De Filipps' LIFO LOOKOUT

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

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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:

Just when you think things are sinking in, settling down and becoming a little clearer, new developments come along that make life interesting again. The common theme in several articles in this quarter's *LIFO Lookout* is the difference of opinions on questions that our clients *think* should have simple "yes" or "no" (or "one correct amount") answers. These questions affecting **all** taxpayers are particularly evident in the three articles dealing with C to S - and vice versa - conversions, combining LIFO pools, and whether or not replacement cost accounting is acceptable for parts-type inventories.

The other three articles reflect this theme in more specialized analyses of auto dealer LIFO information obtained under the Freedom of Information Act (i.e., the IRS' MSSP LIFO templates) and information now surprisingly more readily available without even a FOIA filing (i.e., the IRS' new item listings). Notice in these articles how interconnected the detail in the IRS' MSSP - that's Market Segment Specialization Program - templates is with the detail in the "new item category" lists. Also, keep in mind that the IRS' MSSP templates were the basis for many "rough justice" settlements and were developed long before Revenue Procedure 92-79 and the Alternative LIFO Method came along in 1992.

#1. YEAR-END FINANCIAL STATEMENT LIFO CONFORMITY REQUIREMENT. This technical issue, one of the worst booby traps of all, continues to be discussed by the NADA with the IRS in an effort to save dealers (including a few specific dealers caught in the trap right now) from losing their entire LIFO election and reserves because they did not reflect LIFO in their year-end financial statements to the manufacturers.

The unclear status of the conformity issue - including the possibility of a hard-line, retroactive interpretation of the Regulation by the IRS - clouds the perception and possibility for joint problem-solving to work out many other auto dealer LIFO computation differences. The significant progress made so far in auto dealer new vehicle LIFO computations by issuing the Alternative LIFO Method may be jeopardized and replaced by an enormous creditability gap if the IRS now retroactively enforces an ambiguous technicality secretly buried in the regulations as a means to terminate otherwise acceptable LIFO elections. This conformity issue for dealers needs to be addressed immediately in a responsible, reasonable way at a policy level by the Treasury/IRS. Until that happens, "progress" in any other LIFO areas can only be regarded as tentative.

#2. CONFUSION OVER LIFO ASPECTS OF C TO S AND S TO C CONVERSIONS. As further evidence of IRS audit activity...and confusion...over the LIFO "termination" aspects of a C to S conversion, one reader reports that during an audit, the IRS agent asked to see a *new* Form 970 for

see **LIFO UPDATE**, page 14

LOOKOUT LOOKS INTO

CHANGES FROM C - S OR S - C STATUS: IT ONLY GETS WORSE FOR LIFO INVENTORIES

When businesses using the last-in, first-out (LIFO) method for valuing their inventories decide to change either from C to S status **or** from S to C status, they have to address potential tax problems related to their LIFO inventories. When the Tax Reform Act of 1986 inverted the income tax rates, resulting in individual income tax rates falling below corporate tax rates **and** simultaneously repealed the *General Utilities* doctrine, adding a "double tax" on liquidating businesses, taxpayers by the thousands switched their corporations from C to S status. Some CPAs may have overlooked the LIFO inventory implications in concentrating more fully on the income tax rate changes as the motives for switching to S status.

Several current developments highlight these LIFO problems, the related confusion, and the significant differences depending on whether your answer is "yes" or "no" to what seem to be simple questions. These questions suggest the need for clarification by the Treasury or by the IRS. More importantly, they suggest the need for tax advisors to CYA (that's Cover Your Assumptions), preferably in writing, when discussing the implications of C to S or S to C changes with corporate clients.

SWITCHING FROM C TO S STATUS

The very first issue of the *LIFO Lookout* discussed S elections as the "LIFO Trap of the Year" and indicated that when a C corporation elects S status and repays the income tax on its LIFO reserve...the corporation has *not* terminated its LIFO election. Although this conclusion is not stated specifically in the Code, Regulations or any IRS/ Treasury pronouncement, it follows from a study of all other relevant materials.

A reader recently wrote: "We presently have a client that is to be audited by the IRS. One of the requests made by the agent is to see our LIFO election **after** the corporation converted from C to S status. We were of the understanding we did not need to re-elect LIFO on conversion from C to S. We simply recaptured the reserves and began LIFO over again for the first year as an S corporation. Do you know of any Regs. that would require a re-election of LIFO?"

Our conclusion was the same as his: The LIFO election was not terminated on the switch from C to S. Other than for taxpayers switching before December 17, 1987, Code Section 1363(d) provides for a recapture **of income tax** by having the C corporation add an amount equal to the difference between the value of its inventory on the last day of its C election using the FIFO method and the value using the LIFO method to the other taxable income of the corporation for the last year that the corporation operated as a C corporation. The additional tax attributable to the LIFO reserve income is then spread over 4 years, beginning with the last C corporation year and ending with the third S corporation year thereafter. IRS Announcement 88-60 (IRB 1988-15, 47) provides more information on how this additional tax should be computed and disclosed in the last income tax return (Form 1120) of the C corporation.

Is it possible that the IRS agent who is now requesting to see the Form 970 is simply misinformed; or is the IRS testing a theory or position that the C corporation's LIFO election actually was terminated by the S election and that a new Form 970 was required to be filed in the first S year? There's a lot of revenue at stake on this issue.

Schneider's *Federal Income Taxation of Inventories* concurs with the conclusion that the LIFO election of the C corporation was not terminated and points out some of the additional computational problems resulting from the taxation of the LIFO reserve as a toll charge to elect S status. An article in the *Tax Advisor*, October, 1990 also discusses the treatment of LIFO inventory reserves when converting from C to S status, along with illustrating a number of alternative computational approaches.

If you have a client with LIFO inventories who switched from C to S, you have already taken a position one way or another on some of the problems about to be discussed which concern the computational mechanics for continuing the LIFO election in the first S year. These computational alternatives arise regardless of whether you (1) rebased all of the prior C corporation LIFO layers into one single layer having an average LIFO index valuation or (2) rebased and retained the identity of each annual layer - base plus increments remaining - by that same conversion factor. It would appear that the latter approach (i.e., that of retaining the individual year layer identities) would be advisable because of the possibility that future combinations of pools in a later year would produce more accurate layering results where specific annual layers were tracked than the result obtained by having a single "one lump" layer of inventory as of the last C year.

There is another major problem in continuing the LIFO election in the first S year if you simply started your LIFO index calculations again using 1.000 as the valuation factor on the first day of the first S year. Note that the reader posing the question indicated that they "began LIFO *over again* for the first year as an S corporation." Starting over again from 1.000

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would produce an incorrect result (probably understating the LIFO reserve) for dollar-value, link-chain LIFO users. Assume a link-chain LIFO election with a cumulative index at the end of the last C year of 1.6. Assume further that the 1.6 cumulative index had been developed over a 5 or 6-year prior period and resulted in a "net" or "weighted" revised LIFO index of 1.4375 when the FIFO/current cost on the last day of the C year was divided by the inventory on that date expressed in base dollars. (This is the fact pattern illustrated in the *Tax Advisor* article mentioned above.)

Now assume that the inflation index for the first S year is computed to be 5%. If one simply "starts over" in the first S year with 1.000 at the beginning of the year and 1.05 at the end, then the effective/cumulative inflation factor for the first S year is simply 5% (1.000 x 1.05). *On the other hand*, since the LIFO election continued in force with no modification (other than the restating of the LIFO valuation index), then the effective inflation rate for the first S year would be 7.19%. This is determined by multiplying 1.05 times 1.4375 which produces a cumulative index of 1.5094 at the end of the first S year. From this 1.5094 you would subtract the cumulative index at the beginning of the year or 1.4375 and this would result in a .0719 effective inflation factor.

The additional 2.2 percentage points (7.2% vs. 5.0%) in the first S year's inflation factor would produce a LIFO reserve change 44% greater than the result produced by simply starting over at 1.000! And the resulting difference in LIFO reserve amounts *compounds* over all future S years! For those S elections that "simply started LIFO over at 1.000," if the above analysis fits your situation, what do you think you should do?...Is the statute of limitations still open on those years?

A related and possibly troubling error was made earlier this year by one of the speakers at the NADA Auto Dealer Tax Issues Workshop when he discussed Revenue Procedures 88-15 and 92-20 in the context of the LIFO implications of a switch from C to S status. The speaker did not at all mention Section 1363(d) and mentioned only these two Revenue Procedures which relate to voluntary terminations of LIFO elections. These rules, in general, allow a spread period of not more than 6-years for the recapture of the LIFO reserve amount. Code Section 1363(d) provides a significantly different tax consequence if *the LIFO reserve is not terminated* (and we believe it is not) insofar as Section 1363(d) requires a computation of the additional tax, and the amount of the additional tax (not the amount of the LIFO reserve) is spread over a 4-year period beginning with the last C year.

Two radically different consequences; not to mention the other different computational approaches discussed above.

IS SWITCHING FROM S TO C A LIFO RECAPTURE EVENT?

With the increase in individual income tax rates retroactive to the beginning of 1993 so that the higher effective rates for individuals exceed regular C corporate income tax rates, many businesses are re-evaluating the continuation of S status. Before advising a client changing from S to C status because of the longer range anticipated tax benefits from the income tax rate differentials, have you considered the potential recapture of the LIFO reserve? Will the switch now from S status to C status trigger a similar recapture of the LIFO reserve for about the same reasons and in about the same way as Section 1363(d) now prescribes when an entity goes the other way from C to S?

There is no reason why the Treasury/IRS should not and may not advocate an immediate recapture of tax on the LIFO reserves for corporations switching from S to C, especially where it is obvious that the change is being made "for income tax reasons." The Committee Reports explaining Congressional intent underlying Code Section 1363(d) state that Congress "believes that LIFO method taxpayers, which have enjoyed the deferral benefits of the LIFO method during their status as a C corporation, should not be treated more favorably than their FIFO (First-In, First-Out) counterparts. To eliminate this potential disparity in treatment, the Committee believes it appropriate to require a LIFO taxpayer to recapture the benefits of using the LIFO method in the year of conversion to S status." Does a similar rationale apply when an S corporation decides to change to C status?

Presently there is no code section specifically requiring LIFO reserve recapture immediately or over some period of time, when going from S to C. However, consistency, logic and perhaps even an overall sense of fairness to the general taxpaying public might seem to require such a recapture. Without recapturing the LIFO reserves when switching from S to C status, the individual taxpayers (in higher brackets after the switch from S to C) will be able to shift the burden of repayment of the tax on the recapture of LIFO reserves in declining years to their corporations. Will there be **constructive dividend exposure** to the former S shareholders when the C corporation pays the tax in later years at lower rates on the declining LIFO reserves? If so, how will it be measured? And how will it be paid?

Your client contemplating a change from S to C status in order to beat the rate change may ask you whether or not or how soon they have to repay their LIFO reserves. Who will pay the tax? Will the shareholders personally, or will the corporation as an entity, eventually or immediately have to repay the amount of the LIFO reserve built up as of the date of the switch from S back to C? Or is the amount of the tax deferred the measure of the tax to be recaptured?

see **S - C: IT ONLY GETS WORSE**, page 10

ACCEPTABILITY OF REPLACEMENT COST ACCOUNTING FOR "PARTS-TYPE" INVENTORIES HEADACHES, MORE WORK...AND REFUNDS FOR MANY TAXPAYERS

One currently brewing development may surprise thousands of businesses using replacement cost accounting for their parts-type inventories. Major users of replacement cost include distributors and wholesalers of plumbing, electrical, heating, air conditioning, lighting and a long list of other suppliers. In addition, the development will affect thousands more using replacement cost accounting in some form for relatively small parts inventories. And many of these businesses may not even be using LIFO to defer their year-end taxes.

We see this as an issue of potentially *Thor*-type magnitude. If a relatively small number of LIFO taxpayers are disadvantaged temporarily by the IRS' successful attack on the use of replacement cost, thousands of other non-LIFO taxpayers will be able to file claims for refunds or Forms 3115 to change inventory valuation methods consistent with the Service's disallowance of the use of replacement cost for parts-type inventories.

Here is the general fact pattern: Most businesses do not value their parts-type inventories at year-end - or at any other time for that matter - by using specific cost or even perpetual cost accounting information. That is simply not practical. Instead, they use a replacement cost approach for valuing their inventories which consist of many thousands of items by reference to manufacturer price lists in effect at the end of the year or by reference to the most recent vendor invoice cost, regardless of the quantity purchased (and in some cases, even regardless of whether there were any purchases of that item during the year). In inflationary times, inventories valued using replacement cost accounting are somewhat overstated, and this means that income taxes are being paid **in advance**.

The current challenge by the IRS to the use of replacement costs in LIFO situations is not limited to the narrower issue of whether replacement cost is appropriate as an "other" method for valuing increments. Instead, the issue has been broadened more technically to question whether the use of replacement cost is acceptable for income tax purposes, notwithstanding its acceptance for Generally Accepted Accounting Purposes (GAAP) and its consistent use by all businesses within a taxpayer's particular industry.

It is our understanding that a Letter Ruling/TAM will soon be published involving a truck dealer's use of replacement cost for valuing inventories which will essentially knock out that accounting method and require that some other "actual" cost method be used instead. Upon publication under the Freedom of Information Act, this TAM will be thoroughly analyzed.

TECHNICAL BACKGROUND

Two IRS Letter Rulings/TAMs about 15 years apart seemed to recognize that many businesses by necessity use replacement cost accounting. However, neither ruling addressed the acceptability of replacement cost accounting for valuing the inventory. In other words, they danced around that issue...until now.

In March, 1975, Letter Ruling 7503130350B involved a taxpayer who valued parts and accessories inventories using current replacement value as of the date the inventory was taken. The taxpayer justified this method as being necessary to avoid the additional work involved if each item in inventory were separately costed from the vendor's individual invoices. In focusing only on the increment valuation LIFO aspect, the IRS in this letter ruling allowed the taxpayer to value its current year costs for the parts inventory using current replacement values.

In Letter Ruling/TAM 8906001 about 15 years later, one issue was whether an auto dealer taxpayer could use the "replacement cost method" for valuing increments under the dollar-value LIFO method for its parts inventories. Although the question was clearly phrased, it was not clearly answered. The conclusion in the Technical Advice was that under the facts and circumstances of the case, the use of such method was not grounds for terminating the taxpayer's LIFO election with respect to the parts inventories. The holding in Letter Ruling/TAM 8906001 was that although the taxpayer's use of current replacement cost for valuing its parts ending inventory may, in part, be a non-cost-based inventory method, the use of such method was not grounds for terminating the LIFO election because of the facts and circumstances involved.

In Letter Ruling 8906001, the taxpayer stated that its use of replacement cost accounting was a "rational, unbiased method, designed to accommodate (the) underlying perpetual inventory system and should be accepted as a so-called 'other' increment valuation method" under the LIFO regulations. The taxpayer stated that it would be impractical to attempt to determine actual cost because of the stocking costs and warehousing which prohibited specific identification on a cost-effective basis. Citing industry-wide turnover, the taxpayer asserted that its ending inventory approximated current replacement cost notwithstanding the impracticality of specific identification.

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The technical analysis in Letter Ruling 8906001 centers around the fact that the choice of the particular alternative selected for valuing the LIFO increment has no determination on whether or not an increment will actually be computed. In other words, the choice of the increment valuation method affects only the determination of the LIFO carrying value of the increment. Since the issues in Letter Ruling 8906001 were framed as specifically as they were, that TAM did not address the broader question of whether the IRS would recognize replacement costing as an acceptable, overall inventory valuation method for tax purposes.

Current audit issues may frame the issue more broadly by considering the specific language of Regulation Section 1.472-8(e)(2)(ii)(a) which requires that cost be determined by reference to "actual" cost. This should invoke recall of two general propositions. **First**, the fact that an accounting method is in accordance with GAAP does not necessarily establish that that method clearly reflects income under the tax law. **Second**, the fact that an accounting method has been consistently applied, similarly, does not validate that method for income tax purposes where it fails to clearly reflect income (see *Amity Leather Products, Thor Power Tool, Coors* and other cases).

Accordingly, the particular insistence now by the IRS that actual cost is the criteria which disqualifies the use of replacement cost approaches in parts-type inventories, and the technical ballet interpreting regulations under Code Sections 471 and 472 may cause taxpayers using replacement cost to determine/approximate total current year cost to have to change their accounting methods. Such a conclusion is likely to have enormous ramifications throughout many industries where parts-like goods make up all, or a substantial portion, of their inventories, regardless of whether or not LIFO is being used for tax purposes. But...to what new method will they change?

FURTHER LIFO TECHNICALITIES

In the LIFO context, possibly all of the technical sparring necessary to resolve this issue will come down to whether the taxpayer elected on Form 970 to use the "double extension" method in Regulation Section 1.472-8(e)(2) or to use an "other" method for valuing the dollar-value pools. Under the regulation cited above - 8(e)(2), specific rules are provided for the double extension method. Under 472-8(e)(1), other methods are referred to, but not given any special rules. Therefore, if a taxpayer had elected to use the link-chain method (and was covered under - 8(e)(1)), a case may be made that Regulation Sections 1.472-2(b) and (c) are applicable. Under this interpretation, it would appear that a distributor or parts-type inventory taxpayer that had valued its pre-LIFO inventory at unit costs based on last vendor sheet prices or catalog costs or replacement costs would not be required to recalculate the last pre-LIFO inventory at actual cost because Regulation Section 1.472-2(c) provides that "the actual cost of the aggregate (value of the last pre-LIFO year ending inventory, which constitutes the first year LIFO inventory) shall be determined pursuant to the inventory method employed by the taxpayer under the Regulations applicable to the prior taxable year with the exception that restoration shall be made with respect to any write**down** to market values resulting from the pricing of prior inventories."

The history of the Treasury LIFO regulations on this point (possibly going back to changes in 19**42**) might support the position that actual cost does not necessarily mean original cost, except in the case of inventory that had been written down below original cost. In all other cases, the term "actual cost" could be taken to mean the cost aggregate used in the preceding year's closing inventory. This interpretation would obviously "save" or rescue taxpayers from having to perform detailed computations which the IRS now seems to be trying to require.

COMMON SENSE & PRACTICALITY VS. "TECHNICALITY"

The use of "replacement cost" by entire industries of distributors, wholesalers and retailers to the extent of their parts inventories has tremendous overall implications. One can only opine that this would be a classic opportunity for IRS technicians to try to consider what former IRS Commissioner Fred T. Goldberg, Jr. meant when he said in August, 1990 that:

"the IRS needs "to build on, and...accommodate common commercial practice. We can't operate on the assumption that...small businesses...can be expected to modify and tailor their behavior to the world of taxes - it ought to run in the other direction...Many of the problems we have in the (tax) system right now are traceable back to an honest, genuine, but terribly misguided quest for theoretically pure answers...(we) really cannot live with theoretically pure answers...we need, instead, to be looking for simplifying assumptions."

If the IRS prevails in its technical challenges to the use of replacement cost instead of actual cost, there may be a lot of work and even more Forms 3115 to be filed. Almost 15 years ago, Alan Silver said that "a good case could be made that the Treasury would sooner give up 95% of its principles than 5% of its income." If the IRS "wins the war" on this issue, somebody in Congress may ask them if they ever thought that winning this argument was going to cost the Treasury so much money in the long run!

Readers are invited to comment on the implications to their clients as well as on the technical and practical merits for the use of replacement cost accounting for valuing parts-type inventories.

COMBINING DIFFERENT VINTAGE LIFO POOLS
COMBINING MULTIPLE LIFO POOLS WITH DIFFERING BASE YEARS
AND "DISAPPEARING" BASE DOLLARS...
EVEN THE AICPA MAKES MISTAKES

When changes in LIFO methods or pooling are approved, transition year adjustments are usually required so that new LIFO reserve computations can be built upon the LIFO reserves as previously computed. One aspect of combining pools with differing base years and the concept of "disappearing" base dollars was covered in the March, 1993 *LIFO Lookout* in the context of auto dealers changing to the Alternative LIFO Method who might be required to combine previously separate pools (i.e., by make) into one pool for new autos and one pool for new light-duty trucks.

In reviewing the recently published AICPA *Auto Dealership Engagement Manual,* we note that it contains an example which **incorrectly** illustrates the combination of LIFO pools with different base years. The example involves the combination of a pool with a base year of 1988 and a pool with a base year of 1987. In the AICPA Manual's example, the base dollars for each pool and the LIFO value for each pool are simply added together when increments exist for the same year, with no further adjustment to reflect the difference in the purchasing power of the dollar in the base years of the two pools involved. So, be careful if you use the AICPA *Auto Dealership Engagement Manual* as a reference for combining LIFO pools with different base years because this example misinterprets the Regulations.

The requirements for combining LIFO pools are found in 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 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, if all of the pools being combined as of the beginning-of-the-year of change did not come into existence at the same time, those LIFO pools that came into existence later reflect inflation factors that need to 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 of the pools 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-vintage LIFO pools are restated to (the earliest) base year cost.

The Regulation gives only a limited example showing 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 double extension LIFO calculations. Due to the limited guidance in the Regulations on this matter, and to avoid the overwhelming - if not impossible - burden attendant with specific computations **by item** for each of the "later base date" pools affected, the required reductions or adjustments to deflate later-vintage LIFO pools may have to be reasonably approximated.

Under these circumstances, the reduction of "base dollars" for the "newer" pools being combined as of the beginning of the year of change **may** have to be estimated at x% per year, or the indexes could/**may** have to be adjusted by using dollar-weighting based on current costs of items in ending inventory, or some other reasonable approach may be used to reduce the base dollars in the later pools to make them comparable to the "base dollars" in the earlier pools.

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 in the later-vintage LIFO pools 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 fractions, the LIFO valuation numerators stay the same while the base dollar amount denominators are reduced - thus resulting in larger decimal expressions of the inflation.

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

The moral is: Combinations of LIFO pools having different base years should not be treated as simple exercises in addition and division. The schedules on the facing page show the erroneous treatment per the AICPA Manual (Exhibit 9.902) and the correct result, assuming a 5% inflation factor adjustment.

POOLS TO BE COMBINED

LIFO VALUATION AND INVENTORY LAYERS	1987 POOL BASE DOLLARS	1987 POOL INDEX FACTOR	1987 POOL LIFO VALUATION	1988 POOL BASE DOLLARS	1988 POOL INDEX FACTOR	1988 POOL LIFO VALUATION
CALENDAR YEAR 1987	$300,000	1.0000	$300,000	N/A	N/A	N/A
CALENDAR YEAR 1988	N/A	N/A	N/A	400,000	1.0000	400,000
CALENDAR YEAR 1989	N/A	N/A	N/A	200,000	1.0900	218,000
CALENDAR YEAR 1990	700,000	1.3000	910,000	600,000	1.1772	706,320
CALENDAR YEAR 1991	100,000	1.3780	137,800	100,000	1.2478	124,780
TOTAL	$1,100,000		$1,347,800	$1,300,000		$1,449,100

COMBINED POOL

LIFO VALUATION AND INVENTORY LAYERS	PER AICPA EXAMPLE - INCORRECT BASE DOLLARS	INDEX FACTOR	LIFO VALUATION	THE CORRECT WAY BASE DOLLARS	INDEX FACTOR	LIFO VALUATION
CALENDAR YEAR 1987	$300,000	1.0000	$300,000	$300,000	1.0000	$300,000
CALENDAR YEAR 1988	400,000	1.0000	400,000	380,000	1.0526	400,000
CALENDAR YEAR 1989	200,000	1.0900	218,000	190,000	1.1474	218,000
CALENDAR YEAR 1990	1,300,000	1.2433	1,616,320	1,270,000	1.2727	1,616,320
CALENDAR YEAR 1991	200,000	1.3129	262,580	195,000	1.3466	262,580
TOTAL	$2,400,000	☹	$2,796,900	$2,335,000	☺	$2,796,900
TO RECONCILE: ADD BACK "LOST" BASE DOLLARS: AT 5% REDUCTION FACTOR DUE TO DIFFERENT VINTAGE LIFO POOLS				$65,000		
ORIGINAL BASE DOLLARS				$2,400,000		

DETAIL COMBINATION OF DOLLAR VALUE LIFO POOLS AS OF DECEMBER 31, 1991 *

LIFO METHODOLOGY: LINK, CHAIN-INDEX POOL	BASE YEAR	BASE DATE 01/01/87	INCREMENTS DECEMBER 31, 1988	1989	1990	1991	TOTAL BASE DOLLARS	TOTAL LIFO VALUATION
OLD POOL	1987							
BASE YEAR COST		$300,000	-	-	$700,000	$100,000	$1,100,000	
LIFO VALUATION		300,000	-	-	910,000	137,800		$1,347,800
NEW POOL	1988							
BASE YEAR COST		-	$400,000	$200,000	$600,000	$100,000	$1,300,000	
LIFO VALUATION		-	400,000	218,000	706,320	124,780		1,449,100
							$2,400,000	$2,796,900
ADJUSTMENT TO REDUCE BASE YEAR COSTS **		-	($20,000)	($10,000)	($30,000)	($5,000)	(65,000)	
TOTAL BASE YEAR COST (A)		$300,000	$380,000	$190,000	$1,270,000	$195,000	$2,335,000	
TOTAL LIFO VALUE (B)		$300,000	$400,000	$218,000	$1,616,320	$262,580		
RATIO OF (B) TO (A)		1.0000	1.0526	1.1474	1.2727	1.3466		

* COMPUTATION IN ACCORDANCE WITH REG. SEC. 1.472-8(G)(2)(iv).

** ADJUSTMENT TO RESTATE/EQUALIZE BASE YEAR COSTS; I.E., REDUCTION OF "BASE DOLLARS" FOR NEWER POOL BEING COMBINED (AS OF 12/31/91) WHEN NEWER POOL (NEW POOL-1988) HAS BASE DATE SUBSEQUENT TO THE EARLIEST BASE DATE (1987). RATIO OF 1988 COSTS TO 1987 COSTS: ASSUMED TO BE .95 = REDUCTION FACTOR OF 5% (.05). ONE YEAR @ 5% REDUCTION PER YEAR.

COMPARISON OF IRS' "UNOFFICIAL" NEW ITEM LISTS

As indicated in LIFO Update Comments #5, the IRS/MSSP recently made available its 1993 model year new items list, "The IRS Auditors' Guide to Defining New Vehicles" and a draft of its 1994 model year new items list. This article analyzes the differences between the IRS/MSSP lists and the 1993 and 1994 model year "unofficial" new items lists previously published in the *LIFO Lookout*. Our listing of year-end 1992 (i.e., substantially all 1993 models) was published in the March, 1993 issue of the *Lookout* (pages 12-13) and our listing of year-end 1993 models was published in the March, 1994 issue of the *Lookout* (pages 8-10). The accompanying tables summarize, by make, the number of new item categories appearing on both lists and explanations for any variances.

Based on discussions with Terri Harris, assistant to Robert Zwiers, the IRS Motor Vehicle Industry Specialist, we have jointly analyzed the reasons for all differences in our respective new item lists.

DIFFERENCES

- Information sources used in compiling lists,
- Differences in information available at release dates,
- Interpretation of "new item" definition language in Rev. Proc. 92-79, and
- Minor variations in item category breakdown.

These reflect the differences that anyone using the Alternative LIFO Method will have in agreeing with **ANY** IRS list.

The good news is that our lists are *reasonably* similar. Furthermore, many discrepancies are due to minor variations in item category breakdown (i.e., method of listing automatic and 5-speed item categories with the same base price and extent of recording regionally specific market or value-priced editions).

Other minor differences in our respective lists were traced to the different release dates of the compilations. The *LIFO Lookout* published new item lists with reference to calendar year-ends in order to provide time critical information to CPAs and dealership controllers under tight deadlines for the release of financial statements and tax return filings. On the other hand, the IRS/MSSP lists were more "leisurely" assembled well after the fact and with the benefit of information not available until later dates.

Even with all the additional time, the IRS still did not produce what we regard as error-free lists of new items for either the 1993 or the 1994 model years. We intend no criticism by this observation; it simply reflects the magnitude of the task - which ends up being subjective even for the IRS - and the difficulty the IRS has in getting basic information on a timely basis.

The IRS classified all 1994 model year Toyota Supras as new items. However, the 1993 model year Toyota Supras introduced in May of 1993 were clearly new items due to a change in platform. Since the 1994 Toyota Supras had the same platform and model code as the 1993s, that would mean that the '94s should be treated as continuing items. In a similar fact pattern, the IRS/MSSP lists and ours seemed to agree that all 1993 model year Ford Rangers were new items. However, the IRS' listing of new 1994 Ford Rangers accounts for a major disparity between the our respective new item analyses of 1994 model year light-duty trucks.

Another key difference in our respective new items lists was that of interpretation of the definition of a new item under Revenue Procedure 92-79. The IRS/MSSP lists seem to even more narrowly interpret *any* change in a vehicle (such as engine upgrade, transmission change, air bag, re-skinning), regardless of whether the model code and wheelbase changed, as a new item. For example, in the IRS/MSSP 1993 list, the Audi 100 Series changed the fifth digit of its model code. The only change to the vehicle was an addition of a passenger air bag, yet the IRS deemed the Audi Series 100 a new item. →

ONE TIMELY "OFFICIAL" LIST...PLEASE!

Ideally, one "official" or uniform list of new items should be prepared and made available on a timely basis for use by dealers and their CPAs in performing Alternative LIFO calculations.

We have offered to do this for NADA, hopefully in cooperation with a pre-release review by the IRS.

The time spent in analyzing model changes and pricing information and the difficulty in collecting all necessary information, not to mention the need for consistent interpretation of Revenue Procedure 92-79, suggest that it is unproductive and grossly inefficient to have new item analyses performed on an individualized basis by every CPA and/or dealership. Furthermore, the proliferation of different lists presents increasing burdens and responsibilities for the IRS in monitoring compliance.

Our analysis of the extent of the differences in comprehensive, responsibly compiled listings of new items suggests that it is now time for NADA and the IRS to work together to "solve this problem" before even more confusion over "new item lists" is generated. Otherwise, this confusion will grow and impair the usefulness of the Alternative LIFO Method for everyone.

WHAT IS THE STATUS OF IRS/MSSP NEW ITEM LISTS?

One aspect that is potentially confusing and troublesome is that these IRS/MSSP "unofficial" new items lists appear to have no "official" status as promulgations of the Internal Revenue Service for use in connection with the Alternative LIFO Method. These IRS/MSSP listings were not issued through any formal IRS channels and apparently they have not been coordinated with the IRS National Office which drafted the provisions in Revenue Procedure 92-79 for determining "new item" status. Instead, they appear to be audit guides for examining agents.

The IRS/MSSP new item listings are based on *Kelley Blue Book* information - not on actual dealer invoices as required by Rev. Proc. 92-79. The IRS/MSSP listing for the first calendar year (i.e., 1992) under Rev. Proc. 92-79 is a more "finalized" listing of 1993 models. The IRS/MSSP listing for the second calendar year/1993 involving 1994 models was issued in "draft" form and is yet unpublished in final form. We are told that these "unofficial lists" are likely to be revised as the result of our providing the IRS with information from actual invoices and manufacturer price lists.

This suggests an evolving status of the new item lists, rather than their status as complete, definitive documents at this time. Accordingly, perhaps one should not immediately jump to conclusions or amended return forms; rather, it may be advisable to wait and see what, if anything, develops further.

Whether you realized it or not, if you did any auto dealer LIFO calculations, or used any software to do them, you have indirectly prepared a new items "list" on your own...and the IRS/MSSP will be looking to compare your list sooner or later with theirs. Will your list stand up to IRS scrutiny? If you used somebody else's software, is this information readily available? Should you be thinking about filing amended returns at this time?

All of a sudden it seems like there's more confusion, rather than less, involved with using the Alternative LIFO Method. What seems to be lacking at the moment is some coordinated thinking and activity on these new item lists by the IRS National Office, MSSP and District Directors.

Comparison of "Unofficial" New Item Lists

(Continued)

Additionally, the 1993 model year Mercedes-Benz 300E sedan was treated as a new item by the IRS when the only change to the vehicle was an engine upgrade (a 2.6 to a 2.8 liter engine).

Finally, a *principal* difference in our respective lists was attributable to the information used in compiling the lists. The IRS/MSSP list used *Kelley Blue Book* as its **exclusive** source of information in compiling its new items lists. Our *LIFO Lookout* new items lists were primarily based upon actual invoices and factory price and model information - and on *Black Book* as a secondary reference. Revenue Procedure 92-79 clearly requires the use of actual invoices. Does the IRS/MSSP's sole reliance on *Kelley Blue Book* information constitute adequate research sufficient to warrant adjustment on audit to more carefully computed LIFO indexes?

In this regard, any name or description change of a vehicle, as listed in *Kelley Blue Book* and not necessarily as listed on the invoice, with very little or no change to that vehicle resulted in that vehicle being treated as a new item on the IRS/MSSP lists. *Any* change in the *description* of a vehicle (again, as listed in *Kelley Blue Book*), from one year to the next *automatically* made such vehicle a new item by IRS analysis. Unfortunately, we have found that *Kelley Blue Book* is not always consistent from year to year in listing item category information. In many instances, the *LIFO Lookout* was able to provide the IRS with additional information showing that the factory description of several vehicles as well as such vehicle's description in the *Black Book* remained the same from year to year. As a result of this additional information, the IRS may delete some of these vehicles from its new items lists.

Different types of comparisons are necessary when analyzing make/model information in order to determine whether a vehicle is a continuing model or a new item. Some comparisons involve matching prior year **item** category to current year **item** category; other comparisons require matching prior year **model line** to current year **model line**. *For example*, a change in platform affects an entire model line; therefore, each item category in the model line would be considered a new item and the situation would not require that each prior year item category be compared with each current year item category. *On the other hand*, a change in model code for a particular body style would require that each prior year item category be matched with each current year item category because this type of change doesn't necessarily affect the entire model line.

The accompanying tables provide more information on the comparisons. As explained above, different types of comparisons involve different numbers of item categories - ranging from one item category to an entire model line. The difference in the number of item categories which may constitute a comparison explains the reason that the difference between the number of new item categories on the IRS/MSSP

see **COMPARISON OF IRS' "UNOFFICIAL" NEW ITEM LISTS**, page 10

Comparison of IRS' "Unofficial" New Item Lists

(Continued from page 9)

list and on our list does not equal the number of differences (comparisons) listed in the accompanying tables.

To help maintain a perspective of the number of new items *relative to* the total item categories (i.e., new plus continuing items), consider the following from our *LIFO Lookout* database. Because total item category information was not included as part of the IRS/MSSP lists, we are unable to compute comparable percentages according to the IRS.

Our database for 1993 model year new autos listed approximately 600 total item categories of which approximately 120, or 20% were considered new item categories. Our database for 1993 model year new light-duty trucks listed approximately 550 total item categories of which approximately 75, or 14% were considered new item categories. Combined, these listed approximately 1,150 total item categories, of which 195, or 17% of all 1993 model year vehicles were considered as new items.

Our database for 1994 model year new autos listed approximately 660 total item categories of which approximately 180, or 27% were considered new item categories. Our database for 1994 model year new light-duty trucks listed approximately 500 total item categories of which approximately 85, or 17% were considered new item categories. Combined, our 1994 model year databases, listed approximately 1,160 total item categories of which 265, or 23% of all 1994 model year vehicles were considered as new items.

In comparing our respective 1992 year-end listings, we found our automobile pools to be in substantial agreement. However, *in addition*, the IRS list included about 40 more vehicles as new items... principally due to the IRS' inclusion of many regional/value-priced vehicles.

In comparing year-end 1992 light-duty trucks, we considered as new items about 20 trucks that the IRS did not...and the IRS' list includes about 20 trucks as new items that we did not! This shows how looking only at total new items may fail to emphasize possible differences in the underlying item-by-item analysis.

How far into the detail should you go in determining "item categories"? We've asked this question many times before, always indicating our understanding that you have to go as far as possible. It is interesting to note that the IRS/MSSP lists displayed 169 new light-duty truck item categories for 1994 models compared to our 84. Ironically, the number of light-duty trucks analyzed as new items for the 1993 model year was remarkably similar, with the IRS/MSSP listing 76 new item categories to our 74. The 1994 model year automobile new items present a similar, but not as pronounced, pattern. Here, the IRS lists 231 different 1994 automobiles as new items compared our 178. For the 1993 model year the IRS had 155 automobile new item categories compared to our 119. Is it possible that this disparity in the number of new item categories is due to the fact that the IRS' 1994 list is still in *draft* form? Or, is it time to worry? Are all LIFO calculations to be regarded as "tentative" until the IRS releases a **final** list and requires conformity adjustments? No one knows!

We have provided the IRS/MSSP with information that proves that many of the vehicles that it initially considered as new items are, in fact, continuing items. The IRS has stated that it might delete some of the items on its lists that were originally analyzed as new. At this point it doesn't seem to make sense to jump right in to rework the index calculations or file amended returns based on the IRS' lists as was suggested in a recent issue of the *Car Dealer Insider*. If you used software or a LIFO vendor service in your LIFO calculations for 1993 and 1994, you should call for information on how to determine which item categories were treated as new items "by the software."

S-C: IT ONLY GETS WORSE

(Continued from page 3)

Furthermore, as more and more years go by after changes either to S from C or vice-versa, tension will arise between the applicable statute of limitations (3 years for individual income tax returns) vs. the absence of a statute of limitations preventing Section 481(a) adjustments to assure consistent year-end valuations of inventory and corresponding changes in method of accounting.

Advisors contemplating switches either from C to S or from S back to C should be aware of these unanswered questions. Without further guidance, are these loopholes to be taken advantage of until they are closed? Are they "transactions" awaiting eventual recharacterization on audit by the IRS? Or, are they something else? How should clients be advised now in relation to these uncertain consequences? Until we have answers to these LIFO related questions, switching from C to S status or vice versa unavoidably and automatically raises the possibility of nightmarish tax consequences to be dealt with in the future.

COMPARISON OF NEW ITEM LISTS

SUMMARY

	LIFO LOOKOUT NEW ITEM CATEGORY	DIFFERENCE DUE TO: A	B	C	D	E	IRS NEW ITEM CATEGORY
1993 MODELS IN DECEMBER 31, 1992 INVENTORY							
AUTOMOBILES	119	13	4	13	4	39	155
LIGHT-DUTY TRUCKS	74	27	2	2	4	7	76
TOTAL NEW VEHICLES DEC. 31,1992 (1993 MODELS)	193	40	6	15	8	46	231
1994 MODELS IN DECEMBER 31,1993 INVENTORY							
AUTOMOBILES	178	22	14	7	12	54	231
LIGHT-DUTY TRUCKS	84	62	3	24	3	30	169
TOTAL NEW VEHICLES DEC. 31,1993 (1994 MODELS)	262	84	17	31	15	84	400
TOTALS - BOTH YEARS COMBINED	455	124	23	46	23	130	631

INFORMATION KEY

		A	B	C	D	E	
MAKE - MODEL, DESCRIPTION # number of new items	#	✓					#
MAKE - MODEL, DESCRIPTION	#		✓				#
MAKE - MODEL, DESCRIPTION	#			✓			#
MAKE - MODEL, DESCRIPTION	N/A				✓		N/A
MAKE - MODEL, DESCRIPTION	N/A					✓	N/A
MAKE TOTALS	#						#

EXPLANATIONS

(A) Analysis based on different information. IRS used only a secondary reference, KELLEY BLUE BOOK.
LIFO LOOKOUT used factory price lists, actual invoices (as required by Rev.Proc. 92-79) and BLACK BOOK.

(B) Difference in cut-off and release dates. IRS lists compiled continuously throughout model year.
LIFO LOOKOUT lists cut off as of December 31 for new items.

(C) Different interpretation of the definition of a new item per Section 4.02(5) of Rev.Proc. 92-79.
IRS treated re-skinning, ANY change in model code, and ANY change in the vehicle (no matter how minor) as a new item.

(D) Similar Analysis; difference due to information available or breakdown of model (i.e., 5 speed or automatic).

(E) Same analysis; no difference.

(N/A) Make not included in analysis for current year. (1993 Makes: ACURA, INFINITI, JAGUAR, LAND ROVER, LEXUS, PORSCHE, SATURN, VOLVO. 1994 Makes: KIA.)

AUTOMOBILES	1993 LIFO LOOKOUT NEW ITEM CATEGORY	1993 DIFFERENCE DUE TO: A	B	C	D	E	1993 IRS NEW ITEM CATEGORY	1994 LIFO LOOKOUT NEW ITEM CATEGORY	1994 DIFFERENCE DUE TO: A	B	C	D	E	1994 IRS NEW ITEM CATEGORY
ACURA	N/A	0	0	0	0	0	6	12	0	0	0	0	2	12
AUDI	5	1	0	1	1	0	9	2	0	0	0	0	2	2
BMW	2	0	0	1	0	1	3	4	0	3	0	0	4	7
BUICK	4	0	0	0	0	3	4	8	2	1	0	4	2	20
CADILLAC	2	1	0	0	0	1	1	3	1	0	0	0	3	4
CHEVROLET	2	2	0	0	0	1	8	11	1	0	1	4	2	21
CHRYSLER	2	0	0	0	0	2	2	3	1	0	0	0	2	2
DODGE	6	0	0	0	0	2	6	0	0	1	1	0	0	5
EAGLE	7	0	0	0	0	3	7	2	0	0	1	0	1	3
FORD	2	0	0	0	0	1	2	8	1	1	0	0	3	11
GEO	4	1	0	0	0	1	2	NO NEW MODELS FOR 1994						
HONDA	13	0	1	1	0	4	18	30	0	0	0	1	4	33
HYUNDAI	1	0	0	0	0	1	1	0	0	0	1	0	0	1
INFINITI	N/A	0	0	0	0	0	1	NO NEW MODELS FOR 1994						
JAGUAR	N/A	0	0	0	0	0	1	4	0	0	0	0	2	4
KIA	NO NEW MODELS FOR 1993							N/A	0	0	0	0	0	6
LEXUS	N/A	0	0	0	0	0	3	3	0	0	1	0	2	4
LINCOLN	1	0	0	0	0	1	1	NO NEW MODELS FOR 1994						
MAZDA	6	0	0	0	1	2	4	2	0	2	0	0	2	10
MERCEDES-BENZ	5	0	0	1	0	3	6	2	0	0	0	0	1	2
MERCURY	NO NEW MODELS FOR 1993							0	0	1	0	0	0	1
MITSUBISHI	11	0	0	2	1	1	19	6	0	0	0	0	1	6
NISSAN	14	1	0	2	0	4	17	NO NEW MODELS FOR 1994						
OLDSMOBILE	3	1	2	1	0	2	8	15	0	1	0	1	5	17
PLYMOUTH	4	0	0	0	0	1	4	1	0	1	0	0	1	4
PONTIAC	6	0	0	0	0	1	6	5	2	0	1	1	3	9
PORSCHE	N/A	0	0	0	0	0	6	NO NEW MODELS FOR 1994						
SAAB	3	0	0	0	0	1	3	16	2	0	0	1	0	6
SATURN	N/A	0	0	0	0	0	6	NO NEW MODELS FOR 1994						
SUBARU	3	4	1	4	0	2	14	19	10	1	0	0	7	19
TOYOTA	9	1	0	0	0	1	7	13	0	0	1	0	2	20
VOLKSWAGEN	4	1	0	0	1	0	3	2	1	1	0	0	0	1
VOLVO	N/A	0	0	0	0	0	8	7	1	1	0	0	3	7
1993 & 1994 TOTALS	119						186	178						237
LESS: MAKES N/A	(0)						(31)	(0)						(6)
ADJUSTED TOTALS	119	13	4	13	4	39	155	178	22	14	7	12	54	231

LIGHT-DUTY TRUCKS	1993 LIFO LOOKOUT NEW ITEM CATEGORY	1993 DIFFERENCE DUE TO: A	B	C	D	E	1993 IRS NEW ITEM CATEGORY	1994 LIFO LOOKOUT NEW ITEM CATEGORY	1994 DIFFERENCE DUE TO: A	B	C	D	E	1994 IRS NEW ITEM CATEGORY
CHEVROLET	9	7	0	0	0	2	2	9	3	0	14	0	8	24
DODGE	NO NEW MODELS FOR 1993							24	0	0	0	1	7	23
FORD	21	2	2	2	1	0	25	7	36	1	0	0	5	43
GMC TRUCK	5	7	0	0	0	0	2	7	15	0	9	0	5	27
HONDA	NO NEW MODELS FOR 1993							0	0	1	0	0	0	7
ISUZU	3	2	0	0	0	2	3	0	0	1	0	0	0	2
JEEP	8	2	0	0	1	1	16	0	2	0	0	0	0	3
LAND ROVER	N/A	0	0	0	0	0	2	NO NEW MODELS FOR 1994						
MAZDA	0	1	0	0	0	0	4	17	0	0	0	1	0	18
MERCURY	3	0	0	0	0	1	3	0	0	0	1	0	0	1
MITSUBISHI	NO NEW MODELS FOR 1993							0	1	0	0	0	0	1
NISSAN	10	3	0	0	0	1	4	12	1	0	0	1	2	10
OLDSMOBILE	NO NEW MODELS FOR 1993							3	0	0	0	0	2	3
PONTIAC	NO NEW MODELS FOR 1993							0	1	0	0	0	0	1
PLYMOUTH	0	1	0	0	0	0	2	NO NEW MODELS FOR 1994						
SUZUKI	1	2	0	0	0	0	2	5	1	0	0	0	1	4
TOYOTA	8	0	0	0	1	0	10	0	2	0	0	0	0	2
VOLKSWAGEN	6	0	0	0	1	0	3	NO NEW MODELS FOR 1994						
93 & 94 TRUCK TOTAL	74						78	84						169
LESS: MAKES N/A	(0)						(2)	(0)						(0)
ADJUSTED TOTALS	74	27	2	2	4	7	76	84	62	3	24	3	30	169

ALL VEHICLES	1993 LIFO LOOKOUT	1993 A	B	C	D	E	1993 IRS	1994 LIFO LOOKOUT	1994 A	B	C	D	E	1994 IRS
93 & 94 AUTO TOTAL	119	13	4	13	4	39	155	178	22	14	7	12	54	231
93 & 94 TRUCK TOTAL	74	27	2	2	4	7	76	84	62	3	24	3	30	169
TOTAL AUTOS AND TRUCKS	193	40	6	15	8	46	231	262	84	17	31	15	84	400

the LIFO election. Why?...The LIFO election made by the C corporation was never terminated by the S election, was it?

It seems evident, or so we thought, that when a regular C corporation changes its status to S, there is no termination of the LIFO election - even though a recapture tax is paid and there is a basis adjustment to the LIFO inventories for tax purposes.

Two radically different consequences; not to mention the $64 question: Is the business still on LIFO in its first S year? Are IRS auditors under the impression that the LIFO election terminates when an S election is made by a C corp? Is a NADA Workshop technical error related to, or evidence of, an IRS "position" in one part of the country or another? Considering the thousands of businesses that converted *from C to S* when the 1986 Tax Act dropped personal tax rates below corporate rates, there may be some LIFO time bombs out there waiting to go off.

Switching from S to C: Even worse LIFO problems? There may be even more troublesome LIFO recapture problems when a business using LIFO now converts back *from S to C*. The article on page 2 examines the confusion over LIFO inventories in C to S and in S to C changes.

#3. REPLACEMENT COST ACCOUNTING AND PARTS-TYPE INVENTORIES. Another major problem is brewing for virtually all taxpayers who have inventories of a parts-type nature. As discussed on page 4, this includes thousands of wholesalers and distributors, as well as retailers, such as auto and implement dealers, who maintain inventories of parts and accessories for their major products.

Standard industry practice, as well as GAAP, for such inventories generally recognizes that these diverse inventories may be valued at year-end by using the most recent price taken from the manufacturer's catalog, or the most recent price paid for that item, even though theoretically it might be possible to go back and do a detailed, perpetual-like, cost accounting for each individual item, were it not for the impracticality or prohibitively high cost of doing so.

It appears the IRS does not agree and we have been asked by one reader, currently under audit, to seek your input and opinions on the use and acceptability of replacement cost accounting for parts-type inventories.

#4. IRS SURVEY: ARE YOU READY? It is our understanding that certain IRS districts will be **intensively** reviewing dealer changes and computations to determine compliance with Rev. Proc. 92-79. Some auto dealers will receive letters from the IRS requesting them to submit **complete** information relative to the Form 3115 filing they made in changing to the Alternative LIFO Method.

The IRS is requesting copies of the tax return for the year of change, the Form 3115 and all attachments, rebasing computations by pool, prior years' LIFO summaries and layer analyses (won't the Service be surprised when it sees what some of these prior year computations look like!), the dealer's invoices for **all** vehicles in **both** beginning **and** ending inventories, applicable price lists...and a whole lot more. Included in the list of documents to be provided is a request for: "Section 263A workpapers."

Apparently, after the Service completes its "review," the dealer will be notified as to whether its computations under the Alternative LIFO Method are (1) in compliance, (2) *substantially* in compliance, (3) in compliance but do reflect material errors **or** (4) not in compliance, but the dealer may be eligible for some relief under other applicable Revenue Procedures.

So...what do you think? Are you glad for more summer work? Will you advise the dealer to gather all of this information and provide it? Will these IRS "reviews" be conducted to any extent at the dealership...or will they all be done by correspondence? What about the sheer effort, time and cost of copying all of these documents and invoices? And then shipping all of this information off to the IRS somewhere? What if any of it gets lost? And all of this will **not** constitute an IRS audit under Section 7605(b)!...so, any other LIFO election perils or conformity problems will remain exposed.

Right now, these requests are destined for dealers in the Los Angeles, Denver and Albuquerque districts. Then where...or what?

#5. IRS/MSSP LISTING OF "NEW" ITEMS. In connection with the determination of annual inflation indexes for automobile dealers using the Alternative LIFO Method, a list of new items for year-end 1992 (i.e., substantially all 1993 models) was recently "released" by the IRS/MSSP. A second "preliminary" list of new items for year-end 1993 (i.e., substantially all 1994 models) was also released. These lists analyze 1993 and 1994 models as either continuing models or new items for LIFO computation purposes.

Our article on this subject summarizes the results of completely matching our 1992 and 1993 year-end model lists with those "informally" released by the IRS/MSSP. This analysis followed extensive discussion with the IRS/MSSP to identify the reasons for the differences in our respective new item lists. These differences help sharpen the concepts/terms

see **LIFO UPDATE...**, page 20

IRS/MSSP TEMPLATES - HOW THEY COMPUTE INFLATION: EARLIEST ACQUISITIONS BEWARE... WE THINK THE IRS IS WRONG!

Under a Freedom of Information Act filing, we recently acquired all of the IRS/MSSP's spreadsheet templates for computing LIFO inflation indexes. These spreadsheet templates - twenty-two diskettes in all - compute LIFO indexes for approximately fifty makes for the model years 1978 through 1991. Template computations are provided under either the "Earliest Acquisitions" or the "Latest Acquisitions" method. These methods are two of the possible responses to Question 6 on the LIFO election Form 970 which relate to the mechanics for valuing LIFO inventory annual increments.

Prior to Revenue Procedure 92-79, for many auto dealers these MSSP templates were the vehicles of destruction for incorrectly computed, sloppy or poorly documented LIFO calculations. Until the Alternative LIFO Method compromise became available in September of 1992, many dealers and their CPAs who could not otherwise defend their LIFO calculations were forced to accept the arbitrary results of these MSSP template "calculations."

Taxpayers who have not elected to use the Alternative LIFO Method may have their inflation indexes adjusted in accordance with these IRS/MSSP template approaches. These reflect the hard-line computation approach of Letter Ruling/TAM 8906001 for repricing **options**, as well as **vehicles**.

As a caution to anyone filing under the FOIA for these templates, in addition to the lengthy wait and expense, be aware that there are many obstacles in using the templates once you receive them. We believe we were able to overcome most, if not all, of these obstacles in analyzing and summarizing the templates. Although no segregated instructions or examples are provided with the diskettes, as part of our FOIA request, we also received a copy of the entire IRS/MSSP Manual: *Auto Dealerships - Audit Techniques and Guidelines*.

This Manual provided limited instructions as to the operation of the LIFO index spreadsheets. Copies of five exhibits/examples in the Manual were blanked out and "Refer to *Kelley Blue Book*" was typed onto five barren pages. Certain files contained on the diskettes were apparently copied incorrectly (i.e., certain model years for some makes were missing - other model years were duplicated and certain files were listed on the diskette, but contained no readable information).

Extensive clerical instructions including input procedure, matching of comparable vehicles, reconciliation of total inventory and other obvious computer functions are omitted from this summary because they are not necessary to understand the methodology the IRS uses in computing its inflation indexes for auto dealers.

The instructions in the MSSP Manual relating to computing the LIFO inflation index using the IRS' "First Purchases Method (Earliest Acquisitions Method)" follow. The model year is the reference point or key in determining the years to be compared in computing the inflation index. "This index considers an individual vehicle or option from the Model Year and compares the price of the same vehicle or option from the **prior two model years**. The increase in price, or inflation rate, is the basis of the First Purchases Method Index." For example, in computing the LIFO inflation index for a *1987 calendar year* end (which would involve the *1988 model year* vehicles), under the IRS' "First Purchases Method," the 1987 model year prices (which for the calendar year 1986 would have been the end-of-the-year prices) would be compared with the 1986 model year prices (which for the calendar year 1986 would have been the beginning-of-the-year prices).

This "earliest acquisitions" approach moves the frame of reference for the overall, year-end inflation computation **back one full year!!!** In addition, this approach presents further problems for model year introductions that don't follow the norm: for example, (1) "mid-year model introductions" such as 1993.5 model years or (2) "late" model year introductions such as 1994 models introduced "later" in January or February of 1994 rather than more traditionally introduced during the last few months of calendar year 1993.

What about fiscal year taxpayers? Here the IRS provides that in the case of a fiscal year end which might have more than one model year in ending inventory, a separate index for each Model Year in ending inventory would be prepared on two separate spreadsheets using the above guidelines for computing the index.

All pricing data utilized on the IRS' spreadsheets are from the *Kelley Blue Book, New Car Price Guide*. The manual states that this reference was selected by the IRS because, "the prices listed therein for

see **HOW IRS/MSSP TEMPLATES COMPUTE INFLATION...**, page 16

(Continued from page 15)

'Dealer Cost' match, in most cases, the vehicle cost shown on dealer invoices. The invoices that do not match are de minimus (sic) in amount and are attributable to the pricing differences found in the various editions..." This does not recognize that price changes occur throughout the year and pricing differences may be attributable to vehicles purchased from the manufacturer at different times during the year.

Although the use of the *Kelley Blue Book* might work well for dealerships under audit in California (where the initial thrust of the IRS Audit Initiative against auto dealers' LIFO calculations started and gained momentum), how applicable or accurate are prices in the *Kelley Blue Book* to actual invoices for dealerships elsewhere in the country? In numerous instances, we have found that information in the *Kelley Blue Book* was not very accurate and that it would not have been the best reference or source to use.

The MSSP Manual states that: "If a model does not appear in the *New Car Price Guide* for any of the years sought to be measured(,) that model was not made in the measuring year. To allow the dealer credit for the full measuring period, for all items in ending inventory, these vehicles are assigned an index of 1.0000." It seems this sentence should more accurately read: "...to allow the dealer **NO** credit for the full measuring period, for all items in ending inventory, these vehicles are assigned an index of 1.0000."

Under the template procedure, an agent categorizes each invoice (in ending inventory) by item category and counts the number of invoices for each item category. "If a particular vehicle indicates more than one price when an examination of the dealer's invoices is made, use the last price of the year. This procedure will consistently account for the manufacturer's price changes from year to year." But will this procedure account for a dealer's true ending inventory mix? Also note that while an end-of-the-year price can't be adjusted, neither can a beginning-of-the-year price. The inputting of the quantity in ending inventory for each distinct vehicle (the only required input in this "program") triggers the spreadsheet to compute the IRS' "First Purchases Method LIFO Index." Every price is fixed in IRS "spreadsheetland" and once the quantity has been entered, all calculations are inflexible and automatic.

The IRS/MSSP templates computing inflation under the "Most Recent Purchases Method" follow a similar pattern (i.e., model year is still the key) except that inflation is measured over the current year (instead of over the preceding year). For example, in computing the LIFO inflation index for a *1987 calendar year* end (*1988 model year*) under the IRS' "Most Recent Purchases Method (Latest Acquisitions)", the 1988 model year prices (which for the calendar year 1987 correspond to the end-of-the-year prices) would be compared with the 1987 model year prices (which for the calendar year 1987 correspond to the beginning-of-the-year prices).

CONCLUSION

The IRS/MSSP templates for the "First Purchases/Earliest Acquisitions Method" incorrectly compute LIFO inflation indexes! This template approach is completely opposite and inconsistent with concepts and rationale expressed in many IRS National Office Letter Rulings/TAMs which have held that a taxpayer should not use an index that does not reflect prices at the **end** of the year in order to determine the current year's DEFLATOR index. It appears that the IRS/MSSP template approach has misconstrued the earliest acquisitions concept for valuing increments and erroneously applied it as the means for determining current year inflation for a full year for deflator-index computation purposes.

Even the IRS' main Letter Ruling/TAM 8906001 on auto dealer LIFO states that the choice of any particular alternative *(for valuing an increment)* will have *no impact* on the determination of whether an increment exists or on the determination of how large an increment or decrement is created when measured at base-year or current-year cost. **A taxpayer's choice of increment valuation method affects only the determination of the LIFO carrying value of the increment.** Notwithstanding this and many other TAMs, the IRS/MSSP templates are using a method for valuing increments to *incorrectly* determine the overall rate of inflation for the entire year.

It's alarming to consider how the IRS' application of this **double standard** may have negatively impacted many dealerships under audit before the Alternative LIFO Method became available, as well as currently, especially for those who simply caved in to the IRS for financial or for other reasons. Using its "Earliest Acquisitions" templates, IRS agents audited and justified the settlement of hundreds of auto dealer LIFO cases using an incorrect theoretical assumption tantamount to a non-sequitur. How sad if the IRS' success in settling these audits was largely because the taxpayer's CPAs/advisors didn't know any better.

Something - a sense of fairness (or an understanding of basic LIFO concepts)? - seems to be missing from the overall picture.

HOW THE IRS COMPUTES INFLATION IF A DEALER DOESN'T HAVE ALL YEAR-END INVOICES

In general, examining agents are told that a LIFO election may be terminated if the taxpayer fails to maintain adequate books and records. Revenue Procedure 79-23 contains this language. For many automobile dealers, a termination threat may arise under this "books and records" provision if the dealer is unable to produce copies of all ending inventory vehicle invoices. This is one reason why the Alternative LIFO Method was so attractive to some dealers who knew they would not be able to produce year-end invoices if ever asked to do so by the IRS.

The IRS' Market Segment Specialization Program (MSSP) Manual, *Auto Dealerships - Audit Techniques Guideline*, contains many warnings to agents about the need to be able to **explicitly** identify the vehicles and options compared in a given index. In other words, like item categories must be compared. The Manual states that "the agent must be comparing the same items from year to year and **demonstrate** (that) he/she is comparing the same items. Failure to be explicit in the identification and comparability of the items may invalidate the index."

What happens if the dealer did not save the invoices for all vehicles in ending inventory? The IRS' Manual states that if, for any reason, year-end invoices cannot be produced, then the agent must evaluate whether or not an acceptable inflation index can be computed from the information that is available. Acceptable alternative dealer information must include the number of units of each *specific* item category in ending inventory and the *specific* aggregate dollar amount/dealer cost of each item category in ending inventory. Examining agents are cautioned to "make sure the taxpayer's records contain all the necessary comparability information before starting these procedures."

Without all year-end invoices and/or sufficient alternative information, the IRS Manual advises agents to *consider* computing the current annual inflation index by using the *Kelley Blue Book, New Car Price Guide* and by disregarding the actual year-end inventory mix and using instead the *assumption* that a dealer had one of each manufactured vehicle in ending inventory. The "one-of-each" approach could favor either the IRS or the taxpayer. However, in situations where the LIFO election Form 970 selected the *first purchases or earliest acquisitions method*, there's a real disadvantage built into the IRS' "one-of-each" approach. (See article on page 15.)

The IRS' "First Purchases Method" in effect compares models for **three** consecutive model years in determining new items. For example, under the "one-of-each" assumption, at the end of calendar year 1993, a Lincoln/Mercury dealer would be deemed to have one of each 1994 model year Villager item category in ending inventory. Because the Mercury Villager was a new 1993 model year item, it would not have a comparable or corresponding model year 1992 item. In other words, the two model years being compared to compute inflation under the IRS' "First Purchases Method" would be 1993 models relative to 1992 models. Therefore, in computing the "one-of-each" inflation index, the Villager new item categories would be repriced at current cost..and as a result, they would show no inflation for the current year. An even worse scenario would occur if the dealership

see **HOW THE IRS COMPUTES INFLATION**, page 20

IRS/MSSP TEMPLATE FOR EARLIEST ACQUISITIONS COMPUTATIONS

COMPUTATION OF INFLATION INDEX
MAKE:HONDA
TYPE: AUTOS
YEAR OF VEHICLES: 1991

EARLIEST
ACQUISITION
METHOD

TAXPAYER:
TAX PERIOD ENDING DATE:

No	1989 MODEL NUMBER	1990 MODEL NUMBER	1991 MODEL NUMBER	DESCRIPTION	1991 MODEL ENDING INVENTORY UNITS	1989 MODEL UNIT COST	1989 MODEL EXTENDED COST	1990 MODEL UNIT COST	1990 MODEL EXTENDED COST	INDEX INCREASE OR DECREASE 89/90	
1	ED634K	ED634L	ED634M	Civic Hatchback 3D (4-Spd.)	1	5,746.00	5,746.00	5,971.00	5,971.00	1.0392	
2	EE275K	EE275L	EE275M	Civic Wagon 4D (5-Spd.)	1	8,606.00	8,606.00	8,776.00	8,776.00	1.0196	
3	EE285K	EE285L	EE285M	Civic Wagon 4D (Auto)	1	9,469.00	9,469.00	9,664.00	9,664.00	1.0206	
4	EE476K	EE476L	EE476M	Civic 4WD Wagon 4D (6-Spd.)	1	10,378.00	10,378.00	10,548.00	10,548.00	1.0164	
5	EE486K	EE486L	EE486M	Civic 4WD Wagon 4D (Auto)	1	10,888.00	10,888.00	11,169.00	11,169.00	1.0258	
6	ED635K	ED635L	ED635M	Civic DX Hatchback 3D (5-Spd.)	1	7,178.00	7,178.00	7,390.00	7,390.00	1.0295	
7	ED645K	ED645L	ED645M	Civic DX Hatchback 3D (Auto)	1	7,900.00	7,900.00	8,138.00	8,138.00	1.0301	
8	ED354K	ED354L	ED354M	Civic DX Sedan 4D (5-Spd.)	1	7,811.00	7,811.00	8,024.00	8,024.00	1.0273	
9	ED364K	ED364L	ED364M	Civic DX Sedan 4D (Auto)	1	8,576.00	8,576.00	8,814.00	8,814.00	1.0278	
10	ED736K	ED736L	ED736M	Civic Si Hatchback 3D (5-Spd.)	1	8,483.00	8,483.00	8,706.00	8,706.00	1.0265	
11	ED355K	ED355L	ED355M	Civic LX Sedan 4D (5-Spd.)	1	8,627.00	8,627.00	8,882.00	8,882.00	1.0296	
12	ED365K	ED365L	ED365M	Civic LX Sedan 4D (Auto)	1	9,112.00	9,112.00	9,477.00	9,477.00	1.0401	
13	NONE	ED456L	ED456M	Civic EX Sedan 4D (5-Spd.)	1	9,473.00	9,473.00	9,473.00	9,473.00	1.0000	*
14	NONE	ED466L	ED466M	Civic EX Sedan 4D (Auto)	1	10,068.00	10,068.00	10,068.00	10,068.00	1.0000	*
15	ED836K	ED836L	ED836M	Civic CRX HF Hatchback 2D (5-Spd.)	1	7,560.00	7,560.00	7,773.00	7,773.00	1.0282	
16	ED835K	ED835L	ED835M	Civic CRX Hatchback 2D (5-Spd.)	1	7,913.00	7,913.00	7,998.00	7,998.00	1.0107	
17	ED845K	ED845L	ED845M	Civic CRX Hatchback 2D (Auto)	1	8,398.00	8,398.00	8,506.00	8,506.00	1.0131	
18	ED936K	ED936L	ED936M	Civic CRX Si Hatchback 2D (5-Spd.)	1	9,290.00	9,290.00	9,460.00	9,460.00	1.0183	
19	CA552K	CB754L	CB754M	Accord DX Sedan 4D (5-Spd.)	1	9,886.00	9,886.00	10,369.00	10,369.00	1.0489	
20	CA562K	CB764L	CB764M	Accord DX Sedan 4D (Auto)	1	10,399.00	10,399.00	10,999.00	10,999.00	1.0577	
21	CA616K	CB714L	CB714M	Accord DX Coupe 2D (5-Spd.)	1	9,786.00	9,786.00	10,201.00	10,201.00	1.0424	
22	CA626K	CB724L	CB724M	Accord DX Coupe 2D (Auto)	1	10,298.00	10,298.00	10,831.00	10,831.00	1.0518	
23	CA553K	CB755L	CB755M	Accord LX Sedan 4D (5-Spd.)	1	11,911.00	11,911.00	12,511.00	12,511.00	1.0504	
24	CA563K	CB765L	CB765M	Accord LX Sedan 4D (Auto)	1	12,423.00	12,423.00	13,141.00	13,141.00	1.0578	
25	CA618K	CB715L	CB715M	Accord LX Coupe 2D (5-Spd.)	1	12,339.00	12,339.00	12,343.00	12,343.00	1.0003	
26	CA628K	CB725L	CB725M	Accord LX Coupe 2D (Auto)	1	12,852.00	12,852.00	12,973.00	12,973.00	1.0094	
27	NONE	NONE	CB975M	Accord LX Wagon 5D (5-Spd.)	1	14,616.00	14,616.00	14,616.00	14,616.00	1.0000	*
28	NONE	NONE	CB985M	Accord LX Wagon 5D (Auto)	1	15,246.00	15,246.00	15,246.00	15,246.00	1.0000	*
29	NONE	CB756L	CB756M	Accord EX Sedan 4D (5-Spd.)	1	13,939.00	13,939.00	13,939.00	13,939.00	1.0000	*
30	NONE	CB766L	CB766M	Accord EX Sedan 4D (Auto)	1	14,569.00	14,569.00	14,569.00	14,569.00	1.0000	*
31	NONE	CB716L	CB716M	Accord EX Coupe 2D (5-Spd.)	1	13,771.00	13,771.00	13,771.00	13,771.00	1.0000	*
32	NONE	CB726L	CB726M	Accord EX Coupe 2D (Auto)	1	14,401.00	14,401.00	14,401.00	14,401.00	1.0000	*
33	NONE	NONE	CB976M	Accord EX Wagon 5D (5-Spd.)	1	16,086.00	16,086.00	16,086.00	16,086.00	1.0000	*
34	NONE	NONE	CB986M	Accord EX Wagon 5D (Auto)	1	16,716.00	16,716.00	16,716.00	16,716.00	1.0000	*
35	NONE	NONE	CB768M	Accord SE Sedan (Auto)	1	16,711.00	16,711.00	16,711.00	16,711.00	1.0000	*
36	NONE	BA412L	BA412M	Prelude 2.0 Si Coupe 2D (5-Spd.)	1	12,553.00	12,553.00	12,553.00	12,553.00	1.0000	*
37	NONE	BA422L	BA422M	Prelude 2.0 Si Coupe 2D (Auto)	1	13,183.00	13,183.00	13,183.00	13,183.00	1.0000	*
38	BA413K	BA413L	BA413M	Prelude Si Coupe 2D (5-Spd.)	1	14,250.00	14,250.00	14,250.00	14,250.00	1.0000	
39	BA423K	BA423L	BA423M	Prelude Si Coupe 2D (Auto)	1	14,859.00	14,859.00	14,880.00	14,880.00	1.0014	
40	BA414K	BA414L	BA414M	Prelude Si 4WS Coupe 2D (5-Spd.)	1	15,498.00	15,498.00	15,498.00	15,498.00	1.0000	
41	BA424K	BA424L	BA424M	Prelude Si 4WS Coupe 2D (Auto)	1	16,107.00	16,107.00	16,128.00	16,128.00	1.0013	
42	NONE	BA415L	BA415M	Prelude Si ALB Coupe 2D (5-Spd.)	1	15,582.00	15,582.00	15,582.00	15,582.00	1.0000	*
43	NONE	BA425L	BA425M	Prelude Si ALB Coupe 2D (Auto)	1	16,212.00	16,212.00	16,212.00	16,212.00	1.0000	*
				TOTAL	43		499,669.00		506,550.00	1.0138	

** 1989 AND/OR 1990 MODEL UNIT COST NOT AVAILABLE. VEHICLE NOT PRODUCED IN 1989 AND/OR 1990, CREATED AN INDEX OF 1.0000.

IRS/MSSP TEMPLATE FOR LATEST ACQUISTIONS (MRP) COMPUTATIONS

COMPUTATION OF INFLATION INDEX
MAKE: HONDA
TYPE: AUTOS
YEAR OF VEHICL 1991

LATEST ACQUISITION METHOD

TAXPAYER:
TAX PERIOD ENDING DATE:

No.	1990 MODEL NUMBER	1991 MODEL NUMBER	DESCRIPTION	1991 MODEL ENDING INVENTO UNITS	1990 MODEL UNIT COST	1990 MODEL EXTENDED COST	1991 MODEL UNIT COST	1991 MODEL EXTENDED COST	INDEX INCREASE OR DECREASE 90/91	
1	ED634L	ED634M	Civic Hatchback 3D (4-Spd.)	1	5,971.00	5,971.00	6,385.00	6,385.00	1.0693	
2	EE275L	EE275M	Civic Wagon 4D (5-Spd.)	1	8,776.00	8,776.00	8,993.00	8,993.00	1.0247	
3	EE285L	EE285M	Civic Wagon 4D (Auto)	1	9,664.00	9,664.00	9,881.00	9,881.00	1.0225	
4	EE476L	EE476M	Civic 4WD Wagon 4D (6-Spd.)	1	10,548.00	10,548.00	10,765.00	10,765.00	1.0206	
5	EE486L	EE486M	Civic 4WD Wagon 4D (Auto)	1	11,169.00	11,169.00	11,385.00	11,385.00	1.0193	
6	ED635L	ED635M	Civic DX Hatchback 3D (5-Spd.)	1	7,390.00	7,390.00	7,582.00	7,582.00	1.0260	
7	ED645L	ED645M	Civic DX Hatchback 3D (Auto)	1	8,138.00	8,138.00	8,330.00	8,330.00	1.0236	
8	ED354L	ED354M	Civic DX Sedan 4D (5-Spd.)	1	8,024.00	8,024.00	8,283.00	8,283.00	1.0323	
9	ED364L	ED364M	Civic DX Sedan 4D (Auto)	1	8,814.00	8,814.00	9,073.00	9,073.00	1.0294	
10	ED736L	ED736M	Civic Si Hatchback 3D (5-Spd.)	1	8,708.00	8,708.00	8,899.00	8,899.00	1.0219	
11	ED355L	ED355M	Civic LX Sedan 4D (5-Spd.)	1	8,882.00	8,882.00	9,141.00	9,141.00	1.0292	
12	ED365L	ED365M	Civic LX Sedan 4D (Auto)	1	9,477.00	9,477.00	9,736.00	9,736.00	1.0273	
13	ED456L	ED456M	Civic EX Sedan 4D (5-Spd.)	1	9,473.00	9,473.00	9,732.00	9,732.00	1.0273	
14	ED466L	ED466M	Civic EX Sedan 4D (Auto)	1	10,068.00	10,068.00	10,327.00	10,327.00	1.0257	
15	ED836L	ED836M	Civic CRX HF Hatchback 2D (5-Spd.)	1	7,773.00	7,773.00	7,990.00	7,990.00	1.0279	
16	ED835L	ED835M	Civic CRX Hatchback 2D (5-Spd.)	1	7,998.00	7,998.00	8,215.00	8,215.00	1.0271	
17	ED845L	ED845M	Civic CRX Hatchback 2D (Auto)	1	8,508.00	8,508.00	8,725.00	8,725.00	1.0255	
18	ED936L	ED936M	Civic CRX Si Hatchback 2D (5-Spd.)	1	9,460.00	9,460.00	9,694.00	9,694.00	1.0247	
19	CB754L	CB754M	Accord DX Sedan 4D (5-Spd.)	1	10,369.00	10,369.00	10,773.00	10,773.00	1.0390	
20	CB764L	CB764M	Accord DX Sedan 4D (Auto)	1	10,999.00	10,999.00	11,403.00	11,403.00	1.0367	
21	CB714L	CB714M	Accord DX Coupe 2D (5-Spd.)	1	10,201.00	10,201.00	10,605.00	10,605.00	1.0396	
22	CB724L	CB724M	Accord DX Coupe 2D (Auto)	1	10,831.00	10,831.00	11,235.00	11,235.00	1.0373	
23	CB755L	CB755M	Accord LX Sedan 4D (5-Spd.)	1	12,511.00	12,511.00	12,915.00	12,915.00	1.0323	
24	CB765L	CB765M	Accord LX Sedan 4D (Auto)	1	13,141.00	13,141.00	13,545.00	13,545.00	1.0307	
25	CB715L	CB715M	Accord LX Coupe 2D (5-Spd.)	1	12,343.00	12,343.00	12,747.00	12,747.00	1.0327	
26	CB725L	CB725M	Accord LX Coupe 2D (Auto)	1	12,973.00	12,973.00	13,377.00	13,377.00	1.0311	
27	NONE	CB975M	Accord LX Wagon 5D (5-Spd.)	1	14,616.00	14,616.00	14,616.00	14,616.00	1.0000	*
28	NONE	CB985M	Accord LX Wagon 5D (Auto)	1	15,246.00	15,246.00	15,246.00	15,246.00	1.0000	*
29	CB756L	CB756M	Accord EX Sedan 4D (5-Spd.)	1	13,939.00	13,939.00	14,359.00	14,359.00	1.0301	
30	CB766L	CB766M	Accord EX Sedan 4D (Auto)	1	14,569.00	14,569.00	14,989.00	14,989.00	1.0288	
31	CB716L	CB716M	Accord EX Coupe 2D (5-Spd.)	1	13,771.00	13,771.00	14,191.00	14,191.00	1.0305	
32	CB726L	CB726M	Accord EX Coupe 2D (Auto)	1	14,401.00	14,401.00	14,821.00	14,821.00	1.0292	
33	NONE	CB976M	Accord EX Wagon 5D (5-Spd.)	1	16,066.00	16,066.00	16,066.00	16,066.00	1.0000	*
34	NONE	CB986M	Accord EX Wagon 5D (Auto)	1	16,716.00	16,716.00	16,716.00	16,716.00	1.0000	*
35	NONE	CB768M	Accord SE Sedan (Auto)	1	16,711.00	16,711.00	16,711.00	16,711.00	1.0000	*
36	BA412L	BA412M	Prelude 2.0 Si Coupe 2D (5-Spd.)	1	12,553.00	12,553.00	12,763.00	12,763.00	1.0167	
37	BA422L	BA422M	Prelude 2.0 Si Coupe 2D (Auto)	1	13,183.00	13,183.00	13,393.00	13,393.00	1.0159	
38	BA413L	BA413M	Prelude Si Coupe 2D (5-Spd.)	1	14,250.00	14,250.00	14,653.00	14,653.00	1.0283	
39	BA423L	BA423M	Prelude Si Coupe 2D (Auto)	1	14,880.00	14,880.00	15,283.00	15,283.00	1.0271	
40	BA414L	BA414M	Prelude Si 4WS Coupe 2D (5-Spd.)	1	15,498.00	15,498.00	15,750.00	15,750.00	1.0163	
41	BA424L	BA424M	Prelude Si 4WS Coupe 2D (Auto)	1	16,128.00	16,128.00	16,380.00	16,380.00	1.0156	
42	BA415L	BA415M	Prelude Si ALB Coupe 2D (5-Spd.)	1	15,582.00	15,582.00	15,960.00	15,960.00	1.0243	
43	BA425L	BA425M	Prelude Si ALB Coupe 2D (Auto)	1	16,212.00	16,212.00	16,590.00	16,590.00	1.0233	
			Total	43		506,560.00		518,243.00	1.0231	

** 1990 MODEL UNIT COST NOT AVAILABLE. VEHICLE NOT PRODUCED IN 1990, CREATED AN INDEX OF 1.0000.

(Continued from page 14)

"item" and "new item" in Rev. Proc. 92-79. In addition, they highlight the need for timely/early publication of a more standardized and "official" new item listing.

#6. WHAT AUTO DEALERS REALLY NEED IS A TIMELY ISSUED, COMPREHENSIVE UNIFORM OFFICIAL LIST OF NEW ITEMS.

This should be obvious to everybody: CPAs, Dealers, NADA and the IRS...both MSSP/Audit and National Office branches. Enough said here!!... for more, see article on page 8.

#7. POSSIBLE REVISIONS OF THE ALTERNATIVE LIFO METHOD & REVENUE PROCEDURE 92-79. It is our understanding that the National Office is considering revising and updating Revenue Procedure 92-79 to provide additional clarification in some interpretive areas. We have submitted thoughts and specific suggestions to the IRS for consideration in this regard.

Overall, Revenue Procedure 92-79 has been a significant improvement over the previously unpredictable and inconsistent state of affairs. Hopefully, modification and further interpretation of Revenue Procedure 92-79 at this time will continue the commendably reasonable and realistic approach taken by the National Office in dealing with this extremely complicated LIFO application. We believe that there is good evidence that the IRS needs to better coordinate several facets of Revenue Procedure 92-79. These include the annual, timely release of listings of new items and realistic, equitable, remedial procedures for taxpayers attempting to use the Method.

#8. IRS LOOKING AT USED VEHICLE LIFO. Since the March issue, two readers in different cities have indicated that the IRS is actively looking at their LIFO computations for used vehicles. Apparently, the IRS is in an extensive information-collecting mode. At this time, there is nothing specific to report.

How the IRS Computes Inflation... Without Year-End Invoices

(Continued from page 17)

were a Lincoln/Mercury franchise only and it used a separate light-duty trucks pool for LIFO purposes. In this case, the inflation index for the light-duty trucks pool would be 1.000 for calendar years 1993 *and 1994* under the IRS' "First Purchases Method". Depending on a particular manufacturer's number of new item categories for the previous two years, the IRS' "one-of-each" approach could be extremely disadvantageous for some dealers.

What if a taxpayer/dealer refuses to accept the compromise "one-of-each" approach offered by the IRS? Then, according to the MSSP Manual: "If the taxpayer is unwilling to agree to the use of this method, the agent may want to consider revoking the dealership's LIFO election or disallowing the reserves, due to a lack of necessary recordkeeping that would enable the Service to compute or verify the computation of the LIFO reserves."

Note that after 1991 a dealer electing to use the Alternative LIFO Method should **always** be able to produce year-end invoices for years under the Alternative LIFO Method. Why? Because in order to receive permission to use the new method, the dealer must agree, *in advance*, to save all year-end new vehicle invoices.

De Filipps' LIFO LOOKOUT

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

First-class postage paid at Mt. Prospect, IL