



De Filipp's

LIFO LOOKOUT

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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 REVENUE PROCEDURE 92-79...AN UPDATE

As CPAs are getting into the mechanics of actually working with Revenue Procedure 92-79, a number of practical and technical questions are starting to emerge. Two broad questions are (1) How far down do you have to go in determining "item categories" for repricing purposes and (2) How are the transition computations - especially rebasing to 1.000 - supposed to work?

As to the first question, many CPAs have been frustrated in attempting to streamline their calculations based solely on VIN number digit information because not all of the vehicle characteristics are necessarily accounted for in all VIN numbers...or are they? What is one supposed to do? This may be a **major** question that warrants IRS clarification...soon. See "How Far Do You Have to Go in Determining "Item Categories?"

As to the second question, many CPAs doing rebasing have called with questions or faxed computations showing that they were getting results that they just couldn't believe or understand. Some were hysterical over the "payback of LIFO reserves" they had incorrectly computed. In many instances, in fact *in every instance*, the problems of *rebasings rigor mortis* evaporated upon closer and more accurate analysis. We have included a few more rebasing examples in this issue of the *LIFO Lookout*.

Other problems and questions relative to working with the Alternative LIFO Method are discussed throughout this issue. But please don't misunderstand: Even with an abundance of problems and unanswered questions, most of us still prefer the unknown answers to these questions under the new Alternative Method...to the unknown liabilities locked into prior LIFO calculations under the old methods.

#2 DESIRABILITY OF COORDINATING IRS VIEWPOINTS ON REV. PROC. 92-79

The attitude of the National Office toward the interpretation of Revenue Procedure 92-79 seems to be that the Alternative LIFO Method was not intended

to create "an administrative nightmare" for CPAs, dealers, nor for itself. This has been conveyed through many calls and conversations.

However, some sources indicate that examining agents in the field have adopted much tougher interpretations on some issues. The *Car Dealer Insider* (Feb. 1, 1993) reported that the IRS is still tough and that the simpler Alternative LIFO Method hasn't ended dealers' worries, based on audits now under way. According to one CPA quoted in the *Insider*, IRS examining agents are adopting more strict definitions or interpretations and "the burden of proof is on the taxpayer that something other than this new method is

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TIPS, TRAPS, TIDBITS AND SOME QUESTIONS THAT COULD USE ANSWERS

Here are some points, observations and questions that have started to emerge in working with Revenue Procedure 92-79 over the last few months. Whether one is a "tip" or a "trap" may depend on your point of view or whether or not you might overlook it. Hopefully, some of the more troublesome questions will be answered reasonably soon in an IRS Notice, Question and Answer format or some other form of published guidance. Even more hopefully, that clarification will not apply retroactively and it will not require further accounting method change mechanics.

REMINDER! DON'T FORGET TO FILE THE ORIGINAL OF FORM 3115: Don't forget to include the original of the Form 3115 for 1992 that reflects the dealership's election to change to the Alternative LIFO Method with the dealership's income tax return. It was a *copy* of the Form 3115 that was required to be filed with the IRS National Office in Washington, D.C. before December 31, 1992.

DISAPPEARING BASE DOLLARS: When you are combining or consolidating multiple pools down into the two required pools (#1 New Autos; #2 New Light-Duty Trucks), don't overlook the requirement in Regulations Section 1.472-8(g)(2)(iv) that those pools that came into existence in years after the earliest pool have to be rebased in such a way as to take into account the inflation between the earliest year of the first LIFO pool and those LIFO pools that came along later. This causes a certain amount of base dollars (from the later pools) to be **lost** in the final accounting because those later "base" dollars were comparatively "cheaper."

In the Regulation's example, only \$350 (\$15,000 - 14,650) was lost: In actual computations, the amount of base dollars "lost" to this adjustment can be significantly greater. If you keep track of the amount of the "lost" base dollars, that will help you reconcile your computations to be sure that all base dollars receive a proper accounting.

SPLITTING A SINGLE "TRUCK" POOL: In some instances, a single pool for "Trucks" may include light, medium and heavy-duty trucks. To obtain the protection of Rev. Proc. 92-79 for the light-duty truck component, it is necessary to split the single truck pool into two (or is it three? or more?) components. One approach would be to split the Truck pool into two pools: one for "Light-Duty Trucks" and the other for "All Other Trucks" (i.e., medium *and* heavy-duty trucks). An alternative, and probably more conservative approach, would be to split that single Truck pool into three pools: (1) Light, (2) Medium and (3) Heavy-Duty.

Once this is done, at least the LIFO computations

for the light-duty truck inventory should have the protection of Rev. Proc. 92-79. Query: Is that a proper assumption or are there different requirements for splitting "Truck" pools depending on whether other than Light-Duty Trucks are involved?

Returning to the simpler fact pattern, after splitting off the light-duty trucks, where does that leave the now isolated medium and heavy-duty trucks? How can those LIFO reserves be protected? One course of action that might work would be to file a Form 3115 requesting permission to change the LIFO methodology for the medium and for the heavy-duty truck pools to a methodology similar to the 14 step methodology provided for light-duty trucks in Section 4.03 of Revenue Procedure 92-79. Just list the steps 1 through 14 as set out in Rev. Proc. 92-79. If this is done, that should at least protect the prior years' LIFO computations and reserves for the medium and heavy-duty trucks (assuming an IRS audit is not in progress when the Form 3115 is filed) since the cut-off method is available for all LIFO inventories under Section 9.01 of Revenue Procedure 92-20.

It would be interesting to know if this course of action were followed, whether or to what extent the National Office would modify the computational approach outlined for light-duty trucks in Revenue Procedure 92-79 for medium and/or heavy-duty trucks filing for changes under Revenue Procedure 92-20.

REBASING SCHEDULES AND POOL COMBINING/SPLITTING COMPUTATIONS: Some unusual fact patterns are emerging as the Section 9 conditions calling for rebasing and pool combining or splitting computations are being made. In conversations with the National Office regarding changes to the Alternative LIFO Method, many CPA's have reported that they were told that the Service will accept "reasonable" efforts to combine, consolidate and otherwise transitionalize former LIFO methodologies over to the Alternative LIFO Method and that the IRS (National Office) is not trying to create "an administrative nightmare" for anyone in this regard.

You might consider attaching copies of your computations to the corporate income tax return when it is filed to provide a full record of the computations and underlying interpretations and assumptions where facts simply don't exist. See also Form 8275-R.

REVERSE YEAR-END WRITEDOWNS: Any writedowns from cost during the year for vehicles or other LIFO inventories on hand at year-end should be eliminated or reversed by an adjusting entry so that the General Ledger control figures reflect new automobile and light-duty truck inventories **at cost**. There can be

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no writedowns for inventories on LIFO...except that accorded by the LIFO reserve itself.

This requirement also extends to *demonstrator vehicles* which now are required to be included in the new auto and new light-duty truck pools when the Alternative LIFO Method under Revenue Procedure 92-79 is used.

USE OF MANUFACTURER'S PRICE LISTS WHERE YOU CAN'T GO BACK AND GET PRIOR YEAR-END INVOICES: In the index computation/repricing process, the beginning-of-the-year base cost is required to be determined from the average of comparable item categories for which there were vehicles on hand at the end of the preceding year. If a dealer can provide the prior year's invoices or computations (if they reflect this information), then the corresponding beginning-of-the-year *average* costs for 1992 can easily be computed for each item category.

However, in some instances the dealer may not have saved the beginning-of-the-year invoices or this information may not be readily available. Under these circumstances, a dealer should be able to use the base price information from the corresponding manufacturer's price list for this purpose. Hopefully, this should not present any major difficulty to the IRS, especially since this approach may end up producing a smaller inflation index for the dealer because the most recent (higher) price would be used as the beginning-of-the-year price.

Despite any inconvenience, if the beginning-of-the-year invoices or information can be provided, the LIFO index computations should be made in accordance with the more detailed "computation of beginning-of-the-year average" requirement of Revenue Procedure 92-79. Note: This same consideration/problem arises where the year of change may be several years earlier than 1992 for years under IRS audit.

MORE QUESTIONS NEEDING ANSWERS

In many discussions and calls over the last several months, a wide range of other questions have come up. Some can be dealt with rather easily; others may involve considerable policy consideration and clarification by the IRS.

CUT-OFF METHOD PROTECTION. In applying the cut-off method, is protection from adjustment extended to obvious mathematical and other computation errors buried in prior year LIFO reserve computations and still there as of the beginning of the year of change (i.e., as of December 31, 1991)? Or is the protection afforded by the cut-off method intended to relate only to that part of the LIFO reserve attributable to **methodology differences**?

Errors may become apparent in reviewing prior year LIFO reserve computations and balances, as necessitated by the rebasing to 1.000 requirement.

Prior year LIFO layers may have been relieved in an erroneous manner or other obvious mathematical errors may have distorted the LIFO reserves. This is especially common in carrying decrements back against prior years. Sometimes these errors are so obvious that one wonders why they weren't noticed years ago by even a most basic review. But, in any event, if these errors weren't detected until now and remain in the LIFO valuations as of December 31, 1991, should the result of these errors be swept into the weighted averaging of the rebased layers as of December 31, 1991? Or should amended returns be filed? How do the *AICPA's Responsibilities in Tax Practice* come into the picture where the cut-off method is involved?

FORM 8275-R. How is Form 8275-R, the Regulation Disclosure Statement, supposed to tie in with the disclosure of items or positions that are contrary to Treasury regulations? Are there circumstances or tax return positions which the Internal Revenue Service (National Office) believes require disclosure in Form 8275-R in connection with LIFO inventories?

Are there any circumstances under which the Internal Revenue Service feels Form 8275-R should be filed in connection with LIFO calculations either under Revenue Procedure 92-79 or any other circumstances? While Revenue Procedure 92-79 obviously has not involved any change in, nor any amendment to, the Regulations, are there other circumstances which the IRS might interpret as calling for the filing of Form 8275-R? See Update Issue #5 on page 15.

"SEPARATE TRADES OR BUSINESSES" — WHAT DOES THIS REALLY MEAN? Section 4.02(1) of Revenue Procedure 92-79 indicates that all new automobiles (regardless of manufacturer) including those used as demonstrators must be included in one dollar value LIFO pool and that all new light-duty trucks (regardless of manufacturer and including those used as demonstrators) must be included in a separate dollar value LIFO pool. This requirement is preceded by the phrase, "for each **separate** trade or business."

Some view the "separate trade of business" limitation as suggesting that where an automobile dealership operates at different *geographic locations*, even though all activities may be reported by one taxpayer entity in one tax return, the conduct of business via separate locations and facilities, accounting and sales personnel warrants separate new auto and new truck pools *for each different location*. If the phrase "separate trades or businesses" doesn't mean anything, why is it there? If it does, clarification is needed.

NEW MODELS INTRODUCED AFTER DECEMBER 1ST. In some instances, new models are introduced after December 1st, but before December 31st. When this happens, they are "in existence" as of the last day of the dealer's year. However, there is no

see **TIPS, TRAPS, TIDBITS...**, page 4



manufacturer's price in effect as of December 1st for that year for that vehicle. This will create a problem in the next year if the dealer did not have that vehicle on hand as of December 31 (so as to have an invoice to establish an average beginning-of-the-year base cost) but has the next year's model for that vehicle on hand at the end of that next year. What is one to do?

DEMONSTRATORS AND OTHER VEHICLES ON HAND ALL YEAR. In some situations, a particular vehicle or demonstrator may be in inventory for the entire year. For such a vehicle on hand at both the beginning and the end of the year, there obviously has been no inflation. Revenue Procedure 92-79 requires all vehicles in ending inventory - including those that were on hand at the beginning of the year - be repriced in determining the year-end index.

Revenue Ruling 79-103, addressed to a manufacturing situation, provides that items of inventory for which no purchases were made during the year **cannot** be included in developing an index to be used in determining the LIFO value of the dollar-value pool. Once the index has been developed, however, the cost of all items must be included in determining the overall LIFO value of the inventory. Does Revenue Procedure 92-79 supersede Revenue Ruling 79-103 in this limited automobile dealer fact pattern?

SPECIAL PROBLEMS IN ADDING DEMOS? Are there any special limitations to be introduced into the index computation/repricing process where demos are being included in the LIFO pool? Because of the requirement that pools include all demonstrators and *all* new vehicles, regardless of manufacturer, it would appear that if demos were being added to the pool for the first time in 1992 (as required by Rev. Proc. 92-79), the cost of the demonstrators on hand at December 31, 1991 should be added to the opening 1992 inventory for consistency purposes. This would increase the amount of beginning-of-the-year inventory at cost, and at base dollar equivalence, for the year of change.

Also, as a result of this requirement, would all demonstrators on hand at the end of 1992 be "new items" subject to a 1.000 repricing regardless of their make/model/body style characterizations (because demonstrators were not on LIFO in the prior year)? Or are they to be repriced individually according to their own make/model/body style characteristics irrespective of their "demonstrator" usage or similar description? If the latter, then only those demonstrators on hand at the end of the year which are really new items based on make/model/body style description under the definition in Section 4.02(5) would be treated as new items subject to the 1.000 repricing requirement. Similar questions would be raised in connection with any other classes of newly-added costs required by Rev. Proc. 92-79.

"DISAPPEARING" BASE DOLLARS...HOW MUCH IS ENOUGH? When multiple pools with different base years are being combined into a single pool, how is one to make adjustments to reflect prior year inflation where it is **impossible** to reconstruct the base year costs for prior layers? Guidance more specific than that included in the existing regulation (1.472-8(g)(2)(iv)) is necessary. No cop-outs, please.

Why not publish a table of allowable "deflation factors"? Or allow the use of the BLS Producer Price Index factors in Table 6 for this purpose? Better yet, and simpler, why not just allow 3, 4 or 5% per year?

IS IT A "CAR" OR A "TRUCK"? In the last issue of the *Lookout*, we asked: How can you tell a car from a truck? We indicated that we hoped a particular vehicle would be consistently classified by most of the sources below:

1. The manufacturer's mandatory financial statements for the dealership 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.

Where the classification for a particular vehicle is not consistent, should the classification of that vehicle in the factory financial statements or other manufacturer-provided sources be used in preference to the others?

It has been reported that the IRS wants minivans categorized as trucks *if* other light-duty trucks, such as pickup trucks, are sold by the dealer. Apparently, if the dealer does not sell other light-duty trucks, then the IRS may accept minivans in with other autos in the new auto pool. This might simplify things for a Pontiac or a Mercury dealer.

Query: What criteria should be followed to determine the classification of a debatable or questionable vehicle... so that it can be treated correctly the first time around?

HELP COMPILE A LIST OF QUESTIONS FOR THE IRS BY SENDING SOME OF YOUR OWN. If readers send in (call, fax or write) other questions, I will compile and submit them to the Internal Revenue Service along with the above, requesting clarification.



CHANGING AFTER JANUARY 1, 1993: IF YOU DIDN'T - SHOULD YOU?

A CHECKLIST

The last two issues of the *LIFO Lookout* have stated the view that **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.** I believe this still holds despite the catalog of tips, traps and a host of questions in need of answers discussed elsewhere in this issue of the *Lookout*.

If, for whatever reason, a dealer has not filed Form 3115 by now, then if the dealer so much as receives a letter from the IRS saying that an audit is going to start, the "cut-off" method will not be available to protect prior year LIFO computations if they are challenged. Under Revenue Procedure 92-20, a recomputation of the LIFO inventories under the IRS' method must be made for at least the last ten years on LIFO. And the method insisted upon by the IRS agent may not necessarily be as "liberal" as the Alternative LIFO Method. Worse yet, such a LIFO recomputation is usually next to impossible to do accurately or completely. Consequently, if there are any second thoughts on using the Alternative LIFO Method, a Form 3115 probably should be filed immediately (ASAP!). This will lessen the possibility that the IRS, by chance, start an audit before the Form 3115 is filed.

Should a Form 3115 be filed? That depends on the specific facts and circumstances underlying each specific LIFO situation and how thoroughly and consistently the computations have been carried forward over the years. Consider the checklist below of basic considerations in evaluating whether to file a Form 3115 for an auto dealer's LIFO computations. If you're feeling queasy, see the accompanying procedures for changing to the Alternative LIFO Method after December 31, 1992.

1. Do you have copies of ending inventory invoices for all prior years on LIFO? This could be all the way back into the 70's. If not, what is the year of the LIFO election, what is the first year for which you have all year-end invoices and model change information, and by what miracle do you hope to produce the missing (years) invoices and information?
2. Do you have all of the new vehicles in a single pool? If so, has the size of the respective car and truck inventories changed (up or down) proportionately or disproportionately over the years? Were there significant reductions in the inventories in the years since the LIFO elections? Is it likely that the ratio of the dollars in each inventory (i.e., cars vs. trucks) will be disproportionate in the future? Is a major decrease in either cars or trucks expected?
3. In general, are you "comfortable" with the LIFO computation methodology being applied? Do you "believe" it is "defensible?" Have you ever talked with an IRS agent who really understands LIFO? Note: you may have different levels of comfort for different computations, depending on whether you "inherited" them from another CPA or did the original set-up work and Form 970 filing yourself.
4. Over the years, has there even been a change in the method of doing the computations? Or a change in the treatment of an "item?" Was a Form 3115 filed, permission to change secured, and a signed consent letter attached to the return for the year of change? Can you prove it?
5. Are you willing to put your computations through the IRS shredder - and will they stand up to the tests - evidenced in IRS Letter Rulings 9243010 and 9251001. These "comprehensive" methods were supposedly exactly what somebody thought the IRS wanted and they ended up being rejected. See Dec. 1992, *LIFO Lookout*, "Update" Item #4 and "Update" Item #5 in this Issue.
6. How are **new** items determined, treated and repriced? If new item treatment cannot be supported, will the issue be one involving the accuracy of the index or the definition of the term "item?" Although one might argue that the difference between repricing base price only vs. repricing selected options or all options only relates to the accuracy of the index computation (rather than involves a definition of the term "item" under the link-chain, index approach), the IRS might not agree.
7. Were the dealer's LIFO computations recently audited by an IRS agent who looked carefully through the calculations? Were any LIFO issues raised? Were there any changes? Even if there were not, and the agent said everything "looked OK," that might not prevent a new agent examining a later year from resurrecting old - or new - LIFO issues.
8. Are you repricing less than every item? What kind of sampling are you using? What is your authority for using the method selected in the absence of any published guidance on the application of sampling to LIFO inventories? Whatever sampling method you are using, it may not be good enough or theoretically accurate enough to satisfy the IRS.
9. Does the dealer have any plans for selling or liquidating the business in the near future?

NEW FILING MECHANICS

If, after December 31, 1992, but before the close of the **first taxable year ending after December 31, 1992**, an auto dealer is **not under examination on the date the Form 3115 is filed** with the National Office, then the year of change to the Alternative method will be the dealer's first taxable year ending after December 31, 1992.

1. An original copy of a completed Form 3115, including attachments, must be attached to the dealer's timely filed (including extensions) original Federal income tax return for the year of change.
2. A **copy** of the completed Form 3115, including attachments, must be filed with the IRS National Office in Washington, DC on or before the last day of the year of change. Note that this filing of the **copy** of Form 3115 with the National Office will occur before the filing of the tax return for the year of change. The filing address is: Commissioner of Internal Revenue, Attention: CC:IT&A, P. O. Box 7616, Benjamin Franklin Station, Washington, DC 20044.
3. The dealer must also attach an extra "acknowledgement" copy of page 1 of the Form 3115 to the copy filed with the IRS National Office so that page can be date stamped by the National Office and returned to the dealer.
4. Type of legibly print across the top of Form 3115: "**FILED UNDER SECTION 6.01 OF REVENUE PROCEDURE 92-79.**" Remember to attach the signed Consent Statement that, under the penalties of perjury, the dealer agrees to all of the conditions of consent listed in Section 9 of Revenue Procedure 92-79 to change to the Alternative LIFO Method.

For an auto dealer who is under IRS audit examination after January 1, 1993 and who wants to file Form 3115 to change to the Alternative LIFO Method after that date, the request to make a LIFO change may only be made under the applicable provisions of Revenue Procedure 92-20. Under the 90-day audit window in Revenue Procedure 92-20, this will require recomputations under the new LIFO methodology for up to ten (10) prior years.

For a taxable year **later than** the first taxable year ending **after** December 31, 1992, an auto dealer who is **not** under examination may request to change to the Alternative LIFO Method only under the terms, conditions and provisions of Revenue Procedure 92-20. In this case, Form 3115 must be filed with the IRS National Office in Washington, DC within the first 180 days after the start of the year of change.



HOW FAR DO YOU HAVE TO GO IN DETERMINING "ITEM CATEGORIES"?

In applying Revenue Procedure 92-79 to reprice new vehicles, the definition of an "item of inventory" in Section 4.02(3) provides that "an item of inventory ('item category') must be determined using the entire manufacturer's base model code number that represents the most detailed description of the base vehicles' characteristics, such as model line, body style, trim level, etc. The manufacturer's base model code numbers are almost always used as part of the vehicle identification on each dealer invoice (e.g., domestic model, trim level, 4-door sedan has a specific model code; foreign model, 4-door sedan, trim level, 5-speed has a specific model code)."

In applying this language to determine how far one has to go in breaking down different makes and models into item categories, different results and interpretations are possible.

For example, under the Ford truck F Series pickup, five different vehicles share the same F15 model code. These are:

4x2 F150 Flareside XLT Lariat 117 WB
4x2 F150 Styleside 117 WB
4x2 F150 Styleside 133 WB
4x2 F150 Styleside S 117 WB
4x2 F150 Styleside S 133 WB

Each of these vehicles is different from the other, even though they have a common model code.

Another example: Within the Ranger category, over a two-model year span, no less than 10 different vehicles share the same manufacturer code R10:

4x2 Regular Cab 108 WB	'92
4x2 Regular Cab 114 WB	'92
4x2 Regular Cab S 108 WB	'92
4x2 Regular Cab Sport 108 WB	'92
4x2 Styleside STX 108 WB	'93
4x2 Styleside STX 114 WB	'93
4x2 Styleside XL 108 WB	'93
4x2 Styleside XL 114 WB	'93
4x2 Styleside XLT 108 WB	'93
4x2 Styleside XLT 114 WB	'93

In their published price lists, some manufacturers provide in separate columns a "model number" as well as a "body code." Note that Section 4.02(3) uses the term "manufacturer's base model code number" and that term combines references to both "model" and (body) "code" as if they were one.

Accordingly, for "item category" determination purposes, the vehicles of some manufacturers may present interpretative classification problems. This is illustrated by the possibility of five different F Series pickups all falling within the F15 "item category" classification or 4-6- or 10 different Rangers falling within the R10 "item category" classification.

If the F Series vehicles with their F15 prefix are subdivided further, distinctions in wheel base and other factors will be recognized and we will have five separate vehicles with their own item category status (sub-items?). Under this further subdivision approach, each vehicle would have its own discrete comparative price determined from manufacturer's price information which could be compared (for repricing purposes) against the dealer's actual invoice price so as to determine an index for all or any vehicles in that specific sub-item category. This approach will result in a more accurate reflection of income. The reason for this observation is that the five F15 vehicles ranged in 1992 model introduction prices from \$10,071 at the low end to \$12,187 at the high end; comparable 1993 model introduction prices ranged on the low end from \$9,894 to \$12,056 on the high end.

Alternatively, if one stays with the literal language in the "item category" definition in Section 4.02(3), then the question becomes: what should be used for the average beginning-of-the-year price for an F15 vehicle if the dealer did not have any of the five possible vehicles in stock at the beginning of the year? Further question: even if the dealer had 1 or 2 (but not all), do you give any weight or consideration to the others he didn't have at all? If so, in what manner?

If a dealer did not have any one of the five different vehicles, it would seem that he would have to compute an average as if they were all similar and this average could be as much as \$1,000 off within the F15 group from the actual price of any single one. On the other hand, it is possible that a dealer might have had some F150 Flareside XLT Lariats 117 WB at the beginning of the year having what becomes a 1992 average beginning-of-the-year price of \$12,187, while at the end of the year he may have some F150 Stylesides S 117 WB vehicles with actual prices of \$9,894 each - thus showing a price decrease of almost \$2,200 per unit.

Other potential questions arise with using broader item categories. For example: Within the F15 or R10 categories above: What happens when the manufacturer makes enough change to **one** of the vehicles, but not necessarily to all of them, so that the changed vehicle becomes, by definition, a new item? What should be done then?

Query: Should one use a more complete or detailed analysis in determining "item categories" in order to avoid the averaging that would occur if only the 3-digit

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"model code" were used where several different vehicles share the same model code? "Should" may imply a choice. Is one required to use a more complete analysis?

In considering a resolution of these "item category" questions, one interpretation is that a lesser number of "item categories" is consistent with Revenue Procedure 92-79 and should be acceptable. This, of course, allows for averaging to a greater degree...and this averaging result may be influenced by advance planning or it may merely be a random residual.

Another interpretation is that broader item categories were not intended because of the computational difficulties, inaccuracies, and clear-reflection-of-income problems that might result. This has been amply illustrated above. Furthermore, the allowance of broader item categories might result in deliberate manipulation of year-end inventory items or chance combinations of items to achieve disproportionate averaging benefits with resulting higher LIFO indexes which might not necessarily be offsetting from year to year. Also, a narrower interpretation of the "item category" questions is more closely aligned with the opinion of the Tax Court in *Amity Leather Products* to the effect that the more narrow the definition of the term "item," the more accurate the measurement of income.

Some CPAs may be indifferent one way or the other to these issues. Some are simply looking to the Alternative LIFO Method to allow computations that can be made without worrying about whether there will be any second-guessing in the future. Nobody wants to

have to go back and change their LIFO index calculations years from now over interpretative details like this when, or if, the IRS provides "clarification"...which hopefully will be prospective, and not made retroactive to require "voluntary" recomputations.

In our own LIFO repricing practices, we have concluded that for our more conservative clients it may be easier or more prudent in the long run to spend more time up front compiling more detailed make/model analyses for item categorization purposes. Consistent with this approach, we would come up with five different F15 "item categories" (or more accurately, sub-item categories) and ten different R10 Rangers, rather than having one item category for all Rangers sharing the R10 model.

We recognize that under this approach, new items might occur a little more frequently and there may be certain other disadvantages for a dealer trying to push the LIFO reserve to the hilt. And with higher tax rates anticipated for 1993, this may be a factor to consider carefully.

But most people we've talked with would rather have a little more detail to be sure the IRS has nothing to gain by hassling them, than to have a little less detail and more averaging and risk a recomputation in later years... especially if that might turn out to be more bothersome and costly than it's worth.

The above interpretive issues are not limited to (Ford) light-duty trucks, as other manufacturers present similar problems.



**THE "GAP" PROBLEM: A REPLY FROM THE IRS
SETTLING DEALER AUDITS UNDER REV. PROC. 92-79**

Many dealers who were under audit had LIFO issues pending on September 8, 1992 and elected to lessen their adjustments by changing to the Alternative LIFO Method. For these dealers, the year of change 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).

The December, 1992 issue of the *LIFO Lookout* discussed this problem in more detail. I sent a copy of that *Lookout* and a letter to (former) IRS Commissioner Shirley Peterson pointing out the need for some practical guidance in this area. Below are excerpts from my letter to her and from the reply received last month from the Acting Assistant to the Commissioner.

LETTER TO IRS COMMISSIONER (DECEMBER 11, 1992)

"...I have several examinations in process and find that Revenue Procedure 92-79 has swiftly resolved LIFO issues that otherwise might have gone on for years... One tedious practical problem now surfacing in closing current audits under Rev. Proc. 92-79 is discussed in the article on page 4 of the December, 1992 issue of the *LIFO Lookout*: 'The Gap Years: Dealers Settling Audits under 92-79'... I wonder if this 'Gap Year' problem, too, might benefit from a dose of 'Compliance 2000' thinking."

REPLY RECEIVED FROM IRS (FEBRUARY 23, 1993)

"...With regard to the 'gap' problem mentioned in your letter, revenue agents frequently make adjustments to bring the taxpayer current. Thus, for example, if a taxpayer under audit for 1989 adopted the alternative LIFO method in 1992, the revenue agent will usually make adjustments to the taxpayer's tax returns for 1990 and 1991 in connection with closing out the 1989 audit. **If the revenue agent does not make adjustments for those intervening years, the taxpayer will need to amend its tax returns for 1990 and 1991 to reflect the new method of accounting.**"

MORAL: Think ahead and anticipate this problem before winding up everything in connection with the examining agent for the year under audit. You may be able to simplify your overall workload considerably... unless, of course, you relish the thought of all those amended returns.



REBASING INDEXES TO 1.000...

AN EXPANDED EXAMPLE INVOLVING DUAL INDEXES, SPLITTING A POOL AND ADDING DEMOS

In the December, 1992 issue of the *LIFO Lookout*, the article and example on pages 14-15 showed that in making a change to the Alternative LIFO Method, any prior LIFO inventory layers retain their same LIFO values. This reflects a Condition of Consent (Section 9.02(8)) that requires all of the LIFO indexes for years prior to the year of change to the Alternative Method to be converted so that the first year starts at some decimal amount that is less than 1.000 and subsequent years' indexes gradually get larger reflecting inflation until they reach 1.000 as of the beginning of the year of change. The example included in the December, 1992 *LIFO LOOKOUT* reflected a simple fact pattern out of many different possibilities.

The example in this issue combines three common variations: (1) the use of a dual index or earliest acquisitions method for valuing increments whereby a separately computed index was used to inflate the increment to adjust it to current LIFO cost, (2) the need to add demonstrators or some other category of costs (that were previously not on LIFO) to the new LIFO pools and (3) the need to split or divide a single pool that previously contained both autos and trucks into the required two separate pools.

The **KEY TO UNDERSTANDING** the rebasing portion where dual indexes or earliest acquisitions methods have been used is this: **You should incorporate the cumulative index factor that was used to deflate the ending inventory to base dollars at the end of 1991 somewhere into the rebasing schedule so that it will stand out as the principal reference point.** That cumulative index factor is the one that must be used as the critical rebasing valuation factor by which prior years' layers of base dollars are multiplied.

Since all prior year increments retain their same LIFO valuations in the rebasing process, this simply "forces" all of the prior indexes or valuation factors to be changed to become the quotients produced by dividing (A) the fixed/unchanged LIFO valuation amount by (B) the corresponding "grossed up" or "new" base dollar amount that was determined as the product of multiplying (1) the "old" base dollar amount times (2) the deflator index that was used at the end of the year to reduce the ending inventory at cost to its equivalent expressed in original base dollars. In other words, referring to the second set of 3 column schedules, the third (right hand) "LIFO valuation" column divided by the first (left hand/Base dollar) column produces or equals the middle (center/Index factor) column. It's like squeezing your feet into your best looking pair of tight shoes that you really have to wear...make 'em fit!

The addition of demonstrators to the pool is required by Rev. Proc. 92-79 Section 4.02(1) and reinforced by the Condition of Consent in Section 9.02(5). Consistency requires that if the demonstrator vehicles are required to be included at the end of the year of change, then the corresponding cost amount of demonstrator vehicles at the beginning of the year should be included in the opening inventory (and **not** reflected as part of a current year increment).

The accompanying example shows one format for presenting all of these computations together. Because a dual index/earliest acquisitions method was used for valuing increments, the underlying "GENERAL" guideline (given on page 15 of the December issue) that the decimals shown for the new indexes can be obtained by dividing each year's original cumulative index by the year-end 1991 index...**DOES NOT APPLY.** *



De Filippis' LIFO LOOKOUT

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XYZ AUTO SALES, INC.
 NEW VEHICLE INVENTORY REFLECTING INDEX REBASING OF PRE-1992 INDEXES TO 1.000
 (EXAMPLE INVOLVING DUAL INDEXES, SPLITTING A POOL AND ADDING DEMONSTRATORS)
 AS OF DECEMBER 31, 1991 ****

ALL NEW VEHICLES COMBINED	DECEMBER 31, 1991 BEFORE REBASING INDEXES			DECEMBER 31, 1991 WITH INDEXES REBASED TO 1.0000		
	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION
LIFO VALUATION AND INVENTORY LAYERS						
CALENDAR YEAR 1990 (BASE - INITIAL LIFO YEAR)	\$1,179,777	1.00000	\$1,179,777 (C)	\$1,242,895	0.94922	\$1,179,777 (C)
CALENDAR YEAR 1990 INCREMENT	461,897	1.00000	461,897 (C)	486,608	0.94922	461,897 (C)
CALENDAR YEAR 1991 INCREMENT	1,142,327	1.03060	1,177,282 (C)	1,203,442	0.97826	1,177,282 (C)
CUMULATIVE INDEX AT DEC 31, 1991 **	-	1.05350	-	-	1.00000	-
TOTAL	\$2,784,001 (A)		\$2,818,956 (C)	\$2,932,945 (B)		\$2,818,956 (C)

* ALLOCATION OF REBASED LIFO LAYERS BETWEEN AUTOS (.9297) AND TRUCKS (.0703) AS OF DECEMBER 31, 1991 *	AUTOS - POOL #1 (92.97%) DECEMBER 31, 1991 WITH INDEXES REBASED TO 1.0000 *			TRUCKS - POOL #2 (7.03%) DECEMBER 31, 1991 WITH INDEXES REBASED TO 1.0000 *		
	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION
LIFO VALUATION AND INVENTORY LAYERS						
CALENDAR YEAR 1990 (BASE - INITIAL LIFO YEAR)	\$1,155,519	0.94922	\$1,096,839	\$87,376	0.94921	\$82,938
CALENDAR YEAR 1990 INCREMENT	452,400	0.94922	429,426	34,208	0.94922	32,471
CALENDAR YEAR 1991 INCREMENT ***	1,118,854	0.97825	1,094,518	84,588	0.97844	82,764
TOTAL BASE DOLLARS	\$2,726,773			\$206,172		
TOTAL LIFO VALUATION	\$2,818,956(C)		\$2,620,783			\$198,173

ADD NEW DEMONSTRATOR VEHICLES (OR OTHER MAKES NOT PREVIOUSLY ON LIFO) AT DEC. 31, 1991 COST TO NEW LIFO POOLS	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION	BASE DOLLARS	INDEX FACTOR	LIFO VALUATION
	\$225,000 (D)	1.00000	\$225,000	\$48,000 (D)	1.00000	\$48,000
TOTALS (NEW BASE DOLLARS) AS OF JAN. 1, 1992	\$2,951,773		\$2,845,783	\$254,172		\$246,173

NOTES AND COMMENTS		COST		LIFO	
		12/31/91	PERCENT	VALUATION 12/31/91	RESERVE 12/31/91
* ALLOCATION OF REBASED LIFO LAYERS IS COMPUTED IN THE RATIO OF NEW AUTOMOBILES AT CURRENT COST TO NEW LIGHT-DUTY TRUCKS AT CURRENT COST AS OF DECEMBER 31, 1991:	AUTOS	\$2,726,773	92.97%	\$2,620,783	\$105,990
	TRUCKS	206,172	7.03%	198,173	7,999
	TOTAL	\$2,932,945 (B)	100.00%	\$2,818,956	\$113,989

** METHOD FOR VALUATION OF INCREMENTS IN PRIOR YEARS: EARLIEST ACQUISITION USING A SEPARATELY COMPUTED INDEX (I.E., DUAL INDEX APPROACH) \$2,932,945 DIVIDED BY 1.05350 = \$2,784,001

*** MAY INCLUDE ROUNDING ADJUSTMENTS IN BASE DOLLARS AND LIFO VALUATIONS COLUMNS

****THE YEAR OF CHANGE IS 1992. THE LAST DAY OF THE YEAR PRECEDING THE YEAR OF CHANGE IS DECEMBER 31, 1991.

(A) \$2,784,001 ORIGINAL BASE DOLLARS EQUALS DECEMBER 31, 1991 COST OF \$2,932,945 DIVIDED BY CUMULATIVE INDEX OF 1.05350

(B) DECEMBER 31, 1991 COST (\$2,932,945) EQUALS AMOUNT OF REBASED (NEW) BASE DOLLARS AT 1.000

(C) LIFO VALUATIONS, BY LAYER AND IN TOTAL, DO NOT CHANGE. SAME AMOUNTS APPEAR IN "BEFORE" AND "AFTER" COLUMNS.

(D) THROUGH DECEMBER 31, 1991, DEMONSTRATOR VEHICLES WERE NOT INCLUDED IN THE NEW AUTOMOBILE AND/OR NEW TRUCK POOLS. REVENUE PROCEDURE 92-79 REQUIRES THAT ALL NEW AUTOMOBILES, REGARDLESS OF MANUFACTURER, MUST BE INCLUDED IN A SINGLE NEW AUTOMOBILES POOL AND ALL NEW LIGHT-DUTY TRUCKS, REGARDLESS OF MANUFACTURER, MUST BE INCLUDED IN A SINGLE NEW LIGHT-DUTY TRUCKS POOL.



COMBINING MULTIPLE LIFO POOLS WITH DIFFERING BASE YEARS AND "DISAPPEARING" BASE DOLLARS

As discussed in other articles and examples, transition year adjustments are needed to complete the changeover to the Alternative LIFO Method because the current year LIFO reserve computations are built upon the LIFO reserves as computed under the previous methodology. The LIFO reserve changes for 1992 cannot be determined until after the prior indexes have been rebased to 1.000 as of December 31, 1991 and the amounts at that date have been reconciled to an analysis of the prior years' LIFO layers.

COMBINATION OF PRIOR POOLS BY MAKE OR MODEL

Before any rebasing to 1.000 can be done, however, it may be necessary to combine prior pools by make or model into two pools, one for new autos and one for new light-duty trucks. Revenue Procedure 92-79 requires that where previously separate pools (i.e., by make or model) are to be combined into one pool for new autos and one pool for new light-duty trucks, the combination computations are to be made in accordance with Regulation Section 1.472-8(g)(2)(iv). This Regulation provides that (1) in combining pools having different base years, all base years subsequent to the earliest base year shall be treated as increments and (2) the base year costs for all pools having a base year subsequent to the earliest base year of any pool shall be redetermined in terms of the base cost for the earliest base year.

The illustration in the Regulations indicates that (1) the beginning-of-the-year inventory in base years subsequent to the earliest base year is to be treated as if it were an increment in the year preceding (i.e., before) the year of the newly created pool and (2) that the effect of the adjustments that must be made to restate the "base" costs in those later years will be to **decrease** the later years' equivalent "base" dollars to lesser amounts intended to be the equivalent of using the base date of the earliest LIFO pool as if it had been the starting point in the LIFO calculations for that "later pool." Hence, the "disappearing" base dollars.

Stated another way, since all of the pools being combined as of December 31, 1991 did not come into existence at the same time, those that came into existence later reflect inflation factors that must be "diluted" or cut back in order to restate all of the pools being combined as if they had one common base date, which is the earliest base date for any pool being combined. In a period of rising prices, the result under these circumstances is that some amount of "base dollars" will be LOST or DISAPPEAR as these later pools are restated to (the earliest) base year cost.

Assume that the overall LIFO election for a Ford dealer was made in 1987, so that the base date is January 1, 1987. Since several models did not come into existence until later years, the pools corresponding to those models in existence at December 31, 1991 are subject to the "deflation" or restatement process described above. Pools for Crown Victorias (1991), Probes (1988) and Explorers (1990) would all be subject to this requirement.

The Regulation cited gives only limited guidance, in the form of a portion of an example, as to how base year unit costs are to be or may be reconstructed or established in accordance with "paragraph (e)(2)" for each item in the pool using assumed costs per item in the context of the double extension LIFO methodology.

Due to the absence of any further guidance in the Regulations relative to the type of transition adjustments or computations required in connection with a change in pricing methods, and to avoid the obviously overwhelming burdens attendant with specific computations by item for each of the "later base date" pools affected, there are many ways the required reductions or adjustments might be computed or reasonably approximated.

In one situation where the LIFO computations were made under the link-chain, index method, the above reductions were determined by reviewing the cumulative indexes determined for all of the other models being combined into the same pool, as of the end of the year preceding the year when the new pool came into existence. This was supported by schedules showing the respective separate model pool cumulative indexes and the computations that were derived from them, as summarized below.

The cumulative indexes for all of the other models were added, with the total then divided by the number of models involved. This resulted in an "average" index (which was not further weighted in any fashion). The reduction factor or deflation factor was then computed by (1) dividing 1.000 by the "average" index, (2) rounding the resulting amount to arrive at a January 1, 1987 base date equivalent factor and (3) subtracting that amount from 1.000 to arrive at the "reduction factor." This reduction factor was then multiplied by the base dollar amounts in all or any years for which these later pools reflected base or increment amounts as of December 31, 1991.

In the case of one Ford dealer, approximately \$180,000 of "base" dollars, in total, was **lost** due to the fact that some of the pools came into existence after 1987:



Combining Multiple LIFO Pools

Model	Year Pool Started	Reduction Factor	"Base Dollars Lost"
Probe	1988	0.06 or 6%	\$ 15,000
Crown Victoria	1991	0.20 or 20%	90,000
Explorer	1990	0.10 or 10%	75,000
Total "Disappearing" Base Dollars			\$ 180,000

Obviously, there are a number of other ways to attempt to determine the reduction factor. One might be to attempt to further adjust the indexes by a dollar-weighting based on current costs of vehicles in ending inventory. Another might be to consider or use only indexes of models that are "closer" in size or performance features to the new model. In another case, we estimated the reduction factor at 5% per year for every year after the initial year of the LIFO election.

It is important to note that the "loss of base dollars" does not result in any change or loss in the amount of the LIFO reserve. What really happens (instead) is that the corresponding base/increment layers receive a *higher* inflation factor as the result of relating (1) the recomputed/reduced amounts of base dollars (now having a really common base date) to (2) the corresponding total amounts of LIFO valuations which did not change. In other words, expressed in terms of a fraction, the numerator stayed the same but the denominator got smaller - resulting in a larger decimal expression.

Ultimately, this will have an impact and take its toll when decrements in the LIFO pool in subsequent years are experienced and are carried back to penetrate or invade these restated LIFO layers.

After the multiple pools by make or model have been combined in accordance with Regulation Section 1.472-8(g)(2)(iv) and other necessary subjective

(Continued)

judgements, you have arrived at the starting points and starting amounts which Revenue Procedure 92-79 further requires to be rebased to 1.000 as of December 31, 1991. As explained and illustrated in other articles in the *Lookout*, under the cut-off method, there is no change in the LIFO reserves for the dealership after reflecting the combination of multiple pools as of December 31, 1991 (i.e., the last day of the year immediately preceding the year of change to the new Alternative LIFO Method) and there is no Section 481(a) adjustment for any years prior to the first year under the new Alternative LIFO Method. **Consequently, there should be no payback of any part of the LIFO reserves as a result of splitting, combining or rebasing pools to 1.000 as of the beginning of the year of change.**

Note that the computations making the transition to the Alternative LIFO Method as of January 1, 1992 did not have to be filed with the IRS National Office in Washington, D.C. and they are not required to be included with the dealership's current year income tax return when it is filed. In view of the lack of specific guidance, as well as the alternative assumptions that might be employed, you might consider including copies of the key schedules showing these computations with the corporate income tax return when it is filed so as to make a full disclosure with the return being filed.

It appears that the Service will accept "reasonable" efforts to combine, consolidate, and otherwise transitionalize former LIFO methodologies over to the Alternative LIFO Method and that the IRS is not trying to create "an administrative nightmare" for anyone in this regard. If you opt not to make a full disclosure of your transition assumptions/computations by means of attaching copies of detailed schedules to the corporate income tax return when it is filed, then the dealership should be sure to retain all of these schedules as part of its permanent income tax-related records. *

ANOTHER COMMON OVERSIGHT... 1991 DECREMENT

In some instances, even a very simple fact pattern can cause a lot of problems with the rebasing. This may happen if the business has experienced LIFO inventory decrements for the year before, or for several years immediately before, the year of change.

What happened in many instances is that a dealer's original LIFO election involved inventories that, for the most part, grew for a number of years... but those inventories experienced declines in the more recent years, including 1991. As a result, the cumulative indexes would reflect inflation starting at 1.000 with the initial LIFO election and, over a number of years, increasing to 1.6 or 1.7 or beyond evidencing gradual inflation every year.

If a schedule were put together to show the year-by-year layers of inventory remaining in the ending inventory, that schedule might not necessarily show the cumulative indexes that were used to determine the amount of base dollars in the ending inventory at the end of the most recent year. Therefore, if you look only at the "visible" indexes on that schedule, the last index showing - and the highest index showing - may be the (cumulative) index for the last year in which there was still any remaining net increment...and this year may have been several years before the 1991 year-end point of reference for rebasing purposes.

Accordingly, the correct result can **ONLY** be obtained by looking for, or determining, the cumulative index that actually was used to deflate the December 31, 1991 ending inventory so as to express it in base dollars. That index is the "key" to understanding and doing the entire rebasing computation. In one instance, we found it on about the 17th page of a barely readable taxed schedule that was a reduction of a 14 column hand-written worksheet...but it was there and everything fell into place in a matter of minutes.



"NEW ITEM" 1993 MODELS IN DECEMBER, 1992 INVENTORIES AN "UNOFFICIAL" LIST

New models or new items under the Alternative LIFO Method are required to be included in the index computation at a 1.000 inflation factor. For a new item, this is accomplished by using the end-of-the-year base cost as the beginning-of-the-year base cost. (Basic math: any number divided by itself equals 1.000.)

A new item category is described in Section 4.02(5) as any one of the following:

1. Any new or reassigned manufacturer's model code that was *caused by a change* in an existing vehicle,
2. A manufacturer's model code created or reassigned because the classified vehicle did not previously exist, or
3. If there is no change in a manufacturer's model code, but there has been a change to the platform (i.e., the piece of metal at the bottom of the chassis that determines the length and width of the vehicle and the structural set-up of the vehicle) that results in a change in track width or wheel base, whether or not the same model name was previously used by the manufacturer, a new item category is created.

Based on our review of model change information from various sources, it appears to us that the following 1993 model vehicles warrant treatment as new items in December 31, 1992 year-end inventories. **THIS IS NOT AN OFFICIAL LISTING - IT IS SIMPLY A SUMMARY OF OUR OWN CONCLUSIONS IN THIS REGARD.**

Note that the Ford Thunderbird and the Mercury Cougar XR7 do not appear on this list. I talked with many CPAs who strongly desired to avoid "taking the hit" on the price/index decrease that would result from treating these as continuing models. They had found rationales they felt comfortable with for concluding that these, and other vehicles in similar fact patterns, were *new* items so they could be repriced at 1.000...which was a better deal than .85 or .92!!

AUDI:	90 Series -	All models	FORD:	Probe -	All models
BMW:	7 Series -	740i and 740iL		Aerostar -	All RV Prep Vans (4 models)
BUICK:	Century -	4-dr Wagon 2-seat Special		F Series Cab	4x2 F-Super Duty Chassis
	Roadmaster -	Coachbuilder's Wagon		& Chassis	DRW 185 wb
	Skylark -	2-dr Coupe Custom		Ranger -	All models except 4x2 and 4x4 Supercab XL 125 wb
		4-dr Sedan Custom			
CADILLAC:	DeVille -	4-dr Sixty Special	GMC TRUCKS:	Rally Wagon -	G3500 HD Rally 125 wb C6W G3500 HD Rally Ext 146 wb C6W
	Fleetwood -	4-dr Sedan RWD			G3500 5.7 L V8 125 wb C6C G3500 5.7 L V8 125 wb C6W G3500 5.7 L V8 Ext 146 wb H/D C6W
CHEVROLET:	Camaro -	All models		Vandura -	
	Geo-Prizm -	All models			
	C-K Chassis	2wd C3500 Crew Cab			
	Cab -	168 wb			
		2wd C3500 Reg Cab			
		HD 135 wb			
		4wd K3500 Crew Cab			
		168 wb			
	C-K Pickup -	4wd K2500 F/S C6P 4.3 L	HONDA:	Accord -	2-dr Coupe SE Auto 4-dr Sedan SE Auto
		131 wb		Civic -	All 2-dr Coupe models (6 models)
		4wd K2500 F/S Ext C6P		Del Sol -	All models
		4.3 L 155 wb		Prelude -	2-dr Coupe VTEC 5-sp
	Chevy Van -	G30 5.7 L Ext C6W 146 wb			
		G30 5.7 L H.D. C6W 125 wb	HYUNDAI:	Scoupe -	2-dr Coupe Turbo 5-sp
	Sport Van -	G30 HD 5 Pass C6W			
		5.7 L 125 wb	ISUZU:	Rodeo -	4x2 4-dr S Auto
		G30 HD Ext 12 Pass C6W		Trooper -	2-dr RS 5-sp and Auto
		5.7 L 146 wb	JEEP:	Cherokee -	All Country models (4 models)
CHRYSLER:	Concorde -	All models		Grand Cherokee -	All models
	Lebaron -	4-dr Sedan LE	LINCOLN:	Mark VIII -	2-dr Coupe
DODGE:	Colt -	All 2-dr and 4-dr models	MAZDA:	626 -	All models
	Intrepid -	All models		MX6 -	All models
EAGLE:	Summit -	All 2-dr and 4-dr models		RX7 -	2-dr Coupe
	Talon -	3-dr L/B DL FWD			
	Vision -	All models			

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MERCEDES-300 Class -	300CE 2-dr Cabriolet Auto	PLYMOUTH: Colt -	All 2-dr and 4-dr models
BENZ: S Class -	400SEL 4-dr Sedan	PONTIAC: Firebird -	All models
	500SEC 2-dr Coupe	SAAB: 9000 Series -	4-dr Sedan CD
	600SEC 2-dr Coupe		4-dr Sedan CDE
	SL Class - 600SL		5-dr Hatchback CSE
	2-dr Coupe/ Roadster Auto		
MERCURY: Villager -	All models	SUBARU: Legacy -	4-dr Wagon L Auto
MITSUBISHI: Diamante -	4-dr Luxury Wagon Auto		4-dr Wagon LSi AWD Auto
Mirage -	All models		4-dr Wagon Touring AWD Auto
NISSAN: 240SX -	2-dr Convertible	Impreza -	New model due in Feb. of 1993
300ZX -	All Convertibles (4 models)		
Altima -	All models	SUZUKI: Sidekick -	4-dr 2wd Hardtop JS 5-sp
Sentra -	2-dr Sedan E 5-sp	TOYOTA: Camry -	4-dr Sedan SE V6 - 5-sp and Auto
	2-dr Sedan SE-R Auto		Corolla - All models
4x2 Pickup -	King Cab SE-V6 5-sp and Auto	T100 Pickup -	All models
	Reg Cab Std LB V6 5-sp and Auto	VOLKSWAGEN:Passat -	4-dr Sedan GLX VR6 5-sp and Auto
4x4 Pickup -	King Cab SE-V6 5-sp and Auto		4-dr Wagon GLX VR6 5-sp and Auto
Quest -	All models	Eurovan -	All models
OLDSMOBILE: Cutlass Ciera -	4-dr Sedan Special Edition		
Cutlass Supreme -	2-dr Coupe Special Edition		
	4-dr Sedan Special Edition		

LIFO Update

(Continued from page 1)

more accurate." The CPA reported having trouble closing about a dozen audits and that there is still a lot of controversy about how to price vehicles and what Revenue Procedure 92-79 really means.

The same article (on pages 2 and 3) indicates that the IRS lets dealers under audit change to the new method, but their LIFO reserves could **plummet** if there have been numerous model number changes. In my experience, in some instances the recomputation using the Alternative LIFO Method for earlier years has actually resulted in higher LIFO indexes and larger LIFO reserves. Reader input and experiences on either or both of these matters would be greatly appreciated and passed along in future issues of the *Lookout*.

Everyone would benefit by a coordinated clarification of a number of questions. Hopefully, the IRS will collect more information and consider issuing some type of Notice or "Questions and Answers" dealing with some of the more problematic aspects. But, without some assistance or leadership from CPAs or NADA coordinating key matters, such as collecting information on platform change criteria from all manufacturers, clarification may take a lot longer.

#3 FORMS 970 AND 3115 NEWLY REVISED

Form 970. Application to Use LIFO Inventory Method, has been reissued with a revision date of

November, 1992. This new form contains all of the questions on the predecessor version, and it makes **no mention** of the Alternative LIFO Method for auto dealers. Therefore, all Forms 970 to be filed in connection with an auto dealer's change to the Alternative LIFO Method will have to be appropriately modified on their face and in attachments to reflect that the specific LIFO methodologies required by Revenue Procedure 92-79 are being employed. See Section 9.02(5) and Section 15 in this regard.

Form 3115. Application for Change in Accounting Method, also has been reissued with a revision date of November, 1992. The new version of Form 3115 still has 8 pages and numerous schedules keyed into various accounting method change categories and it is closely coordinated with Revenue Procedure 92-20. This is evidenced by questions relative to classifying proposed method changes as either "Designated A," "Designated B" or "Category A" methods and by other questions that ask whether the taxpayer has been contacted prior to submitting Form 3115 by the IRS to schedule an examination. It also references to corresponding "window periods" under Section 6 of Revenue Procedure 92-20.

Other Form 3115 tightenings require an applicant to disclose any net operating loss or any credit carryover that will expire in the year of change, as well as the

see LIFO UPDATE, page 15



SOME DECEMBER, 1992 YEAR-END INDEX RESULTS

Some readers have called to ask if indexes under the Alternative LIFO Method were running higher or lower than last year's indexes. That's hard to answer because of all the variables involved.

1. Average beginning-of-the-year inventory costs for each item category are determined by last year's costs and whether or not the dealer had that item category on hand at the end of the previous year.
2. Inventory mixes at both ends of the year — December 31, 1991 and December 31, 1992.
3. Whether a more or less detailed approach taken is in determining "item categories."
4. "New item" determinations made regarding "borderline" models, especially those that reflect significant price decreases. Also, manufacturers do not have uniform criteria for platform change determination or reporting.
5. Discounts received by certain dealers may have been direct reductions of base unit cost.
6. Different purchasing patterns.

Subject to all these variables, for whatever it may be worth, below are some "typical" December year-end inflation indexes that we computed under the Alternative LIFO Method for new vehicles. Keep in mind that these were based on our interpretations of "new items" and a "more detailed" approach in deciding how far down we would go in determining "item categories." Enjoy.

	POOL #1 AUTOS		POOL #2 LIGHT-DUTY TRUCKS			POOL #1 AUTOS		POOL #2 LIGHT-DUTY TRUCKS		
	UNITS	INDEX	UNITS	INDEX		UNITS	INDEX	UNITS	INDEX	
BUICK	45	1.043			LEXUS	30	1.095			
	125	1.035				MAZDA	180	1.048	35	1.055
CADILLAC	80	1.039					95	1.038	30	1.078
	45	1.041			MERCURY	65	0.980			
	240	1.049				MITSUBISHI	85	1.061		
	115	1.044						50	1.061	
						40	1.057			
CHEVROLET / GEO	40	0.998	50	1.027		95	1.064			
	70	1.011	150	1.029	NISSAN	65	1.041	15	1.038	
	55	1.015	105	1.046		OLDSMOBILE	50	1.031		
	35	1.014	160	1.039				35	1.039	
	25	1.004	45	1.043		PONTIAC	240	1.044		
DODGE	40	1.006	45	1.048				30	1.037	
	105	1.019					40	1.048		
EAGLE	45	1.010				190	1.041			
						30	1.036			
FORD	155	1.004	60	1.026	SUBARU	50	1.155			
	205	1.024				TOYOTA	105	1.036	45	1.053
GMC			50	1.030			130	1.056	100	1.048
			50	1.037			105	1.046	50	1.056
			30	1.031						
HONDA	50	1.033								
HYUNDAI	85	1.041								
JEEP			350	1.003						
			45	1.005						



amounts of taxable income **before** application of any net operating loss deduction for the four tax years preceding the year of change.

Question 15 on Form 3115 reflects the de minimis rule allowing the taxpayer to elect to take the entire net Section 481(a) adjustment into account in the year of change if it is less than \$25,000 and the Form now asks whether the applicant wants a Conference of Right in the IRS National Office.

The instructions under "When **Not** to File Form 3115" state that taxpayers making changes to comply with Section 263A inventory cost capitalization rules in the **first required year** need only file Form 3115 with their income tax return. Note: This applies only if the Form 3115 is necessitated because the taxpayer was not required to comply in any previous year (i.e., it is only for "first timers").

Although the new Form 3115 includes references to several Revenue Procedures that were late breaking in 1992 - such as Revenue Procedures 92-74, 92-75 and 92-85, it makes no mention whatsoever of Revenue Procedure 92-79 either on its face or in the instructions. Hopefully, anyone filing Form 3115 now in connection with their elections to use the Alternative LIFO Method in 1992 will be able to just send in the original Form 3115 even though it was prepared on the revision dated July, 1991 - without having to transfer all of the information onto the newer revision dated November, 1992.

Despite the November, 1992 revision date on its face, the newer version was not available for use in 1992 at the time when Forms 3115 were being filled out so copies could be sent to the IRS National Office. Nor were the new Forms available so they could be included in the Form 3115 Pro Forma Filing Package in the December, 1992 *LIFO Lookout*.

#4 STILL MORE TROUBLE FOR OTHER METHODS

The IRS recently continued its attack on auto dealerships that use methods other than the Alternative LIFO Method in their LIFO computations. Letter Ruling 9251001 continued the IRS theme that dealerships cannot exclude new items from their LIFO indexes under the link-chain method and that an index cannot be used if it reflects only "comparables."

#5 SUBSEQUENT IRS AUDIT DOES NOT PREVENT CHANGE IN METHOD OF ACCOUNTING APPLICATION

In Letter Ruling 9253004, the IRS addressed the question of whether the acts of filing Form 3115 and filing an amended return for an earlier year after the Form 3115 was filed might be interpreted as an effort

to frustrate compliance efforts. The IRS was concerned that the taxpayer intentionally sought to avoid its obligation to disclose all material facts in its request for permission to change accounting methods on Form 3115.

This Technical Advice Memorandum indicates that the IRS will closely examine the underlying facts to try to determine whether a taxpayer is attempting to frustrate the IRS' compliance efforts by carefully staged or orchestrated filings of Forms 3115 and the filing, or non-filing, of amended returns. (Query: What about hanging onto the earliest acquisition/dual index method for one more year [1992] and filing Form 3115 for 1993 on January 1, 1993?)

#6 NADA CONVENTION SILENT ON LIFO

I attended the National Automobile Dealers Association Convention on February 6-9, 1993 in New Orleans. This year the Convention did not have any workshops on implementing the Alternative LIFO Method...or even on its pros and cons. Equally disappointing, no workshops were offered on extended service contract issues despite the issuance of Revenue Procedures 92-97 or 92-98 in November of 1992. Although different viewpoints exist on these controversial issues, it's too bad some information or workshops couldn't have been presented at the Convention.

#7 COST CAPITALIZATION - POSSIBLE RELIEF FOR MIXED SERVICE COST COMPUTATIONS

The Tax Simplification Bill of 1993 (HR 13) and the Technical Corrections Bill of 1993 (HR 17) contains a noteworthy simplification provision relating to Section 263A inventory cost capitalization requirements. The provision authorizes, but does not require, the Treasury to issue regulations allowing taxpayers to determine the costs of any administrative, service or support function or department allocable to production or resale activities by using an "average rate" determined *from prior experience*.

This experience factor would be determined by multiplying the total amount of costs of any such function or department by a fraction. The fraction's numerator would be the amount of cost of the function or department allocable to production or resale activities **for a base period** and the fraction's denominator would be the total amount of costs of the function or department **for the base period** consisting of the immediately preceding four taxable years.

This new method could only be applied to years beginning after the enactment of the Bill.



STATISTICAL SAMPLING AND LIFO INVENTORIES: HERE'S WHAT YOU GET UNDER THE FOIA

Last summer, we requested the Internal Revenue Service to provide all information relative to statistical sampling and LIFO inventories. This request was made under the Freedom of Information Act (FOIA). Quite some time later, and after paying copying charges in excess of \$100, we received a package of materials about 1-1/2" thick (double sided copying) in response to our request. Here's what we received:

1. Portions of Chapter 4200 for Income Tax Examinations (pages 4200-290 to 300).
2. Portions of the Handbook for Computer Audit Specialists (including Defense Contract Audit Agency General Purpose Statistical Sampling Programs).
3. Various and sundry regulations.
4. Revenue Procedure 64-4.
5. Revenue Procedure 65-5.
6. Revenue Procedure 72-36.
7. Revenue Procedure 81-70.
8. Module 2: Statistical Sampling by Taxpayers (used in agent classroom training). 3211-100
9. Continuing Professional Education for Computer Audit Specialists - FYE '92 Examination. Coursebook. Training 3211-104 (01-92) TPDS 83625Z
10. Advanced Statistical Sampling Student Coursebook No. 3174-002 Rev (05-92). TPDS 87030A
11. Basic Statistical Sampling - Student Guide Training 3172-01 Rev (8-88). TPDS 87125

Some of this material will be discussed in future issues of the *LIFO Lookout*.

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