



De Filippis'

LIFO LOOKOUT

A Quarterly Update of LIFO - News, Views, and Ideas

Volume 2, Number 4

Publisher: Willard J. De Filippis, C.P.A.

December 1992

LIFO UPDATE

If you had called me personally to ask "what's happening lately with LIFO that I need to know about?"...Here's what I'd say:

#1 DEALERS' NEW LIFO METHOD GAINS WIDE ACCEPTANCE BY CPAS

Almost all of the several hundred CPAs and CPA firms with whom I have spoken in the last few months have concluded that the IRS' new Alternative LIFO Method is an offer that is too good to refuse. All of the member firms of one group of twenty CPA firms specializing in auto dealers, servicing more than 600 dealers nationwide, are unanimously recommending adoption of the Alternative LIFO Method in Revenue Procedure 92-79 to virtually all of their dealer clients.

As for vendors selling LIFO computations, one major vendor servicing hundreds of dealers apparently has decided to give up its "pet method," and even a modified substitute, in favor of the amnesty and certainty provided by the new method. Another, with almost Messianic fervor, still preaches that only its more comprehensive and more costly method is "right" - even in the face of newly released IRS Letter Ruling 9243010 (see Update #4 on page 2) which ought to make anyone stuck on a "noncomps" approach think twice: **First**, about the chances of beating the IRS in any technical arguments about LIFO and **second**, about the possibility of other non-LIFO audit adjustments that just might be provoked in the process.

The guideline I suggested in the last *Lookout* still stands: **Unless you can come up with a good reason for not changing to the Alternative LIFO Method, then changing to it would seem advisable for a lot of reasons.**

#2 DECEMBER 31, 1992 FILING DEADLINE AND FORM 3115 PRO FORMA FILING PACKAGE

December 31, 1992 is the critical deadline date for filing Forms 3115 in order to make the election to use the Alternative LIFO Method, except it is sooner for September 30 fiscal year-end taxpayers planning to file their income tax returns by December 15th.

LOOKOUT LOOKS INTO

LIFO UPDATE.....	1
THE GAP YEARS: DEALERS UNDER IRS AUDIT.....	4
THINK TWICE BEFORE MAKING THESE STATEMENTS.....	5
FORM 3115 PRO FORMA FILING PACKAGE	
INTRODUCTION.....	6
STATEMENTS ATTACHED TO FORM 3115.....	7
ADDITIONAL COMMENTS AND EXPLANATIONS.....	9
FORM 970 FOR NEW COSTS ADDED TO LIFO POOLS.....	11
FORM 3115 & SELECTED SCHEDULES.....	SUPP
GETTING OFF LIFO...MADE SAFER BY 92-79.....	12
SPLITTING ONE LIFO POOL IN TWO.....	13
IS IT A "CAR" OR A "TRUCK"?.....	13
REBASING INDEXES TO 1.000.....	14
YEAR-END WARNING: THE ULTIMATE LIFO TRAP	
THE FINANCIAL STATEMENT CONFORMITY REQUIREMENT.....	18
PROJECTING YEAR-END LIFO RESERVES	
TO MEET THE CONFORMITY REQUIREMENT.....	19

The actual filing mechanics involving where the originals of Form 3115 are to be filed depend on whether or not an automobile dealer was under audit on September 8, 1992 and had a LIFO issue pending in connection with that IRS audit. This was covered in detail in the September, 1992 issue of the *LIFO Lookout* on pages 8 and 9. Informal conversations with some IRS agents and technicians indicate reasonable interpretations in the real spirit of the IRS Compliance 2000 initiative toward many matters raised for discussion...although some examining agents in the field may favor more restrictive interpretations.

This issue of the *Lookout* includes a sample Form 3115 Pro Forma filing package beginning at page 6 to help you through the completion of that form and attachments.

see LIFO UPDATE, page 2

#3 TRANSITIONAL COMPUTATIONS TO ADOPT 92-79 WILL REQUIRE THOUGHT AND MAY BE MESSY...BUT YOU SHOULD STILL CHANGE ANYWAY

Revenue Procedure 92-79 allows auto dealers to "freeze" their LIFO reserve amounts as of the last day of the year prior to the year of change to the new Alternative LIFO Method. As part of the trade-off in electing the new method, the IRS automatically accepts the dealer's prior year LIFO computations without further question or change. This is to be done by using the "cut-off" method...whereby the LIFO value of the base inventory and layers of increment for all years prior to the year of change retain their LIFO values after the change is made. In short, the dealer is not required to make any Section 481(a) adjustment.

As part of other related conditions and special rules, dealers adopting the Alternative LIFO Method are required to: (1) **rebase all indexes to 1.000** as of the beginning of the year of change, (2) **include demonstrator vehicles** and other appropriate LIFO costs in the pools if they previously were being excluded, (3) **split any prior single LIFO pool** into one pool for all new automobiles (including demonstrators) regardless of manufacturer and a separate pool for all new light-duty trucks (including demonstrators) regardless of manufacturer and/or (4) **combine previous multiple pools** for new cars or new trucks so as to end up with only one pool for all new automobiles (including demonstrators) regardless of manufacturer and a separate pool for all new light-duty trucks (including demonstrators) regardless of manufacturer.

Depending on the timing of the different LIFO elections and whether the LIFO computations were of the unit, double extension or link-chain variety, the requirements of adding costs to pools, splitting or consolidating multiple pools **and** rebasing them to 1.000 may provide some computational challenges.

These requirements are intended to achieve greater uniformity and minimize mistakes in keeping track of subsequent inventory liquidations when they occur so that decrements can be carried back against appropriate amounts of prior year increments expressed in base dollars.

See "Rebasing Indexes to 1.000" in this issue for a discussion of the rebasing concept and mechanics. This article suggests that there may be some confusion because the Regulations do not contain any specific examples to illustrate the mechanics of implementing the concept of a substitute base year, also known as rebasing to 1.000, in connection with a LIFO accounting method change. It appears the Internal Revenue Service is not planning to issue any further

formal guidance, examples or illustrations as to how these computational mechanics are to be made, although that would be greatly welcomed by IRS agents as well as CPAs.

#4 WHAT IF A DEALER DOESN'T ELECT 92-79? IRS SAYS "YOU'D BETTER WATCH OUT" IN LTR 9243010

Last month the IRS issued Letter Ruling 9243010 in which it reacted unfavorably toward the taxpayers' use of "comparables" and "non-comparables" in a rather detailed index computation procedure. In this Technical Advice Memo, the IRS said that a dealer's LIFO computations cannot arbitrarily exclude new items from the index computation. It also said the dealer cannot reconstruct the beginning-of-the-year costs of new items using an annual LIFO index computed by excluding new items from that computation. Furthermore, the IRS said that only a "facts and circumstances analysis" by the District Director (i.e., an IRS audit) would be sufficient to determine whether the dealer was using a reasonable reconstruction method.

Dealers whose LIFO computations employ these "techniques" should be on notice that the IRS apparently will not take too kindly to methods other than the Alternative LIFO Method. Accordingly, dealers using this method should be aware that agents may clearly approach computations of the type in Letter Ruling 9243010 with a strongly negative bias.

If IRS agents are really looking for something to attack in new vehicle LIFO calculations that are not under the Alternative Method, then they may go after index computation methods that reflect decisions regarding new items that are not **at least** as narrow or restrictive as those contained in Section 4.02 of Revenue Procedure 92-79. In other words, since the IRS never really followed up on its July, 1989 Coordinated Issues Memo on comparability with a followup Coordinated Issues Memo on "new item" definition, the "new item" definition in Revenue Procedure 92-79 may be the equivalent that IRS agents will follow in challenging non-Alternative LIFO Method computations.

The peril may not so much be that if the LIFO computations are examined, they will be changed. Rather, it may be that once an IRS agent is in there to examine LIFO, he or she may examine a whole lot of other things just to make it worth their while...especially if they're not getting anywhere on the LIFO issues or those LIFO adjustments may be relatively small. Under these circumstances, the cost of defending LIFO computations (even if there is no change or little change) may be a non-factor...but what about other non-LIFO adjustments made in the wake of the IRS



audit? Even if the dealer's LIFO computations are "right," wouldn't it be a shame if the dealer "**won** the battle,... **BUT lost** the war?"

While one certainly can't guarantee that adopting the Alternative LIFO Method will lower a dealer's IRS audit profile, that speculation has certainly come up in many conversations. One has to wonder whether it may really be worth the hassle for a dealer to remain outside the "main stream," if most dealers decide to elect the Alternative LIFO Method.

#5 WHAT ABOUT A DEALER'S OTHER LIFO INVENTORIES?

Revenue Procedure 92-79 specifically does **not** address: (1) used vehicles on LIFO, (2) parts and accessories inventories on LIFO, or (3) medium and heavy-duty truck inventories on LIFO. These LIFO applications are specifically excluded from its coverage.

The National Office is reported to be taking the position that **parts and accessories** LIFO inventories may not be eligible for link-chain or link-chain, index computation treatment. Apparently, the IRS feels that its unwritten/administrative rule requiring 85% change over five years is not as readily met by parts inventories as by new vehicle inventories. If actually followed in practice, IRS opposition to the use of link-chain methods for parts and accessories inventories will result in significant confusion and less accurate index computations in the future. Is the technicality over link-chain applicability involving the significantly smaller P&A portion of an auto dealer's inventory worth all the hassle?...Witness what we have just gone through with new vehicles, ending up with Rev. Proc. 92-79...

In connection with applying LIFO to **used** vehicle inventories, the IRS has not specifically addressed the mechanics of used car LIFO index computations in a Technical Advice Memorandum or other precedential document. It has said in technical advice that LIFO pooling for used vehicles should involve one pool for used cars and a separate pool for used trucks. The "item category" definition for new vehicles in Revenue Procedure 92-79 would be quite difficult to apply to used vehicles. It will be interesting to see what develops in the future, as LIFO computations for used vehicle inventories still are open to question and are not protected or covered by 92-79.

#6 DON'T COMMIT LIFO SUICIDE BY FORGETTING TO UPDATE LIFO RESERVES ON ALL YEAR-END (12TH & 13TH) FACTORY STATEMENTS

The December, 1991 *LIFO Lookout* included considerable discussion of the year-end financial statement LIFO conformity requirement, pointing out the alarming potential this has to destroy LIFO elections.

An abbreviated portion of that discussion is included in this year-end issue of the *LIFO Lookout* as a timely reminder that precaution is needed for **all** auto dealer financial statements that represent a 12-month reporting period. This includes both the 12th and 13th statements furnished by the dealer to the manufacturer, as well as reports issued by CPAs.

In one current audit, the IRS has terminated the dealer's LIFO election because that dealer's 12th statement did not reflect a LIFO reserve adjustment even though that financial information was not transmitted to the manufacturer in a financial statement format, but was instead **electronically transmitted** to the factory. So watch out: some IRS agents may be looking to enforce this restrictive interpretation of the LIFO conformity requirement with all the more vigor since their attacks on new vehicle LIFO computations have been significantly blunted by Rev. Proc. 92-79.

An IRS challenge on the LIFO financial statement conformity requirement carries the potential to terminate the dealer's LIFO election and some IRS agents simply mention Revenue Procedure 79-23 and the regulations and the dealer's LIFO election is effectively killed right then and there...unless the dealer is willing to go to Court.

Document requests sent out preceding IRS exams now typically ask the dealer to provide information to the examining agent to show that the conformity requirement has been satisfied in all year-end financial statements.

See page 19 for a discussion on how to project year-end LIFO reserve changes.

#7 MISSING FORM 970?

REV. PROC. 92-85 MAY HELP

One thing is certain: If a taxpayer cannot produce a Form 970 to back up its LIFO election, that taxpayer risks losing its entire LIFO election for failure to comply with the filing (Form 970) requirement. Revenue Procedure 79-23 makes this clear, as did the Tax Court in *Fischer Industries, Inc.* Unfortunately, the problem of a *missing* Form 970 is not all that unusual.

The IRS recently issued Revenue Procedure 92-85 (IRB 1992-42, October 1, 1992) which revises and updates the standards and procedures to be followed if the necessity for filing Form 970 with the tax return was overlooked and/or you cannot find a copy of the Form 970. The IRS now allows taxpayers to correct this problem through somewhat more expedited procedures. The purpose of Revenue Procedure 92-85 is to provide relief to taxpayers who reasonably and in good faith failed to make a timely election and it contains procedures by which taxpayers can be placed in the same position they would have been had they made their LIFO election filing Form 970 in a timely fashion.

see **LIFO UPDATE**, page 17



THE "GAP" YEARS: DEALERS SETTLING AUDITS UNDER 92-79

Many dealers were under audit and had LIFO issues pending on September 8, 1992. For these dealers, the year of change to the Rev. Proc. 92-79 Alternative LIFO Method generally is to be the latest or most recent year under audit. In many instances, that year of change may be 1988, 1989 or 1990, thus leaving a "gap" of a year or more separating the last year under IRS audit (which becomes the year of change to the Alternative LIFO Method) and the current year for which an income tax return will next be filed (for example, 1992).

In these situations, it will be necessary to recompute the LIFO indexes and LIFO reserve changes under the Alternative LIFO Method for all of these interim years and file amended tax returns for each interim year. This also would involve amending various state income tax returns, as well as individual shareholder returns, Federal and state, for dealerships operating as S corporations. And maybe even some state property tax returns for possibly many consecutive years in certain states. Obviously, there will be a lot of paperwork involved, not to mention the possibility of confusion and further followup by the IRS or other state agencies.

To try to minimize this "paper blizzard," one might try to demonstrate and persuade the examining agent that the net adjustment due to any index recomputations for the interim or gap years (from the last year under audit through the current year for which a return has yet to be filed) can be satisfactorily adjusted by means of an adjustment to the opening inventory...or in some other fashion... in the tax return that will next be filed. This would avoid the need for amended returns at Federal and various State levels, thus simplifying processing, clerical and review work for the IRS and State agencies, as well as for dealers and CPAs.

In many instances, recomputations under the Alternative LIFO Method are resulting in **higher** or **greater** LIFO indexes than those previously computed. This means there would be an adjustment in favor of the taxpayer as LIFO reserves go up (rather than a deficiency). This could carry some weight with the IRS in considering a request that the net adjustment to reflect the Alternative LIFO Method be made as of the beginning of some later year for which the current (next) income tax return will be filed, especially if the dealer will agree to waive a favorable adjustment

or refund and just file the Form 3115. Or alternatively, why not just make the change on a prospective basis?

On a case-by-case basis, perhaps some de minimis approach could be agreed upon so that if the cumulative adjustment were not material, it would be ignored or the cumulative/net adjustment could be made as an adjustment in the next tax return to be filed. Alternatively, if the net result is an **increase** in the LIFO reserve and the taxpayer agrees to waive it, maybe the taxpayer could be spared the entire Rev. Proc. 92-79 index recomputation process for the gap years *if* the indexes already computed for those gap years were "reasonable."

In this regard, Section 3.01 of Revenue Procedure 92-79 is referenced to Revenue Procedure 92-20 which provides that an IRS examining agent or appeals officer has the authority to accept terms and conditions other than those set forth in that Revenue Procedure (92-20) when it is in the best interests of the Government to do so.

Hopefully, in gap year situations, a case can be made or negotiated for either (1) ignoring entirely or (2) moving the net effect of the adjustments to the beginning of the year for which the next tax return will be filed (i.e., 1992 in the case of calendar year) so as to spare everybody the time and expense of (1) recomputing indexes and the (2) preparing, filing and reviewing ...not to mention auditing... amended returns for all the gap or interim years involved.

I have yet to meet a CPA delighted by the prospect of all this additional paperwork..., rather, aren't we all horrified by it? Everyone is aware of the rule that "each tax year stands on its own" and that the *technically correct* answer is that amended returns are required, no matter how small the adjustment in either direction.

In contrast, we all support the three objectives of the IRS Compliance 2000 initiative which aim at (1) improving voluntary compliance, (2) relieving taxpayer burden and (3) increasing the overall productivity of the IRS. It is hard to imagine how requiring amended returns necessitated by "gap" years involving relatively small amounts would cost-effectively serve any of these three objectives. Hopefully, flexibility in resolving these matters will become another example of the IRS' continued demonstration of the spirit of its Compliance 2000 initiative.



THINK TWICE BEFORE MAKING THESE STATEMENTS ABOUT 92-79

Some alleged disadvantages of the Alternative LIFO Method reflect, at a minimum, a lack of adequate thought or disclosure. Competent CPAs would never fall for these; but less sophisticated dealers might.

ALLEGED DISADVANTAGE R.P. 92-79

New models **NEVER** increase LIFO benefits

Lose benefits of increases in option prices

Benefits may be lost due to technicalities, for example, where a wheel base is lengthened from 8 feet to 8 feet, 1 inch.

Inconsistency of LIFO benefits and *impossibility* to predict. Estimates and planning made difficult.

When standard equipment becomes optional, LIFO benefits are reduced.

Manufacturers might "play games" with model number and wheel base changes.

Granted, there are some unusual situations where a dealer might not be attracted to the Alternative LIFO Method. But those situations really seem to be few and far between, or reflect gullibility rather than common sense.

REALITY

This is **ABSOLUTELY FALSE**...when there is an overall price **decrease**, since models introduced at 1.000 will cause the overall index to be greater than it otherwise would have been. In years when there is net price deflation reflected in continuing models, new models introduced into the index calculation at 1.000 pull the index **UP**!

An inflation index for a pool is determined by the weighted combination of (1) continuing models and (2) new models at 1.000 and it is attributed to **all** of the dollars in that LIFO pool. Therefore, if option prices, computed separately, were found to be **lower** than the weighted average of the base costs in the pool, then attributing the overall inflation index under Rev. Proc. 92-79 to the options actually will cause the overall inflation index to be higher or greater. A more technically accurate statement would be: "To the extent that the **rate of overall inflation** on options computed separately exceeds the overall rate of inflation on base prices computed separately, the differential reduces the LIFO index." **But**, more often than not, hasn't the rate of inflation on base prices exceeded the rate of inflation on options?... causing LIFO benefits to **increase** because options are **not** repriced!

Informal discussion with some IRS representatives indicates to the contrary; although some zealous examining agents in the field may pursue this literally. Note that if this "technicality" results in the creation of a new item in a given year, then a similar technicality in the next few years would be disregarded and not be deemed to result in a new item under the general guidelines that refer to the frequency of new items occurring within a 5 to 7-year range.

Alleged inconsistencies and predictive difficulties are no greater nor less significant than they were before the Alternative LIFO Method. The real problem is that a change in the ending inventory mix can cause assumptions to lead to projections far different from the final calculations...but this has always been the case and will always be the case. Manufacturer price information is available well before year-end...as it always has been, making projections and "dry run" calculations, as imperfect as they may be, the best way to anticipate LIFO reserve changes.

How often has this happened to any significant degree in the past? Although there are exceptions, the overall trend seems to be more in the direction of optional equipment becoming standard due to manufacturing process efficiencies and market considerations.

One gets the impression lately that GM has more pressing things on its mind than helping dealers by doctoring model numbers. Ditto for other manufacturers. What I smell here is not some potential joint conspiracy against the IRS by manufacturers and dealers, but rather some weak non sequiturs.



FORM 3115, APPLICATION FOR CHANGE IN ACCOUNTING METHOD AUTO DEALERS ELECTING TO USE THE ALTERNATIVE LIFO METHOD UNDER REVENUE PROCEDURE 92-79

Here is a **Form 3115, Application for Change in Accounting Method**, pro forma package that may be of assistance in electing to use the Alternative LIFO Method for automobile dealers. Generally, the earliest date by which Form 3115 must be filed is December 31, 1992; but watch out if you have a September 30 year-end and are filing that tax return on time - without an extension.

This package consists of the following:

1. Form 3115, Pages 1 and 2 and Schedule B.
2. **STATEMENTS ATTACHED TO FORM 3115** - from which you will need to extract and modify appropriate statements in order to complete narrative supporting disclosures.
3. **ADDITIONAL COMMENTS AND EXPLANATIONS** - to be considered in connection with completing Forms 3115 and 970.

You might also want to refer to pages 8 and 9 of the September, 1992 **LIFO LOOKOUT** for other Form 3115 procedural and timing mechanics.

There can be significant variation in past practices and methods for dealers filing Forms 3115 to elect the Alternative LIFO Method. Therefore, no single "pro forma" Form 3115 really makes sense. In addition, the lack of coordination between the current Form 3115 and the more recently issued Revenue Procedure 92-79 makes apparent a number of different interpretations over how certain schedules might be completed, or questions might be answered, in an effort to make it obvious to the Internal Revenue Service that the Alternative LIFO Method under Revenue Procedure 92-79 is being elected.

The **STATEMENTS ATTACHED TO FORM 3115** should be included as white paper narrative attachments. The suggested wording can be further tailored to your own stylistic preferences. In several of these statements you will need to select the appropriate disclosures from several alternatives listed. **Accordingly, these attachments cannot be used as they appear without some further modification by you to reflect your specific facts and circumstances.**

The **statements attached to Form 3115** include:

1. General Statements
2. Page 1, Question 3(b) and Schedule B: Changes Within the LIFO Inventory Method
3. Page 1, Questions 1 and 4(b) for Dealerships Under IRS Audit:
Year of Change and Examination Status
4. Page 1, Question 5(a) and 5(b) and Possibly Page 2, Question 9(e):
Section 263A Inventory Cost Capitalization Matters
5. Page 2, Question 12: Section 481(a) Adjustment
6. Consent Statement Required by Section 9.01 of Rev. Proc. 92-79

Overall, filers of Forms 3115 electing the Alternative LIFO Method will have to suffer with the lack of coordination and direction on exactly how detailed responses must be. What should be clear from the overall Form 3115 filing is that the LIFO changes being made are to the Alternative LIFO Method. If any further information might be required by the IRS in connection with the Form 3115, that additional information can be provided without jeopardizing the taxpayer's eligibility to elect to use the Alternative LIFO Method.

The **additional comments and explanations** consist of the following discussions:

1. Dealer Variable Information: Pages 1 and 2, Form 3115
2. Specific Form 3115 LIFO-Change Related Information
3. Form 3115 schedules to be Completed and Attached to Pages 1 and 2 of Form 3115
4. Sample Language Describing Year of Change and Examination Status for Dealers Under Audit: Form 3115 page 1, Questions 1 and 4(b)
5. Forms 970 for New Costs (i.e., Demos, etc.) Required in New Pools

Hopefully, these materials and comments will guide you through most of the interpretative areas.

→



STATEMENTS ATTACHED TO FORM 3115

GENERAL STATEMENTS

Taxpayer is a franchised automobile dealer who elects to use the Alternative LIFO Method for new automobiles and new light-duty trucks pursuant to the provisions and conditions of consent of Revenue Procedure 92-79.

This Form 3115 is filed under Section 5.01 of Revenue Procedure 92-79 and the year of change is the taxpayer's **CURRENT** year: calendar year ____ or the fiscal year ending ____, 199__.

This Form 3115 is filed under Section 5.02 of Revenue Procedure 92-79 (applicable to automobile dealers under examination and for which a LIFO issue was pending on September 8, 1992) and the year of change is calendar year ____ or the fiscal year ending ____, 199__.

This Form 3115 is filed under Section 6.01 after December 31, 1992, but before the close of the first taxable year ending after December 31, 1992, and taxpayer is not under IRS audit examination on the date this Form 3115 is being filed with the IRS National Office, and the year of change is calendar year ____ or the fiscal year ending ____, 199__ (the first taxable year ending after December 31, 1992).

Note: Select, complete and include only the one paragraph above that describes whether you are filing under Section 5.01 (with a current year of change), Section 5.02 (under audit with issue pending on Sept. 8, 1992) or Section 6.01 (filing after December 31, 1992 and not under audit at the time of filing).

Also note: auto dealers must use Revenue Procedure 92-20 to change to the alternative LIFO method: (1) if they are under IRS audit after December 31, 1992 (Section 6.02) and/or (2) for any year later than the first taxable year ending after December 31, 1992.

PAGE 1, QUESTION 3(b) AND SCHEDULE B: CHANGES WITHIN THE LIFO INVENTORY METHOD

Taxpayer is changing from its present (select one: dollar-value link-chain, index method or dollar-value double extension method or specific goods/unit method), employing a (select one: most recent purchases, (separate) earliest acquisitions, average cost or other) index method to value increments, to the Alternative LIFO Method prescribed in Revenue Procedure 92-79. The Alternative LIFO Method is a dollar-value, link-chain (index) method employing a specific identification increment method and sub-methods, definitions and special rules provided in Section 4.02 and computational methodology set forth in 14 steps in Section 4.03 of Revenue Procedure 92-79.

A COPY OF FORM 970 SHOWING THE TAXPAYER'S INITIAL LIFO ELECTION IS ATTACHED.

Other changes within the LIFO methodology required by and incident to electing the Alternative LIFO Method are indicated by an "X" below:

___ Demonstrator vehicles not previously on LIFO will be added to existing/corresponding LIFO pools. Demonstrator vehicles in ending inventory were not previously included in taxpayer's LIFO election and pools. Demonstrator vehicles will be included in the new LIFO pools pursuant to Section 4.02(1) of Rev. Proc. 92-79.

FORM 970 ATTACHED

___ Other costs (for example, the costs of options and accessories) not previously on LIFO are being added to existing/corresponding LIFO pools. **FORM 970 ATTACHED**

___ A single pool (all new vehicles) previously employed is being split into the two pools required by Section 4.02(1):

POOL #1: AII NEW AUTOMOBILES (regardless of manufacturer) including demonstrators.

POOL #2: AII NEW LIGHT-DUTY TRUCKS (regardless of manufacturer) including demonstrators.

___ Multiple pools (by make, model, body style, or other pooling classification, etc.) previously employed are being combined/consolidated into the two pools required by Section 4.02(1):

POOL #1: AII NEW AUTOMOBILES (regardless of manufacturer) including demonstrators.

POOL #2: AII NEW LIGHT-DUTY TRUCKS (regardless of manufacturer) including demonstrators.



**PAGE 1, QUESTIONS 1 AND 4(b) FOR DEALERSHIPS UNDER IRS AUDIT:
YEAR OF CHANGE AND EXAMINATION STATUS**

For dealerships under IRS audit filing Forms 3115 under Section 5.02, it may be necessary or appropriate to attach a separate more detailed explanation regarding the determination of the year of change, citing such factors as shown below and using or modifying, if appropriate, the sample language attached:

1. Date IRS audit exam began.
2. Date(s) LIFO information was requested by agent or provided to IRS agent.
3. Whether or not a LIFO issue was pending on September 8, 1992.
4. Dates on which various tax returns were filed, coordinating those dates with the most recent year under audit and the date on which a LIFO issue was first raised.

**PAGE 1, QUESTIONS 5(a) AND 5(b) AND POSSIBLY PAGE 2, QUESTION 9(e)
SECTION 263A INVENTORY COST CAPITALIZATION MATTERS**

Taxpayer made appropriate changes using the Simplified Resale Method (or, if appropriate, the Alternative Simplified Resale Method or the Modified Resale Method) to its methods of accounting for inventories to reflect the Uniform Cost Capitalization Rules under Section 263A pursuant to provisions enacted by the Tax Reform Act of 1986.

The changes for Inventory Cost Capitalization purposes under Section 263A were treated as initiated by the taxpayer but made with Internal Revenue Service consent. Therefore, no ruling letter granting approval for these changes was required nor received by the taxpayer.

PAGE 2, QUESTION 12 - SECTION 481(a) ADJUSTMENT

CUT-OFF METHOD. Under Section 9.02(6) of Revenue Procedure 92-79, the automobile dealer must effect the change to the Alternative LIFO Method using the cut-off method. Under the cut-off method, the value of the new automobile and new light-duty truck inventory...at the beginning of the year of change shall 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.

Therefore, no Section 481 (a) adjustment is required for the change in LIFO methods pursuant to the conditions of consent (Section 9.02(6)) of Revenue Procedure 92-79. In addition, no Section 481 (a) adjustment is required for any Section 263A additional resale costs since taxpayer has previously elected the Simplified Resale Method (or, if appropriate, the Alternative Simplified Resale Method or the Modified Resale Method) and the layers of LIFO inventories remain unchanged as one of the conditions of consent.

CONSENT STATEMENT REQUIRED BY SECTION 9.01 OF REV. PROC. 92-79

Under penalties of perjury, _____ (name of automobile dealer) agrees to all of the conditions of consent contained in Section 9 of Rev. Proc. 92-79, to change to the Alternative LIFO Method.

NOTE: THE ABOVE STATEMENT MUST BE INCLUDED AS AN ATTACHMENT TO FORM 3115.

(End of Statements Attached to Form 3115)



ADDITIONAL COMMENTS AND EXPLANATIONS

Overall, filers of Forms 3115 electing the Alternative LIFO method will have to suffer with the lack of coordination and direction on exactly how detailed responses must be. What should be clear from the overall Form 3115 filing is that the changes being made are to the Alternative LIFO method. If any further information might be required by the IRS in connection with the Form 3115, that additional information can be provided without necessarily disqualifying the taxpayer's eligibility to elect to use the Alternative LIFO method.

DEALER VARIABLE INFORMATION: PAGES 1 AND 2, FORM 3115

Several questions on pages 1 and 2 of Form 3115 require information specific to the auto dealer filing the change request. These questions include:

1. Name, Address, etc: First 4 lines at top of Page 1.
2. Taxpayer/tax entity status.
3. Question 1a: Year of change.
4. Question 1b: 180th day of tax year. (Note for filings under Section 5.02, we have simply indicated: "RP 92-79".)
5. Question 3a: Leave blank.
6. Question 3b: Description of present LIFO methodology.
(The instructions to Form 3115 indicate that "statement attached" entered on this line would not be acceptable. Therefore, to be on the safe side, you will want to put in the specifics of the prior LIFO methodology here, as well as including them in the statement attached. See specific wording in the attached statement.)
7. Question 3d: Number of years on present LIFO method: Insert appropriate figure.
8. Question 3g: Whether present method of accounting conforms to GAAP: assume answer would generally be "YES."
9. Question 3h: Assume generally answer would be "NO."
10. Question 4a: Assume generally answer would be "NO."
11. Question 4b: Answer will vary based on IRS audit status. Specifics re: current IRS examination, if any, need to be provided. Note that Rev. Proc. 84-74 has been superseded by Rev. Proc. 92-20.
12. Question 4c: See comments re: Schedule C applicability. Answer will vary depending on \$10,000,000 gross receipts eligibility for exclusion. Answer generally would be "YES" for larger dealerships.
13. Question 5c: Answer will generally be "NO" unless other Forms 3115, etc. are pending. If so, complete particulars for line 5d.
14. Question 6a: Insert amount of net operating loss, if any.
15. Question 6b: Insert amount of other credit carryovers, if any.
16. Question 7: Gross receipts information for last 4 years: to be inserted.
17. Question 8a: Answer generally will be "NO."
18. Question 9: Whether applicant is a member of a affiliated group filing a consolidated return: answer depends on specific facts and circumstances.
19. Question 10: Answer generally would be "NO."
20. Question 11: Answer generally would be "YES."
21. Question 13: Answer generally would be "NO."



SPECIFIC FORM 3115 LIFO-CHANGE RELATED INFORMATION

1. At the top of page 1 of Form 3115, type or legibly print: **"FILED UNDER (INSERT APPLICABLE SECTION 5.01, 5.02, OR 6.01) OF REV. PROC. 92-79."**
2. Check box for Schedule B and add **"PER REVENUE PROCEDURE 92-79."**
3. Question 12:re: Section 481 (a) columns for adjustment amounts should be left blank: Type across all 4 columns: **"N/A: CUT-OFF METHOD: R.P. 92-79, SEC. 9.02(6)."**
4. Page 2, Signature box: Amount of user fee: enter **"None"** and indicate: **"WAIVED BY SECTION 13.03 OF REV. PROC. 92-79."**
5. Depending on the circumstances, the **ORIGINAL** of Form 3115 is filed either as an attachment to the tax return Form 1120 or 1120-S (if the dealer is not under audit) or with the examining agent.

The **COPY** of Form 3115 must be filed with the IRS National Office, in most cases, on or before December 31, 1992:

Commissioner of Internal Revenue
Attention: CC:IT&A
P. O. Box 7616
Benjamin Franklin Station
Washington, DC 20044

6. A dealer must also attach an extra acknowledgment copy of Page 1 of the Form 3115 to the copy of Form 3115 filed with the IRS National Office so that the copy of Page 1 can be date-stamped by the National Office and returned to the dealer. Accordingly, you will need to paper clip this acknowledgment copy of Page 1 to Form 3115 so it can be date-stamped and returned by the IRS.
7. A copy of the Form 970 reflecting the original LIFO elections (and any subsequent LIFO elections) must be attached to Form 3115. The instructions to Form 3115 indicate that if the applicant properly elected the LIFO inventory method but is unable to furnish a copy of Form(s) 970, attach the following statement, signed by the applicant, to Form 3115:

"Under penalties of perjury, I certify that to the best of my knowledge and belief (name of applicant) properly elected the LIFO inventory method by filing Form 970 with its return for the taxable year(s) ended (insert date(s)) and otherwise complied with the provisions of Section 472(d) and Regulations Section 1.472-3."

In this regard (i.e., missing Forms 970), see Revenue Procedure 92-85 (IRB 1992-42) October 1, 1992, which supersedes Rev. Proc. 79-63 and modifies Rev. Procs. 87-32 and 92-20.

FORM 3115 SCHEDULES TO BE COMPLETED AND ATTACHED TO PAGES 1 AND 2 OF FORM 3115

1. Schedule B, Parts I, II and III, if applicable. Note: It appears the IRS may prefer to have these schedules completed in their entirety; however, the accompanying narratives may be sufficient if the following wording is typed in the columns provided in Part I, Schedule B:

**CHANGE IS TO ALTERNATIVE LIFO METHOD
DOLLAR-VALUE, LINK-CHAIN
IN ACCORDANCE WITH REV. PROC. 92-79
STATEMENT ATTACHED**

2. Schedule C, Part II: The instructions to Form 3115 appear to indicate that Schedule C, Part II does not need to be completed where the applicant is currently using a LIFO inventory method and is changing to another LIFO inventory method.
3. Schedule C, Part III re: Section 263A Cost Capitalization. Although the IRS may prefer to have Schedule C, Part III, Sections A-B-C completed, the narrative paragraphs indicating taxpayer's Section 263A methods and practices should be sufficient. If it is not, the specific information can be provided upon request.



SAMPLE LANGUAGE DESCRIBING YEAR OF CHANGE AND EXAMINATION STATUS FOR DEALERS UNDER AUDIT: FORM 3115 PAGE 1, QUESTIONS 1 AND 4(b)

Taxpayer is under examination. _____ (insert agent name), of the _____ District Director's office is the current IRS examining agent. **TAXPAYER HAS RECEIVED A (30 DAY LETTER DATED _____ OR FORM _____) INDICATING PROPOSED ADJUSTMENTS TO THEIR LIFO COMPUTATIONS FOR THE (CAL-
ENDAR YEARS _____ OR THE FISCAL YEARS ENDING _____).**

INSERT OTHER FACTUAL, DEALER VARIABLE INFORMATION HERE.

Section 5.02 of Rev. Proc. 92-79 provides that "in the case of an automobile dealer under examination and for which a LIFO issue is pending...as of September 8, 1992, the year of change is the most recent taxable year that is being examined by the Service as of September 8, 1992, but not later than the most recent taxable year for which a Federal income tax return had been filed as of the date the examination (in which the issue is pending) began, provided a Form 3115 is filed with the National Office, pursuant to the provisions of Section 5.02(3), on or before December 31, 1992."

The original Form 3115, including attachments, is being filed with the IRS examining agent (_____) in (insert District Office here) to be associated with the current audit file. At the same time as the original Form 3115 is filed with the IRS examining agent, a copy of Form 3115 is being filed with the National Office of the Internal Revenue Service in Washington, DC as required by Section 5.02(3) of Revenue Procedure 92-79.

Attached to the copy of Form 3115 filed with the National Office is a copy of Page 1 of Form 3115 to be used as an "acknowledgment copy." As soon as the automobile dealer receives the date-stamped copy of Page 1 of Form 3115 back from the National Office, a copy of that date-stamped Page 1 will be provided promptly to the IRS examining agent.

FORMS 970 FOR NEW COSTS (I.E., DEMOS, ETC.) REQUIRED IN NEW POOLS

If Form 970 is required because of the addition of additional costs (such as demonstrator vehicles) to the respective LIFO pools, Form 970 will also have to be altered significantly to reflect the intention to elect the Alternative LIFO method (because the current version of Form 970 obviously makes no reference anywhere on its face to Rev. Proc. 92-79 nor to the Alternative LIFO method). Specific questions to be careful in answering on Form 970 include:

1. Form 970, upper right-hand corner, check the box for **"Subsequent Election."**
2. Box A Insert appropriate year end and describe costs being added to existing LIFO pools. An alternative response might simply be: **"new autos and new light-duty trucks."**
3. Question 3a: The response will depend on your prior accounting practices.
4. Question 3b: Probably should be answered **"N/A per Revenue Procedure 92-79,"** if there are no writedowns to be restored.
5. Question 5: Relates to Financial Statement Conformity Requirement. Be careful to use LIFO on all year-end Financial Statements.
6. Question 6a: Check the box for **"Other"** and indicate **"Rev. Proc. 92-79"**. If you want to add a further description, indicate that the increment valuation index is based on the specific identification of vehicles on hand at year-end and this method will closely approximate the "most recent purchases" method.
7. Question 7: Check the box for **"Dollar-Value Method."**
8. Question 8: Check the first box: **"by line, type or class of goods..."** Add statement that costs are being added to existing pools. This is where you can coordinate wording with that used in Form 3115 attachment relative to pooling changes.

(... continued on page 12)



9. Question 9: Check the box for "Other Method" and describe as "Revenue Procedure 92-79 Alternative LIFO Method."
10. Question 10: "Specific Identification of vehicles by purchase invoice" should be appropriate.
11. Question 11: Check the box "Yes" and add beneath it: "Automatic - Per Rev. Proc. 92-79."
12. Question 12: Should be answered "Yes" and below it indicate "Not Applicable" in response to the request for an explanation regarding discontinuation.
13. The Form 970 instructions require the attachment of a detailed analysis of inventories as of the beginning and end of the current LIFO tax year and as of the beginning of the preceding year. This analysis of inventories as of the three years-end should be in sufficient detail to tie out with ending inventory amounts per tax returns filed and the pooling arrangements that were previously used and/or currently will be used.
14. The Form 970 instructions for Item 9 indicate that if you do not use the "double-extension" or "index" method, attach a detailed statement to explain the method used and how it is justified under Regulations Section 1.472-8(e)(1).

Assuming this instruction is intended to apply to Rev. Proc. 92-79 Alternative LIFO Method new filings, the following statement should suffice:

Taxpayer is electing to use a dollar value, link-chain, index method authorized by Revenue Procedure 92-79. This approach has been selected because of anticipated future technological changes in the stock of inventory, the extensive variety of items, and the changes in the items which are combined into and make up the vehicles sold by the taxpayer at retail.

15. The Regulations at Reg. Sec. 1.472-8(e)(1) contain the following requirement: "In addition, a copy of the statement shall be filed with the Commissioner of Internal Revenue, Attention: T:R, Washington 25, D.C." The "statement" referred to is a statement justifying the use of a link-chain method.

Apparently, a copy of the statement (submitted with the Form 970 justifying the use of the link-chain, index method) should be filed with the IRS National Office in Washington, D.C. if one is to be in "100% compliance" with the Regulations on this matter.

Given the outdated zip code provided in the Regulations and the obvious lack of coordination between Revenue Procedure 92-79 and Forms 970 and 3115, it may be the intention of the Internal Revenue Service not to press this extra National Office filing requirement too strongly. But...If you want to avoid any doubt in connection with this filing, then mail a copy of the statement to the National Office as literally required by the Regulation.



GETTING OFF LIFO...MADE SAFER BY 92-79

The new Alternative LIFO Method under Revenue Procedure 92-79 affords some welcome relief for dealers who simply want to get off LIFO now because they feel they have obtained enough benefits in the past and are more willing to "settle up" with the IRS under terms they feel are more under their own control.

Especially for a dealer whose LIFO reserves might be unjustifiably high, the election to use the Alternative LIFO Method will prevent audit adjustment for prior year computations and that can be followed by a request to terminate the LIFO election with the repayment of the LIFO reserve spread over six years. This eliminates the risk of any adjustment to the prior LIFO computations and is especially attractive if the LIFO termination can be made under Revenue Procedure 88-15 - the "no questions asked" expeditious consent procedure - instead of Revenue Procedure 92-20.

With repayment spread over six years and the certainty that LIFO calculations in prior years can't be audited to produce major deficiencies or penalties, those dealers who want to terminate their LIFO elections now can do so with a greater sense of control.



SPLITTING ONE LIFO POOL IN TWO

Under Revenue Procedure 92-79, if a dealer has been using a single pool for LIFO purposes, that pool must be split into two pools: Pool #1 - all new autos (including demonstrators) regardless of manufacturer, and Pool #2 - all new light-duty trucks (including demonstrators) regardless of manufacturer.

Section 9.02(7) of Revenue Procedure 92-79 directs a taxpayer separating a dollar-value inventory pool to do so in accordance with Regulation 1.472-8(g)(2). The problem with this is that the example in the Regulations is based on a taxpayer separating pools under a double extension LIFO application. The fact pattern in the example is "rigged" by the underlying assumption that all information regarding prior year base costs is either known or readily determinable.

In many instances, that prior information is not known or available, especially where the taxpayer has previously used a link-chain method. Unfortunately, the Regulations do not provide any guidance on how to split pools where a link-chain LIFO methodology was used before the change.

Under these circumstances, it would appear that a single new vehicle pool can be split into the required two pools (one for new autos and one for new light-duty trucks) by using the ratio of the current costs of these two inventory categories as reflected in the ending inventory for the taxable year immediately before the year of change. In other words, for a calendar year 1992 taxpayer, the ratio of the total actual cost at December 31, 1991 of new autos and the total actual cost of new light-duty trucks at December 31, 1991 would provide the ratio for splitting or allocating the total LIFO reserve as of December 31, 1991 between these two new pools. The base inventory and each subsequent year's increment as of the end of the last year would be allocated in this ratio to arrive at this overall result.

This would appear to be a reasonable and practical approach, and it was permitted by the National Office in Letter Ruling 8137143 and in probably many other situations where a link-chain method was previously used. Also, for a good example of splitting a LIFO pool and rebasing it to 1,000, see *The Tax Advisor*, July, 1991, at page 451.

If using only the prior year-end ratio of costs provides some extreme or unusual result, or is unacceptable for some other reason, this ratio approach could be modified by using the ratio of new auto and new light-duty truck costs to each other over a period of three years prior to the year of change (or some more "representative" combination of years), to obtain a more weighted average as the basis for allocating the single pool's LIFO reserve between the two new pools.

IS IT A "CAR" OR A "TRUCK"?

Revenue Procedure 92-79 tries to eliminate or minimize subjective decisions whenever possible. But how can you tell a car from a truck? What is the proper classification for LIFO pooling purposes? Objective sources in making this determination include:

1. The manufacturer's financial statement pro formas for the dealership which show how vehicles are to be classified either by model counts in the inventory section of the Balance Sheet or in the sales analysis portion of the Statement of Income.
2. Factory price information and/or factory model information which may contain listings of "cars" and "trucks".
3. State licensing requirements.
4. Classification for import tariff/duty purposes.
5. Industry publications such as the *Automotive News* contain market classification listings.
6. Other industry sources such as NADA or Black Book compilations or publications.

Hopefully, a particular vehicle will be consistently classified by most of the above sources. If it is not, then its classification in the factory financial statements³ or other manufacturer-provided sources should be used in preference to the others. The above sources in the order listed offer objective input that the IRS should be willing to accept on whether "it" is a car or a truck.



REBASING INDEXES TO 1.000

One of the conditions (of consent to which an auto dealer must agree) in making the change to the Alternative LIFO Method is that any layers of inventory increments previously determined and the LIFO value of such increments shall be retained. Instead of using the earliest taxable year for which the automobile dealer adopted the LIFO method...the year of change shall be used as the base year in determining the LIFO value of the inventory pool or pools for the year of change and later taxable years (i.e., the cumulative index at the beginning of the year of change shall be 1.000). The base-year costs of layers of increments in the pool or pools at the beginning of the year of change shall be restated in terms of the new base-year costs, using the year of change as the new base year.

Unfortunately, there are no examples or illustrations in the Regulations either under Section 446 for accounting method changes or under Section 472 for LIFO method changes indicating exactly how this rebasing is to be accomplished. Informal discussion with the National Office indicated that Technical Advice Memorandum (Letter Ruling) 8137143 dated June 22, 1981 can be referred to for guidance. This Letter Ruling indicates that the key procedure involved is one whereby the LIFO indexes generated in years before the year of change are restated to indexes of less than 1.000, gradually rising or ascending according to the overall inflation pattern so that they reach (but do not exceed) 1.000 as of the beginning of the year of the change, while retaining their percentage relationships to each other year-by-year in the restatement.

The rebasing to 1.000 is a general requirement that the IRS National Office prescribes when LIFO changes are made from double extension method to link-chain, index methodologies. Apparently, rebasing prior indexes to 1.000 is also required in the Revenue Procedure 92-79 context even for those dealers who used a link-chain methodology prior to the change to the Alternative LIFO Method - which also involves a dollar-value, link-chain methodology. Intuitively or otherwise, many CPAs seem to agree that there should not be a major difference in result where indexes are rebased to 1.000 if the intention underlying the requirement is simply to provide a means or mechanism by which the taxpayer in future years can more accurately keep track of increments and layers before the year of change so that if a decrement is experienced after the year of change, that decrement

can be carried back against the appropriate prior years' inventory layers expressed in "base dollars."

The facts in Letter Ruling 8137143 are somewhat involved and may make it more difficult to see what is actually supposed to happen, inasmuch as the Letter Ruling involves computations for splitting one pool into several dollar-value LIFO pools. The key principle appears to be that the indexes for each increment are restated by creating a fraction, the numerator of which is the cumulative index for valuing that year's increment and the denominator of which is the cumulative index for the last year before the year of change. In other words, in the Letter Ruling 8137143 example, the indexes are as follows:

YEAR	ORIGINAL INDEX	REBASING FRACTION	REBASED INDEX
1974	1.00	1.00/1.25	.80
1977	1.10	1.10/1.25	.88
1979	1.20	1.20/1.25	.96
1981	1.25	1.25/1.25	1.00

Letter Ruling 8137143 continues with the need to split out costs and allocate them to the new pools with reference to prior year costs.

The total "new base year costs to be allocated" simply represents the product of the (1) sum of the old base year costs multiplied by (2) the cumulative index at the end of the year before the year of change. In the Letter Ruling 8137143 example, this is \$20,000 times 1.25 or \$25,000. Based on assumed facts, the Letter Ruling then allocates the new base year costs of \$25,000 between the two pools with an allocation of \$8,000 to one pool and \$17,000 to the other pool, and with the "new base year costs as allocated" multiplied by the rebased indexes (i.e., .80, .88, .96 and 1.000) resulting in the LIFO valuation of the inventory as of the end of the year before the year of change being exactly the same LIFO valuation (i.e., \$22,100) as it was before any of the rebasing mechanics were employed.

It may be easier to grasp the concept of rebasing to 1.000 in a simpler context without complicating matters by the additional pool-splitting facts in the Letter Ruling.

Consider the fact pattern below, noting that the total "old base year costs" of \$1,600 and the total LIFO Value of \$1,647 do not change after the restatement of indexes to 1.000.

→



NEW BASE YEAR FOR COMPUTATION PURPOSES ONLY

ORIGINAL FACTS

<u>YEAR</u>	<u>OLD BASE YEAR COSTS</u>	<u>ORIGINAL (CUMULATIVE) INDEX</u>			<u>LIFO VALUE</u>
1988	1,000	1.000	-	-	1,000
1989	200	1.050	-	-	210
1990	100	1.070	-	-	107
1991	<u>300</u>	1.100 *	-	-	<u>330</u>
	<u>1,600</u>				<u>1,647</u>

RESTATED TO 1.000

<u>YEAR</u>	<u>OLD BASE YEAR COSTS</u>	<u>CONVERSION FACTOR 1.100 * INDEX</u>	<u>NEW BASE YEAR COSTS</u>	<u>NEW INDEXES</u>	<u>SAME LIFO VALUE</u>
1988	1,000	x 1.100	1,100	.90909	1,000
1989	200	x 1.100	220	.95455	210
1990	100	x 1.100	110	.97273	107
1991	<u>300</u>	x 1.100	<u>330</u>	1.00000	<u>330</u>
	<u>1,600</u>	(x 1.100)	<u>1,760</u>		<u>1,647</u>
	NO CHANGE				NO CHANGE

What seems to be intended through this procedure is the creation of a new base year solely for computation purposes. Under this procedure, the original or oldest base year and the layer increments experienced before the year of change (i.e., before the new or substitute base year) are restated in terms of the new base year price levels. The LIFO values for the original base year and all annual layer increments for the years between (a) the original LIFO election and (b) the year of change to the new method **do not change**. The old LIFO indexes are simply recomputed to reflect the ratio percentages of the new base costs to the old LIFO values. This can be observed from the 4th and 5th columns added to the "Restatement" portion of the example. Note also that the same decimals shown for the "new indexes" can be obtained by dividing each year's original (cumulative) index by the 1991 index of 1.100.

Although there are no specific examples in the Regulations, the new/substitute base year cost restatement to 1.000 procedure has been authorized previously when major changes have been made in the inventory regulations. For example, when the new dollar-value LIFO regulations were issued in 1961, Regulation Section 1.472-8(g)(3) provided for the use of restated base year costs to implement the transition. In 1973, when the full absorption costing regulations were implemented, LIFO taxpayers were permitted to use the rebasing to 1.000 concept under the transition rule in Regulation Section 1.471-11(e)(3)(ii)(B)(2). Again in 1983, when the use of an inventory price index computed with reference to the Consumer or Producer Price Indexes (IPIC) methodology was introduced, the rebasing to 1.000 concept was included in the transition rules under Section 1.472-8(e)(3)(iii)(B)(5).

Finally, and more recently, when the Tax Reform Act of 1986 established the Uniform Inventory Cost Capitalization Rules under Section 263A, the use of a new base year approach was specifically provided for LIFO taxpayers restating their opening inventory using the 3-year average method. Regulation Section 1.263A-1T(e)(6)(iv)(C) contains an example which might be instructive in this regard. However, in analyzing this example, keep in mind that the Section 263A transition rules for restating the opening inventory under 263A required a Section 481(a) adjustment (in contrast, a Section 481(a) adjustment is not required as part of the Rev. Proc. 92-79 Alternative LIFO Methodology change). The regulation just cited states that "for purposes of determining future indexes, the year prior to the year of change becomes a new base year, and all costs are restated in new base year costs for purposes of extending such costs in future years. However, costs associated with old layers retain their separate

see **REBASING INDEXES TO 1.000**, page 16



identity within the base year, with such layers being merely restated in terms of the new base year index. For example, for purposes of determining whether a particular layer has been invaded, each layer shall retain its separate identity; thus, if a decrement in an inventory pool occurs, layers accumulated in more recent years shall be viewed as invaded first, in order of priority."

What is puzzling is that in the Section 263A transition example, the year **prior** to the year of change is referred to as becoming the new base year - but the seven years' indexes beginning with the original base layer of 1.000 and running **through** 1986 all result in restated indexes which are determined by dividing the ratio of the original LIFO index by the index used to value the 1986 layer (i.e., the last year before the year of change). So, for example, the original index of 1.000 for the original January 1, 1981 LIFO base layer is restated to have an index of .625 since that is the result obtained by dividing 1.000 by 1.600 (the 1986 layer cumulative index).

A number of commentators (Schneider and Seago in their respective treatises) have indicated that the use of a new base year method will produce adjustments that differ from adjustments that would have otherwise been computed if the entire LIFO base layering tiers or schedules had been recomputed and that in some cases, the new base year method may be more advantageous to the Internal Revenue Service, while in other instances it may not be. This appears to follow in the more limited context of changes from double extension to link-chain. Although it **appears** that the intention underlying the rebasing to 1.000 condition in Revenue Procedure 92-79 is intended to be neutral (i.e., neither favorable nor unfavorable to either the Internal Revenue Service or to the taxpayer), clarification on this matter by the IRS - and sooner, rather than later - would seem to be in everyone's best interest because all subsequent year's LIFO computations under the Alternative LIFO Method will be predicated on the rebased numbers.

Various factual patterns will present difficulties in interpretation and application, especially where a dual index or earliest acquisition approach may have been used for valuing increments and depending on whether or not strict or literal interpretation focuses upon the costs at the "beginning of the year of change" or the costs in the last year prior to the year of change (more generally) as the critical denominator in the recomputation of indexes.

Other sources for guidance on this subject include IRS Letter Ruling 8008012 which has a straightforward fact pattern and states:

"Consideration has been given to the contention that taxpayers changing to the link-chain method are likely to encounter problems in determining, for each

taxable year prior to the year of change, the yearly index...that would be required in order to calculate the cumulative indices necessary to recompute, using the link-chain method, the LIFO value of a pool for the base year and for each layer of increment added prior to the year of change. Therefore, in effecting changes, taxpayers have been permitted to use 'the costs at the beginning of the year of transition as the new base year costs' in applying the link-chain method rather than requiring the recomputation of LIFO inventories based on the link-chain method for taxable years beginning prior to the year of transition.

"In changing to the link-chain method without performing a recomputation of the LIFO value of the inventory at the beginning of the year of change under the link-chain method, it is necessary for the ratios of costs in layers added prior to the year of change to be computed in their relationship to the 'new' base year costs rather than the 'old' base year costs.

"For this purpose, an appropriate index to base (i.e., to *determine*) costs for each layer added prior to the year of change would be the ratio of the LIFO value of such layer to the base cost of the layer. The LIFO value of the inventory is not changed and the total of the 'new' base year costs is treated in the same manner as the 'old' base year costs; that is, used solely for the purpose of determining whether there has been an increase or a decrease in the inventory value, and as a basis for determining the value of such increase or decrease.

"For example, if in a taxable year subsequent to the year of change, a decrease in inventory at base costs were to occur, the decrease in inventory at base costs would be applied to reduce the value of the successive layers of increment in reverse chronological order. If the layer being reduced was added in the year of change or in a taxable year subsequent thereto, the cumulative index for the year of the layer would be applied to the decrease in base costs to determine the amount of reduction in the layer. If the year the layer was added was a year prior to the year of change, the index of the LIFO value of the layer to base cost of the layer would be used to determine the portion of the LIFO value of the layer equivalent to the reduction at base costs.

"Since permission to use the link-chain method is granted only when one of the base year cost methods is impractical or unsuitable, the indexes used prior to the change are not suitable. In order to obtain a good basis for future computations of the cumulative indexes, it is necessary to establish a new base year. The LIFO value of the inventory prior to the change remains unchanged and the purpose of the new base year cost is to establish a basis for determining future increments or decrements."

It should be kept in mind that Technical Advice

→



The procedures will vary depending on whether the Form 970 omission, error, oversight or exclusion was noted **within** one (1) year from the date of the filing requirement or whether this problem is noted **more than** one (1) year after the time for filing.

Where an oversight is noticed within 12 months of the deadline for making the original election, Section 4 of Revenue Procedure 92-85 provides an automatic 12-month extension during which corrective action by filing an amended return may be taken. Any return or statement of election that must be made to obtain an automatic extension must provide the following statement at the top of the document: **"FILED PURSUANT TO REV. PROC. 92-85."** Any filing made under Section 4 should be sent to the same address that the filing to make the election originally would have been sent had the filing been timely made. No request for a private letter ruling is required to obtain the extension and no user fee is charged for taxpayers taking corrective action under Section 4.

Where the oversight is not noticed or discovered until **more than 12 months** have passed since the deadline for making the election, then Section 5 of Revenue Procedure 92-85 applies and the corrective action requires more effort in order for the taxpayer to be deemed to have acted reasonably and in good faith.

There are special rules that provide when the interests of the Government are deemed to be prejudiced by the granting of relief under this Revenue Procedure. One indicates that "ordinarily, the Service will not grant relief when the tax years that would have been effected by the election had it been timely made are closed by the statute of limitations." This seems to indicate that more serious problems are faced if the Form 970 filing was missed many years ago.

#8 SECTION 263A FINAL REGULATIONS STILL RUMORED TO BE DUE SOON

It is still rumored that before December 31, the IRS may issue the **final** regulations under Section 263A for the Inventory Uniform Cost Capitalization Rules. As we go to press in early December, the final Section 263A regulations have not been issued, but informal discussion with sources outside the IRS, including the Tax Division of the AICPA, indicate that the IRS seems to be working to complete this regulation project *before this year-end*.

It is not known whether the regulations will contain any controversial or previously unaired issues and it appears that various suggestions by the AICPA for simplification (such as allowing the use of a simplified index for three years before computing a new one) will not be part of the final regulations.

One might reasonably expect that the final regulations will incorporate much of what has already become public record through the issuance of IRS Notices 88-78, 88-86, 88-92, and 89-67. *

Rebasing Indexes to 1.000

(Continued)

Memoranda and IRS Letter Rulings are directed only to the taxpayer who requested them and that Section 6110(j)(3) of the Code provides that these may not be used or cited as precedent. However, if the underlying reasoning/rationale is sound, these "unofficial" discussions may be quite useful.

Where the prior method was a link-chain method, it may be that one way to double check the LIFO computations after they are rebased, especially where a subsequent decrement is experienced, is to recompute the LIFO reserve changes as if the computations were not required to reflect any rebasing to 1.000. This could be a means of double checking the results

produced from rebasing the computations to 1.000 as required by the condition of consent in Revenue Procedure 92-79, at least where link-chain was used both before and after the change.

Additional discussion on the rebasing to 1.000 requirement may also be found in *The Tax Advisor*, July, 1991, at pages 447-451. Also, the AICPA Issues Paper: "Identification and Discussion of Certain Financial Accounting and Reporting Issues Concerning LIFO Inventories," dated November 30, 1984 (File 3175) contains a discussion of substitute base years on pages 26-27 and illustrates an application for a double extension LIFO taxpayer on pages 97-98. *



De Filippis' LIFO LOOKOUT

Willard J. De Filippis, CPA, P.C.

317 West Prospect Avenue Mt. Prospect, IL 60056

(708) 577-3977 FAX (708) 577-1073

Published Quarterly
March, June, September
and December

Start my subscription for the next four issues of the **LOOKOUT** with the _____ issue.

☐ **YES!**

My check for \$250 is enclosed for 4 issues.

NAME(S): _____

FIRM NAME: _____

ADDRESS: _____

CITY: _____ STATE: _____ ZIP: _____ PHONE: (____) _____

YEAR-END WARNING: THE ULTIMATE LIFO TRAP

THE FINANCIAL STATEMENT CONFORMITY REQUIREMENT

The most serious trap of all for LIFO users is highlighted by three questions on line 5 of Form 970. These questions ask whether the taxpayer has issued credit statements or reports at year-end to any one of a variety of users and, if so, what inventory method of accounting was used in determining income, profit or loss in those statements.

Question 5 relates to the requirement that LIFO must be used to compute income in the year-end financial statements: technically, only in the primary presentation of income. For many taxpayers, this LIFO conformity requirement really poses multiple requirements: First, it requires all year-end financial statements sent to the manufacturer or supplier (12th, 13th and any other fiscal year-end statements) to reflect LIFO. Second, the conformity restriction also requires that any other year-end financial statements issued in report form by the taxpayer to creditors, shareholders, partners or other users must also reflect the year-end results on LIFO.

The intent underlying the LIFO conformity requirement is that the accounting method used for tax purposes for inventories should be the best method available. Accordingly, if a taxpayer wants to use LIFO for tax purposes, then LIFO **must** also be good enough to be used on the year-end income statements sent to shareholders, creditors and other parties.

Section 472(c) of the Code says that a taxpayer may adopt LIFO only if it has used no other procedure than LIFO in preparing an income or profit or loss statement covering the first taxable year of adoption. For subsequent taxable years, similar restrictions are imposed - but the Commissioner has the discretion to allow a taxpayer to continue to use the LIFO method even though conformity violations might have occurred.

Therefore, if a taxpayer violates the conformity requirement, the IRS can terminate the LIFO election. And usually, the IRS will terminate the LIFO election when it detects a conformity violation. Accordingly, a LIFO reserve - no matter how large - can be completely and abruptly lost if careful attention is not paid to the conformity requirement in year-end financial statements sent to the Factory, as well as to year-end statements issued in report form by CPAs.

REPORTS ISSUED BY CPAS

Let us first look at the conformity requirement in relation to year-end financial statements included in reports issued by CPAs where the CPA has control over the release and format of the statements, notes and accompanying supplementary information. These

financial statements are unlike Factory statements which are routinely sent out directly by the dealership without CPA involvement or review.

The LIFO conformity requirement requires that in the primary presentation of income (i.e., the income statement), the results disclosed must only be the **net of LIFO** results. The primary income statement CAN-NOT show results before LIFO, followed by either an addition or subtraction for the net LIFO change, coming down to a final net income or loss after-LIFO figure. In an inflationary period with stable or rising inventory levels, this means that a business using LIFO will be reporting (without adjacent explanation) lower operating results - maybe even converting income into loss or converting losses into even larger losses - in order to satisfy the conformity requirement.

The Regulations were liberalized in 1981 to allow taxpayers to disclose non-LIFO operating results in **supplementary** financial statements as long as those supplementary non-LIFO financial statements are 1) issued as part of a report which includes the primary presentation of income on a LIFO basis and (2) as long as each non-LIFO financial statement contains on its face a warning or statement to the reader that the non-LIFO results are supplementary to the primary presentation of income which is on a LIFO basis. Accordingly, for audit, review or compilation reports issued by a CPA to accompanying financial statements at year-end, results on a non-LIFO basis can be disclosed in this manner as supplementary information.

Alternatively, the Regulations permit disclosure of non-LIFO results in a footnote to the regular year-end financial statements, as long as the statement of income itself does not disclose this information parenthetically or otherwise **on its face** and the notes are all presented together and accompany the income statement in a single report. That was the good news or liberalization that occurred when the Regulations were changed in 1981.

Some interim reports covering a period of operations that is **less than** the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement. However, GAAP seems to require that if financial statements at year-end will be reporting using LIFO, then any interim financial statements should also report using LIFO.

DEALERSHIP YEAR-END STATEMENTS SENT TO THE FACTORY

The **BAD NEWS** is that the Regulations contain severe LIFO conformity reporting restrictions that apply to the Factory-prescribed format financial state-



ments sent by a dealership to the Factory immediately after year-end. These restrictions are the ultimate LIFO trap and are potentially more troublesome than those previously discussed for year-end reports issued by CPAs.

In this regard, the Regulations provide that any income statement that reflects a full years operations must report on a LIFO basis, whether it is the last in a series of interim statements, or the December statement itself which shows two columns - one for current month and one for year-to-date figures. The Regulations provide that a series of credit statements or financial reports is considered a single statement or

report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period. Sometimes this is referred to as the aggregation theory, meaning that if you can combine or aggregate a series of interim or partial-year statements to disclose the results of operations for a full year, then the last statement must reflect income computed using LIFO to value the inventory.

Literally interpreted, this wording applies to an auto dealers 12th statement (i.e., December - unadjusted)
see **YEAR-END WARNING**, page 20

PROJECTING YEAR-END LIFO RESERVES TO MEET THE CONFORMITY REQUIREMENT

Very often, it is not possible to make the computation of the year-end change in the LIFO reserve before the so-called 12th statement has to be sent to the Factory. Nevertheless, these year-end statements must not be released until an **ESTIMATE** of the LIFO reserve change has been computed and reflected in them. In current IRS audits, agents have requested documentation to check compliance with the year-end LIFO conformity requirement. Therefore, it is important to prepare a reasonable estimate of change in the LIFO reserve for the year. The estimate should be documented and saved for all time in the LIFO-SAVE FOREVER file.

Computing the estimate of the projected change in the LIFO reserve is usually not too difficult or time-consuming. It involves two factors: (1) the actual ending inventory level and (2) an **estimate** of inflation percentage for the year. By the time the estimate is being prepared, the actual dollar amount of the ending inventory usually is known. That means the only unknown is the estimated rate of inflation for the year. All other factors necessary to compute the estimated change are known:

- (1) Beginning-of-the-year inventory expressed in total dollars and in base dollars,
- (2) Beginning-of-the-year LIFO value of the inventory,
- (3) Method used for valuing current year increments, and
- (4) Cumulative inflation index as of the beginning-of-the-year.

The computation of the projected change in the LIFO reserve is made by plugging in the estimate of the current year's rate of inflation or inflation index and then working backwards in the following order:

- (1) Determine the cumulative index as of the end-of-the-year - this is the estimate of current year inflation index times beginning of year cumulative index,
- (2) Divide the end-of-the-year actual inventory dollars by the cumulative index - to get the end-of-the-year inventory stated in base dollars,
- (3) Compare the end-of-the-year inventory at base dollars with the beginning-of-the-year inventory stated in base dollars to determine whether there is an increment or a decrement projected for the year,
- (4) Proceed to value the projected increment under the method selected. Alternatively, if a decrement is projected for the year, carry the decrement back against prior increments on a LIFO basis,
- (5) Next, add all the resulting layers of inventory at their respective LIFO valuations to get the end-of-the-year inventory stated at its LIFO valuation,
- (6) Then subtract the ending inventory at its LIFO valuation from the ending inventory at its actual or current non-LIFO cost to determine the projected LIFO reserve as of the end-of-the-year, and
- (7) **Finally**, compare the actual LIFO reserve as of the beginning-of-the-year with the projected LIFO reserve as of the end-of-the-year.

The result after step 7 is the estimate of change in LIFO reserve for the year. This amount is usually rounded somewhat and then put into the 12th statement by an adjusting entry before it is sent to the Factory.

These **estimates** of change are routinely prepared and reflected in the dealers year-end financial statements sent to the Factory: you don't have to know the exact change to reflect LIFO in the December statement. Reasonable estimates are permitted on the 12th statement. The actual computation of the change in the LIFO reserve for the year is usually made **after** the 12th statement has been sent out, when the actual inventory invoices and mix of models and model years can be fully evaluated and the LIFO index computations computed in accordance with the dealer's established LIFO practices. After the actual change in the LIFO reserve for the year has been computed, the 13th statement should adjust the estimated amount to the actual LIFO reserve amount.

Remember: Do it, Do it, Do it...even though you'd rather not!



Year-End Warning...

(Continued from page 19)

as well as the 13th statement. The 12th statement is usually issued on a preliminary basis, before accruals are refined by detailed adjusting entries. The 13th statement is usually issued several weeks after the 12th, and it reflects year-end accrual adjustments and other computations not otherwise permitted by the tight time frame for the issuance of the December/12th statement.

This conformity requirement means that **every year** to remain eligible to use LIFO, the dealerships December (or last monthly) statement must reflect an estimate of that years change in the LIFO reserve.

If the dealer is anticipating making a LIFO election for the year, an estimate of the LIFO reserve should be placed in the year-end statements issued to the Factory or issued to anyone else in order to preserve the option to elect LIFO available when the tax return for the year is filed. Don't overlook this conformity requirement if a dealer already has new vehicles on LIFO and is considering extending LIFO to either used vehicles or to parts and accessories. In this case, the dealers year-end statement going to the Factory should also reflect an estimate of the size of the LIFO reserve expected upon making the additional LIFO election(s) in order to preserve the dealers eligibility to extend LIFO to whatever class of goods is under consideration.

Special reporting situations exist in some dealerships where a so-called different year end is used for reporting to the Factory (calendar year - Dec. 31) than the fiscal year used for income tax purposes. Separate wording in the Regulations requires the dealerships financial statements to reflect LIFO at the end of both twelve month annual reporting periods or years in order to satisfy this **strict** conformity requirement.

The actual wording of the regulation on this point is that the conformity rules also apply to the determination of income, profit, or loss for a one-year period other than a taxable year and credit statements or financial reports that cover a one-year period other than a taxable year, but only if the one-year period both

begins and ends in a taxable year or years for which the taxpayer uses the LIFO method for Federal income tax purposes. For example,...in the case of a calendar year taxpayer, the requirements...apply to the taxpayers determination of income for purposes of a credit statement that covers the period October 1, 1981, through September 30, 1982, if the taxpayer uses the LIFO method for Federal income tax purposes in taxable years 1981 and 1982.

The intention underlying the conformity requirement is that LIFO should be used in all reports covering a full year to insure that the use of LIFO for tax purposes conforms as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income. If one simply remembers that this exists as a restriction on the taxpayers general desire to pay lower taxes using a favorable LIFO method while reporting more income to their shareholders or banks using a non-LIFO method, that should dispel any temptation to try to get around the conformity requirement.

The projection of year-end change in the LIFO reserve is usually needed in planning estimated tax payments either for the corporation (due December 15 - if a regular C corporation) or by January 15 for dealerships that operate as S corporations and flow net income, or loss, through to their individual shareholders via Schedule K-1s.

CPAs and their clients should be especially careful to monitor all year-end financial statements so as not to get trapped by the conformity requirement...since the position of the IRS is that once financial statements have been issued on a non-LIFO basis, it is too late to recall them and reissue statements on a LIFO basis.

The bottom line is that the IRS takes the conformity requirement seriously. On many audits, instead of assuming that the taxpayer has complied, the IRS is now asking for proof that financial statements at year-end were not in violation of the LIFO conformity requirements. Don't be a nonconformist or let this requirement catch you unaware.

✱

The De Filippis' LIFO Lookout newsletter is a quarterly publication of LIFO News, Views and Ideas by Willard J. De Filippis, CPA, P.C., 317 West Prospect Avenue, Mt. Prospect, IL 60056. It is intended to provide accurate, general information on LIFO matters and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Readers should consult their certified public accountant, attorney and/or other competent advisors to discuss their own situations and specific LIFO questions. Mechanical or electronic reproduction or photocopying is prohibited without permission of the publisher. Annual subscription: \$250. Not assignable without consent. Any quoted material must be attributed to De Filippis' LIFO Lookout published by Willard J. De Filippis, CPA, P.C. Editorial comments and article suggestions are welcome and should be directed to Willard J. De Filippis at (708) 577-3977; FAX (708) 577-1073. Lookout format designed by Publish or Perish, (708) 289-6332. © Copyright 1992 Willard J. De Filippis.

De Filippis' LIFO LOOKOUT

Willard J. De Filippis, C.P.A., P.C.
317 West Prospect Avenue
Mt. Prospect, IL 60056

First-class postage paid at Mt. Prospect, IL



Form **3115**

(Rev. July 1991)

Department of the Treasury
Internal Revenue Service**Application for Change in Accounting Method**

▶ See separate instructions, including "When Not To File Form 3115" to determine if this form must be filed.
All filers must complete pages 1 and 2.

OMB No. 1545-0152
Expires 6-30-94

Name of applicant (if joint return is filed, also give spouse's name)	Identifying number (see instructions)
Number, street, and room or suite no. (If a P.O. box, see page 2 of instructions.)	Applicant's area code and telephone number/Fax number () ()
City or town, state, and ZIP code	District Director's office having jurisdiction
Name of person to contact (If not applicant, power of attorney must be submitted.)	Contact person's telephone number/Fax number () ()
Check one: <input type="checkbox"/> Individual <input type="checkbox"/> Corporation <input type="checkbox"/> Cooperative (Sec. 1381) <input type="checkbox"/> Qualified Personal Service Corporation (Sec. 448(d)(2)) <input type="checkbox"/> Exempt organization. Enter code section ▶ <input type="checkbox"/> Other (specify) ▶	Check the box(es) for other schedules that will be completed and attached to pages 1 and 2 of Form 3115. <input type="checkbox"/> Schedule A—Change in Overall Method of Accounting <input checked="" type="checkbox"/> Schedule B—Changes Within the LIFO Inventory Method Per Rev. Proc. 92-79 <input type="checkbox"/> Schedule C—Change in the Treatment of Long-Term Contracts, Inventories, or Other Section 263A Assets <input type="checkbox"/> Schedule D—Miscellaneous Changes in Method of Accounting

- 1a Tax year of change begins (mo., day, yr.) ▶ and ends (mo., day, yr.) ▶
- b Enter the 180th day of the tax year ▶ If this date is earlier than the date signed by the applicant on page 2, see **Late Applications** in the separate instructions.
- 2 Type of business designated on the latest income tax return and principal source of income ▶
Automobile Dealership - Vehicle sales and service
- 3 Approval is requested to change (see instructions):
- a ☐ Overall method of accounting from **present method** ▶ to **new method** ▶
- b ☒ The accounting treatment of (identify item) ▶ New automobile and new light-duty truck inventories from **present method** ▶ to **new method** ▶ Alternative LIFO Method for Automobile Dealers per Rev. Proc. 92-79
Attach a separate statement of all relevant facts, including a detailed description of present and proposed methods and an explanation of the legal basis (statutes, regulations, published rulings, etc.) for making this application.
- c If a change is requested under Item 3b, check the present overall method of accounting that is not being changed:
☒ Accrual ☐ Cash ☐ Hybrid
- d Number of tax years present method has been used by the applicant. (See Item 3d in the separate instructions.) ▶
- e Is the present method a "designated method," for purposes of section 5.12(2) of Rev. Proc. 84-74, that has been designated in a revenue ruling or revenue procedure published more than 2 years prior to the filing of this application?
- f Is the use of the present method specifically not permitted by the Internal Revenue Code, the Income Tax Regulations, or by a decision of the U.S. Supreme Court? See sections 4, 5, and 6 of Rev. Proc. 84-74
- g Does the present method of accounting conform to generally accepted accounting principles (GAAP)? If "No," attach an explanation
- h Has the applicant entered into a transaction to which section 381(c)(4) or 381(c)(5) applies during the tax year of change or is the applicant considering this type of transaction during the tax year of change? If "Yes," attach explanation
- 4a Is this the first tax year the applicant is required to change its method of accounting under section 263A, 447, 448, 460, or 585? If "Yes," state which section is applicable ▶
- b (i) Is the applicant currently under examination, or has the applicant or any member of an affiliated group been contacted by the Internal Revenue Service to schedule an examination of the applicant's income tax return prior to submitting Form 3115, and/or (ii) does the applicant have an examination under consideration by an appeals officer or before any Federal court, or (iii) is any criminal investigation pending? See sections 4 through 7 of Rev. Proc. 84-74
- c Does the applicant produce or acquire property for resale subject to section 263A? If "Yes," Schedule C, Part III must be completed if the costs to be changed are subject to section 263A Schedule C Not Applicable
- 5a In the last 6 years has the applicant applied for or changed its tax year, its overall method of accounting, or its accounting treatment of any item? If "Yes," attach a statement describing the changes and the year of change
- b If "Yes," has a ruling letter granting approval been received? Attach an explanation if no letter was received or if a letter was received but the change was not made. Members of an affiliated group, see Item 9e See Attached
- c Does the applicant, an affiliated corporation, or any other related corporation have pending any accounting method, tax year ruling, or technical advice request in the National Office?
- d If "Yes," indicate the name(s) of the corporation, type of request (method, tax year, etc.), and the specific issue involved in each request on an attached statement.

Yes	No
	X
	X
X	
	X
	X
X	
X	
	X
	X

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 19280E

Form 3115 (Rev. 7-91)



- 6a Enter the amount of any net operating loss to be carried over to the year of change \$
- b Enter the amount of any credit carryover to this year of change (identify) \$

Members of an affiliated group are to complete items 6a and 6b on a consolidated basis.

- 7 Gross receipts for the 4 tax years preceding the year of change. (See Item 7 in the separate instructions.)

1st preceding year ended: mo. yr.	2nd preceding year ended: mo. yr.	3rd preceding year ended: mo. yr.	4th preceding year ended: mo. yr.
\$	\$	\$	\$

- 8a Does the applicant have more than one trade or business?

- b If "Yes," is each trade or business accounted for separately? (If "Yes," see Item 8 in the separate instructions.)

- 9a Is the applicant a member of an affiliated group filing a consolidated return for the tax year of change?

- b If "Yes," state the parent corporation's name, identifying number, address, tax year, and the service center where the return is filed ▶

- c If 9a is "Yes," do all other members of the affiliated group use the method of accounting being requested?

- If "No," explain ▶

- d If 9a is "Yes," are any of the items involved in determining the net section 481(a) adjustment attributable to transactions between members of the affiliated group? If "Yes," attach an explanation

- e If 9a is "Yes," provide the information requested in Items 5a and 5b, for each member of the affiliated group

- 10 Are any of the items involved in determining the net section 481(a) adjustment attributable to transactions between members of an affiliated group, controlled group, or other related parties? If "Yes," attach an explanation

- 11a If the change is approved, will the new method be used for financial reporting purposes?

- b If "No," attach an explanation. In addition, explain whether the new method of accounting conforms to GAAP and whether it will clearly reflect income for Federal income tax purposes.

Year of change	1st preceding year	2nd preceding year	3rd preceding year
N/A: CUT-OFF METHOD:	R.P. 92-79, SEC. 9.02(6)		
\$	\$	\$	\$

- 13 Has the net adjustment under section 481(a) for the year of change been reduced in any way by a pre-1954 amount?

Signature—All Filers (See instructions.)

Under penalties of perjury, I declare that I have examined this application, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than applicant) is based on all information of which preparer has any knowledge.

Applicant

Parent corporation (if applicable)

Officer's signature and date

Parent Officer's signature and date

Name and title (print or type)

Name and title (print or type)

Signature of individual or firm preparing the application and date

Name of firm preparing the application

- Is Form 2848, Power of Attorney and Declaration of Representative, attached to this application? ▶ ☐ Yes ☐ No

- Enter amount of User Fee attached to this application ▶ \$ None ** (See separate instructions.)

** Waived by Section 13.03 Rev. Proc. 92-79



Name of applicant as shown on page 1

Identifying number

Schedule B.—Changes Within the LIFO Inventory Method**Part I LIFO Information**

Complete this section if the requested change involves changes within the LIFO inventory method. Check (/) the appropriate boxes in 1, 2, 3, or 4 showing both the present method and the proposed method. If the present method shown in boxes 1, 2, 3, or 4 is not the same as the method shown on Form(s) 970, attach an explanation. **Note:** Attach the copy(ies) of the **Form 970(s), Application to Use LIFO Inventory Method, filed to adopt or expand the use of the method.**

	Present method	Proposed method
1 Method for valuing inventories:		
a Unit method		
b Dollar value method		CHANGE IS TO
2 Method for pooling:		
a By line, type, or class of goods (Regulations section 1.472-8(c)).		ALTERNATIVE
b Natural business unit (Regulations section 1.472-8(b)(1))		
c Multiple pools (Regulations section 1.472-8(b)(3)(i))		LIFO METHOD
d Raw material content (Regulations section 1.472-8(b)(3)(ii))		
e Simplified dollar value method (section 474)		DOLLAR VALUE,
f Pooling method authorized by Regulations section 1.472-8(e)(3)(iv)		LINK-CHAIN IN
g Other (describe)		
3 Method used to figure the cost of goods in the closing inventory over those in the opening inventory:		
a Most recent purchases		ACCORDANCE WITH
b Earliest acquisitions during the year		
c Average cost of purchases during the year		REV. PROC. 92-79
d Other (describe)		
4 Method for pricing dollar value pools:		STATEMENT
a Double-extension method		ATTACHED
b Index method*		
c Link-chain method*		
d Inventory Price Index computation method		
e Other method*		
*An example of another method is the retail method using the Bureau of Labor Statistics (BLS) department store indexes. If the applicant is requesting to change to one of these methods, submit: (1) a description of the particular method, and (2) the reasons why the use of the double-extension and/or index method(s) is impractical or unsuitable for each pool.		

Part II Additional Information

- 1 Will the change(s) indicated above apply to all of the applicant's inventory? ☐ Yes ☒ No
- 2 If the change(s) indicated above applies to specific inventory pools, identify the pool(s) and describe the contents of each pool.
Pool 1 - New Automobiles Pool 2 - New Light-Duty Trucks
- 3 Is the applicant requesting a change in method for its LIFO inventory that is not indicated in Part I above? . . . ☒ Yes ☐ No
 If "Yes," explain. ► Change to Alternative LIFO Method per Rev. Proc. 92-79

Part III Change in Pooling LIFO Inventories

- 1 List and describe each dollar value pool and show the base year of each pool under the present and proposed pooling methods. SEE ATTACHED
- 2 Applicants engaged in the manufacturing or processing of goods and proposing to use natural business unit (NBU) pools:
- a Attach a description of the applicant's organization, facilities, manufacturing processes, and product lines in sufficient detail to show that each proposed NBU pool complies with Regulations section 1.472-8(b). NOT APPLICABLE
- b Does the applicant have inventories of items purchased and held for resale? ☐ Yes ☐ No
 If "Yes," attach a statement indicating that these items will not be included in any proposed NBU pool.
- c Are all items, including raw materials, goods in process, and finished goods entering into the entire inventory investment for each proposed NBU pool, presently valued under the LIFO method? ☐ Yes ☐ No
 If "No," attach an explanation.
- 3 Applicants engaged in the manufacturing or processing of goods: NOT APPLICABLE
- a If proposing to use the multiple pooling method, attach information to show that each proposed pool will consist of a group of items that are substantially similar.
- b If proposing to use raw material content pools, attach information to show that each proposed pool will consist of items that are substantially similar.
- 4 Applicants engaged in the wholesaling or retailing of goods purchased from others:
- a Attach information to show that each of the proposed pools is based upon customary business classifications of the applicant's trade or business. N/A - SEE REVENUE PROCEDURE 92-79
- b If proposing to use natural business unit pools, attach an explanation as to why the natural business unit pooling is appropriate.



Name of applicant as shown on page 1

Identifying number

Schedule C—Change in the Treatment of Long-Term Contracts, Inventories, or Other Section 263A Assets

Part I **Change in Reporting Income From Long-Term Contracts** (See separate instructions. Complete this part and Part III below.)

- | | | | |
|-----------|--|------------------------------|-----------------------------|
| 1 | Are the applicant's contracts long-term contracts as defined in section 460? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 2 | Is the applicant a manufacturer or a processor? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 3 | Does the change involve any pre-March 1, 1986 contracts? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 4 | Will the applicant elect the simplified cost-to-cost method for determining the degree of contract completion? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| 5a | Is the same method used for reporting income from all long-term contracts? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| b | If "No," explain other method(s). ▶ | | |
| 6a | Do any of the applicant's contracts qualify for any of the exceptions under section 460(e) for certain construction contracts? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| b | If "Yes" provide a separate cost allocation worksheet (Part III below) for the contracts and the method used for computing the percentage of completion method under Regulations section 1.451-3(c)(2), if applicable. | | |
| 7a | Is the change requested for all contracts that were outstanding at the beginning of the tax year of change? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| b | If "No," explain. ▶ | | |
| 8a | Are the applicant's contracts either cost-plus long-term contracts or Federal long-term contracts? | <input type="checkbox"/> Yes | <input type="checkbox"/> No |
| b | If "Yes," answer items 3 through 7 above for each of those contracts. Also complete Part III below. | | |
| 9 | Net adjustment required under section 481(a) | \$ | |

Part II **Change in Valuing Inventories** (See separate instructions and complete Part III if applicable.)

- 1 Describe inventory goods being changed ►
- 2 Describe inventory (if any) not being changed ►
- 3 Does the proposed change involve a change in the treatment of package design costs? ☐ Yes ☐ No
- 4 Is the applicant's present inventory valuation method in compliance with section 263A? ☐ Yes ☐ No

5a Check (/) the appropriate boxes below that identify the present and proposed inventory identification and valuation methods being changed and the present inventory identification and valuation methods not being changed.

Identification methods:

Specific identification

FIFO

LIFO*

Valuation methods:

Cost

Cost or market, whichever is lower.

Retail cost**Retail, lower of cost or market**

Other (attach explanation).

- b Enter the value at the end of the tax year preceding the year of change.
- *If LIFO, attach the copy(ies) of Form 970 filed to adopt or expand the use of the method.
- 6 Attach the computation used to determine the section 481(a) adjustment. If the section 481(a) adjustment is based on more than one component, show the computation for each component.

Part III Method of Cost Allocation

Complete this part if the requested change involves either property subject to section 263A or to long-term contracts subject to section 460. Check (☒) the appropriate boxes in Section A to indicate the allocation and capitalization methods to be used under the present and proposed methods. Check (☒) the appropriate boxes in Sections B and C showing which costs, under both the present and proposed methods, are fully included, to the extent required, in the cost of property

produced or acquired for resale under section 263A, or allocated to long-term contracts under section 460. If a box is not checked, it is assumed that those costs are not fully included to the extent required. If a cost is not fully included, attach an explanation. Mark "N/A" in a box if those costs are not incurred by the applicant with respect to its production, resale, or long-term contract activities.

Section A—Allocation and Capitalization Methods (See separate instructions.)

- ### 1 Method of allocating indirect costs:

Specific identification

Standard cost

Burden rate (attach explanation).

Other (attach explanation).

Present method	Proposed method
----------------	-----------------

Continued on next page



Form **970**
(Rev. April 1990)
Department of the Treasury
Internal Revenue Service

Application To Use LIFO Inventory Method

► Attach to your tax return.

► For Paperwork Reduction Act Notice, see instructions on back.

OMB No. 1545-0042
Expires 2-28-93

Name _____	Identifying number (See instructions) _____
Address (Number, street, (or P.O. box number if mail is not delivered to street address) city, state and ZIP code) _____	CHECK ONE: <input type="checkbox"/> Initial Election <input type="checkbox"/> Subsequent Election

Statement of Election and Other Information:

A The taxpayer applies to adopt and use the LIFO inventory method provided by section 472. The taxpayer will use this method for the first time (or modify this method) as of (date tax year ends) _____, for the following goods (give details as explained in instructions; use more sheets if necessary):

B The taxpayer agrees to make any adjustments that the District Director of Internal Revenue may require, on examination of the taxpayer's return, to reflect income clearly for the years involved in changing to or from the LIFO method or in using it.

1 Nature of business _____

2a Inventory method used until now _____

b Will inventory be taken at actual cost regardless of market value? If "No," attach explanation ☐ Yes ☐ No

3a Was the inventory of the specified goods valued at cost as of the beginning of the first tax year to which this application refers, as required by section 472(d)? If "No," attach explanation ☐ Yes ☐ No

b Will you include in income over 3 tax years any adjustments that resulted from changing to LIFO? If "No," attach explanation ☐ Yes ☐ No

4a List goods subject to inventory that are not to be inventoried under the LIFO method. _____

b Were the goods of the specified type included in opening inventory counted as acquired at the same time and at a unit cost equal to the actual cost of the total divided by the number of units on hand? If "No," attach explanation ☐ Yes ☐ No

5a Did you issue credit statements, or reports to shareholders, partners, other proprietors, or beneficiaries covering the first tax year to which this application refers? ☐ Yes ☐ No

b If "Yes," state to whom, and on what dates. _____

c Show the inventory method used in determining income, profit, or loss in those statements. _____

6a Check method used to figure the cost of the goods in the closing inventory over those in the opening inventory. (See instructions.)

☐ Most recent purchases ☐ Earliest acquisitions during the year
☐ Average cost of purchases during the year ☐ Other—Attach explanation

b The taxpayer selects the month of _____ as the appropriate representative month to be used in selecting the index or indexes to be used in determining the current-year cost of the taxpayer's inventory pool(s) under Regulations section 1.472-8(e)(2)(ii) (see instructions). (This applies only to taxpayers using the Inventory Price Index Computation Method.)

7 Method used in valuing LIFO inventories: ☐ Unit method ☐ Dollar-value method

8 If you use pools, indicate pooling method below. List and describe the contents of each pool.

- ☐ By line, type, or class of goods authorized by Regulations section 1.472-8(c) (retailer, wholesaler, jobber, or distributor)
☐ Pooling method authorized by Regulations section 1.472-8(e)(3)(iv) (retailer, wholesaler, jobber, or distributor)
☐ Natural business unit authorized by Regulations section 1.472-8(b)(1) (manufacturer or processor)
☐ Multiple pools authorized by Regulations section 1.472-8(b)(3)(i) (manufacturer or processor)
☐ Raw material-content authorized by Regulations section 1.472-8(b)(3)(ii) (manufacturer or processor)
☐ Simplified Dollar-Value Method under section 474 (see instructions)
☐ Other (describe and justify) _____

9 Method used in computing LIFO value of dollar-value pools (see instructions and attach required information)

☐ Double-extension ☐ Published Price Index (describe) ☐ Index (describe and justify)
☐ Link-chain (describe and justify) ☐ Other method (describe and justify)

10 Briefly describe in an attached statement the cost system used _____

11 Did you change your method of valuing inventories for this tax year with the Commissioner's permission? ☐ Yes ☐ No
If "Yes," attach a copy of the National Office's "grant letter" to this Form 970.

12 Were you ever on LIFO before? ☐ Yes ☐ No
If "Yes," attach a statement to list the tax years you used LIFO and to explain why you discontinued it.

Under penalties of perjury, I declare that I have examined this application, including any accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of taxpayer	Date
Signature of officer	Title
Signature of officer	Date

Form **970** (Rev. 4-90)



Section A—Allocation and Capitalization Methods (See separate instructions.)

	Present method	Proposed method
2 Method of allocating service costs:		
Direct reallocation		
Labor-based simplified service cost		
Simplified resale service cost		
Simplified service cost		
Step-allocation		
Other (attach an explanation)		
3 Method of capitalizing additional section 263A costs (including service costs):		
Simplified production		
Alternative simplified resale		
U.S. ratio		
Simplified resale		
Modified resale		
Other (attach an explanation)		

Section B—Direct and Indirect Costs Required to be Allocated (See Regulations under sections 263A and 451.)

1 Direct material		
2 Direct labor		
3 Repairs that relate to a production, resale, or long-term contract activity		
4 Maintenance		
5 Utilities		
6 Rent		
7 Indirect labor and production supervisory wages		
8 Indirect materials and supplies		
9 Tools and equipment		
10 Quality control and inspection		
11 Taxes other than state, local, and foreign income taxes		
12 Depreciation, amortization, and cost recovery allowance for equipment and facilities placed in service and not temporarily idle		
13 Depletion		
14 Administrative costs (not including any costs of selling or any return on capital)		
15 Direct or indirect costs of other administrative, service, or support function or department		
16 Officers' compensation (not including selling activities)		
17 Insurance		
18 Employee benefits		
19 Research and experimental expenses attributable to long-term contracts		
20 Rework labor, scrap, and spoilage		
21 Bidding expenses incurred in the solicitation of particular contracts ultimately awarded to the applicant		
22 Engineering and design costs (not including section 174 research and experimental expenses)		
23 Storage and warehousing costs including a portion of allocable general and administrative costs*		
24 Purchasing costs including a portion of allocable general and administrative costs		
25 Handling, processing, assembly, and repackaging costs including a portion of allocable general and administrative costs		
26 Interest		
27 Other costs (Attach a list of such costs.)		
* Resalers may distinguish between off-site and on-site storage and do not have to capitalize on-site storage costs. Check if the applicant is only allocating off-site storage costs	<input type="checkbox"/>	

Section C—Other Costs (Not required to be allocated)

1 Repairs that do not relate to a production, resale, or long-term contract activity		
2 Research and experimental expenses not included on line 19 above		
3 Bidding expenses not included on line 21 above		
4 Marketing, selling, advertising, and distribution expenses		
5 General and administrative costs attributable to the performance of services that do not directly benefit or are not incurred by reason of a particular production, resale, or long-term contract activity		
6 Income taxes		
7 Cost of strikes		
8 Other costs (Attach a list of such costs.)		

