. She said the IRS still hasn't seen an acceptable tool plan.

Practical Tax Applications for Dealerships

The presenters for this session were Sid Tobiason and Kelly Porter. Both are partners in Moss Adams LLP. Their structured presentation lasted about 50 minutes, followed by another 20 minutes of questions and answers.

The major areas covered in the presentation were (1) bonus depreciation, especially with respect to rental fleet applications and like-kind exchange strategies, (2) the new and used Vehicle-Pool Method, (3) the new automatic accounting method change revenue procedure, (4) lower of cost or market valuation issues for used ... and for new ... vehicle inventories, (5) Section 263A issues and (6) choice of entity issues, including self-employment tax aspects.

In many respects, much of their technical discussions are the same as those in various *DTW* articles. I was pleased to hear that my own long-held belief that *Black Book* is the better reference for LIFO and other inventory valuation purposes than the *Blue Book* was in accord with their firm's practice and opinion. They also said that the opportunity to use a single vehicle pool is not one all dealers should jump to immediately. Rather, although opportunities do exist in some situations, the decision needs to be approached on a case-by-case basis to determine the proper year for making the change. Finally, I was glad to hear that often they had used the IPIC method as a fail-safe to obtain audit protection when they encountered LIFO practices that were just too horrible to describe.

Both presenters are to be complimented on their willingness to share their practical experiences in discussing the technical aspects of the subjects they covered. Especially interesting were their comments regarding various practices they have encountered that dealers were using in valuing their (used vehicle) inventories. Their insights will provide any listener with a lot of food for thought. Also, they did a very good job of relating the curing of many ill-advised practices to the use of the opportunities for automatic changes under Rev. Proc. 2008-52.

In my opinion, this year's presentation was far more effective and practical than last year's four-member "Tax Panel" approach. Even if you are an experienced practitioner, I believe you will pick up many interesting insights that you can apply to your dealerships if you listen carefully to the audio presentation of this session.

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Latest Manufacturer Initiatives Threatening Dealership Viability

Richard Sox's update on dealer legal/franchise issues was excellent, as usual. This was the third year in a row that he presented on this subject.

Bankruptcy. This year, Mr. Sox's 90-minute presentation included a discussion of the potential implications for the dealer body as a whole if either General Motors and Chrysler were to file for bankruptcy. In general, the results would be extremely unfavorable to dealers. A judge in bankruptcy would probably agree to the manufacturer's request for significant reductions in the size of its overall dealer network. He also discussed almost equally dire consequences for dealers if Chrysler and General Motors were to merge.

The one ray of sunshine in his comments was that if the manufacturer went into bankruptcy, the various operating accounts that the dealer has with the manufacturer (receivables, warranties, etc.) most likely would continue to go forward in the ordinary course of operations, since that "business as usual" approach would more likely contribute to the ability of the manufacturer to emerge from the bankruptcy proceeding, sooner, rather than later, as a viable business.

Floorplan lenders. This year, a new subject of considerable discussion was the increasingly aggressive and dealer-unfriendly practices of floorplan lenders and credit corporations. Mr. Sox emphasized defensive tactics that dealers might be able to employ to protect themselves when these lenders seek to capitalize on the increasingly frequent out-of-trust positions many dealers experience. Many lenders are almost arbitrarily further tightening loan covenants and call provisions. Also, many lenders are unwilling to finance new deals.

Network consolidations. Mr. Sox reviewed the various manufacturers activities directed toward consolidating their respective dealer networks, with heavy emphasis on the idea that some manufacturers are engaging in the "constructive termination" of some of their dealers' franchises by various actions or practices. One example of this newly emerging legal concept would be the manufacturer's arbitrary decision to drop a linemake and then, as a consequence, providing their dealers with increasingly fewer vehicles. Under these circumstances, dealers just become progressively less profitable until their operations are no longer viable. (Death by a thousand cuts.)

He commented on the increasing resistance many manufacturers are showing in denying approval of transfers or sales of franchises for reasons that are not legal. (See the box at the bottom of page 5: *Causes for Termination of a Dealer's Selling Agreement.*) He also emphasized the growing practice of many manufacturers to demand or require dealers to sign "Exclusive Use Agreements." Mr. Sox emphatically expressed his firm's consistent recommendation to dealers that they not tie up their facilities and land use in these agreements. But, realistically in some instances, a dealer may have no better option and, should this be the case, it may be possible to negotiate certain concessions from the manufacturer in return for the dealer's agreeing to such exclusive use.

Image programs. In connection with various manufacturers' image programs, Mr. Sox emphasized the importance of "doing the math" and he stressed that dealers should ask whether the manufacturer's analysis has changed based on the economic downturn the industry is experiencing. Another question the dealer might ask when, or if, pressed to participate in a facility or image program, would be ... "If we go into this program, will you (the manufacturer) commit not to add another point ... for some period of time ... or within a certain geographic area or proximity?" Yet another possible negotiating point in this context would be for the dealer to attempt to obtain a favorable concession for the allocation of (desirable) vehicles for some period of time or for certain models.

Incentive programs. Because Mr. Sox had "only" 90 minutes, this year time did not permit him to go into a more complete discussion of some of the Factory incentive programs which he covered extensively in prior years. He did have time to mention a few, with his comments mostly in the context of how unfairly these programs usually are structured with respect to the smaller dealers. (For an extensive report of Mr. Sox's comments on various Factory incentive programs at the AICPA Conference last year, see pages 12-23 of the December 2007 issue of the *Dealer Tax Watch*).

Franchise protections. In conflicts with the Factory, dealers often find that they have relatively limited rights and are often on the defensive. In some cases, and in some states, dealers have a greater degree of protection through their state law. This varies considerably from state to state. Throughout his presentation, Mr. Sox discussed many provisions that would, if present, protect or more clearly define dealers' rights. He and his firm, working with state dealer associations, have been able to introduce many of these dealer-favorable provisions into specific state laws. These suggested franchise protections are summarized in checklist form on page 5.

Mr. Sox seems to have an almost unlimited knowledge of what is going on with all of the manufacturers and their various programs. In addition, his comments - as well as his responses to a host of questions covering a broad range of issues and manufacturers - reflect an abundance of alternatives and protective strategies for his firm's dealer clients.

His was truly a ***five-star presentation***.

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REVISED PROCEDURES FOR SECURING AUTOMATIC CONSENT FROM THE IRS TO MAKE CHANGES IN LIFO & OTHER METHODS OF ACCOUNTING

REV PROC 2008-52

In Revenue Procedure 2008-52, the IRS recently updated the procedures by which taxpayers may obtain automatic consent for certain changes in methods of accounting. This new guidance supersedes Rev. Proc. 2002-9 which formerly was the controlling document for automatic changes.

INTRODUCTION

On a somewhat regular basis, CPAs have to consider the advisability of recommending changes in their clients' methods of accounting. This advice may be needed in connection with new developments and pronouncements by the IRS or recently decided tax cases. Or it may be needed in connection with knowing that a taxpayer's method of accounting is not correct (or as good as it could be) and trying to decide whether to "voluntarily" change the method or just wait for the IRS to come along and initiate a change.

The first part of this article discusses some of these considerations in greater detail. The second part of this article gives an overview of Rev. Proc. 2008-52 and comments more extensively on several provisions or sections in the Revenue Procedure that involve issues discussed in previous articles in the *LIFO Lookout* and/or the *Dealer Tax Watch*. Finally, several sections of the Revenue Procedure Appendix dealing with LIFO and non-LIFO inventories are discussed in greater detail.

WHY CHANGE A METHOD OF ACCOUNTING BEFORE THE IRS FORCES YOU TO?

If a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must be made in a manner that, in the opinion of the Commissioner, does clearly reflect income.

To IRS wants to encourage taxpayers to voluntarily change incorrect or impermissible accounting methods. In doing this, it tries to achieve an appropriate balance between the goals of mitigating distortions of income that result from accounting method changes and providing appropriate incentives for voluntary compliance by taxpayers. In part, the Service has done this by providing procedures by which taxpayers may change accounting methods before they come under audit.

There are several advantages to making a voluntary change in an IRS-designated automatic change method of accounting. With these kinds of changes, taxpayers have a certain amount of hindsight about whether or not to make the change because they are not required to file the Form 3115 until after the end of the year. No user fee is required to be paid with the filing of Form 3115.

Voluntarily changing an accounting method - before the IRS requires a change - also eliminates significant exposure to potential penalties. Penalties, additions to the tax or additional amounts will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all of the applicable provisions.

If a Section 481(a) adjustment is required in order to avoid a distortion of income, for voluntary changes, that adjustment is usually made starting with the year of change, and not in an earlier year. In general, the spread period for a net positive Sec. 481(a) adjustment is 4 years and a net negative Sec. 481(a) adjustment may be taken into income (as a deduction) in the year of change.

There is also a ***de minimis rule*** that many taxpayers elect to use for purely practical reasons. A

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Six Provisions of Special Interest to Automobile Dealerships

- *Application of Inventory Cost Capitalization Rules to Auto Dealerships ... Sec. 263A* 17
- *Changes in Selecting an Official Used Vehicle Guide for Valuing Used Vehicles* 18
- *Termination of LIFO Elections by Auto Dealerships ... Uncertainties Eliminated* 19
- *Lack of Overall Audit Protection for Changes in LIFO Submethods* 20
- *Change in Accounting Method for Certain Advertising Costs* 21
- *Ineligibility to Use the Automatic Accounting Method Change Procedures* 22

taxpayer may elect to use a one-year Sec. 481(a) adjustment period in lieu of the 4-year spread period for a positive Sec. 481(a) adjustment if the net Sec. 481(a) adjustment for the change is less than $25,000. To elect this *de minimis* rule, all a taxpayer has to do is complete the appropriate line on Form 3115, basically by checking the box.

For many (voluntary) changes involving LIFO submethods, the cut-off method is used and no Section 481(a) adjustment is required. When a change in method of accounting is made on a cut-off basis, in general, only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. Any items arising before the year of change continue to be accounted for under the former method of accounting. Because no amounts are duplicated or omitted when a change in method of accounting is made on a cut-off basis, no Section 481(a) adjustment is necessary.

Taxpayers complying with all the applicable provisions obtain the consent of the Commissioner to change the method of accounting under Section 446(e). However, in this regard, taxpayers must fully comply with the detailed filing and timely duplicate notification requirements that are included in Revenue Procedure 2008-52.

CORRECTIONS OF ERRORS ARE NOT THE SAME AS CHANGES IN ACCOUNTING METHODS

Some taxpayers have tried to correct errors by treating their attempts at correction as changes in accounting methods. The regulations, and the IRS in many litigated cases, establish the principle that a change in accounting method does ***not*** include the correction of a mathematical error or errors in the computation of a tax liability.

A recent major case in the Tax Court highlighting the distinction between a change in accounting method versus the correction of a mathematical error is *Huffman, et al v. Comm.* (126 T.C. No. 17), filed May 16, 2006. In this case, the Tax Court did not accept the LIFO computations made over long periods of time by the CPA for four automobile dealerships in Kentucky. These computations were supposedly made using the link-chain, dollar-value LIFO method. In auditing the dealerships, the IRS refused to accept their calculations because the CPA had consistently omitted the critical step of properly valuing inventory increments in all of the computations for periods ranging from 11 to 21 years.

The CPA/accountant responsible for the LIFO calculations for the Huffman dealerships was consistent, without exception, in applying his method of making the link-chain computations each year, for each member, beginning with the year that the member initially elected the link-chain method and continuing thereafter. The problem (for these dealerships) was that he was just consistently wrong.

In March of 2008, the U.S. Court of Appeals for the 6th Circuit affirmed the Tax Court holding in this case. The 6th Circuit Court placed emphasis on the fact that "systemic flaws" in a taxpayer's method of accounting cannot be described as mere mathematical or posting errors.

The Court said: "It cannot seriously be argued that the consistent correction in this case to the repeated identical error in calculating yearly carryover inventory values is not a 'change in method of accounting,' in the plain English sense of the words ... We are fully satisfied that the Regulation precludes application of either the 'mathematical error' or the 'computational error' exception on the facts of this case."

see **REVENUE PROCEDURE 2008-52**, page 16

CAMs — *AUTOMATIC CHANGES IN ACCOUNTING METHODS & REV. PROC. 2008-52*

- *Overview & Discussion of Selected Provisions of Interest to Auto Dealerships* 14
- *CAM's Designated as Automatic Changes in Accounting Methods Described in Appendix* 23
- *Basic General Rules for Changes in Accounting Methods* 24
- *Terms & Conditions* 26
- *Audit Protection & Effect of Consent* 27
- *General Application Procedures & Form 3115 Filing Requirements* 28
- *Scope & Limitations that Prevent Some Taxpayers from Using the Automatic Change Procedures* 30
- *Subsequent Review of Forms 3115 by Director & National Tax Office* 32
- *Automatic Inventory Method Changes - Other than LIFO ... Sec. 21 of Appendix* 34
- *Automatic Last-In, First-Out (LIFO) Inventory Valuation Method Changes ... Sec. 22 of Appendix* 38

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 (Continued from page 15)

Both Courts allowed the IRS to make Section 481(a) adjustments to adjust the first open year of each of the dealerships and to properly revalue the dealership's inventory because the adjustments constituted a change in the method of (LIFO) accounting. There was no statute of limitations preventing the adjustments, despite several prior IRS audits which apparently "looked at" these calculations.

MAKING THE MOVE TO CHANGE THE METHOD BEFORE IT'S TOO LATE

It's too late to make a voluntary change in method if a taxpayer's method of accounting for an item is an ***issue under consideration*** for a taxable year under IRS audit examination. Accordingly, if a taxpayer receives written notification from an examining agent specifically citing the treatment of the item as an issue under consideration, then it's too late for the taxpayer to "voluntarily" change that method. Written notification includes the agent's examination plan, Information Document Request (IDR), or notification of proposed adjustments or income tax examination changes.

A one-paragraph digression is in order here. The recitation in the previous paragraph comes straight from the revenue procedure. In the real world where many tax issues (involving LIFO, at least) are not settled at the examination level, but proceed beyond the Examination level to the Appeals level, taxpayers are often permitted - as a matter of settlement strategy acceptable to both the IRS and the taxpayer - to effect a change in accounting method even though the method in question was an "item under consideration."

Two examples are helpful in understanding the IRS' interpretation of the term "issue under consideration." In the context of a taxpayer's method of pooling under the dollar-value LIFO inventory method, that method would be an "issue under consideration" if it is mentioned in an IRS audit examination plan that identifies LIFO pooling as a matter to be examined. However, that pooling method would not be an "issue under consideration" as a result of an IRS audit examination plan that merely identifies LIFO inventories as a matter to be examined.

Similarly, in the context of the application of the inventory cost capitalization rules under Section 263A, a taxpayer's method of determining inventoriable costs under Section 263A would be an "issue under consideration" as a result of an Information Document Request that requests documentation supporting the costs included in inventoriable costs. However, it (i.e., the taxpayer's method of determining inventoriable costs under Section 263A) would not be an "issue under consideration" as a result of an IDR that requests documentation supporting the amount of costs of goods sold reported on the income tax return.

Finally, in connection with defining changes in method, a change within the LIFO inventory method is a change from one LIFO inventory method or submethod to another LIFO inventory method or submethod. However, a change within the LIFO inventory method ***does not include*** a change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by Section 471 or Section 263A).

REV. PROC. 2008-52 UPDATES PROCEDURES

Form 3115 (*Application for Change in Accounting Method*) is the form which must be filed in connection with accounting method changes. The last revision date for Form 3115 is December, 2003. However, the Instructions for Form 3115 have been updated more frequently to reflect the constant high level of monitoring that the IRS applies to all accounting method changes.

In general, Revenue Procedure 2008-52 is effective for Forms 3115 filed after August 18, 2008 for a year of change ending on or after December 31, 2007. There are certain transition rules for Forms 3115 that were filed shortly before issuance of this revenue procedure using the guidance in "old" Rev. Proc. 2002-9.

The only methods of accounting that can be changed using the procedures in Rev. Proc. 2008-52 are those methods which are specifically identified in the Appendix to the revenue procedure. This Appendix lists 33 general areas, many with extensive subdivisions, which are designated automatic changes.

There are three sections in the Appendix relating to inventories which are of special interest. These are Sec. 11 (Uniform Inventory Cost Capitalization (UNICAP) Methods), Sec. 21 (Inventories - General) and Sec. 22 (Last-In, First-Out (LIFO) Inventories). These sections of the Appendix relate to Internal Revenue Code Sections 263A, 471 and 472, respectively. The Appendix also contains a contact list or directory of individual specialists in the National Tax Office (with phone numbers) who can be contacted to discuss specific designated changes in method.

The Revenue Procedure is divided into fifteen sections. The most important or key sections are ... "Scope," "Terms & Conditions of Change," "General Application Procedures" and "Audit Protection for Taxable Years Prior to Year of Change," (Sections 4,

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5, 6 and 7, respectively). These are discussed in the Section-by-Section Analysis immediately following this article.

PROVISIONS IN RP 2008-52 OF SPECIAL INTEREST TO AUTOMOBILE DEALERSHIPS

Based on the readership of our publications (the *LIFO Lookout* and the *Dealer Tax Watch*) and our previous articles, six provisions in Rev. Proc. 2008-52 seem to be most relevant. These provisions are discussed in the order of importance to dealerships, based on an admittedly arbitrary evaluation of their impact.

Before discussing these provisions, it should be emphasized that all of the provisions in the Revenue Procedure are equally important in their own right. The Revenue Procedure, even without its lengthy Appendix, is long and complicated, and it covers many special situations which are beyond the scope of our coverage and interests.

#1 APPLICATION OF INVENTORY COST CAP RULES TO AUTO DEALERSHIPS ... SEC. 263A (UNICAP)

Previous issues of the *Dealer Tax Watch* have included extensive discussions on the controversies with the IRS over the application of the Sec. 263A rules to automobile dealerships. The focal points of these controversies can be summarized as (1) the distinction between "producer" vs. "reseller" classification and (2) the issuance of TAM 200736026 by the IRS and the implications of its holdings for dealers.

Should the auto dealership be treated as a "producer" or as a "reseller" under Sec. 263A? Briefly, the issue here is whether the activities and services provided by a typical dealership's Service

see REVENUE PROCEDURE 2008-52, page 18

Form **3115** (Rev. December 2003) Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

OMB No. 1545-0152

Name of filer (name of parent corporation if a consolidated group) (see instructions)	Identification number (see instructions)
	Principal business activity code number (see instructions)
Number, street, and room or suite no. If a P.O. box, see the instructions.	Tax year of change begins (MM/DD/YYYY) Tax year of change ends (MM/DD/YYYY)
City or town, state, and ZIP code	Name of contact person (see instructions)
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)	Contact person's telephone number ( )

If the applicant is a member of a consolidated group, check this box . . . . . . ▶ ☐

If Form 2848, Power of Attorney and Declaration of Representative, is attached, check this box . . . . . ▶ ☐

Check the box to indicate the applicant.

☐ Individual
☐ Corporation
☐ Controlled foreign corporation (Sec. 957)
☐ 10/50 corporation (Sec. 904(d)(2)(E))
☐ Qualified personal service corporation (Sec. 448(d)(2))
☐ Exempt organization. Enter Code section ▶
☐ Cooperative (Sec. 1381)
☐ Partnership
☐ S corporation
☐ Insurance co. (Sec. 816(a))
☐ Insurance co. (Sec. 831)
☐ Other (specify) ▶ ....

Check the appropriate box to indicate the type of accounting method change being requested. (see instructions)

☐ Depreciation or Amortization
☐ Financial Products and/or Financial Activities of Financial Institutions
☐ Other (specify) ▶ ....

Caution: *The applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.*

Part I Information For Automatic Change Request	Yes	No
1 Enter the requested designated accounting method change number from the **List of Automatic Accounting Method Changes** (see instructions). Enter only one method change number, except as provided for in the instructions. If the requested change is not included in that list, check "Other," and provide a description. ▶ (a) Change No. ______ (b) Other ☐ Description ▶ ______		
2 Is the accounting method change being requested one for which the scope limitations of section 4.02 of Rev. Proc. 2002-9 (or its successor) **do not** apply? . . . . . If "Yes," go to Part II.		
3 Is the tax year of change the final tax year of a trade or business for which the taxpayer would be required to take the entire amount of the section 481(a) adjustment into account in computing taxable income? . . . If "Yes," the applicant is not eligible to make the change under automatic change request procedures.		

Note: *Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).*

Part II Information For All Requests	Yes	No
4a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)? . . . If you answered "No," go to line 5.		
b Is the method of accounting the applicant is requesting to change an issue (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?		

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 (Continued from page 17)

Department meet(s) the definition of "providing services" under Reg. Sec. 1.263A-1(b)(11). If the activities fall within the definition, that would put the dealership either ... directly under the "producer" rules of Section 263A, ... or result in the dealership being treated as a "reseller with production activities" under the "reseller" portion of the rules of Sec. 263A.

TAM 200736026, issued by the IRS in September, 2007, addresses multiple issues involving how the regulations under Section 263A should be interpreted in dealership situations for (1) production and handling activities, (2) retail sales facility issues and (3) the identification and allocation of costs.

For several years, the IRS has been implying (if that's too strong a word, let's say "weakly hinting") that guidance, in one form or another, that would really address these issues might be forthcoming reasonably soon.

No new IRS "guidance" at this time. Regrettably, there's no guidance (at all) in Rev. Proc. 2008-52 that is useful in coming to grips with any of these issues or with what methods of accounting are or are not permissible in determining inventory costs to be capitalized under Section 263A.

Accordingly, at this time we still do not know anything more or less than we knew before.

#2 CHANGES IN SELECTING AN OFFICIAL USED VEHICLE GUIDE FOR VALUING USED VEHICLES

The IRS will now allow automobile dealers to make certain changes related to the use of "official used car guides" in connection with valuing their used vehicle inventories.

Here's some background on this. In a very old IRS revenue ruling (Revenue Ruling 67-107), the IRS acknowledged that "it is a common practice for the car dealer to sell a car and as part of the payment to take in trade the purchaser's old car. The dealer values the car taken in trade at cost which is an amount representing the average wholesale price listed by an official used car guide at the time of trade-in. If (the car is) not sold, the used car is carried in inventory at the cost figure until the end of the year. The inventory value is then adjusted to conform to the average wholesale price listed at that time. This is the practice recommended by the auto industry and used by nearly all car dealers."

This revenue ruling added that, under Section 471, inventories must conform as nearly as may be to the best accounting practice in the trade or business and must clearly reflect income. The methods of valuation most commonly used which meet these requirements are (1) cost and (2) cost or market, whichever is lower. Reg. Sec. 1.471-4(a) defines *market* as "the current bid price prevailing at the date of inventory for the particular merchandise in the volume in which usually purchased by the taxpayer."

This 40-year old revenue ruling held that "a car dealer may value his used cars for inventory purposes at valuations comparable to those listed in an official used car guide as the average wholesale prices for comparable cars."

Despite this revenue ruling, for many years some, IRS agents took the position in auditing dealerships that some used vehicles should be treated as "subnormal" goods, rather than as "normal" goods and raised objections to the dealerships valuations of their used vehicles. In the September 1999 *Dealer Tax Watch*, we reported that the IRS finally indicated that it would allow used cars to be written-down to the lower of cost or market at the end of the year. In effect, this treats used cars as normal goods – not as subnormal goods – in the context of a used vehicle inventory. There was no official pronouncement by the IRS on this. This concession (if you will) was simply reported by the Motor Vehicle Technical Advisor (then the IRS Motor Vehicle Specialist) at a National Conference.

Section 21.12 of the Appendix to Rev. Proc. 2008-52 now provides that auto dealerships may make certain changes relating to the valuation of used vehicles as automatic changes in accounting method. The caption for this section of the Appendix reads "*Change in the official used vehicle guide utilized in valuing used vehicles.*" The first sentence describing the change states that "Used vehicles taken in trade as part payment on the sale of vehicles by a dealer may be valued for inventory purposes at valuations comparable to those listed in an official used vehicle guide as the average wholesale prices for comparable vehicles. See Rev. Rul. 67-107, 1967-1 C.B. 115."

In describing the changes permitted to be made as automatic, the text reads "This change applies to: (1) a taxpayer that wants to change from not using an official used vehicle guide to using an official used vehicle guide for valuing used vehicles; or (2) a taxpayer that wants to change to a different official used vehicle guide for valuing used vehicles."

For dealers who have been writing down their used vehicle inventories at year-end based on arbitrary judgments or other (inconsistent) combinations of fact and fiction, the opportunity to make an automatic change in method to use an official used vehicle industry guide should not be overlooked. Particularly,

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for the reasons discussed earlier in this article on *Why Change a Method of Accounting Before the IRS Forces You to.*

The designated automatic accounting method change number for a change under this Section of the Appendix is 138.

For this change, the computation of an adjustment under Section 481(a) is required. This computation should not be too burdensome because, generally speaking, used vehicles in inventory turn over rapidly and used vehicles on hand at the beginning of the year usually are not still on hand at the end of the year.

Although most of the text (including the caption) discussing the two changes refers broadly to "valuing used vehicles," the opening sentence and Rev. Rul. 67-107 to which it refers specifically limit their application to "vehicles taken in trade as part payment on the sale of vehicles." This raises the question of whether the valuation of used vehicles that a dealership has acquired by purchase at auction (or from another dealer) can be included as eligible for an automatic change in method under this section of the Appendix.

#3 TERMINATION OF LIFO ELECTIONS BY AUTO DEALERSHIPS ... UNCERTAINTIES ELIMINATED

In teaching seminars on LIFO, I've often reminded students that there are only three problems involved with LIFO ... (1) getting on ... (2) staying on ... and (3) getting off. Dealerships considering going onto LIFO don't always like to hear about the problems associated with going off of LIFO. And when these are discussed, sometimes more emphasis is placed on the aspect of coming up with the cash to pay the tax on the LIFO reserve recapture than is given to the procedural requirements to be followed in terminating a LIFO election.

Technically, the termination of a LIFO election is referred to as a "change ***from*** the LIFO inventory method."

Some background. When the IRS liberalized its procedures for the termination of LIFO elections in Rev. Proc. 2002-9, the wording there was such that significant problems could emerge in the future ... if the IRS ever looked closely at the specifics of the inventory methods employed by the dealership after it terminated its LIFO election.

For several years, there seemed to be no problems, but more recently, the National Office had been rejecting Forms 3115 filed by dealerships for automatic terminations of their LIFO elections under Rev. Proc. 2002-9. It appeared that the IRS was taking the position that dealerships could not use the automatic change provisions to go off of LIFO because they are using different methods of accounting for their non-LIFO inventories (i.e., if they are not using the same method for all of their non-LIFO inventories).

Needless to say, this position of the IRS can create significant problems for dealerships who thought they had terminated their LIFO elections when they filed Form 3115 (automatic change) and never heard back from the IRS. Some of them were being notified by the IRS, at a date (many) years later that they should have filed Form 3115 ***before*** the end of the year the LIFO election was terminated. This is the requirement under Rev. Proc. 97-27 which applies to non-automatic changes.

Apparently, the IRS' position all along has been that a dealership's automatic change request was invalid and should be denied because all of the dealership's non-LIFO inventory was not being valued using the same method. Ironically, there was nothing really difficult involved here. The devil is in the details ... in the procedures. It was just a matter of the IRS requiring taxpayers to know before the year was over that they were going to terminate their LIFO election for the year so that they could file Form 3115 for permission to change ***before*** the end of the year of change. And, of course, pay the appropriate user fee.

However, the implications for dealers caught in this *Catch-22* are nothing short of horrendous, for some are finding out (in many cases, several years) after the fact that, according to the IRS, they are still on LIFO! Or worse yet, that they have made an unauthorized change in accounting method ... and that leaves them at the mercy of the IRS to do with them whatever it wants.

In summary, Revenue Procedure 2002-9 required that when a dealership terminated its LIFO election, all of the dealership's non-LIFO inventories must be using the same method for valuation and identification of inventories. If the same method was not being used, then, under Rev. Proc. 2002-9, the dealership could not terminate its LIFO method using the automatic change in method procedures by filing Form 3115 ***after*** the end of the year of change.

Out of practical necessity, every automobile dealership uses the replacement cost method for valuing its parts and accessories inventories. As a result, a dealership going off of LIFO could not satisfy this requirement and, therefore, it was required to obtain consent in advance from the IRS to terminate its LIFO election (i.e., by filing Form 3115 under Rev. Proc. 97-27 before the end of the year of change and paying a user fee).

see **REVENUE PROCEDURE 2008-52**, page 20

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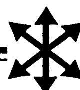

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The good news ... Rev. Proc. 2008-52 now eliminates these uncertainties. In a liberalization of the IRS' previous position, Section 22.01 of the Appendix to the Rev. Proc. now provides that a taxpayer may change to one or more non-LIFO inventory methods for the LIFO inventories that are the subject of this accounting method change, but only if the selected non-LIFO method is a permitted method for the inventory goods to which it will be applied.

For example, a heavy equipment dealer may change to the specific identification method for new heavy equipment inventories and to the replacement cost method for heavy equipment parts inventories.

So the question is ... what is a "permitted" method? The answer is that now an inventory method (identification or valuation, or both) is a permitted method if it meets two requirements. ***First***, it is specifically permitted by the Code, the regulations, a decision by the United States Supreme Court, a revenue ruling, a revenue procedure, or other guidance published in the Internal Revenue Bulletin for the inventory goods. The ***second*** requirement is that the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods. In general, these requirements should be easily satisfied by the typical dealership.

Fortunately, whether an inventory method is a permitted method is determined without regard to the types and amounts of costs capitalized under the taxpayer's method of computing inventory cost under Section 263A which governs the types and amounts of costs required to be included in inventory cost.

What about those dealers who are caught between and still in the "Catch 22"? After celebrating this good news, let's not forget that it only applies prospectively. There are still many dealers who think they effectively terminated their LIFO election years ago, but according to the IRS, they did not comply with the procedural requirements.

What should a dealership do if it previously (thought it) terminated its LIFO election, and since then, it has not been using the LIFO method for valuing its inventories? Should it file amended income tax returns for all of the intervening years? Should it apply for a Ruling and "confess" to a LIFO financial statement conformity violation? Obviously, under these circumstances, the dealership would not have reflected LIFO on its year-end financial statements if it thought it had terminated its LIFO election.

In this gray area, is there still a 4-year spread period for the recapture of the dealership's LIFO reserve? ... Or, might the IRS insist on the full LIFO reserve being picked up in income 100% in the intended year of termination? ... Or, is the dealership still on LIFO (if the IRS will waive its inadvertent violations of the year-end financial statement conformity requirements)?

The ramifications for these dealers are not clear. The IRS could take the position that they are still on LIFO and by not continuing to stay on LIFO, they have made an unauthorized change in accounting method. This could render a dealership vulnerable to the IRS either requiring that dealership to continue using the LIFO method or requiring the dealership to change to another (specific identification) method. Or, things could be worse.

It will be interesting to see how all of this works out.

#4 LACK OF OVERALL AUDIT PROTECTION FOR CHANGES IN LIFO SUBMETHODS

Often, taxpayers are willing to voluntarily change an accounting method because, in return for making the change, the IRS agrees that it will not make audit adjustments to prior years related to the method that was previously used.

If a taxpayer complies with all of the requirements of Revenue Procedure 2008-52, the IRS will not require the taxpayer to change its method of accounting for the same item for a taxable year ***prior*** to the year of change.

Unfortunately, there is one major qualification that is upsetting to LIFO-related changes in method. Section 7.02(2) states that "The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method." This is followed by ... ***"For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a <u>prior</u> taxable year even though the taxpayer changes its method of valuing increments in the <u>current</u> year."*** [Emphasis added]

This is not a new limitation ... it is carried over from Rev. Proc. 2002-9. It seems to indicate that even though a taxpayer may change one of its submethods under its broader LIFO method, the IRS still can go back to prior years and make adjustments (or possibly take the taxpayer off of LIFO) if it finds a financial statement conformity violation, a cost violation or some other critical omission such as the failure to file Form 970 in the initial LIFO year.

In addition to the LIFO situation discussed above, there are several other situations where the IRS may change a taxpayer's method of accounting for prior taxable years. This can occur if the taxpayer fails to

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implement the change or the taxpayer implements the change but does not comply with all the applicable provisions of the revenue procedure.

The IRS also may change a taxpayer's method of accounting for prior taxable years if the method of accounting is changed or modified because there has been a misstatement or omission of material facts or if prior year adjustment is necessary in order to reflect a prior year Service-initiated change reported as an issue pending or in a Revenue Agent's Report.

#5 CHANGE TO ELIMINATE CERTAIN ADVERTISING COSTS FROM INVENTORY COSTS

Both the *LIFO Lookout* and the *Dealer Tax Watch* have given extensive coverage to the benefits and procedures to be followed by dealerships that change their methods of accounting to eliminate (1) trade discounts and/or (2) local and regional advertising costs from their inventory costs.

These are two separate changes in accounting methods, although for practical reasons, many dealerships often make both changes at the same time, for the same year. Both changes are beneficial regardless of whether or not a dealership is using LIFO to value its new vehicle inventories.

Distinction between a change in accounting method for "trade discounts" vs. "advertising credits." It should be noted that previously, a change in accounting method to eliminate trade discounts was permitted to be made as an automatic change. It contrast, a change in accounting method to eliminate advertising costs and credits was ***not*** permitted to be made as an automatic change.

What this meant in the past was that for a dealership wanting to make both changes for the same year, it was required to file the Form 3115 for the advertising credits change ***before*** the end of the year (and pay a user fee). And it filed the second Form 3115 for the trade discounts change ***after*** the end of the year.

This required a significant amount of paper shuffling. Worse yet, if the IRS did not reply to the Form 3115 filed for the advertising credits before it was time to file the tax return for the year of change, technically the dealership was required to not reflect that change for that year. And you know how slow the IRS can be in these situations.

What is new is that Revenue Procedure 2008-52 has now identified a change in accounting method to eliminate advertising costs and credits (from inventory costs) as a change that taxpayers can make as an automatic change.

The following paragraphs provide some basic background information on both changes in accounting methods. However, much of what has been said in previous articles in our publications will not be repeated here.

Elimination of trade discounts (i.e., Factory floorplan assistance payments) from inventory costs. A trade discount is a reduction allowed by the seller in the invoice or purchase price that is allowed or granted regardless of when the payment is made. Generally, trade discounts are allowed for volume or quantity purchases.

It is clear that trade (or quantity) discounts are required to be eliminated from inventory costs. This treatment is not optional; it is mandatory according to Reg. Sec. 1.471-3(b) and Revenue Ruling 84-481.

As noted above, dealerships may change their method of accounting for "qualifying volume-related trade discounts" without first securing permission from the IRS. This automatic change in accounting method is described in Section 21.04 of the Appendix to Rev. Proc. 2008-52. It is designated accounting method change number #53. For this change, the computation of a net adjustment under Section 481(a) is required. Taxpayers are not permitted to use the cut-off method in making this change. Therefore, taxpayers on LIFO are required to make a detailed recalculation of the layer history for each pool affected by this change.

Elimination of certain advertising costs and credits from inventory costs. Revenue Procedure 2008-52 now permits dealerships to eliminate certain invoiced advertising association costs from inventory costs and to make this change as an automatic change in accounting method.

Advertising costs must meet the following criteria in order to qualify for this automatic change in method.

ADVERTISING COSTS

(1) The dealership must pay this advertising fee when acquiring vehicles from the manufacturer,

(2) The advertising costs are separately coded and included in the manufacturer's invoice cost of the new vehicle,

(3) The advertising cost is a flat fee per vehicle or a fixed percentage of the invoice price, and

(4) The fees collected by the manufacturer are paid to ***local*** advertising associations that promote and advertise the manufacturer's products in the dealership's market area.

see **REVENUE PROCEDURE 2008-52**, page 22

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 (Continued from page 21)

It had long been the position of the IRS that advertising costs (credits and fees) paid to ***national*** advertising associations must be distinguished from fees paid to local advertising associations, with the latter (local advertising) eligible for a change in accounting method and the former (national advertising), ineligible for such change. Rev. Proc. 2008-52 does not change this position. Accordingly, advertising fees paid to national advertising associations do not qualify for this change in accounting method.

Under the new method for handling advertising costs, the dealership will exclude advertising costs that meet the above criteria from the cost of new vehicles. These costs will be deducted under Section 162 as the advertising services are provided to the dealership. More details on the timing aspect of when the advertising services are provided are found in Reg. Sec. 1.461-4(d)(2)(i).

Two questions arise based on the wording of the criteria these advertising costs must meet in order to qualify for automatic change status. ***First***, in some instances, the second requirement (that the advertising costs must be separately coded and included in the manufacturer's invoice cost of the new vehicle) may not be satisfied. If the other three criteria are met, but the manufacturer does not separately state the ad fee on the invoice, can the change be made as an automatic change?

The ***second*** question is, does the fourth requirement (that the advertising costs relate to ***local*** advertising associations) extend beyond local to ***regional*** advertising? It seems clear that ***national*** advertising does not qualify and ***local*** advertising does. Query: Where on the spectrum does ***regional*** advertising fall?

This automatic change in accounting method for advertising costs is described in Section 21.13 of the Appendix to Rev. Proc. 2008-52. It is designated accounting method change number #139. For this change, the computation of a net adjustment under Section 481(a) is required. Taxpayers are not permitted to use the cut-off method in making this change. Therefore, taxpayers on LIFO are required to make a detailed recalculation of the layer history for each pool affected by this change.

#6 INELIGIBILITY TO USE THE AUTOMATIC CHANGE PROCEDURES

There are several circumstances in which a dealership may not be eligible to file Form 3115 for an automatic change in accounting method under Revenue Procedure 2008-52.

A taxpayer must fall within the "scope" of Revenue Procedure 2008-52 in order to file under its more relaxed provisions. If a "scope limitation" applies, the taxpayer's Form 3115 for a change in accounting method must be filed before year-end under Revenue Procedure 97-27 (and not under Revenue Procedure 2008-52).

Revenue Procedure 2008-52 has now refined two scope limitations that might prevent a taxpayer from being able to use the automatic change provisions where that taxpayer has made certain changes within the previous five years. This 5-year period includes the year of change, so it is really the year of change plus the four immediately preceding years that need to be examined to see if the taxpayer is eligible to make automatic changes in accounting methods under this Revenue Procedure.

The ***first*** prior 5-year change scope limitation focuses on a prior change in ***overall method.*** This is found in Section 4.02(6) and it is less likely to be problematic.

The ***second*** prior 5-year change scope limitation focuses on a prior change in an ***item.*** This limitation is found in Section 4.02(7). For dealerships on LIFO that intend to make automatic LIFO changes, this ***item*** scope limitation is more frequently encountered.

In general, if a taxpayer has changed its method of accounting for a ***specific item*** (or applied for consent to change a method of accounting for a specific item regardless of whether it implemented that change) during any of the five taxable years ending with the year of change, the taxpayer may not obtain automatic consent to change its method of accounting for that same item.

There are exceptions to the above. A taxpayer is not prohibited from changing a Last-In, First-Out (LIFO) inventory ***sub-method*** (for example, the method of determining current-year cost or the method of computing a dollar-value pool index) within five years of adopting or changing to the LIFO inventory method or ***another*** LIFO inventory ***sub-method.*** The Revenue Procedure includes two examples to further convey the meaning.

In discussing the prior 5-year item change scope limitation, the Revenue Procedure adds for emphasis: ***"However, a taxpayer that changes a LIFO inventory sub-method within five years of adopting or changing to the LIFO inventory method does not receive audit protection under Section 7 of this Revenue Procedure."*** This limitation on audit protection for prior years where other issues are involved has been discussed previously in this article. Also, both of these scope limitations are discussed in greater detail in the accompanying analysis.

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There are a number of other scope limitations contained in Section 4 including limitations related to taxpayers under examination or who are members of a consolidated group or are special entities such as S corporations, partnerships and limited liability companies. These are not discussed in this article, nor are the scope limitations applicable to Section 381(a) transactions, separate trades or businesses and final years or a trade or business.

CONCLUSION

New Revenue Procedure 2008-52 should be carefully studied whenever voluntary changes in accounting methods are being contemplated. And, given some of the changes discussed in this article that have been newly added to the list of automatic changes, now might be a good time to consider some of these for 2008. ✻

Appendix Contents

CAMs Designated as Automatic Changes in Accounting Methods Described in the Appendix to Rev. Proc. 2008-52

* *1 ... Gross Income (Sec. 61)*
2 ... Commodity Credit Loans (Sec. 77)
3 ... Trade or Business Expenses (Sec. 162)
4 ... Bad Debts (Sec. 166)
5 ... Amortizable Bond Premium (Sec. 171)
6 ... Depreciation or Amortization (Various Sections)
7 ... Research & Experimental Expenditures (Sec. 174)
* *8 ... Elective Expensing Provisions (Secs. 179, 181 & 194)*
9 ... Computer Software Expenditures (Secs. 162, 167 & 197)
10 ... Capital Expenditures (Sec. 263)
11 ... Uniform Capitalization (UNICAP) Methods (Sec. 263A)
12 ... Losses, Expenses & Interest w/r/t Transactions Between Related Taxpayers (Sec. 267)
13 ... Deferred Compensation (Sec. 404)
14 ... Methods of Accounting (Sec. 446)
15 ... Taxable Year of Inclusion (Sec. 451)
16 ... Obligations Issues at Discount (Sec. 454)
17 ... Prepaid Subscription Income (Sec. 455)
18 ... Special Rules for Long-Term Contracts (Sec. 460)
19 ... Taxable Year of Deduction (Sec. 461)
* *20 ... Rent (Sec. 467)*
21 ... Inventories (Sec. 471)
22 ... Last-In, First-Out (LIFO) Inventories (Sec. 472)
23 ... Mark-to-Market Accounting Method for Dealers In Securities (Sec. 475)
24 ... Bank Reserves for Bad Debts (Sec. 585)
* *25 ... Insurance Company Premium Acquisition Expense (Sec. 832)*
* *26 ... Discounted Unpaid Losses (Sec. 856)*
* *27 ... Real Estate Mortgage Investment Conduit (REMIC) (Sec. 860)*
28 ... Income from Sources within the United States (Sec. 861)
29 ... Functional Currency (Sec. 985)
* *30 ... Basis of Certain Securities Sold or Transferred (Sec. 1012)*
31 ... Original Issue Discount (Secs. 1272 & 1273)
32 ... Market Discount Bonds (Sec. 1278)
33 ... Short-Term Obligations (Sec. 1281)

Comments

- The numbers 1 through 33 above are the section numbers of the Appendix corresponding to the changes in accounting methods which are designated as automatic changes. Corresponding Internal Revenue Code Section are indicated parenthetically.
- The Appendix sections designated by an asterisk (*) were included in the Appendix to Revenue Procedure 2002-9. Those methods not included in the Appendix to Rev. Proc. 2002-9 were designated as automatic change methods by guidance issued by the IRS during the interim period, or else they were just added to the Appendix to Rev. Proc. 2008-52 as part of its finalization.
- Section 14 (Methods of Accounting - Code Sec. 446) includes the following ...
  14.02 Multi-year insurance policies for multi-year service warranty contracts
  14.10 Multi-year service warranty contracts
- *Appendix Contact List.* The Appendix contains a contact list or directory of individual specialists in the National Tax Office (with phone numbers) who can be contacted to discuss specific designated changes in method.

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BASIC (GENERAL) RULES FOR CHANGES IN ACCOUNTING METHODS

Change in method of accounting defined **(Section 446)**	• A change in method of accounting includes a change in the overall plan of accounting for gross income or deductions, or a change in the treatment of any material item. ◆ A material item is any item that involves the proper time for the inclusion of the item in income or the taking of the item as a deduction. ◆ ***Lifetime income considerations.*** In determining whether a taxpayer's accounting practice for an item involves timing, generally the relevant question is whether the practice permanently changes the amount of the taxpayer's lifetime income. ◆ If the practice does not permanently affect the taxpayer's lifetime income, but does or could change the taxable year in which income is reported, it involves timing and the practice therefore involves a method of accounting. • ***Pattern of consistent treatment.*** Although a method of accounting may exist under the above definition without a pattern of consistent treatment of an item, a method of accounting is not adopted in most instances without consistent treatment. ◆ The treatment of a material item in the same way in determining the gross income or deductions in two or more consecutively filed Federal income tax returns (without regard to any change in status of the method as permissible or impermissible) represents consistent treatment of that item. ◆ If a taxpayer treats an item properly in the first return that reflects the item, however, it is not necessary for the taxpayer to treat the item consistently in two or more consecutive returns to have adopted a method of accounting. ◆ ***Cannot change accounting method by amending prior tax returns.*** If a taxpayer has adopted a method of accounting under these rules, the taxpayer may not change the method by amending its prior income tax return(s). • ***Correction of mathematical error is not a change in accounting method.*** ◆ A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability (such as errors in computation of the foreign tax credit, net operating loss, investment credit, etc.).
Securing permission to make a method change	• In general, a taxpayer must secure the consent of the Commissioner before changing a method of accounting ... unless Section 446(e) and the regulations thereunder provide otherwise. • In general, in order to obtain the Commissioner's consent to a method change, a taxpayer must file a Form 3115, *Application for Change in Accounting Method*, during the taxable year in which the taxpayer wants to make the proposed change. • ***Terms and conditions of a method change.*** The Commissioner may prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with Section 446(e). ◆ The terms and conditions the Commissioner may prescribe include the year of change, whether the change is to be made with a Section 481(a) adjustment or on a cut-off basis, and the Section 481(a) adjustment period. • ***No retroactive method change.*** Unless specifically authorized by the Commissioner, a taxpayer may not request, or otherwise make, a retroactive change in method of accounting, regardless of whether the change is from a permissible or an impermissible method.
Section 481(a) adjustment **(No Statute of Limitations)**	• Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. • When there is a change in method of accounting to which Section 481(a) is applied ◆ Income for the ***taxable year preceding the year of change*** must be determined under the method of accounting that was then employed, and ◆ Income for the ***year of change*** and the following taxable years must be determined under the new method of accounting as if the new method had always been used. • The Section 481(a) adjustment is computed notwithstanding that the period of limitations on assessment and collection of tax may have closed on the years (closed years) in which the events giving rise to the need for an adjustment occurred.

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Background Overview	***Basic (General) Rules for Changes in Accounting Methods*** ***Page 2 of 2***
Adjustment Period	• The adjustment required by Section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer. • Generally, the Sec. 481(a) adjustment is taken into account completely in the year of change, subject to Sec. 481(b) which may limit the amount of tax where the Sec. 481(a) adjustment is substantial. • Section 5 of Rev. Proc. 2008-52 modifies the above rule by providing specific adjustment periods (for example, the spread period of four years for a net positive Section 481(a) adjustment) that are intended to achieve an appropriate balance between the goals of ◆ Mitigating distortions of income that result from accounting method changes, and ◆ Providing appropriate incentives for voluntary compliance.
Method change using a "cut-off" approach	• The Commissioner may determine that certain changes in methods of accounting will be made without a Section 481(a) adjustment, using a cut-off basis or approach. • When a change in method of accounting is made on a cut-off basis, in general, only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. ◆ Any items arising before the year of change continue to be accounted for under the taxpayer's former method of accounting. ◆ Because no amounts are duplicated or omitted when a change in method of accounting is made on a cut-off basis, no Section 481(a) adjustment is necessary. • Examples are in Sections 2.01, 10.04 and 22.02 of the Appendix of this Revenue Procedure.
Consistency and clear reflection of income.	• Methods of accounting should clearly reflect income on a continuing basis. • The Commissioner exercises discretion under Sections 446(e) and 481(c) in a manner that generally minimizes distortions of income across taxable years and on an annual basis.
Separate trades or businesses	• When a taxpayer has two or more separate and distinct trades or businesses, a different method of accounting may be used for each trade or business provided that the method of accounting used for each trade or business clearly reflects the overall income of the taxpayer as well as that of each particular trade or business. • No trade or business is separate and distinct unless a complete and separable set of books and records is kept for that trade or business. • The trades or businesses of the taxpayer are not separate and distinct if, by reason of maintaining different methods of accounting, there is a creation or shifting of profits or losses between the trades or businesses of the taxpayer (for example, through inventory adjustments, sales, purchases, or expenses) so that income of the taxpayer is not clearly reflected.
Penalties	• Any otherwise applicable penalty, addition to the tax, or additional amount for the failure of a taxpayer to change its method of accounting (for example, the accuracy-related penalty under Section 6662 or the fraud penalty under Section 6663) may be imposed if the taxpayer does not timely file a request to change a method of accounting. • The taxpayer's return preparer may also be subject to the preparer penalty under Section 6694. • Penalties, additions to the tax, or additional amounts will not be imposed when a taxpayer changes from an impermissible method of accounting to a permissible one by complying with all applicable provisions of this Revenue Procedure.
Change in accounting method made as part of an IRS audit	• If a taxpayer does not regularly employ a method of accounting that clearly reflects its income, the computation of taxable income must be made in a manner that, in the opinion of the Commissioner, does clearly reflect income. • If a taxpayer under examination is not eligible to change a method of accounting under this Revenue Procedure, the change may be made by the Director. • A change resulting in a positive Section 481(a) adjustment will ordinarily be made in the earliest taxable year under examination with a one-year Section 481(a) adjustment period. See Rev. Proc. 2002-18, 2002-1 C.B. 678.
Source	• Section 2 of Revenue Procedure 2008-52 ... Note: Citations to many specific Code and regulation sections (omitted here) are included in the text of the Rev. Proc.

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Terms & Conditions	*TERMS & CONDITIONS IMPOSED ON TAXPAYERS MAKING AUTOMATIC CHANGES IN ACCOUNTING METHODS UNDER REV. PROC. 2008-52*
In General	• An accounting method change (and the corresponding Form 3115) filed under this Revenue Procedure must comply with all of the terms and conditions set forth in the Revenue Procedure. • For purposes of Section 481, a change in method of accounting made under this Revenue Procedure is considered to be a change in method of accounting ***initiated by the taxpayer***.
Year of Change	• The year of change is the taxable year designated on the application and for which the application is timely filed under Section 6.02(3) of this Revenue Procedure.
Sec. 481(a) Adjustment	• Unless otherwise provided in the Revenue Procedure, a taxpayer making a change in method of accounting must take into account a Section 481(a) adjustment. ♦ In other words, the general rule is that all changes in accounting method require an adjustment under Section 481(a) ... and the cut-off method cannot be used unless the IRS specifically provides that it can be used.
Sec. 481(a) Adjustment Period **... General Rules**	• For a net positive Sec. 481(a) adjustment, the spread period is 4 years. • For a net negative Sec. 481(a) adjustment, the spread period is 1 year. • ***De minimis rule.*** If the net positive Sec. 481(a) adjustment for the change in method is less than $25,000, a taxpayer may elect to use a one-year Sec. 481(a) adjustment period, in lieu of the 4-year spread period. ♦ The taxpayer must complete the appropriate line on Form 3115 to elect this treatment. • ***Short period as a separate taxable year.*** If the year of change or any other taxable year during the Sec. 481(a) adjustment period is a short taxable year, the Sec. 481(a) adjustment must be included in income as if that short taxable year were a full 12-month taxable year.
Certain Events May or May Not Shorten the Spread Period	• ***Conversion to or from S corporation status.*** No acceleration of a Sec. 481(a) adjustment is required when a C corporation elects to be treated as an S corporation or an S corporation terminates its S election and is then treated as a C corporation. ♦ An exception to this is provided in Section 22.01 of the *Appendix* of the Revenue Procedure in connection with a method change that terminates a taxpayer's LIFO election. • ***Certain transfers to which Section 381(a) applies.*** No acceleration of the Sec. 481(a) adjustment is required when a taxpayer transfers substantially all the assets of the trade or business that gave rise to the Sec. 481(a) adjustment to another taxpayer in a transfer to which Sec. 381(a) applies and the accounting method (the change to which gave rise to the Sec. 481(a) adjustment) is a tax attribute that is carried over and used by the acquiring corporation immediately after the transfer pursuant to Sec. 381(c). ♦ The acquiring corporation is subject to any terms and conditions imposed on the transferor (or any predecessor of the transferor) as a result of its change in method of accounting.
Certain Events Will Shorten the Spread Period	• The spread period may be shortened if the taxpayer ceases to engage in the trade or business or if it terminates its existence. ♦ If a taxpayer ceases to engage in a trade or business or terminates its existence, it must take the remaining balance of any Sec. 481(a) adjustment relating to the trade or business into account in computing taxable income in the taxable year of the cessation or termination. • In general, a taxpayer is treated as ceasing to engage in a trade or business if the operations of the trade or business cease or substantially all the assets of the trade or business are transferred to another taxpayer. ♦ For this purpose, "substantially all" has the same meaning as in Section 3.01 of Rev. Proc. 77-37 (1977-2 C.B. 568). • Examples of the cessation of a trade or business include ♦ the incorporation of the trade or business, ♦ the purchase of the trade or business by another taxpayer in a transaction to which Section 1060 applies, ♦ the transfer or termination of the trade or business pursuant to a taxable liquidation, or ♦ the contribution of the assets of the trade or business to a partnership.
Source	• Section 5 of Revenue Procedure 2008-52

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Audit Protection	*AUDIT PROTECTION (FOR TAXABLE YEARS PRIOR TO THE YEAR OF CHANGE) & EFFECT OF CONSENT*
Audit Protection... In General	• *In general,* when a taxpayer timely files a copy of the application Form 3115 with the National Office of the IRS in compliance with all the applicable provisions of this Revenue Procedure, the Service will not require the taxpayer to change its method of accounting for the same item for a taxable year prior to the year of change. ◆ Exceptions to this general rule may be found in Sections 4.02(7)(b), 6.03(5), 6.03(6), 6.04, 6.05, 7.02 of the Revenue Procedure, or in the discussions of certain method changes in the Appendix to it, or in any other guidance published in the I.R.B.
Three Exceptions to Audit Protection for Prior Years	• *Change not made or made improperly.* The Service may change a taxpayer's method of accounting for prior taxable years if ◆ The taxpayer fails to implement the change, ◆ The taxpayer implements the change but does not comply with all the applicable provisions of this Revenue Procedure, or ◆ The method of accounting is changed or modified because there has been a misstatement or omission of material facts (see Section 8.02 of this Revenue Procedure). • *Change in sub-method.* The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method. ◆ ***For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a prior taxable year even though the taxpayer changes its method of valuing increments in the current year.*** ◆ Note, this exception could be extremely problematic for LIFO taxpayers in certain situations. • *Prior year Service-initiated change.* The Service may make adjustments to the taxpayer's returns for the same item for taxable years prior to the requested year of change in order to reflect a prior year IRS-initiated change that was reported as an issue pending or in a Revenue Agent's Report.
Source	• Section 7 of Revenue Procedure 2008-52
Effect of Consent ... In General	• A taxpayer that changes to a method of accounting pursuant to Rev. Proc. 2008-52 may be required to change or modify that method of accounting for the following reasons: ◆ The enactment of legislation, ◆ A decision of the United States Supreme Court, ◆ The issuance of temporary or final regulations, ◆ The issuance of a revenue ruling, Revenue Procedure, notice, or other statement published in the Internal Revenue Bulletin (I.R.B.), ◆ A change in the material facts on which the consent was based, or ◆ The issuance of written notice to the taxpayer that the change in method of accounting is not in accord with the current views of the Service. • Note, the last reason given above seems to give the IRS license to be arbitrary.
Retroactive Change or Modification	• Generally, if a taxpayer changes a method of accounting, and it is subsequently required to make a further change as a result of one of the conditions above, that required change or modification in the method of accounting ***will not a be applied retroactively.*** • In order to avoid that retroactive application, the taxpayer must satisfy the following requirements. ◆ The taxpayer complied with all the applicable provisions of Rev. Proc. 2008-52, ◆ There has been no misstatement or omission of material facts, ◆ There has been no change in the material facts on which the consent was based, ◆ There has been no change in the applicable law, and ◆ The taxpayer to whom consent was granted acted in good faith in relying on the consent, and applying the change or modification retroactively would be to the taxpayer's detriment.
Source	• Section 8 of Revenue Procedure 2008-52

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Filing Requirements	***Automatic Changes in Accounting Methods*** ***General Application Procedures & Form 3115 Filing Requirements*** ***Page 1 of 2***
Overview	• The consent of the Commissioner will be granted to a taxpayer to automatically change a method of accounting if ♦ That method is specifically described in the *Appendix* to the Revenue Procedure and ♦ The taxpayer is within the scope of Revenue Procedure. • Such consent is granted only for the change(s) of accounting method and the affected item(s) that are clearly and expressly identified on the Form 3115 filed by the taxpayer. • Such consent is granted only to the extent that the taxpayer complies with all the applicable provisions of this Revenue Procedure and implements the change in method of accounting for the requested year of change. • ***No user fee.*** A user fee is not required for an application filed under this Revenue Procedure. • If a taxpayer makes a change in accounting method without complying with all the applicable provisions of this Rev. Proc., the taxpayer will be treated as having initiated a change in method of accounting without obtaining the consent of the Commissioner, and this could have adverse consequences for the taxpayer.
Application on Form 3115	• Generally, a taxpayer applies for consent to change a method of accounting pursuant to Rev. Proc. 2008-52 by completing and filing a current Form 3115. ♦ In some cases, however, the provisions of this Revenue Procedure applicable to a particular change may require or allow a taxpayer to file a statement in lieu of a Form 3115 as an application for consent to make such change. • Ordinarily, a taxpayer must submit a ***separate application*** for each change in method of accounting. ♦ In some cases, however, a taxpayer may be required or allowed to file a single application with respect to two or more changes. • Certain taxpayers may file a single application to change an identical method of accounting on behalf of two or more of its separate and distinct trades or businesses, two or more members of a consolidated group or two or more controlled foreign corporations.
Form 3115 Contents	• The taxpayer must submit an application that is accurate and complete as to all information required by this Revenue Procedure. ♦ Unless this Revenue Procedure provides that a Form 3115 is not required for the requested change in method of accounting, the taxpayer must submit a current Form 3115 that contains all information required by the applicable portions of the Form 3115 and its instructions. • The application must fully describe the item(s) being changed; the present method(s) of accounting from which the taxpayer is changing and the proposed method(s) of accounting to which the taxpayer is changing. ♦ The taxpayer must provide all other information required by Parts I, II, and IV, and any applicable schedule(s) on the Form 3115.
Due Date For Filing Form 3115	• ***Waiver of taxable year filing requirement.*** The requirement (in Reg. Sec. 1.446-1(e)(3)(i)) to file a Form 3115 within the taxable year for which the change is requested is waived for any application for a change in method of accounting filed pursuant to this Revenue Procedure. • For a designated automatic change in method of accounting, the Form 3115 is filed after the end of the year of change as part of the income tax return for the year of change.
Timely Duplicate Filing Requirement ... In General	• Form 3115 must be completed and filed in duplicate. ♦ The ***original of Form 3115*** must be attached to the taxpayer's timely filed (including any extension) original Federal income tax return for the year of change, ♦ A ***copy*** (with signature) of Form 3115 must be filed with the National Office • no earlier than the first day of the year of change and • no later than when the original is filed with the income tax return for the year of change. • For the National Office copy of Form 3115, the taxpayer need only include the pages containing Parts I through IV, any applicable schedule(s), and required attachments.
Automatic Extension of Time for Filing	• An automatic extension of 6 months from the due date of the income tax return for the year of change (excluding any extension) will be granted to file Form 3115, if the taxpayer satisfies five conditions set forth in Section 602(3)(c)(i). ♦ This relief provision is discussed in detail on page 17 of the last issue of the *LIFO Lookout.* • Except in unusual and compelling circumstances, further extensions of time will not be granted.

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Filing Requirements	AUTOMATIC CHANGES IN ACCOUNTING METHODS GENERAL APPLICATION PROCEDURES & FORM 3115 FILING REQUIREMENTS *Page 2 of 2*
Designated Automatic Accounting Method Change Number	• The taxpayer must type or clearly print the designated automatic accounting method change number for the requested change in method on the appropriate line (Line 1(a)) on Form 3115. ♦ When a change in method is being made using a statement in lieu of Form 3115, the designated automatic accounting method change number must be entered at the top of the first page of the statement, directly above the taxpayer's name and employer identification number. • In general, a taxpayer may enter only one designated automatic accounting method change number on an application. ♦ However, where Rev. Proc. 2008-52 (or other published guidance) specifically permits two or more particular changes in method of accounting to be made on a single application, a taxpayer must enter the designated automatic change number for each such particular change being requested on the application. • Designated automatic accounting method change numbers are provided for all authorized method changes in the *Appendix* to the Revenue Procedure. In addition, as new automatic changes in method are authorized, they will be assigned corresponding automatic change numbers in other guidance that will be published in the Internal Revenue Bulletin. ♦ See also the Instructions for Form 3115.
Signature Requirements	• The copy of Form 3115 filed with the National Office must be signed by, or on behalf of, the taxpayer requesting the change by an individual with authority to bind the taxpayer in such matters. ♦ If the taxpayer (or the designated shareholder) is a member of a consolidated group, an application submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. ♦ Signature requirements are set forth in the current Instructions for Form 3115 regarding those who are to sign.
Authorized Representative	• If an agent is authorized to represent the taxpayer before the Service in various capacities related to the Form 3115 being filed, a power of attorney reflecting such authorization(s) must be attached to the copy of the application Form 3115. • The IRS prefers that Form 2848, *Power of Attorney and Declaration of Representative*, be used to provide the representative's authority and qualification.
Address To Use For Filing Copy of Form 3115* *For taxpayers other than exempt organizations	• ***If mailed*** *Internal Revenue Service* *Attn: CC:ITA -- Automatic Rulings Branch* *P.O. Box 7604* *Benjamin Franklin Station* *Washington, D.C. 20044* • ***If delivered by a designated private delivery service*** *Internal Revenue Service* *Attn: CC:ITA -- Automatic Rulings Branch* *1111 Constitution Avenue, NW, Room 5336* *Washington, D.C. 20224* • ***If hand delivered*** *Courier's Desk, Internal Revenue Service* *Attn: CC:PA:LPD:DRU* *1111 Constitution Avenue, NW, Room 5336* *Washington, D.C. 20224* ♦ A receipt will be given at the courier's desk. ♦ Delivery may be made between the hours of 8:00 a.m. and 4:00 p.m. to the courier's desk at the loading dock (located behind the 12th Street Security Station) of 1111 Constitution Avenue, NW, Washington, D.C. • Except for hand deliveries at the courier's desk, the IRS does not send or provide an acknowledgment of the receipt of Form 3115 (original or copy) filed under this Rev. Proc. • Additional copies of Form 3115 are required to be filed in situations where the taxpayer is under examination or before an Appeals Office or a Federal Court.
Source	• Section 6 of Revenue Procedure 2008-52

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Scope Limitations	***Scope Limitations that Prevent Taxpayers from Being Eligible to Make Automatic Changes in Accounting Methods*** **Page 1 of 2**
Applicability ... In General	• Revenue Procedure 2008-52 is the exclusive procedure for a taxpayer within its scope to obtain the Commissioner's consent to change to a method of accounting that is described in the Appendix of the Revenue Procedure. • Some taxpayers may not be eligible to make an automatic change in accounting method. • Special rules are provided in Section 4.02(1)-(5) that may prevent a taxpayer from using the automatic change procedures in certain situations. In other words, these situations place the taxpayer beyond or outside the "scope" of Rev. Proc. 2008-52. • These scope limitations may apply to ... ♦ Taxpayers under examination (but only in certain circumstances) ♦ Certain consolidated group members ♦ Certain partnership and S-corporation entities having issues under consideration ♦ Section 381(a) transactions which provide other rules for changes in accounting methods to be made by acquiring corporations ♦ The final year of a trade or business
5-Year Prior Change Scope Limitations	• Two situations, in addition to those above, could result in the taxpayer not falling within the scope of Rev. Proc. 2008-52. These two situations involve taxpayers who may have been involved in a ... ♦ Prior 5-year ***overall method*** change, or ♦ Prior 5-year ***item*** change. • Rev. Proc. 2008-52 clarifies the operation and interpretation of the prior 5-year ***item*** change scope limitation.
	Prior 5-Year Overall Method Change Scope Exception
Prior 5-Year Overall Method Change	• If a taxpayer changed its ***overall*** method of accounting, or applied for consent to change its overall method of accounting (regardless of whether it implemented that change), during any of the five taxable years ending with the year of change, the taxpayer may not obtain automatic consent to change its overall method of accounting under this Revenue Procedure. ♦ This rule applies unless there is a special exception to its application stated in the section of the Appendix to the Rev. Proc. that deals exclusively with the method of accounting being changed. • This five-year overall method change prohibition applies regardless of whether the taxpayer's current or prior method is a permissible method or clearly reflects the taxpayer's income. It also applies regardless of the administrative guidance used to request consent or to change the prior method of accounting., • There are two important exceptions to the application of the scope limitations where a previous change in an ***overall*** method is involved. ♦ ***Items within an overall method.*** A taxpayer that changed its ***overall*** method of accounting during the five taxable years ending with the year of change may obtain automatic consent to change a method of accounting for an ***item*** when that change may otherwise be implemented under the provisions of this Revenue Procedure. ♦ ***Initial returns.*** The term "change in overall method of accounting" does not include the use of an overall method of accounting when computing taxable income for the taxable year that the taxpayer first files a Federal income tax return ("adopts an overall method of accounting") or a change in method of accounting imposed by the IRS in certain circumstances.
Source	• Section 4.02(6) of Revenue Procedure 2008-52.

Scope Limitations	***Scope Limitations that Prevent Taxpayers from Being Eligible to Make Automatic Changes in Accounting Methods*** Page 2 of 2
	Prior 5-Year Item Change Scope Exception
Item Changes In General	• In general, if a taxpayer changed its method of accounting for a ***specific item***, or applied for consent to change a method of accounting for a specific item (regardless of whether it implemented that change), during any of the five taxable years ending with the year of change, the taxpayer may not obtain automatic consent to change its method of accounting for that same item. ♦ This covers the year of change plus the four years immediately preceding the year of change. • A change in method of accounting for an ***item*** does not include ♦ The use of a method of accounting for the first taxable year that the taxpayer accounts for the item (for example, include in income, deduct, or capitalize) to which the method of accounting relates, or ♦ A change in method of accounting imposed by the IRS in certain circumstances where Revenue Procedure 2002-18 applies. • This five-year ***item*** change prohibition applies regardless of ... ♦ Whether the taxpayer's current or prior method is a permissible method or clearly reflects the taxpayer's income, and ♦ The administrative guidance used to request consent or to change the prior method of accounting.
Exceptions ... Some Problematic for LIFO Taxpayers	• A taxpayer may obtain automatic consent to change its method of accounting for an item when that change is required as part of another change in method of accounting that the taxpayer may otherwise implement under the provisions of this Revenue Procedure. • ***LIFO sub-methods.*** In addition, a taxpayer is not prohibited from changing a Last-In, First-Out (LIFO) inventory sub-method (for example, the method of determining current-year cost or the method of computing a dollar-value pool index) within five years of adopting or changing to the LIFO inventory method or another LIFO inventory sub-method. ♦ ***However, a taxpayer that changes a LIFO inventory sub-method within five years of adopting or changing to the LIFO inventory method does not receive audit protection under Sec. 7.*** ♦ ***Note, this could be problematic in certain LIFO situations.***
LIFO Taxpayer Example #1	• ***A*** uses the LIFO inventory method. • In 2004, ***A*** changed a LIFO inventory sub-method. Specifically, ***A*** changed from the average-cost method of determining the current-year cost of inventories to the earliest-acquisitions cost method. • In 2007, ***A*** seeks to change to the IPIC method of computing the index and value of its dollar-value pools, a method that ***A*** has never used. • As part of this change, ***A*** seeks to change its method of determining the current-year cost of inventories from the earliest-acquisitions cost method to the most-recent acquisitions cost method. • ***Automatic Change is Permitted. A*** is eligible to change its method of computing the index and value of its dollar-value pools to the IPIC method under this Revenue Procedure. • ***Automatic Change is Not Permitted.*** However, A is not eligible to change its method of determining the current-year costs of inventories (i.e., a LIFO sub-method) under this Revenue Procedure because ***A*** changed this LIFO inventory sub-method within the proscribed five-year period.
Auto Dealer LIFO Taxpayer Example #2	• ***B*** uses the dollar-value LIFO inventory method and maintains separate dollar-value pools for its inventory of (1) new cars, (2) new trucks, (3) used cars and (4) used trucks. • In 2004, ***B*** terminated its use of the LIFO inventory method for its used cars and used trucks under Rev. Proc. 2002-9. • In 2007, ***B*** seeks to terminate its use of the LIFO inventory method for its new cars and new trucks. (In other words, ***B*** wants to go off of LIFO for its new vehicle inventories.) • ***Automatic Change is Permitted.*** B is eligible to change its method of accounting for new cars and new trucks under Rev. Proc. 2008-52 because it has not changed the inventory-identification method for those (new vehicle) pools within the proscribed five-year period.
Source	• Section 4.02(7) of Revenue Procedure 2008-52.

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Subsequent Reviews	***Subsequent Reviews of Forms 3115 for Changes in Methods by the Director and/or the National Tax Office*** Page 1 of 2
	Director
Review by Director ... In General	• The Director must apply a change in method of accounting made in compliance with all the applicable provisions of this Revenue Procedure in determining the taxpayer's liability, unless the Director recommends that the change in method of accounting should be modified or revoked. • Factors that the Director will consider in ascertaining if the change in method of accounting was made in compliance with all the applicable provisions of this Revenue Procedure, include whether ♦ The representations on which the change was based reflect an accurate statement of the material facts, ♦ The amount of the Section 481(a) adjustment was properly determined, ♦ The change in method of accounting was implemented in compliance with all the applicable provisions of this Revenue Procedure, ♦ There has been any change in the material facts on which the change was based during the period the method of accounting was used, and ♦ There has been any change in the applicable law during the period the method of accounting was used.
Director Remedies if Changes Are Not Fully Compliant	• If the Director determines that the taxpayer has not complied with all of the applicable provisions of this Revenue Procedure, the Director may... ♦ Deny the change in method of accounting and require the taxpayer to continue to use the prior method of accounting, ♦ Deny the change in method of accounting and place the taxpayer on a proper method of accounting, ♦ Make any adjustments (including the amount of any Section 481(a) adjustment) that are necessary to bring the change in method of accounting into compliance with all applicable provisions of this Revenue Procedure, or ♦ Impose any otherwise applicable penalty, addition to tax, or additional amount on the understatement of tax attributable to the change in method of accounting.
National Office Involvement	• If the Director recommends that a change in method of accounting (other than the Section 481(a) adjustment) made in compliance with all the applicable provisions of this Revenue Procedure should be modified or revoked, ***before any further action is taken***, the Director will forward the matter to the National Office for consideration. ♦ Such a referral to the National Office will be treated as a request for technical advice to which the provisions of Rev. Proc. 2008-2 (or any successor) will apply.
Source	• Section 9 of Revenue Procedure 2008-52

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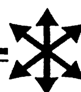

SUBSEQUENT REVIEWS OF FORMS 3115 FOR CHANGES IN METHODS BY THE DIRECTOR AND/OR THE NATIONAL TAX OFFICE

IRS National Office

In General

- Any application filed under Rev. Proc. 2008-52 may be reviewed by the IRS National Office.
- The National Office will apply special procedures if the Form 3115 under review is incomplete, and it has considerable authority to modify or deny a taxpayer's application for change.

Incomplete Application

- If the National Office reviews an application and determines that the taxpayer has not properly completed Form 3115, or if supplemental information is needed, the National Office will notify the taxpayer.
  - ***30-day rule.*** The notification will specify the information that the taxpayer needs to provide and permit the taxpayer 30 days from the date of the notification to furnish the information. The National Office reserves the right to impose shorter reply periods if subsequent requests for additional information are made.
  - An extension of the 30-day period to furnish information, not to exceed 30 days, may be granted to a taxpayer.
  - A request for an extension of the 30-day period must be made in writing and submitted within the initial 30-day period.
  - If the extension request is denied, there is no right of appeal.
- ***Failure to provide additional information.*** Ordinarily, if the taxpayer fails to provide the additional information on a timely basis, the application does not qualify for the automatic consent procedures of this Revenue Procedure.
  - Under these circumstances, the National Office will notify the taxpayer that consent to make the change in method of accounting is not granted.

Tentative Adverse Determinations & National Office Conferences & Procedures

- ***Conference in the National Office.*** If the National Office tentatively determines that the taxpayer has changed its method of accounting without complying with all the applicable provisions of Rev. Proc. 2008-52, the National Office will notify the taxpayer of its tentative adverse determination and will offer the taxpayer a conference of right, if the taxpayer has requested a conference.
  - Conference procedures for taxpayers other than exempt organizations, are found in Section 10 of Rev. Proc. 2008-1 (or any successor).
  - Taxpayers filing under Rev. Proc. 2008-52 may become involved in these procedures if they have changed to a method of accounting that varies from the applicable accounting method described in this Revenue Procedure or they are outside the scope of this Revenue Procedure (i.e., the scope limitations are applicable).
  - It is advisable to always request a conference of right as part of the Form 3115 application.
- ***Consent not granted.*** Except as discussed below under "Possible Relief," if the National Office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of this Revenue Procedure, the National Office will notify the taxpayer that consent to make the change in method of accounting is not granted.
  - In no event will an application under this Revenue Procedure be treated as an application under Rev. Proc. 97-27 (or any successor). In other words, if the taxpayer still wants to change its method of accounting, the taxpayer will have to start all over by filing Form 3115 under Rev. Proc. 97-27 before the end of the desired year of change. Typically, this means that the year of change will be at least one year later (and it could be several years later) than originally intended by the taxpayer.

Possible Relief For Taxpayers

- If the National Office determines that a taxpayer has changed its method of accounting without complying with all the applicable provisions of Rev. Proc. 2008-52, the National Office, in its discretion, may allow the taxpayer to ...
  - Make appropriate adjustments to conform its change in method of accounting to the applicable provisions of this Revenue Procedure, and
  - Make conforming amendments to any Federal income tax returns filed for the year of change and subsequent taxable years.
- The Director may review any application that is changed by the National Office.

Source

- Section 10 of Revenue Procedure 2008-52

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AUTOMATIC INVENTORY METHOD CHANGES ... OTHER THAN LIFO

14 Automatic Changes (Section 471)

.01		Cash Discounts	
.02		Estimating Inventory "Shrinkage"	
.03		Small Taxpayer Exception from Rqmt. to Account for Inventories Under Sec. 471	
.04	*	Qualifying Volume-Related Trade Discounts	Pg. 1
.05	*	Impermissible Methods of Valuation	Pg. 1
.06	*	Core Alternative Valuation Method	Pg. 2
.07	*	Replacement Cost for Automobile Dealers' Parts Inventory	Pg. 2
.08	*	Replacement Cost for Heavy Equipment Dealers' Parts Inventory	Pg. 3
.09		Rotable Spare Parts	
.10		Advance Trade Discount Method	
.11	*	Permissible Methods of Identification and Valuation	Pg. 3
.12	*	Change in the Official Used Vehicle Guide Utilized in Valuing Used Vehicles	Pg. 3
.13	*	Invoiced Advertising Association Costs for New Vehicle Retail Dealerships	Pg. 4
.14	*	Rolling-Average Method of Accounting for Inventories	Pg. 4

Source & Notes

Section 21 of the Appendix to Revenue Procedure 2008-52.
Sections 21.01 through 21.05 were included in Rev. Proc. 2002-9.
Sections 21.06 through 21.14 are added as automatic changes since issuance of Rev. Proc. 2002-9.
* Changes discussed below

Sec. 21.04 Qualifying Volume-Related Trade Discounts

Designated automatic accounting method change number ... 53.

Description of change. This change applies to a taxpayer that wants to change its method of accounting to treat qualifying volume-related trade discounts as a reduction in the cost of merchandise purchased at the time the discount is recognized in accordance with Reg. Sec. 1.471-3(b).

A "qualifying volume-related trade discount" means a discount satisfying the following criteria:

- The taxpayer receives or earns the discount based solely upon the purchase of a particular volume of the merchandise to which the discount relates;
- The taxpayer is neither obligated nor expected to perform or provide any services in exchange for the discount; and
- The discount is not a reimbursement of any expenditure incurred or to be incurred by the taxpayer.

Section 481(a) adjustment is required. The net Section 481(a) adjustment attributable to the change is computed in a manner similar to the computation of a net Section 481(a) adjustment in the case of a change to the net invoice method of accounting for cash discounts.

For further information on this change, selected articles include ...

- *This automatic change is more fully discussed in the accompanying overview article.*
- *Elimination of Trade Discounts (Floorplan assistance Payments) and Advertising Fees and Expenses from Inventory Cost*
  - *Part I ... LIFO Lookout, September 2003*
  - *Part II ... LIFO Lookout, September 2004*
- *Trade Discounts & Advertising Expense CAMs may be the Answer for Dealers Looking for Big, One-Time Tax Write-offs ... LIFO Lookout, December 2002 & Dealer Tax Watch, December 2002*

Sec. 21.05 Impermissible Methods of Valuation

Designated automatic accounting method change number ... 54

This change applies to taxpayers who are changing from an impermissible method of accounting described in Reg. Sec. 1.471-2(f)(1) through (5). This includes a LIFO taxpayer restoring a write down of inventory below cost or discontinuing maintaining an inventory reserve.

This change also applies to taxpayers who are changing from a gross profit method or from a method of determining market that is not in accordance with Reg. Sec. 1.471-4.

Gross profit method. A gross profit method is a method in which the taxpayer estimates the cost of goods sold by reducing its gross sales by a percentage "mark-up" from cost. The estimated cost of goods sold is subtracted from the sum of the beginning inventory and purchases and the result is used as the ending inventory.

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Sec. 21.05 Impermissible Methods of Valuation (continued)

Method of determining market. An example of a method of determining market that is not in accordance with Reg. Sec. 1.471-4 is where a taxpayer, under ordinary circumstances, determines the market value of purchased merchandise using judgment factors, and not using the prevailing current bid price on the inventory date for the particular merchandise in the volume in which it is usually purchased by the taxpayer.

Applicability. For purposes of this change, a taxpayer must be changing to an inventory method (identification or valuation, or both) specifically permitted by the Code, the regulations, or a decision by the United States Supreme Court, a revenue ruling, a revenue procedure, or other guidance published in the Internal Revenue Bulletin (I.R.B.) for the inventory goods, and the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods. This change does not apply to a change described in another section of this revenue procedure or in other guidance published in the I.R.B.

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required.

Sec. 21.06 Core Alternative Valuation Method

Designated automatic accounting method change number ... 55.

Applicability. This change applies to a remanufacturer and rebuilder of motor vehicle parts and a reseller of remanufactured and rebuilt motor vehicle parts that use the cost or market, whichever is lower, (LCM) inventory valuation method to value their inventory of cores held for remanufacturing or sale and wants to use the Core Alternative Valuation (CAV) method specified in Rev. Proc. 2003-20.

Inapplicability. This change does not apply to a taxpayer that values its inventory of cores at cost (including a taxpayer using the LIFO inventory method) unless the taxpayer concurrently changes (under section 6.02 of Rev. Proc. 2003-20) from cost to the LCM method for its cores (including labor and overhead related to the cores in raw materials, work-in-process and finished goods).

Concurrent automatic change. A taxpayer that wants to make both this change and (i) a change from the cost method to the LCM method under Section 21.11 of this Appendix, or (ii) a change from the LIFO inventory method to a permitted method for identification under (and as determined and defined in) Section 22.01(1)(b) of this Appendix for the same year of change, should file a single Form 3115 for both changes, provided the taxpayer enters the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required.

For further information on this change, selected articles include ...

- *Safe Harbor Valuation Method for Core Inventories ... Rev. Proc. 2003-20 ... LIFO Lookout March 2003*
- *IRS Terminates Consolidate Manufacturing Inc.'s LIFO Election Made for Some - But not all - Costs that Make Up Goods ... LIFO Lookout September 1988*

Sec. 21.07 Replacement Cost for Automobile Dealers' Parts Inventory

Designated automatic accounting method change number ... 63.

Description of change. This change applies to a taxpayer that is engaged in the trade or business of selling vehicle parts at retail, that is authorized under an agreement with one or more vehicle manufacturers or distributors to sell new automobiles or new light, medium, or heavy-duty trucks, and that wants to use the replacement cost method described in Section 4 of Rev. Proc. 2002-17, for its vehicle parts inventory.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories on or after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

For further information on this change, selected articles include ...

- *Valuing Parts Inventories ... Whether Using LIFO or Not ... the IRS Replacement Cost Safe Harbor Method ... LIFO Lookout June 2002*
- *Mountain State Ford Truck Sales, Inc. ... Dealers Can't Use Replacement Cost for Parts Inventories on LIFO ... LIFO Lookout March 1999 & Dealer Tax Watch March 1999*

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Sec. 21.08 Replacement Cost for Heavy Equipment Dealers' Parts Inventory

Designated automatic accounting method change number ... 96.

Description of change. This change applies to a heavy equipment dealer that is engaged in the trade or business of selling heavy equipment parts at retail, that is authorized under an agreement with one or more heavy equipment manufacturers or distributors to sell new heavy equipment, and that wants to use the replacement cost method described in Section 4 of Rev. Proc. 2006-14 for its heavy equipment parts inventory.

Manner of making the change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Concurrent automatic change. A taxpayer that wants to make both this change and another automatic change in method of accounting under Section 263A (see Section 11 of this Appendix) for the same year of change may file a single Form 3115 for both changes, provided the taxpayer enters the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115, and complies with the ordering rules of Reg. Sec. 1.263A-7(b)(2).

For further information on this change, selected articles include ...

- *Rev. Proc. 2006-14 Heavy Equipment Dealers May Use Replacement Cost Method with LIFO for Valuing Parts Inventories ... LIFO Lookout March 2006 & Dealer Tax Watch December 2005*

Sec. 21.11 Permissible Methods of Identification and Valuation

Designated automatic accounting method change number ... 137.

Applicability. This change applies to a taxpayer that wants to change from one permissible method of identifying and valuing inventories to another permissible method of identifying and valuing inventories that is not a change described in another section of this Revenue Procedure or in other guidance published in the I.R.B..

Permissible method defined. For purposes of this change, a permissible method is an inventory method (identification or valuation, or both) specifically permitted by the Code, the regulations, a decision by the United States Supreme Court, a revenue ruling, a Revenue Procedure, or other guidance published in the I.R.B. for the inventory goods, and the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods.

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required.

Sec. 21.12 Change in the Official Used Vehicle Guide Utilized in Valuing Used Vehicles

Designated automatic accounting method change number ... 138.

Description of change. Used vehicles taken in trade as part payment on the sale of vehicles by a dealer may be valued for inventory purposes at valuations comparable to those listed in an official used vehicle guide as the average wholesale prices for comparable vehicles. (See Rev. Rul. 67-107).

This change applies to a taxpayer that wants to change from not using an official used vehicle guide to using an official used vehicle guide for valuing used vehicles.

This change also applies to a taxpayer that wants to change to a different official used vehicle guide for valuing used vehicles.

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required. However, given the rapid turnover of used vehicles in a typical dealership inventory, the 481(a) adjustment may involve only one year's calculation.

For further information on this change, selected articles include ...

- *Confusion Over Use of Different Official Guides ... LIFO Lookout September 2001*
- *IRS Concedes Used Car Write-Downs at Year-End to Industry Book Value ... Dealer Tax Watch September 1999*
- *Used Vehicle Inventories ... Year-End Write-Down Documentation Worksheet ... Dealer Tax Watch December 2006*

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Sec. 21.13 Invoiced Advertising Association Costs for New Vehicle Retail Dealerships

Designated automatic accounting method change number ... 139.

Description of change. This change applies to a taxpayer that is engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("dealership") that wants to discontinue capitalizing certain advertising costs as acquisition costs under Reg. Sec. 1.471-3(b).

The change applies to advertising costs that meet the following criteria: (a) the dealership must pay this advertising fee when acquiring vehicles from the manufacturer; (b) the advertising costs are separately coded and included in the manufacturer's invoice cost of the new vehicle; (c) the advertising cost is a flat fee per vehicle or a fixed percentage of the invoice price; and (d) the fees collected by the manufacturer are paid to local advertising associations that promote and advertise the manufacturer's products in the dealership's market area.

Under the new method, the dealership will exclude advertising costs that meet the above criteria from the cost of new vehicles and deduct the advertising costs under Section 162 as the advertising services are provided to the dealership. See Reg. Sec. 1.461-4(d)(2)(i).

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required.

For further information on this change, selected articles include ...

- *This automatic change is more fully discussed in the accompanying overview article.*
- *Elimination of Trade Discounts (Floorplan assistance Payments) and Advertising Fees and Expenses from Inventory Cost*
  - *Part I ... LIFO Lookout, September 2003*
  - *Part II ... LIFO Lookout, September 2004*
- *Trade Discounts & Advertising Expense CAMs may be the Answer for Dealers Looking for Big, One-Time Tax Write-offs ... LIFO Lookout, December 2002 & Dealer Tax Watch, December 2002*

Sec. 21.14 Rolling-Average Method of Accounting for Inventories

Designated automatic accounting method change number ... 114.

Description of change. This change applies to a taxpayer that uses a rolling-average method to value inventories for financial accounting purposes and wants to use the same rolling-average method to value inventories for Federal income tax purposes in accordance with Rev. Proc. 2008-43.

Scope limitation inapplicable. The scope limitation in Section 4.02(7) of this Revenue Procedure does not apply to the change to a rolling-average method in the taxpayer's first or second taxable year ending on or after Dec. 31, 2007.

Manner of making change. This change is made on a cut-off basis unless the taxpayer's books and records contain sufficient information to compute a Section 481(a) adjustment, in which case the taxpayer may choose to implement the change with a Section 481(a) adjustment as provided in section 5.04 of this Revenue Procedure. See Section 2.06 of this Revenue Procedure for more information regarding a cut-off basis.

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LIFO Inventories	LAST-IN, FIRST-OUT INVENTORIES AUTOMATIC CHANGES IN LIFO ACCOUNTING METHODS PAGE 1 OF 7
10 Automatic Changes (Section 472)	.01 Change from the LIFO Inventory Method (i.e., Termination of LIFO Election)............Pg. 1 .02 Determining Current-Year Cost Under the LIFO Inventory Method............Pg. 2 .03 Alternative LIFO Inventory Method for Retail Automobile Dealers............Pg. 3 .04 Used Vehicle Alternative LIFO Method............Pg. 4 .05 Determining the Cost of Used Vehicles Purchased or Taken as a Trade-In............Pg. 5 .06 Change to the Inventory Price Index Computation (IPIC) Method............Pg. 5 .07 Changes Within the Inventory Price Index Computation (IPIC) Method............Pg. 6 .08 Changes to the Vehicle-Pool Method............Pg. 6 .09 Changes Within the Used Vehicle Alternative LIFO Method............Pg. 7 .10 Changes to Dollar-Value Pools of Manufacturers............Pg. 7
Source & Notes	Section 22 of the Appendix to Revenue Procedure 2008-52. Sections 22.01 through 22.07 were included in Rev. Proc. 2002-9. Sections 22.08 through 22.10 are added as automatic changes since issuance of Rev. Proc. 2002-9.

Section 22.01 Change from the LIFO Inventory Method (i.e., Termination of LIFO Election)

Designated automatic accounting method change number ... 56.

This change applies to a taxpayer that wants to (1) change ***from*** the LIFO inventory method for all its LIFO inventory or for one or more dollar-value pools and (2) change ***to*** a permitted method or methods as discussed below.

Determining the permitted method to be used. A taxpayer may change to one or more non-LIFO inventory methods for the LIFO inventories that are the subject of this accounting method change, but only if the selected non-LIFO method is a permitted method for the inventory goods to which it will be applied.

For example, a heavy equipment dealer may change to the specific identification method for new heavy equipment inventories and the replacement cost method, as described in Rev. Proc. 2006-14, 2006-1 C.B. 350, for heavy equipment parts inventories.

Permitted method defined. An inventory method (identification or valuation, or both) is a permitted method if it is specifically permitted by the Code, the regulations, a decision by the United States Supreme Court, a revenue ruling, a Revenue Procedure, or other guidance published in the Internal Revenue Bulletin (I.R.B.) for the inventory goods and if the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods.

Determining permitted method. Whether an inventory method is a permitted method is determined without regard to the types and amounts of costs capitalized under the taxpayer's method of computing inventory cost. See Section 263A and the regulations thereunder, which govern the types and amounts of costs required to be included in inventory cost for taxpayers subject to those provisions.

Certain scope limitation inapplicable. The scope limitation in Section 4.02(7) of this Revenue Procedure does not apply in the first taxable year that the taxpayer does not or will not comply with the requirements of Section 472(e)(2) because the taxpayer has applied or will apply International Financial Reporting Standards in its financial statements or because the taxpayer has been acquired by an entity that has not or will not use the LIFO method in its financial statements.

Additional requirements to identify new methods. The taxpayer must complete the following statements and attach them to its Form 3115. If the taxpayer will use different methods for different inventory goods to which the change applies, the taxpayer must complete the statements ***for each of those different types of inventory goods.***

- "The new method of ***identifying*** [*Insert description of inventory goods*] is the [*Insert method, as appropriate; that is, specific identification; FIFO; retail; etc.*] method," and
- "The new method of ***valuing*** [*Insert description of inventory goods*] is [*Insert method, as appropriate; that is, cost; LCM; etc.*]."

Other special rules included in the Appendix for this change are on the following page.

For further information on LIFO election terminations, selected articles include ...

- *This automatic change to terminate LIFO is more fully discussed in the accompanying overview article.*
- *Would You Believe? ... Dealerships that Terminated Their LIFO Elections ... May Actually Still be on LIFO ... LIFO Lookout Spring 2008 (pg. 3)*
- *Sample Form 3115 Filing for Dealerships Terminating Alternative LIFO Election ... LIFO Lookout March 2006*
- *Dealer LIFO Election Termination Problems ... "Permitted Methods" for Valuing Inventories Formerly on LIFO ... LIFO Lookout September 2005*

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Section 22.01 Change from the LIFO Inventory Method (i.e., Termination of LIFO Election (continued)

Limitation on reelection of LIFO method after prior termination. The taxpayer may not re-elect the LIFO inventory method for a period of at least five taxable years beginning with the year of change unless, based on a showing of unusual and compelling circumstances, consent is specifically granted by the Commissioner to change the method of accounting at an earlier time.

A taxpayer that wants to re-elect the LIFO inventory method within a period of five taxable years (beginning with the year of change) must file a Form 3115 in accordance with Rev. Proc. 97-27 (or any successor).

A taxpayer that wants to re-elect the LIFO inventory method after a period of five taxable years (beginning with the year of change) is not required to file a Form 3115 in accordance with Rev. Proc. 97-27, but must file a Form 970, *Application to Use LIFO Inventory Method*, in accordance with Reg. Sec. 1.472-3.

Special rule ... S Corporation election effective for year of LIFO discontinuance. If a C corporation elects to be treated as an S corporation for the taxable year in which it discontinues use of the LIFO inventory method, Section 1363(d) requires an increase in the taxpayer's gross income for the LIFO recapture amount for the taxable year preceding the year of change (the taxpayer's last taxable year as a C corporation) and a corresponding adjustment to the basis of the taxpayer's inventory as of the end of the taxable year preceding the year of change. Any increase in income tax as a result of the inclusion of the LIFO recapture amount is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation. Any corresponding basis adjustment is taken into account in computing the Section 481(a) adjustment (if any) that results upon the discontinuance of the LIFO inventory method by the corporation.

Special rule ... S Corporation election effective for a year after LIFO discontinuance. If a C corporation elects to be treated as an S corporation for a taxable year after the taxable year in which it discontinued use of the LIFO inventory method, the remaining balance of any positive Section 481(a) adjustment must be included in its gross income in its last taxable year as a C corporation. If this inclusion results in an increase in tax for its last taxable year as a C corporation, this increase in tax is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation unless the taxpayer is required to take the remaining balance of the Section 481(a) adjustment into account in the last taxable year as a C corporation under another acceleration provision in Section 5.04(3)(c) of this Revenue Procedure.

Section 22.02 Determining Current-Year Cost Under the LIFO Inventory Method

Designated automatic accounting method change number ... 57.

This change applies to a taxpayer using the LIFO inventory method that wants to change its method of determining current-year cost to:

- The actual cost of the goods most recently purchased or produced (most-recent-acquisitions method),
- The actual cost of the goods purchased or produced during the taxable year in the order of acquisition (earliest-acquisitions method),
- The average unit cost equal to the aggregate actual cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced. (See Reg. Sec. 1.472-8(e)(2)(ii)),
- The specific identification method; or
- A rolling-average method if the taxpayer uses that rolling-average method in accordance with Rev. Proc. 2008-43.

Inapplicability. This change does not apply to a taxpayer using the lower of cost or market method to determine current-year cost. A taxpayer using the lower of cost or market method that valued inventory below cost may not change to a proper cost valuation under this Section 22.02 of the Appendix.

Manner of making change. This change is made using a cut-off basis and applies only to the computations of current-year cost after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Concurrent change to a rolling-average method. A taxpayer that wants to make both a change to a rolling-average method of determining current-year cost for its LIFO inventory and a change to a rolling-average method of accounting for non-LIFO inventories should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *Why Taxpayers Prefer to Use Dual Indexes for Valuing LIFO Inventories ... LIFO Lookout Sept. 2002*
- *Comparing LIFO Reserve Results ...Dual Link-Chain Indexes for Valuing Increments ...LIFO Lookout Sept. 2002*
- *Dollar Value LIFO Method ... the Technicalities ... LIFO Lookout Sept. 2002*
- *Earliest Acquisitions Method for Valuing Increments ...Final IRS Issues Paper ... LIFO Lookout June 1996*

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Section 22.03 Alternative LIFO Inventory Method for Retail Automobile Dealers

Designated automatic accounting method change number ... 58.

This change basically applies to automobile dealers that want to change to the "Alternative LIFO Method" described in Section 4 of Rev. Proc. 97-36 (as modified by Rev. Proc. 2008-23, election to change to a single, combined LIFO pool), for their LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which also are referred to as class 1, 2, or 3 trucks.

Manner of making change. This change is made using a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

IPIC Issues ... This change does not apply to an automobile dealer that uses the inventory price index computation (IPIC) method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks.

IPIC Issues ... Concurrent change from IPIC method. An automobile dealer using the IPIC method that also has parts and accessories, used automobiles, or used light-duty trucks (other goods) inventory may incorporate a change, using a cut-off basis, from IPIC to another acceptable LIFO method for those other goods into this change. When changing from IPIC to a dollar-value LIFO method for its other goods, the automobile dealer must establish separate inventory pools for new automobiles and new light-duty trucks, unless the automobile dealer also concurrently changes to the Vehicle-Pool Method (see Section 22.08 of this Appendix). The automobile dealer also must establish a separate inventory pool for the parts and accessories.

Additional requirements to be complied with. An automobile dealer also must comply with the conditions in Section 5.03 of Rev. Proc. 97-36. One of these conditions is that the automobile dealer must effect the change using the cut-off method. Under the cut-off method, the value of the automobile dealer's new automobile and new light-duty truck inventory (and in the case of an automobile dealer changing from the IPIC method, the parts and accessories, used automobile, and used truck inventory) at the beginning of the year of change must be the same as the value of such inventory at the end of the preceding taxable year plus market value restorations, if any are required,.

In addition, if the auto dealer is changing from the IPIC method, the dealer also must attach to the application Form 3115 a schedule setting forth the classes of goods for which the automobile dealer has elected to use the LIFO method and the accounting method changes being made for each class of goods.

Concurrent change to the Vehicle-Pool Method. A taxpayer that wants to make both a change to the Alternative LIFO Method under this section and a change to the Vehicle-Pool Method under Rev. Proc. 2008-23, (see Section 22.08 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *Revenue Procedure 92-79: Overview, Advantages, Disadvantages, Special Rules & Definitions, Other Requirements and Consent Conditions ... LIFO Lookout Sept. 1992*
- *Alternative LIFO Method for New Vehicles - A Good Summary ... LIFO Lookout March 1995*
- *Alternative LIFO Method for Auto Dealers: Rev. Proc. 97-36 Restates Rev. Proc. 92-79 ... LIFO Lookout Sept. 1997*
- *Dealership Considerations in Evaluating the Alternative LIFO Method vs. the IPIC/BLS Method ... LIFO Lookout Dec. 2006*
- *Sample Proforma Filing Packages for Electing (Form 970), Terminating or Changing to the Alternative LIFO Method (Forms 3115) ... LIFO Lookout March 2006*

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Section 22.04 Used Vehicle Alternative LIFO Method

Designated automatic accounting method change number ... 59.

This change basically applies to used vehicle dealers that want to change to the "Used Vehicle Alternative LIFO Method" as described in Rev. Proc. 2001-23, as modified by Announcement 2004-16, and Rev. Proc. 2008-23.

A used vehicle dealer making this change must comply with the additional conditions set forth in Section 5.04 of Rev. Proc. 2001-23.

Manner of making change. This change is made on a cut-off basis, which requires that the value of the taxpayer's used automobile and used light-duty truck inventory at the beginning of the year of change must be the same as the value of that inventory at the end of the preceding taxable year, plus cost restorations, if any, required by Section 5.04(5) of Rev. Proc. 2001-23. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

If there has been a previous bargain purchase. If the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer must, as part of this change, first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991),and compute a Section 481(a) adjustment for that part of the change. See Announcement 91-173,1997-47 I.R.B. 29.

Upon examination, if a taxpayer has properly changed its method under this section except for complying with the above requirement, an examining agent may not deny the taxpayer the change. However, the taxpayer does not receive audit protection under Section 7 of this Revenue Procedure with respect to the improper method of accounting for the bargain purchase. Accordingly, the examining agent may make any necessary adjustments in any open year to effect compliance with *Hamilton Industries, Inc.*

New base year. In effecting a change to the Used Vehicle Alternative LIFO Method under this Revenue Procedure, any LIFO inventory cost increments previously determined and the value of those increments must be retained. Instead of using the earliest taxable year for which the taxpayer adopted LIFO as the base year, the year of change must be used as the new base year in determining the value of all existing LIFO cost increments for the year of change and later taxable years. (The year of change becomes a new base year, with the cumulative index at the beginning of the year of change reset to 1.0000).

The base-year cost of all LIFO cost increments at the beginning of the year of change must be restated in terms of new base-year costs, using the year of change as the new base year, and the indexes for previously determined inventory increments must be recomputed accordingly. The new base-year cost of a pool is equal to the total current-year cost of all the vehicles in the pool.

Taxpayers are reminded to complete all applicable parts of the Form 3115, including Part I of Schedule C.

Concurrent change to the Vehicle-Pool Method. A taxpayer that wants to make both a change to the Used Vehicle Alternative LIFO Method under this section of the Appendix and a change to the Vehicle-Pool Method under Rev. Proc. 2008-23 (see Section 22.08 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

IPIC Issues ... Concurrent change from IPIC method. A used vehicle dealer using the IPIC method that also has parts and accessories, new automobiles, or new light-duty trucks (other goods) inventory may incorporate a change, using a cut-off basis, from IPIC to another acceptable LIFO method for those other goods into this change. When changing from IPIC to a dollar-value LIFO method for its other goods, the used vehicle dealer must establish separate inventory pools for new automobiles and new light-duty trucks, unless the used vehicle dealer also concurrently changes to the Vehicle-Pool Method (see Section 22.08 of this Appendix). The used vehicle dealer must also establish a separate inventory pool for the parts and accessories.

For further information on this change, selected articles include ...

- *Revenue Procedure 2001-23 Highlights & Sample Letter to Dealers ... LIFO Lookout March 2001*
- *Evaluating the "New and Improved" LIFO Method for Used Vehicles ... LIFO Lookout June 2001*
- *Form 3115 Proforma Filing Package for Changing to the Used Vehicle Alternative LIFO Method ... LIFO Lookout June 2001*
- *Confusion Over Use of Different Official Guides ... LIFO Lookout Sept. 2001*
- *Good News for Dealers Who've Stayed With Their Used Vehicle LIFO Elections ... LIFO Lookout June 2004*

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Section 22.05 Determining the Cost of Used Vehicles Purchased or Taken as a Trade-In

Designated automatic accounting method change number ... 60.

This change applies to a taxpayer using the LIFO inventory method that wants to determine the cost of used vehicles acquired by trade-in using the average wholesale price listed by an official used vehicle guide on the date of the trade-in. (See Rev. Rul. 67-107.) In this case, the official used vehicle guide selected must be consistently used unless the taxpayer receives permission to use a different guide.

This change also applies to a taxpayer using the LIFO inventory method that wants to (1) use a different official used vehicle guide for determining the cost of used vehicles acquired by trade-in, (2) determine the cost of used vehicles purchased for cash using the actual purchase price of the vehicle or (3) reconstruct the beginning-of-the-year cost of used vehicles purchased for cash using values computed by national auto auction companies based on vehicles purchased for cash. The national auto auction company selected must be consistently used.

This change does not apply to a taxpayer that adopted or changed to the Used Vehicle Alternative LIFO Method (see Section 22.04 of the Appendix).

Manner of making change. This change is made on a cut-off basis and applies only to used vehicles acquired on or after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Section 22.06 Change to the Inventory Price Index Computation (IPIC) Method

Designated automatic accounting method change number ... 61

This change applies to a taxpayer that wants to change from a non-IPIC LIFO inventory method to the IPIC method in accordance with all relevant provisions of Reg. Sec. 1.472-8(e)(3).

This change also applies to a taxpayer that wants to change from the IPIC method as described in T.D. 7814 (the old IPIC method) to the IPIC method as described in T.D. 8976 (the new IPIC method). This change includes the following required changes (if applicable):

- From using 80% of the inventory price index (IPI) to using 100% of the IPI to determine the base-year cost and dollar-value of a LIFO pool(s),
- From using a weighted arithmetic mean to using a weighted harmonic mean to compute an IPI for dollar-value pool(s) and
- From using a components-of-cost method to define inventory items to using a total-product-cost method to define inventory items.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Previous bargain purchases of inventory. If the taxpayer has previously improperly accounted for a bulk bargain purchase, special rules require the taxpayer to first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991), and to compute a Section 481(a) adjustment for that part of the change.

Concurrent automatic changes. A taxpayer that wants to make this change and to also change its method of determining current-year cost (under Section 22.02 of this Appendix) for the same year of change may file a single Form 3115 for both changes. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

A taxpayer that wants to make this change and to also change its method of pooling to IPIC-method pools described in Reg. Sec. 1.472-8(b)(4) or Reg. Sec. 1.472-8(c)(2) for the same year of change may file a single Form 3115. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

A taxpayer that wants to make this change and to also change its method of pooling (under Section 22.10 of this Appendix) for the same year of change may file a single Form 3115. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *A Look at the IPIC Method ... with Special Emphasis on its Use by Auto Dealers ... LIFO Lookout June 2007*
- *A Summary of the IPIC Method ... What it is and How it Works ... LIFO Lookout June 2007*
- *A Case Study Showing the Disadvantage of the IPIC Method for Auto Dealerships ... LIFO Lookout Sept. 2007*
- *Highlights of the Final IPIC Regulations ... LIFO Lookout December 2002*

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Section 22.07 Changes Within the Inventory Price Index Computation (IPIC) Method

Designated automatic accounting method change number ... 62

This change applies to a taxpayer using the new IPIC method (i.e., described in Reg. Sec. 1.472-8(e)(3) as revised by T.D. 8976) that wants to make one or more of the changes below. Citations to specific IPIC dollar-value LIFO regulations are included in the Appendix discussion of these changes.

- Change from the double-extension IPIC method to the link-chain IPIC method, or vice versa,
- Change to or from the 10 percent method,
- Change to IPIC-method pools described in Reg. Sec. 1.472-8(b)(4) or Reg. Sec. 1.472-8(c)(2), including a change to begin or discontinue applying one or both of the 5 percent pooling rules,
- Change to combine or separate pools as a result of the application of a 5 percent pooling rule,
- Change its selection of BLS table from Table 3 (Consumer Price Index for All Urban Consumers ...) of the monthly CPI Detailed Report to Table 6 (Producer price indexes percent changes for commodity groupings and individual items, not seasonally adjusted) of the monthly PPI Detailed Report, or vice versa,
- Change the assignment of one or more inventory items to BLS categories under either Table 3 (Consumer Price Index for All Urban Consumers (CPI-U): U.S. City average, detailed expenditure categories) of the monthly CPI Detailed Report or Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the monthly PPI Detailed Report and
- Change the representative month when necessitated because of a change in taxable year or a change in method of determining current-year cost made pursuant to Section 22.02 of this Appendix.

Manner of making change. These changes are made on a cut-off basis and apply only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required. A taxpayer that makes some of these changes must establish a new base year in the year of change.

For further information on this change, see selected articles listing for Section 22.06

Section 22.08 Changes to the Vehicle-Pool Method

Designated automatic accounting method change number ... 112.

This change applies to a retail dealer or wholesale distributor ("reseller") of cars and light-duty trucks that wants to change to the "Vehicle-Pool Method" as described in Rev. Proc. 2008-23.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

A reseller that changes its method of pooling under Rev. Proc. 2008-23 and this section of the Appendix must comply with Reg. Sec. 1.472-8(g). Instead of using the earliest taxable year for which the reseller adopted the LIFO method for any items in a pool, the reseller must use the year of change as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years (i.e., the cumulative index at the beginning of the year of change will be 1.00). The reseller must restate the base-year cost of all layers of increment in a pool at the beginning of the year of change in terms of new base-year cost. For an example of establishing a new base year, see Reg. Sec. 1.472-8(e)(3)(iv)(B)(*1*)(*ii*).

The scope limitation in Section 4.02(7) of this Revenue Procedure does not apply for the reseller's first taxable year ending on or after December 31, 2007.

Concurrent change to the Alternative LIFO Method or the Used Vehicle Alternative LIFO Method. A reseller that wants to make both a change to the Vehicle-Pool Method under this section of the Appendix and a change to the Alternative LIFO Method under Rev. Proc. 97-36 (see Section 22.03 of this Appendix) or the Used Vehicle Alternative LIFO Method under Rev. Proc. 2001-23 (see Section 22.04 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, see LIFO Lookout Mid-Year (Spring) 2008. This entire issue of the LIFO Lookout (Vol. 18, No. 1) is devoted to an analysis of Rev. Proc. 2008-23: The Vehicle-Pool (Single, Combined) LIFO Method for Auto Dealerships & Alternative Rules for Classifying "Crossover Vehicles."

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Section 22.09 Changes Within the Used Vehicle Alternative LIFO Method

Designated automatic accounting method change number ... 140.

This change applies to a taxpayer using the "Used Vehicle Alternative LIFO Method" as described in Rev. Proc. 2001-23 that wants to change the particular "official used vehicle guide" utilized by the taxpayer in connection with the Used Vehicle Alternative LIFO Method.

This change also applies to any change in the precise manner of its utilization (e.g., a change in the specific guide category that a taxpayer uses to represent vehicles of average condition for purposes of Section 4.02(5)(a) of Rev. Proc. 2001-23).

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required. A taxpayer that changes its method pursuant to this section of the Appendix must establish a new base year in the year of change.

For further information on this change, see selected articles listing for Section 22.04

Section 22.10 Changes to Dollar-Value Pools of Manufacturers

Designated automatic accounting method change number ... 141.

This change applies to a manufacturer that:

- Purchases goods for resale (resale goods) and, thus, must reassign resale goods from the pool(s) it maintains for the goods it manufactures to one or more resale pools;
- Wants to change from using multiple pools described in Reg. Sec. 1.472-8(b)(3) to using natural business unit (NBU) pools described in Reg. Sec. 1.472-8(b)(1), or vice versa; and
- Wants to reassign items in NBU pools described in Reg. Sec. 1.472-8(b)(1) into the same number or a greater number of NBU pools.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

A taxpayer that changes its method of pooling pursuant to this section of the Appendix must combine or separate pools as required by Reg. Sec. 1.472-8(g).

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YEAR-END 2008 DEALER TAX UPDATE

TAX STRATEGIES & IRS ACTIVITIES ... PRESENTATION SUMMARY

Willard J. De Filipps, CPA - November 2008

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V. ***Supplementary Discussion Materials***

Since mid-year, I've made several year-end update presentations to different dealer-CPA groups. As usual, my presentation outline includes some topics and items that were not included by Ms. Terri Harris in her update of IRS activities in her presentation at the AICPA National Auto Dealership Conference in October.

Several of the topics in my year-end presentation are discussed more fully in this issue of the DTW and some of them were included in my mid-summer update that was reprinted in the Mid-Year 2008 issue of the DTW.

I have reprinted two items from my discussion outline in case you are interested. The first is a rather brief commentary on the IRS' guidance on combining LIFO pools found in Chief Counsel Memo 200825044. The second item is a discussion of the *Solomon* and *Muskat* cases referred to in Update item #12.

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I. *LIFO Inventory Matters*

A. *The single, combined LIFO pool method for new vehicles ... Rev. Proc. 2008-23 ... "Lipstick on a Pig?"*

1.-3. [*Text omitted*]

4. IRS Chief Counsel Office Memo No. 200825044 (dated May 7, 2008; released June 20, 2008) provides guidance for dealerships implementing the change to the Vehicle-Pool Method.

   a. CCM No. 200825044 provides two examples showing how to establish the year of change as the new base year for making the change to the new, single combined pool for new vehicles.

      (1) Example #1 ... LIFO pools being combined (i.e., Pool #1 New Automobiles and Pool #2 New Light-Duty Trucks) both have the same base year. This is pretty straight-forward.

      (2) Example #2 ... both LIFO pools do not have the same base year. This is a situation which I have described as one involving "disappearing base dollars."

      (3) Both examples in the Chief Counsel Memo follow the format used for examples found in the LIFO Regulations.

   b. The CCM concludes that "if a reseller combines its new car and new truck pools (or used car and used truck pools) in a single vehicle pool as shown in *Example 1* or *Example 2*. whichever is applicable, Exam should not challenge the reseller's implementation of the change to the Vehicle-Pooling Method during an examination of the reseller's Federal income tax return."

   c. ***"Before and After Standard."*** The CCM also states the following ... "it is important to note that in both examples, the base-year cost of each LIFO layer is in the same proportion to the total base-year cost ***both before and after*** the establishment of the new base year. Though there may be other approaches to implementing the change to the Vehicle-Pool method, we have doubts about any approach that allocates the new base-year cost among LIFO layers in different proportions." [Emphasis added]

   d. The computational approach in the Examples may be problematic for many dealerships.

      (1) After the two LIFO pools are combined, the LIFO reserve for the single pool should equal the sum of the LIFO reserves of the two pools being combined.

      Furthermore, after the two LIFO pools are combined, the amount of the LIFO reserve for that pool that is allocable to each LIFO layer or year making up the LIFO valuation for the pool should be the same as the sum of the contribution to the LIFO reserve for each year before the two pools were combined.

I. LIFO Inventory Matters (continued)

A. The single, combined LIFO pool method for new vehicles ... Rev. Proc. 2008-23 ... "Lipstick on a Pig?" (continued)

(2) If one analyzes the Examples in the CCA Memo in terms of the contributions to the LIFO reserve before and after the combination of pools that is attributable to the year immediately preceding the new base year, it can be seen that some amount of the LIFO reserve (prior to the combination of the pools) has been reallocated to that immediately preceding year and thus will be subject to recapture to the extent that this newly combined layer for the year preceding the new base year is invaded by the carryback of a decrement in a subsequent year.

(3) Taxpayers may take the position that the result of shifting the contribution made by each year's layer to the LIFO reserve (from the amount that it was before the combination of pools to a different amount after the combination of pools) does not comply with (i.e., this result is inconsistent with) the overriding "clear reflection of income" requirement or standard that (1) is set forth in the Internal Revenue Code in Section 446 relating to accounting methods and Sections 471 and 472 relating to inventories and (2) has been expanded by the Tax Court in many of its decisions interpreting the regulations under Section 472.

(4) This result (i.e., of shifting contributions to the LIFO reserve by certain years' layers) can be eliminated or significantly lessened if the sequence or order of the computational steps is reversed and the two pools being combined are each rebased to 1.0000 before they are combined.

In other words, the shifting of contributions to the LIFO reserve between layers will not occur if, after adjusting for the difference in base years (i.e., by computing the amount of disappearing base dollars and adjusting the valuation factors for all layers accordingly), the first step after that is to independently rebase each pool to 1.0000 as of the beginning of the year and then the second step after that is to then combine the pools.

I. B-C-D-E [Text Omitted]

II. Rev. Proc. 2008-52 ... [Text Omitted]

III. A-B [Text Omitted]

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III. *Other Dealer Tax Practice Issues & Developments*

C. *Solomon & Muskat ... Two 2008 non-dealership cases relating to the allocation of sales proceeds to sellers goodwill, customer lists, employment agreements and non-competition agreements*

1. Update and general discussion ... is there any blue sky out there today?
2. ***Solomon v. Commissioner*** ... April 16, 2008 (T.C. Memo 2008-102) ... issue(s) involved: allocation of sales proceeds to customer lists and non-compete agreements.
   a. The Tax Court held that of the $700,000 payment received by the corporation (Solomon Colors, Inc.) in connection with the sale of a division of its business, $550,000 was paid for its customer list and $150,000 was paid for its covenant not to compete with the company that purchased the division of the business that was sold.
   b. The Tax Court also held that an additional $700,000 received by the selling owners/employees/individuals should be treated as received by them for their covenants not to compete with the purchaser. Accordingly, this amount received by the individuals would be taxed as ordinary income and not as long-term capital gain.
   c. The Court held that:
      (1) The purchaser was not primarily interested in purchasing the personal assurances of the two individual sellers that they would maintain the customer base of the division of the business that was being sold.
      (2) Rather, the purchaser was interested in (1) eliminating the company from the relevant industry and (2) assuring itself that neither of the two owners/employees/individuals (i.e., Robert Solomon and Richard Solomon) could re-enter that industry through a different form.
   d. The position of the taxpayers was that the buyer was really purchasing their personal goodwill because there were only 24 customer names on the list and the buyer already knew the identity of those 24 customers.
      (1) Taxpayers relied (unsuccessfully) on *Martin Ice Cream Co. v. Comm.* (110 TC 189 (1998)).
      (2) The Tax Court held that *Martin Ice Cream* was distinguishable for three reasons:
         (a) The value of Solomon Colors in the market was not attributable to the quality of service and customer relationships developed by the individuals, Robert Solomon and/or Richard Solomon. Rather, Solomon Colors, as a business of processing, manufacturing and sale - rather than one of personal services - did not depend entirely on the goodwill of its employees for its success.
         (b) Unlike the founder of Haagen-Dazs in the *Martin Ice Cream* case, who signed an agreement with the purchaser in his personal capacity, the individual sellers in this case (Robert Solomon and Richard Solomon) were not named as the sellers of any asset but they were included in the sale in their individual capacities solely to guarantee that they would not compete with the purchasing entity.

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III. *Other Dealer Tax Practice Issues & Developments* *(continued)*

C. Solomon & Muskat ... (continued)

(c) The fact that the purchasing entity required non-compete agreements, but not employment or consulting agreements, of Robert Solomon and Richard Solomon, made it unlikely that the purchaser was interested in purchasing the personal goodwill of these individuals.

(3) After the purchaser acquired the division that was sold by Solomon Colors, Inc., the purchasing entity was left as the sole business in the industry. Thus, it did not need the goodwill of the selling entity (Solomon Colors, Inc.) or of any of its key employees to succeed.

(a) In fact, after the acquisition, the purchasing entity (Prince) continued to do business in the industry under its own name, and not under the name of Solomon Colors, Inc.

(b) However, after the acquisition, the acquiring entity (Prince) did need the promises of Solomon Colors, Inc. and each of its owners/employees/ individuals that they would not compete with Prince in the industry for a desired period of time. Prince was, therefore, required to compensate those persons for their promises not to compete with it in the industry.

(4) Note: The taxpayers "paper trail" was very pool and inconsistent in several critical respects.

2. ***Irwin Muskat v. U.S.A.*** ... April 2, 2008 (U.S. District Court for the District of New Hampshire [Docket No. 1:06-cv-00030]) ... issue involved: capital gain vs. ordinary income treatment

a. ***Summary.*** The issue involved was whether a $1 million payment that Muskat received was compensation under a non-compete agreement (taxable as ordinary income, i.e., the position of the IRS) or was for goodwill (taxable a long-term capital gain, i.e., the taxpayer's position). Muskat was unable to show that $1 million paid under a non-compete agreement as part of the sale of the business was a payment received for goodwill. Therefore, Muskat was required to treat the payment as ordinary income.

(1) The $1 million payment was actually a relatively smaller component of a much larger transaction arising from the sale of a very successful meat packing business. The non-compete agreement called for payments totaling $4 million, of which $1 million was paid at, or shortly after, the closing in 1998 and it is this $1 million initial payment received in 1998 that is involved in the Court's decision.

(2) ***Self-Employment Tax on Non-compete Payments?*** There is an interesting side issue in this case. It relates to Muskat's claim for a refund of self-employment tax that he had previously paid when he reported the $1 million payment as income in his income tax return for 1998. Muskat's claim for the refund of self-employment tax paid was dismissed. However, it is clear that this payment should not have been subject to self-employment tax even if it was treated as received as payment for Muskat's agreement not to compete with the purchaser. This self-employment tax refund issue is not germane to our interest in this case with respect to the allocation of the sales price issue.

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III. Other Dealer Tax Practice Issues & Developments (continued)

C. Solomon & Muskat ... (continued)

b. After significant "back and forth" negotiations, an asset purchase agreement was signed on March 31, 1998. A non-compete agreement, and other agreements, were signed on May 7, 1998.

   (1) Under a subscription agreement, Muskat agreed to invest $2 million in the purchasing entity.

   (2) Under an employment agreement, Muskat was entitled to salary and also to bonuses that were based on reaching certain sales targets.

c. Muskat's non competition agreement provided that he would not participate or engage directly or indirectly in any business that during the term of the agreement was competitive with the business conducted by the purchaser or any entity owned or controlled by the purchaser within a geographic area in which the company or any related entity did business.

   (1) The term of the agreement was thirteen years. It was agreed that these payments would survive Muskat's death or disability.

   (2) The agreement prohibited Muskat from soliciting employees to leave the company and affiliate with a competitor.

   (3) The agreement prohibited Muskat from diverting business from the purchasing company.

   (4) The agreement called for a total of almost $4 million payable in separate installments, beginning with a $1 million payment on the date of the agreement.

d. Muskat received payments promised under the non-compete agreement. He also worked for the purchaser and invested in the company as the subscription agreement required. Furthermore, when the purchaser was itself acquired by another entity a few years later, Muskat continued his employment with the new company and worked until 2004.

e. On Muskat's 1998 personal return, he treated the $1 million first payment under the non-compete agreement as ordinary income. In 2002, he filed an amended return for 1998 in which he treated that payment as long-term capital gain from the sale of goodwill. That amended return and claim for refund was the basis for this case in the United States District Court of New Hampshire.

f. Muskat's position was that despite the provisions of the non-competition agreement, the payments were ***intended by the parties*** to purchase his personal goodwill.

g. The IRS position was that Muskat was bound by the terms of the non-competition agreement and could not reconfigure the purpose of that agreement for income tax purposes.

   (1) The IRS also contended, (i.e., in the alternative) that even if the payment received were related to Muskat's personal goodwill, he was required to provide services to the purchaser in connection with his personal goodwill ... and that his providing the services would require treatment of the payments as ordinary income. (This alternative position did not have to be addressed by the Court because it held, in the first instance, that the payments received were not related to Muskat's personal goodwill.)

III. Other Dealer Tax Practice Issues & Developments (continued)

C. Solomon & Muskat ... (continued)

h. The overriding or key issue in this case is ... what is the "applicable standard" to be applied?

(1) Muskat's position was that the "economic reality" standard should be applied (and that would override the specific language of the documents prepared by the parties).

(2) The IRS position was that "strong proof" is required to overcome the parties' expressed intent.

(3) The Court said that for Muskat to prevail on his personal goodwill claim, he must show by "strong proof" that despite the express terms of the agreement, both Muskat ***and the purchaser*** intended the $1 million payment to be compensation for his personal goodwill and not for the promises he made in the non-competition agreement.

(a) The standard from *Harvey Radio Labs, Inc. v. Comm.* requires strong proof of the parties intentions when they entered into the non competition agreement.

(b) Note the intention of both the buyer and the seller has to be established.

(c) Another factor having a bearing is whether or not the buyer and the seller have tax avoidance motives that are opposite. When the buyer and seller have conflicting tax positions, it is more likely that their agreements will reflect their actual intent.

i. The Court noted that:

(1) The negotiation process that culminated in the sale did not include a discussion of Muskat's personal goodwill.

(2) Neither the non-competition agreement nor any other agreement in the transaction mentioned Muskat's personal goodwill.

(3) During the negotiation process, the parties had allocated more than $15 million of the purchase price to business goodwill.

(4) The non-competition agreement defined "goodwill" as an asset of the selling entity "including its goodwill and business as a going concern."

(5) The purpose of the non-competition agreement with Muskat was to protect the selling entity's "goodwill" in the transaction.

(6) The consideration paid under the non-competition agreement was expressly for the covenants not to compete, and made no mention of personal goodwill.

j. With respect to the severability of personal goodwill from business goodwill in determining enterprise value, the Court made the following observation (with which some taxpayers may strongly disagree).

(1) "Indeed, the concept of personal goodwill as an asset, separate from business goodwill and from the obligations imposed by the non-competition agreement, in the context of the sale of a business like Jac Pac [i.e., the selling entity] is unclear."

(2) The Court cited four cases in connection with its statement.

III. Other Dealer Tax Practice Issues & Developments (continued)

C. Solomon & Muskat ... (continued)

(a) *Matter of Prince* [85 F 3d 314, 320-23(7th Cir 1996)]

(b) *Bruss Co. v. K & S Brokerage, Inc.* [1992 WL 25375 (N.D. Ill. 1992)]

(c) *In re Cooley* [87 B.R. 432, 443(S.D. Tex 1988)]

(d) *Martin Ice Cream v. Comm.* [110 TC 189, 206-07 (1998)]

k. The taxpayer, Muskat, argued that the provisions of the non-competition agreement, including the long term of the agreement and the survivability provision, were unusual and show that the agreement was really a sale of his personal goodwill.

(1) Muskat contended that in reality there was no need for a non-competition agreement because of his age, his lack of interest in competing with the purchaser, his employment and investment in the company and the insurmountable difficulties that would be encountered in starting a competing business.

l. The purchaser testified that although it was not particularly concerned that Muskat might leave to start a competing business, it nevertheless intended that the non-competition agreement with Muskat would protect the shareholders of the purchaser and the interests of other allied related entities.

m. The Court found that although the agreement accommodated Muskat's demand for additional compensation, the purchaser did not pay more in the transaction, but instead merely reallocated the purchase price.

n. Although Muskat did persuasively show or demonstrate to the Court that the purchaser agreed to allocate additional compensation to him through the non-competition agreement, Muskat, however, did not provide "strong proof" that the purchaser and Muskat intended the payments under the non-competition agreement to buy Muskat's personal goodwill. Therefore, the taxpayer did not carry its burden of proof on its claim that the payment made under the non-competition agreement was for the sale of his personal goodwill.

D. [Text Omitted]

IV. Other Dealer Tax Practice Issues & Discussion Topics [Text Omitted]

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