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:

#1. LIFO FINANCIAL STATEMENT CONFORMITY REQUIREMENTS. At year-end 1994, this mess has gotten far worse for auto dealers than it was a year ago. It's becoming a real fiasco. As one caller described it: "A Spear to the Heart!"

At the AICPA Conference in Las Vegas, Robert Zwiers, the top IRS/MSSP dealership specialist, announced that on November 16th NADA and the Treasury/IRS were to going to meet to discuss auto dealer conformity matters...as an industry-wide problem. This meeting was cancelled, with nothing to replace it... suggesting that the IRS may think that a case-by-case (a/k/a "divide-and-conquer") approach will be in **Its own** best interests. At the moment there are no docketed Tax Court (or other court) cases on this... and when there are - each one will have different facts and circumstances, still leaving other dealers isolated, vulnerable and less effective in their own defense.

In my opinion, what the "conformity problem" really needs is plenty of ventilation so that the IRS' unreasonable positions and their ramifications can be critically examined from a national-policy standpoint by Treasury officals and by the Commissioner's Office.

I believe you should write as emphatically as possible to all of your elected representatives to bring this matter to their attention. Have your dealers do the same...if you're not afraid to get their attention by pointing out the vulnerability of their own LIFO elections to all the tests on page 6!

Pressure needs to be applied to raise awareness levels and seek reasonable results through a chain reaction initiated by taxpayers - and their representatives. All dealers with "conformity problems" should be treated equally... if not fairly.

Our unflinching coverage (pages 2-8) realistically surveys a landscape littered with invalid LIFO elections and reviews the LIFO termination traps waiting in year-end statements. See also Update #2 on page 21. This emphasizes the need to be vigilant in monitoring all year-end financial statements released by clients using LIFO. If you're quite upset when you're finished with all of this... do something about it!

In the meantime, with NADA, we are trying to reach appropriate individuals... so that the IRS will recognize this as a problem disrupting the entire industry, not to mention its own credibility...so we can sit down together and try to reason our way to a rational resolution.

LOOKOUT LOOKS INTO

WHAT CAN YOU DO?

- Realistically assess your vulnerability... Wake up! This really affects **you**!
- Talk to your clients and level with them.
- Write your representatives in Congress: Maybe they will care enough to press for changes if thousands of dealers can be forced out of business by the IRS over conformity technicalities that have nothing to do with timing or tax payment calculations.

see **LIFO UPDATE**, page 21

THE ULTIMATE LIFO TRAPS: FINANCIAL STATEMENT CONFORMITY REQUIREMENTS

Traps- plural - as in more than one - as in **MANY:** There are many conformity requirements and they exist as restrictions on a taxpayer's general desire to pay lower taxes using LIFO while reporting more income to shareholders or banks using a non-LIFO method. The intention underlying the conformity requirements is that LIFO should be used in all reports covering a full year to insure that the use of LIFO for tax purposes conforms as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income.

LIFO must be used to compute income in the year-end financial statements: technically, only in the primary presentation of income. For many taxpayers, the LIFO conformity requirements really pose two general sets of requirements: **First**, they require that any year-end financial statements issued in report form by the taxpayer to creditors, shareholders, partners or other users must also reflect the year-end results on LIFO. **Second**, they also require all year-end financial statements sent to a manufacturer or supplier (12th, 13th and any other fiscal year-end statements) to reflect LIFO.

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

Currently, the IRS is unwilling to exercise any discretion or leniency to a taxpayer who has violated a conformity requirement and it will simply terminate the LIFO election. Accordingly, a LIFO reserve - no matter how large - can be completely and abruptly lost if careful attention is not paid to the conformity requirements in year-end financial statements sent to the Factory/Manufacturer/Supplier...as well as to the more conventional year-end statements issued in report form by CPAs.

REPORTS ISSUED BY CPAS

This section deals with reports issued by CPAs, where the CPA controls the release, content and format of the statements, notes and supplementary information. These are unlike monthly statements which may be prepared internally and sent out to the manufacturer or supplier without CPA involvement or review.

The LIFO conformity requirement requires that in the primary presentation of income (i.e., the income statement), the results disclosed must only be the **net-of-LIFO** results. The primary income statement CANNOT show results before LIFO, followed by either an addition or subtraction for the net LIFO change, coming down to a final net income or loss after-LIFO figure. This means that a business using LIFO will usually be reporting lower operating results in order to satisfy the conformity requirement.

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

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

As a result of the "liberalizations" in 1981, these LIFO conformity requirements shouldn't present any major reporting problems for reports issued by CPAs.

"GETTING AROUND" THE CONFORMITY REQUIREMENTS

Many businesses using LIFO would like to report lower taxable income/earnings in tax returns while reporting higher earnings/more income to their shareholders and creditors for financial purposes. This can easily be done through loopholes conveniently provided in the Regulations. The Regulations allow taxpayers to legitimately avoid the intent of the conformity requirement by allowing them to use LIFO methods and sub-elections in their financial statements that are different from those LIFO sub-elections and methods that are used in their income tax return computations. That's right: ***DIFFERENT*** LIFO METHODS MAY BE USED FOR BOOK AND FOR TAX PURPOSES. It is **not** necessary for the year-end financial statements to use the same exact LIFO sub-elections that are used in the tax return LIFO calculations. The Regulations simply require that both sets of statements (financial reports and tax returns) must report using LIFO methods.

This allows some companies to use more pools for financial reporting purposes than for income tax purposes. Others use link-chain or link-chain, index methods to lower LIFO income for tax purposes, but use double-extension LIFO for financial reports. Still others reconstruct base prices for new items in their tax return LIFO calculations while pricing new items at current cost in their financial statements. These companies enjoy the best of both worlds without violating the fine print in the "conformity" requirements.

Query: If all this can be done to "beat" the requirements so easily, why is the IRS now being so tough on auto dealers?

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INTERIM REPORTS

Interim reports covering a period of operations that is **less than** the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement for tax purposes. However, GAAP may present some difficulties in this regard.

FACTORY/MANUFACTURER/ SUPPLIER DEALERSHIP YEAR-END STATEMENTS

The **BAD NEWS** is that the Regulations contain several LIFO reporting restrictions which the IRS interprets to apply to the Factory-prescribed format financial statements sent by a dealership immediately after year-end to the Factory/Manufacturer/Supplier. These restrictions pose fatal LIFO traps that are potentially more perilous than those for year-end reports issued by CPAs.

In this regard, the Regulations provide that any income statement that reflects a full year's operations must report on a LIFO basis. This would apply regardless of whether the income statement is the last in a series of interim statements, or the December statement itself which shows two columns - one for current month and one for year-to-date figures. The Regulations provide that a series of credit statements or financial reports is considered a single statement or report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period. This is sometimes referred to as the "aggregation" theory: If one can combine or aggregate a series of interim or partial-year statements to disclose the results of operations for a full year, then the last statement must reflect income computed using LIFO to value the inventory.

Literally interpreted, this wording applies to an auto dealer's 12th statement (i.e., December - unadjusted) as well as to the 13th statement. The 12th statement is usually issued on a preliminary basis, before accruals are refined by detailed adjusting entries. The 13th statement is usually issued several weeks after the 12th statement, and it reflects year-end accrual adjustments and other computations not otherwise completed by the tight time frame for the issuance of the December or 12th statement (usually the 10th day of the following month).

FIRST YEAR AND EVERY YEAR

This conformity requirement means that to remain eligible to use LIFO, ***EVERY YEAR*** the dealership's December (or last monthly) statement must reflect an estimate of that year's change in the LIFO reserve if the actual change cannot be computed before the statement has to be released.

If the dealer is considering or planning to make a LIFO election for the year, an ***ESTIMATE*** of the LIFO reserve must be placed in the year-end statements issued to the Factory/Manufacturer or issued to any other party in order to preserve the ability to elect LIFO for the year by filing Form 970 when the tax return is filed at a later date.

Also, don't overlook this conformity requirement if a dealer already has new vehicles on LIFO and is considering extending LIFO to other inventories, such as used vehicles or parts. In this case, the dealer's year-end statement going to the Factory should also reflect an estimate of the LIFO reserve expected by extending the LIFO election(s) to the additional class of goods under consideration.

A NADA Bulletin on *The LIFO Conformity Requirement* in December, 1985 stated:

Unfortunately, the inadvertent violation of the LIFO conformity requirement cannot be retroactively corrected. Once the violation has occurred, the only thing that can be done at the present time is for the dealer to make sure that the problem does not reoccur and to hope that the statute of limitations runs on the year(s) of violation without discovery by a revenue agent. Many practitioners believe that a revenue agent can only terminate LIFO if the conformity requirement has been violated in a so called open year and that once the statute of limitations has run on the year(s) of violation, a revenue agent may not terminate LIFO. Unfortunately, this "belief" by many practitioners is unsupported and many IRS agents are now aggressively going all the way back - more than 10 years in many cases - to examine the Factory statements for the initial LIFO year to see if they "properly reflected LIFO."

DIFFERENT YEAR-ENDS FOR BOOK AND TAX PURPOSES (FISCAL YEARS)

LIFO conformity problems are multiplied where the dealer has a different year end for reporting to the Factory/Manufacturer/Supplier (calendar year - Dec. 31) than the fiscal year used for income tax return purposes. For these fiscal year taxpayers, in order to satisfy another **strict** conformity requirement, the Regulations require the financial statements to reflect LIFO at the end of **both** twelve month annual reporting periods or years.

This regulation states that the conformity rules also apply to the determination of income profit, or loss for a one-year period other than a taxable year and credit statements or financial reports that cover a one-year period other than a taxable year, but only if the one-year period both begins and ends in a taxable year or years for which the taxpayer uses the LIFO method for Federal income tax purposes. For example,...in the case of a calendar year taxpayer, the requirements...apply to the taxpayers determination of income for purposes of a credit statement that covers the period October 1, 1981, through September 30, 1982, if the taxpayer uses the LIFO method for Federal income tax purposes in taxable years 1981 and 1982.

PLACEMENT OF LIFO CHANGE IN THE STATEMENT OF INCOME

In an Exclusive Special Alert, on November 7, 1994 we warned *Lookout* readers that the top IRS LIFO specialist for dealerships (at the AICPA Dealer Convention in Las Vegas) said that on the twelfth statement the LIFO adjustment had to go through cost of goods sold (via the beginning-of-the-year and end-of-the-year inventory valuations) rather than through an other deductions account...or else dealers would not be complying with the LIFO year-end conformity requirement. The IRS specialist said he believed the regulations could be interpreted to support the agents on this point.

see **ULTIMATE LIFO TRAPS**, page 4

Ultimate LIFO Traps

(Continued from page 3)

Under this interpretation, where and how the LIFO adjustment is run through on the income statement becomes critical. This current position will result in even more LIFO election terminations where the projected change in the LIFO reserve was run through an "Other Income/Other Deductions" account.

EITHER WAY, DEALERS CAN'T WIN

Many manufacturers' prescribed statement formats either do not permit or strongly discourage putting the LIFO adjustment in any (Cost of Goods Sold) account that affects gross profit determinations because that destroys or greatly impedes their ability to analyze gross profit by line items/models. Accordingly, the IRS' LIFO conformity requirement and the manufacturers' statement preparation requirements are not compatible with each other - and the dealer stands to lose either way.

This incompatibility is heightened tremendously because the Factory prescribed formats do not allow for a typical or conventional "Statement of Income" presentation which includes separate disclosure of the beginning-of-the-year inventory and the end-of-the-year inventory amounts. The Factory prescribed format for the Statement of Income begins with Gross Profit. Gross Profit is also shown in a supporting schedule by model/line item only, with corresponding sales revenue by model/line items. There is no "traditional" Cost of Goods Sold detail on the Factory prescribed statement (in the sequence: Beginning Inventory plus Purchases minus Ending Inventory equals Cost of Goods Sold). The amount corresponding to "Purchases" is simply a "plugged" or forced differential amount. This explains some of the contortions in attempting to comply with the vague requirements in the regulations.

Almost all dealers will have a hard (if not impossible) time reporting to the factory at year-end and keeping their LIFO elections by not violating the conformity requirements.

So...according to the IRS, kiss all of those LIFO elections goodbye where the twelfth statement LIFO adjustment - or the thirteenth statement adjustment - is not placed in the inventory valuations in Cost of Goods Sold.

CAN'T REPAIR DAMAGE (ONCE OUT, TOO LATE)

CPAs and their clients should be especially careful to monitor the release of all year-end financial statements. The position of the IRS is that once financial statements have been issued or released on a non-LIFO basis, it is too late to recall them and reissue statements on a LIFO basis. A discussion of the *William Powell Company* decision was included in our conformity discussion in the December, 1993 issue. So was the *Insilco* decision. As far as the IRS is concerned, these may not be of much help, even though the taxpayers went to Court and won!

"QUALITY" OF ESTIMATES

The IRS is aggressively on the attack: some agents now are asking for proof that all financial statements at year-end were not in violation of the LIFO conformity requirements, and they are asking to see detailed computations in support of any year-end estimated changes. In other words, they're looking at the "quality" of the estimate placed on year-end statements as well.

CAN IT POSSIBLY GET WORSE?

Of course! Bet on it! First, there's always interest on tax deficiencies... And, in some termination situations, the IRS even proposes accuracy related penalties! That's really adding insult to injury. And (worse still), that's not to mention the possibility of tax preparer/advisor negligence in not informing clients about these interpretation problems so they could be avoided.

PRACTITIONER LIABILITY CONCERNS

Several suggestions included in our November 7 Special Alert bear repeating:

1. Consider having a dealer follow the precise "supplementary information disclosure" approaches provided by the regulations on their twelfth and thirteenth statements - even though they may risk reporting non-compliance repercussions and franchise violation with the manufacturer by not reporting to the factory in its prescribed formats. Discuss with counsel!

2. Don't expect the manufacturers to immediately change their reporting demands to accommodate "dealer tax problems" in the near future. The IRS has not published any official notice informing taxpayers of these horrendous consequences and some may not budge on this until something "official" is issued by the IRS. See reader comments.

3. Do a "damage control" assessment by surveying your firm's exposure to claims by dealer clients that you should have told them about this long ago and prevented their LIFO elections from being jeopardized under these circumstances. (See pages 6-7: Do You Really Pass All the LIFO Conformity Tests?)

4. If your CPA firm issues any reports on dealer financial statements, consider including a note regarding contingencies or potentially adverse results to the financial statements. This would apply to all audit, review and/or compilation reports. This disclosure should inform readers that dealers' LIFO elections are in jeopardy and may be terminated at any time by the IRS under these interpretations where dealer financial statements have failed to conform *at any time* in the past. (See: Damage Control Sample Wording.)

The liability implications to the accounting profession are enormous. Each CPA whose name has been associated with dealers' financial statements and/or tax returns in the past must immediately assess the potential impact of these most unfavorable developments on (1) their dealer clients - both current and former - and (2) on their own firm's liability.

Dealers may not have been informed about these requirements by their CPAs and their unintentional violation of the requirement may provide (1) the basis for requesting the Commissioner to exercise discretion and not terminate the LIFO election for a conformity violation and (2) lawsuits against CPAs for failure to advise. This raises further problems regarding proof or documentation of advice or notice to the dealer in terms of (1) oral vs. written advice, (2) general vs. specific advice and (3) advice given, but oversight occurs and conformity violation results anyway. All of these problems are multiplied when dealers frequently change CPA firms.

see **ULTIMATE LIFO TRAPS**, page 8

TEN ARGUMENTS WORTH TRYING

1. Dealer-prepared financial statements on Factory prescribed formats are not used by the Factory "for credit purposes" within the intention of Section 472.
2. Dealer-prepared statements are "Internal Management Reports" for which an exception is allowed under the Regulations.
3. There is no express language or guidance in the regulations indicating how the term "Internal Management Reports" is to be interpreted where there is an overlap with the **possibility** of statements being used "for credit purposes." This has been "Reserved" and never officially clarified since the regulations were changed in 1981.
4. The dealership's violation of the conformity requirement was not intentional or willful and termination of LIFO election does not automatically have to be the penalty. The Commissioner would be justified (not to mention humane) in exercising discretion to waive the conformity violation.
5. Retroactive termination based on financial statements issued many years ago is unconscionable and violates the Due Process clause under the Fifth Amendment.
6. **HISTORICALLY,** IRS agents have been inconsistent in interpretation and enforcement of the conformity regulations as they relate to Factory required dealer financial statements.
7. **CURRENTLY,** IRS agents are inconsistent in interpretation and enforcement of these regulations.
8. The decade of silence of IRS agents in connection with these questions (while all of this has been going on right under their noses since 1981) should be interpreted as tacit interpretation and acceptance favorable to dealers. Any change in IRS interpretation and enforcement policy at this time should only be applied on a prospective basis...and only after it is "officially" published.
9. A dealer's election to use the Alternative LIFO Method (Revenue Procedure 92-79) should prevent any termination for a conformity violation in years prior to election of the Alternative LIFO Method.
10. Terminating LIFO elections on the basis of narrow interpretations of the Regulations is completely inconsistent with "Compliance 2000" principles and with taxpayer compliance initiatives as announced on many occasions by Commissioners of the IRS, both past and present. Termination of a dealer's LIFO election achieves the full perfection of absurdity when the least degree of unintentional violation of any one of the ambiguous and hitherto unclarified conformity requirements results in the same devastating (and business-terminating) penalty as the most egregious and willful infraction.

A CATALOG OF CONFORMITY NIGHTMARES
DO YOU REALLY PASS A-L-L THE TESTS?

Some of the conformity violations the IRS can interpret as grounds for terminating a LIFO election:

1. The 12th statement is sent to the Factory without a LIFO amount - estimated or actual - charged against income.

   Note: The first year is sometimes all you need to look at - especially for older LIFO elections. In the first year on LIFO, the dealer would have had to know the election was going to be made before the 10th day after the end of the year because that's when the 12th statement for that year was due into the manufacturer. If the dealer decided to elect LIFO after he sent his 12th statement to the Factory (without showing LIFO properly in it), the LIFO election is not valid - right from the very first year!

2. No LIFO estimate is reflected on the 12th statement; even though the actual amount is properly reflected in the 13th statement.

3. An estimate is reflected on the 12th statement, but no 13th statement for the year is prepared.

4. An estimate is reflected on the 12th statement, but the amount is run through the Retained Earnings account (and not against income).

5. An estimate is reflected on the 12th statement, but it is run through the "Other Deductions" account, or run through some account other than the valuations of the beginning and ending inventories in Cost of Goods Sold.

6. An estimate is reflected on the 12th statement (with disclosure in the proper place), but on the 13th statement for the current year, the adjustment to actual is run through Retained Earnings (and not through income directly).

7. Any estimate is reflected on the 12th statement, and that estimate is still reflected on the 13th statement and the adjustment to the final LIFO reserve computed change is made later in the following year by an entry netting the LIFO adjustment to any account. If the LIFO adjustment is charged to income in the following year, this splits the impact of the LIFO reserve change over two years, instead of placing it all against income in the current year/if it is charged to Retained Earnings, it has never hit income at all.

8. An estimate is reflected on the 12th statement, and the 13th statement is finalized before the LIFO reserve calculations for the year are completed. Later in the year, when the LIFO reserve calculations are completed, the net adjustment is run through the Retained Earnings account in that later year.

9. The manufacturer's instructions are followed completely, but the manufacturer's guidance does not result in the entire impact of the change in the LIFO reserve being reflected in income (through the valuation of the beginning and ending inventories at LIFO) for the current year.

10. **Do You Have LIFO Elections for New, Used and Parts?**

    If so, **multiply** all of the above possibilities for financial statement conformity violations **by two or three** if separate LIFO elections have been made for new vehicles, used vehicles and parts inventories. Why? Because it is necessary to satisfy the conformity requirements for all classes of goods on LIFO, not just for the new vehicles!

This is the *easy* part
There's more... and it only gets worse...
Read #11-17 if you dare

11. **Double Threat For Dealers With Fiscal Years:**

The IRS position is that the dealer Factory statements at the end of December and at the end of the fiscal year must both report LIFO reserve changes in the valuations of the beginning and ending inventories at LIFO. This doubles all the possibilities above.

12. **Triple Threat or "Hat Trick":**

Consider a dealer with a fiscal year for tax purposes, reporting to the Factory on the calendar year basis **and** providing the manufacturer's affiliated credit arm with a statement at some month-end other than December and the regular fiscal year. For example, a dealer with a fiscal September year-end for tax purposes, reporting to the Factory on a December 31 basis and providing statements to the credit corporation as of June 30. This dealer must satisfy all the conformity requirements on all three "year-end" statements. Accordingly, if only two month-ends statements satisfy the requirements, the third would disqualify the LIFO eligibility.

13. **Worst of all (and flat out wrong):**

If any bank or other lending institution has copies of the dealer's Factory financial statements in their "loan files," the IRS will claim that these statements - even though in the manufacturer's prescribed format - are being "used for credit purposes" since they are not in the hands of the manufacturer (pursuant to the franchise relationship) but in the hands of the bank, a lender in the ordinary sense of the term.

Ditto for shareholders!!

14. **First and Every Year Thereafter:**

The LIFO conformity requirement applies to the initial year, as well as each succeeding year of the LIFO election. Therefore, any slip-up, no matter how slight, in any year (first or subsequent) raises the risk that the conformity requirement may have been violated. Where a dealer frequently changes CPA firms, this presents serious problems - which are further compounded - if an examining agent claims these financial statements are "books and records" relevant to the LIFO election and they cannot be produced.

15. **"Quality" of LIFO Estimated Used:**

Some dealers may be using any amount pulled out of the air on the 12th statement as their "estimate" of the LIFO reserve change. The IRS is looking at the "quality" or reasonableness of year-end projection amounts. **These computation worksheets should be saved permanently.** Agents are now asking for detailed workpapers to support the LIFO change estimated reflected in year-end statements.

16. **Accuracy-Related Penalties:**

What is even more devastating is that the IRS may be assessing accuracy-related penalties in these termination situations.

17. **And... You Can't Even Escape by Terminating The LIFO Election!**

In order to terminate a LIFO election and obtain the general relief of a 6-year spread period for the repayment of the LIFO reserve, it is necessary to confirm that there has not been a LIFO terminating event in any open year. Given the substantial possibilities that LIFO financial statement violations may have occurred in an open year, **this places in doubt many prior terminations of LIFO elections where dealerships have claimed a spread period for the repayment of the LIFO reserve**.

...Don't say conformity is not a "problem"
unless you are positive you can pass
ALL the LIFO conformity tests above.

Ultimate LIFO Traps

(Continued from page 4)

One attorney representing CPA liability insurance carriers indicated that CPAs ought to be notifying their carriers now if there is a risk. Ironically, the more expertise a CPA firm advertises or claims to have in dealership matters, and the more dealer clients it has, the greater the potential exposure that firm may have to these extremely restrictive interpretations of the conformity rules! And what about banks and other lenders who thought dealerships had valid LIFO elections when they applied for loans and other lines of credit??

Some CPAs may have a hard time mustering up the courage to deal with this unpleasant state of affairs. And they may find themselves uncomfortable in discussing all of this with their dealer clients... if they even have the courage to do so. Nevertheless, like Pentium chips, most dealers' LIFO elections have probably been fatally flawed by financial statement conformity violations at some time in the past. The accompanying list (pages 6-7) reveals countless ways that dealer LIFO elections can be fully and fatally flawed with no possibility to repair the situation. How many can read it and say: "Don't worry: We/You Don't Have a Problem?"

WHAT CAN YOU DO?

Three things: Realistically assess your vulnerability. Talk to your clients and level with them. Write your representatives in Congress: Maybe they'll care enough to press for changes if thousands of dealers are about to be forced out of business by the IRS over these technicalities.

DAMAGE CONTROL SAMPLE WORDING

"Recently, the Internal Revenue Service has informally indicated several interpretations of the LIFO inventory year-end financial statement conformity regulations under which XYZ Dealership's LIFO election might be terminated retroactively (to 19*XX*) causing all of the income cumulatively deferred in its LIFO reserve account ($ indicate dollar amount) to become fully taxable, with interest computed correspondingly.

"Until these interpretive controversies are resolved, the tax deferral previously experienced by XYZ Dealership and/or its shareholders under its LIFO election(s) for new vehicles, used vehicles and/or parts inventories should be regarded as potentially subject to challenge and termination by the Internal Revenue Service.

"If challenged, the likelihood of the outcome either cannot be predicted or may be adverse to XYZ Dealership and/or its shareholders."

READER COMMENTS ON CONFORMITY

December, 1993: "...When the factory requires the LIFO adjustment to be shown in other than the cost of goods sold area, I have my clients prepare two financial statements, one that is in compliance with the factory requirement and is clearly marked as **'supplemental data'** across the top and attach this to the back of the financial statement which indicates the LIFO adjustment as an adjustment to cost of goods sold. I have them send these statements along with a cover letter to the factory indicating that they are enclosing the dealer financial statement, as required for the 12 or 13 months (which ever the case may be) along with the supplemental data that is requested by the factory. The financial information transmitted via computer to the factory only includes the LIFO adjustment as cost of goods sold. I feel that this is one of the safest methods for our clients to use and falls within the parameters of the IRS requirements."

December, 1994: "I guess we got a Christmas present from American Honda. I spent about a half hour on the phone with the people at American Honda, and was able to explain our concerns about the IRS conformity requirements. We were able to get in the words, 'supplemental information' and they were understanding about this matter and will try to resolve this in a more permanent way."

The factory instructions detail the line item Cost of Goods Sold (series 600) accounts to be charged with the LIFO reserve adjustment and indicate: "Some accounting firms are instructing their clients to make this adjustment to 'New Vehicle Cost of Sales' instead of Account 910 - LIFO Adjustment. If you make your LIFO adjustment to Cost of Sales, please attach a copy of the entry to your December Financial Statement (12th month) as supplemental information. The Business Management Department will reflect ACTUAL vehicle Gross Profit."

Observations: First, the projection/estimate in the LIFO reserve will have to be prorated in some fashion among all of the models involved. **Second**, curing a conformity problem now - even with the factory's cooperation - does not in any way lessen the dealer's exposure to termination of the election if any prior year failed to meet the standards!

1994-1995 MODEL/ITEM CATEGORY INFLATION SURVEY FOR QUICK YEAR-END LIFO ESTIMATES

'94-'95 INTRO INDEX

Auto dealers need an estimate of their LIFO reserve change before all the detailed inventory repricing can be made. For the 1995 model year, most new vehicle prices have increased, but others havedecreased or remained the same. The question is: How much have prices changed and which items are not showing inflation at all?...the answer depends on where you've read about it, whether you're using the Alternative LIFO Method and how far you're going in your make/model analysis to determine detailed item categories. It also depends on whether certain vehicles in the ending inventory are classified as new items.

Automotive News reported that introductory prices of 1995 Japanese cars and light-duty trucks increased an average of $89 more than Big 3 prices on comparably equipped vehicles (which excludes price adjustments for equipment that is made standard on the 1995 vehicles). However, this is important in LIFO index computations only if a dealer is not using the Alternative LIFO Method.

Price increases in general are notably lower than they were last year. *Automotive News* reported sticker-to-sticker price increases on 1995 models for Chrysler at 2%, Ford at .8% and General Motors at 2.6%. For "Japanese leaders," *Automotive News* reported Acura price increases at 3.1%, Honda at 1.9%, Infiniti at 4.0%, Lexus at 1.3%, Mazda at 2.6%, Mitsubishi at 5.9%, Nissan at 3.4% and Toyota at 1.5%.

The Wall Street Journal reported that General Motors Corp. is increasing prices on 1995 model cars and light-duty trucks by an average of 2.5%, or $494 per vehicle. GM attributes more than half of these price increases to costs associated with new safety features. However, for GM's most popular models, price increases are much greater than the 2.5% average. For example, the price of a popular Cavalier model was increased 13.7%.

On the other hand, pricing for certain models has stayed relatively the same, or even decreased. 1995 model Porsche prices are the same or less than the 1994s with one 911 Carrera model drastically reduced by $12,550. Volkswagen cut prices on the Passat models by 9.3 to 9.8 percent. Toyota decreased prices on the base Camry two-door and four-door sedans by $300 and didn't raise prices on seven other Camry models. Rolls Royce even cut prices...some by as much as $20,000!

Our analysis which follows reflects a weighted average by model for 1995 models. This listing shows for each model the weighted average intro-to-intro increase; it also indicates the change in underlying item categories. This increase was determined by taking all of the underlying 1995 item categories and assuming a dealer had one of each and then dividing the total dealer base cost of one of each at the end of the year by the comparable beginning-of-the-year totals. This assumes that for each model, the dealer would have had one of each new item category in the ending inventory and this one of each assumption tends to decrease the overall model index where many new item categories were introduced in 1995. These weighted indexes vary significantly depending on a number of factors. In our computations, many market editions, special editions and value priced vehicles (item categories) were considered as new items (unless a comparable 1994 model year vehicle existed) based on a narrow interpretation of Revenue Procedure 92-79. Accordingly, each of these new item categories results in a 1.000 index on its own.

When the year-end LIFO repricings are made using all actual year-end invoices, the inflation indexes based on detailed item category costs may be significantly greater than the one of each weighted average assumed for all item categories within the given model. Also, a dealer's beginning-of-the-year average cost for an item category may be considerably less than the 1994 intro dealer cost used in compiling the intro-to-intro averages. This would give the dealer a higher inflation index.

Despite these general limitations, we have found the one-of-each, intro-to-intro inflation percentages on the following pages to be useful in estimating LIFO reserve changes where time is short and the dealer's statement has to be in to the factory by January 10th. (By the way, be careful how you reflect the LIFO estimate in the income statement!)

LOOKOUT EXCLUSIVE

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
ACURA							
Integra	10	10	6	-	16	1.0313	1.0000
Legend	11	11	-	-	11	1.0414	1.0775
NSX	2	2	-	-	2	*	1.0214
Vigor	4	-	-	4	-	-	1.0949
AUDI							
100 Series	7	-	-	7	-	-	1.0421
90 Series	5	2	4	3	6	0.9862	1.0667
A6 Series	-	-	6	-	6	1.0000	-
Cabriolet Series	1	1	-	-	1	0.9547	1.0000
S4 Series	1	-	-	1	-	-	1.0471
S6 Series	-	-	1	-	1	1.0000	-
V8 Quattro	1	-	-	1	-	-	1.0406
BMW							
3 Series	12	12	1	-	13	1.0252	1.0477
5 Series	7	7	1	-	8	1.0058	1.0120
7 Series **	3	3	-	-	3	1.0393	1.0360
8 Series **	4	4	-	-	4	1.0264	1.0252
BUICK							
Century	5	3	5	2	8	1.0240	1.0451
Lesabre	3	2	2	1	4	1.0205	1.0867
Park Avenue	3	2	1	1	3	1.0300	1.0362
Regal	8	4	3	4	7	1.0454	1.0408
Riviera	-	-	1	-	1	1.0000	-
Roadmaster	4	3	1	1	4	1.0382	1.0655
Skylark	7	2	6	5	8	1.0122	1.0868
CADILLAC							
De Ville	2	2	-	-	2	1.0678	1.0000
Eldorado	2	2	-	-	2	1.0240	1.0443
Fleetwood	1	1	-	-	1	1.0472	1.0578
Seville	2	2	-	-	2	1.0232	1.0874
CHEVROLET AUTOMOBILES:							
Beretta	6	2	4	4	6	1.0185	1.0123
Camaro	4	4	-	-	4	1.0529	1.0000
Caprice	5	3	4	2	7	1.0395	1.0375
Cavalier	8	-	3	8	3	1.0000	1.1082
Corsica	3	1	2	2	3	1.0182	1.0449
Corvette	2	2	-	-	2	1.0165	1.0443
Geo Metro	3	-	4	3	4	1.0000	1.0711
Geo Prism	4	4	-	-	4	1.0832	1.0876
Lumina	5	-	2	5	2	1.0000	1.0621
Monte Carlo	-	-	2	-	2	1.0000	-

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
LIGHT-DUTY TRUCKS:							
Astro Van	8	4	2	4	6	1.0666	1.0318
Blazer	-	-	4	-	4	1.0000	-
Blazer-K	1	-	-	1	-	-	1.0558
C-K Chassis Cab	13	13	-	-	13	1.0393	1.0346
C-K Pickup	30	30	-	-	30	1.0507	1.0628
Chevy Van	6	6	4	-	10	1.0399	1.0624
Geo Tracker	5	5	-	-	5	1.0615	1.0550
Lumina APV	2	2	-	-	2	1.0474	1.0559
S10 Blazer	4	-	-	4	-	-	1.0494
S10 Pickup	10	10	-	-	10	1.0479	1.0162
Sportvan	3	3	-	-	3	1.0510	1.0418
Suburban	4	4	-	-	4	1.0657	1.0538
Tahoe	-	-	1	-	1	1.0000	-
CHRYSLER							
Cirrus	-	-	1	-	1	1.0000	-
Concorde	1	1	-	-	1	1.0846	1.0605
Leberon	4	1	-	3	1	1.0269	1.0125
LHS	1	1	-	-	1	1.0479	1.0000
New Yorker	1	1	-	-	1	1.0825	1.0000
DODGE AUTOMOBILES:							
Avenger	-	-	2	-	2	1.0000	-
Colt	4	-	-	4	-	-	1.1719
Intrepid	2	2	-	-	2	1 0935	1.0987
Neon	-	-	6	-	6	1.0000	-
Shadow	4	-	-	4	-	-	1.0451
Spirit	2	1	-	1	1	1.0479	0.9831
Stealth	3	2	1	1	3	1.0308	1.1377
Viper	1	1	-	-	1	1.0269	1.0877
LIGHT-DUTY TRUCKS:							
Caravan	11	11	-	-	11	1.0370	1.0611
Caravan C/V	2	2	-	-	2	1.0859	1.0496
Dakota	15	14	-	1	14	1.0725	1.0466
Ram Cab & Chassis	6	6	-	-	6	1.0395	1.0000
Ram Pickup	12	12	8	-	20	1.0233	1.0000
Ram Vans	7	7	-	-	7	1.0881	1.0056
Ram Wagon	5	5	-	-	5	1.0571	1.0035
EAGLE							
Summit	9	7	-	2	7	1.0735	1.1129
Talon	4	-	3	4	3	1.0000	1.0115
Vision	2	2	-	-	2	1.0195	1.0923

LIFO LOOKOUT EXCLUSIVE

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
FORD							
AUTOMOBILES:							
Aspire	3	3	-	-	3	1.0369	1.0000
Contour	-	-	3	-	3	1.0000	-
Crown Victoria	3	3	-	-	3	1.0513	1.0099
Escort	6	6	-	-	6	1.0498	1.0704
Mustang **	6	6	-	-	6	1.0422	1.0000
Probe	2	2	-	-	2	1.0386	1.0576
Taurus	5	5	1	-	6	1.0414	1.0655
Tempo	3	-	-	3	-	-	1.0554
Thunderbird	2	2	-	-	2	1.0249	1.0610
LIGHT-DUTY TRUCKS:							
Aerostar	28	4	-	24	4	0.9825	1.0331
Bronco	3	3	-	-	3	1.0310	1.0559
Cutaway Van	12	9	4	3	13	1.0365	0.9873
E Series Van/Wagon	15	15	-	-	15	1.0564	1.0176
Explorer	14	14	-	-	14	*	1.0335
F Series C & Chassis	10	9	-	1	9	1.0168	1.0269
F Series Pickup	30	30	-	-	30	1.0252	1.0521
Ranger	22	22	-	-	22	*	1.0625
Windstar	-	-	3	-	3	1.0000	-
GMC TRUCKS							
C-K Cab & Chassis	13	13	-	-	13	1.0371	1.0391
C-K Sierra Pickup	30	30	-	-	30	1.0107	1.0649
Jimmy	-	-	4	-	4	1.0000	-
Rally Wagon	3	3	-	-	3	1.0458	1.0414
S15 Jimmy	4	-	-	4	-	-	1.0487
S15 Sonoma	10	10	-	-	10	1.0719	1.0795
Safari	8	2	4	6	6	1.0269	1.0317
Suburban	4	4	-	-	4	1.0654	1.0446
Vandura	6	6	4	-	10	1.0405	1.0623
Yukon	1	1	-	-	1	1.0333	1.0470
HONDA							
Accord	24	21	2	3	23	1.0581	1.0000
Civic	20	19	-	1	19	1.0723	1.0605
Del Sol	5	5	-	-	5	1.1063	1.0617
Prelude	7	5	-	2	5	1.0720	1.0858
HYUNDAI							
Elantra	4	4	-	-	4	1.0507	1.0722
Excel	6	-	-	6	-	-	1.0478
Scoupe	5	5	-	-	5	1.0663	1.0447
Sonata	6	-	5	6	5	1.0000	1.0304

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
INFINITI							
G20	6	4	-	2	4	1.0418	1.0407
J30	1	1	-	-	1	1.0691	1.1004
Q45	2	2	-	-	2	1.0639	1.0587
ISUZU							
Amigo	4	-	-	4	-	-	1.1443
Pickup	6	3	-	3	3	1.0535	1.0765
Rodeo	8	8	-	-	8	1.0561	1.1081
Trooper	7	7	-	-	7	1.0356	1.0682
JAGUAR							
XJ	4	-	4	4	4	1.0000	1.0185
XJS	4	4	-	-	4	1.0308	1.0106
JEEP							
Cherokee	12	10	2	2	12	1.0471	1.0440
Grand Cherokee	5	5	2	-	7	1.0516	1.0753
Wrangler	5	3	-	2	3	1.0576	1.0567
LEXUS							
ES 300 Sedan	2	2	-	-	2	1.0420	1.0775
GS 300 Sedan	2	2	-	-	2	1.0847	1.0640
LS 400 Sedan	2	-	2	2	2	1.0000	1.0708
SC 300 Coupe	4	4	-	-	4	1.0885	1.0448
SC 400 Coupe	2	2	-	-	2	1.1000	1.0428
LINCOLN							
Continental	2	2	-	-	2	*	1.0138
Mark VIII	1	1	-	-	1	1.0218	1.0635
Town Car	3	3	-	-	3	1.0680	1.0394
MAZDA							
AUTOMOBILES:							
323	1	-	-	1	-	-	1.0732
626	4	4	-	-	4	1.0465	1.0550
929	1	1	-	-	1	1.1874	1.0445
Miata **	3	3	-	-	3	1.0758	1.0752
Millenia	-	-	3	-	3	1.0000	-
MX-3	2	1	-	1	1	1.0740	1.1336
MX-6	2	1	-	1	1	1.0924	1.1005
Protege	2	-	3	2	3	1.0000	1.0469
RX-7	1	1	-	-	1	*	1.0462
LIGHT-DUTY TRUCKS:							
MPV	4	-	5	4	5	1.0000	1.0872
Navajo	4	-	-	4	-	-	1.0538
Pickup	17	*	*	*	*	*	1.0000

LIFO LOOKOUT EXCLUSIVE

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
MERCEDES-BENZ							
C Class	2	2	-	-	2	1.0377	1.0000
E Class	8	6	-	2	6	1.0175	0.9595
S Class	7	-	7	7	7	1.0000	1.0098
SL Class	3	3	-	-	3	0.9458	1.0079
MERCURY							
AUTOMOBILES:							
Capri	2	-	-	2	-	-	0.9486
Cougar	1	1	-	-	1	1.0289	1.0948
Grand Marquis	2	2	-	-	2	1.0504	1.0100
Mystique	-	-	2	-	2	1.0000	-
Sable	4	4	-	-	4	1.0260	1.1224
Topaz	2	-	-	2	-	-	1.0678
Tracer	3	3	-	-	3	1.0875	1.0244
LIGHT-DUTY TRUCKS:							
Villager	4	4	-	-	4	1.0340	1.0735
MITSUBISHI							
AUTOMOBILES:							
3000GT	5	5	-	-	5	1.0554	1.1090
Diamante	3	1	-	2	1	1.0847	1.1114
Eclipse	10	-	8	10	8	1.0000	1.0420
Expo	4	-	-	4	-	-	1.0183
Expo-LRV	4	-	-	4	-	-	1.1592
Galant	6	4	-	2	4	1.0857	1.0000
Mirage	11	-	3	11	3	1.0000	1.1590
LIGHT-DUTY TRUCKS:							
Montero	3	3	-	-	3	1.1304	1.1871
Pickup	5	2	-	3	2	1.0938	1.0975
NISSAN							
AUTOMOBILES:							
240SX	9	-	4	9	4	1.0000	1.0726
300ZX	11	9	-	2	9	1.0413	1.0000
Altima	7	7	-	-	7	1.0622	1.0687
Maxima	3	-	5	3	5	1.0000	1.0574
Sentra	14	*	*	*	*	*	1.0998
LIGHT-DUTY TRUCKS:							
4x2 Pickup	8	6	2	2	8	1.0626	0.9995
4x4 Pickup	6	6	-	-	6	1.1784	0.9943
Pathfinder	7	7	-	-	7	1.0651	1.0565
Quest	2	2	-	-	2	1.0519	1.0660

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
OLDSMOBILE							
AUTOMOBILES:							
Achieva	10	4	-	6	4	1.0134	1.0484
Aurora	-	-	1	-	1	1.0000	-
Cutlass Ciera	3	1	2	2	3	1.0559	1.0601
Cutlass	2	1	1	1	2	1.0176	1.0705
Cutlass Supreme	7	5	3	2	8	1.0260	1.0568
Eighty Eight	4	2	1	2	3	1.0400	1.0259
Ninety Eight	3	1	1	2	2	1.0328	1.0236
LIGHT-DUTY TRUCKS:							
Bravada	2	-	-	2	-	-	1.0126
Silhouette	3	2	-	1	2	1.0264	1.0149
PLYMOUTH							
AUTOMOBILES:							
Acclaim	2	1	-	1	1	1.1438	1.0205
Colt	7	-	-	7	-	-	1.1471
Laser	4	-	5	4	5	1.0000	1.0114
Sundance	4	-	-	4	-	-	1.0435
LIGHT-DUTY TRUCKS:							
Grand Voyager	5	5	-	-	5	1.0226	1.0615
Voyager	4	3	-	1	3	1.0651	1.0667
PONTIAC							
AUTOMOBILES:							
Bonneville	2	2	2	-	4	1.0204	1.0456
Firebird	7	6	2	1	8	1.0343	1.0000
Grand Am	6	4	4	2	8	1.0040	1.0341
Grand Prix	3	2	1	1	3	1.0281	1.0505
Sunbird	5	-	-	5	-	-	1.0628
Sunfire	-	-	6	-	6	1.0000	-
LIGHT-DUTY TRUCKS:							
Trans Sport	1	1	1	-	2	1.0136	1.0407
SAAB							
900 Series	15	4	12	11	16	1.0103	1.0000
9000 Series	22	4	11	18	15	1.0173	1.0614
SATURN							
Coupe	4	4	-	-	4	1.0126	1.0355
Sedan	5	5	-	-	5	1.0148	1.0701
Station Wagon	4	4	-	-	4	1.0235	1.0452
SUBARU							
Impreza	14	-	37	14	37	1.0000	1.0000
Justy	2	-	-	2	-	-	1.0116
Legacy	36	-	24	36	24	1.0000	1.0096
Loyale	2	-	-	2	-	-	1.0554
SVX	*	*	*	*	*	*	1.0000

LIFO LOOKOUT EXCLUSIVE

1994-1995 MODEL / ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES AS OF DECEMBER 31, 1994

Make/Model	Total 1994 Item Categories	Continuing	New	Dropped	Total 1995 Item Categories	Weighted Average One-Of-Each 1995 Intro to 1994 Intro	Weighted Average One-Of-Each 1994 Intro to 1993 Intro
SUZUKI							
AUTOMOBILES:							
Swift	7	-	4	7	4	1.0000	1.0821
LIGHT-DUTY TRUCKS:							
Samurai	1	1	-	-	1	1.0444	1.1256
Sidekick	14	12	-	2	12	1.0482	1.0586
TOYOTA							
AUTOMOBILES:							
Avalon	-	-	4	-	4	1.0000	-
Camry	15	14	-	1	14	1.0488	1.0551
Celica	8	8	2	-	10	1.0484	1.0000
Corolla	5	5	2	-	7	1.0398	1.0657
MR2	4	4	-	-	4	1.0697	-
Paseo	2	2	-	-	2	1.0961	1.0815
Supra	7	7	-	-	7	1.0698	1.0626
Tercel	5	-	6	5	6	1.0000	1.0573
LIGHT-DUTY TRUCKS:							
4 Runner	4	4	-	-	4	1.0703	1.0551
4x2 Pickup	9	9	-	-	9	1.0536	1.0648
4x4 Pickup	8	8	-	-	8	1.0642	1.0639
Land Cruiser	1	1	-	-	1	1.0926	1.0991
Previa Van	6	6	2	-	8	1.0149	1.1233
T100 Pickup	11	7	2	4	9	1.0578	1.0532
VOLKSWAGEN							
AUTOMOBILES:							
Cabrio	-	-	2	-	2	1.0000	-
Corrado	2	-	-	2	-	-	1.1189
Golf III	6	6	7	-	13	1.0526	1.0246
Jetta III	10	10	1	-	11	1.0834	1.0242
Passat	4	-	4	4	4	1.0000	1.1104
LIGHT-DUTY TRUCKS:							
Conversion-Ready Eurovan	-	-	2	-	2	1.0000	-
VOLVO							
850 Series	8	8	2	-	10	1.0457	1.0166
900 Series	11	4	6	7	10	1.0125	0.9842

* Complete 1995 intro price is not currently available.

** Index excludes certain item(s) for which 1995 intro price information is not currently available.

NOTE: Information on 1994 models does not necessarily reconcile to December 1993 LIFO Lookout article "1993-1994 Model/Item Category Inflation Survey: For Quick Year-End LIFO Estimates" due to additional information which became available after that article was published such as additional introduction prices and item categories.

Source: ***W.J. De Filipps' Make / Model Analysis Data Base Report***, Preliminary Edition (Copyright, 1994)

LIFO LOOKOUT EXCLUSIVE

PROJECTING YEAR-END LIFO RESERVES CHANGES

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

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

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

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

(1) Determine the cumulative index as of the end-of-the-year - this is the estimated current year inflation index times (i.e. multiplied by the) beginning of year cumulative index,
(2) Divide the end-of-the-year actual inventory dollars by the year-end cumulative index - to get the end-of-the-year inventory stated or expressed in base dollars,
(3) Compare end-of-the-year inventory at base dollars with the beginning-of-the-year inventory stated in base dollars to determine whether there is an increment or a decrement projected for the year,
(4) Value the projected increment under the method already selected. Alternatively, if a decrement is projected for the year, carry the decrement (expressed in base dollars) back against prior years increments (also expressed in base dollars) on a LIFO or reverse-chronological-order basis.
(5) Add all the resulting layers of inventory at their respective LIFO valuations to get the end-of-the-year inventory stated at its LIFO valuation,
(6) Subtract the ending inventory at its LIFO valuation from the ending inventory at its actual or estimated current non-LIFO cost to determine the projected LIFO reserve as of the end-of-the-year,
(7) **Finally**, subtract the **actual** LIFO reserve as of the beginning- of-the-year from the **projected** LIFO reserve as of the end-of- the-year.

The result in step 7 is the estimate of change in LIFO reserve for the year. This amount is then rounded and put into the 12th statement by an adjusting entry before the statement is released. The entry should be to the inventory valuations in the Cost of Goods Sold section of the income statement.

These **estimates** of change are routinely prepared and reflected in the dealer's year-end financial statements sent to the Factory: You don't have to know the exact change to reflect LIFO in the December statement. Reasonable estimates are permitted on the 12th statement. The actual computation of the change in the LIFO reserve for the year is usually made **after** the 12th statement has been sent out, when all of the actual inventory invoices are available and fully reconciled. After the actual change in the LIFO reserve for the year has been computed, the 13th statement should adjust the estimated amount to the actual LIFO reserve amount. On the 13th statement, the finalizing entry should be to the inventory valuations in the Cost of Goods Sold section of the Income Statement.

See the 1994-1995 Model/Item Category Survey included in this issue for one-of-each-kind shortcut inflation estimates when projections are needed and time is short. This year, we've also included the comparable information for the 93-94 models for added reference value. Good Luck!

CONSIDERATIONS IN EVALUATING A LIFO ELECTION

PRACTICE GUIDE

SUMMARY

1. Writedowns from cost are not permitted with LIFO. **COST** requirement.
2. Financial statement **CONFORMITY** requirement for all year-end statements.
3. Form 970 must be filed with tax return for year of LIFO election.
4. Any contractual relationship dependent upon the definition of "net income" or "net book value" will be affected.
5. Projected size of "first year" LIFO reserve.
6. LIFO is only a deferral.
7. Tax rates are likely to be changing over the years.
8. Changing tax entities may impact LIFO considerations.
9. LIFO changes cannot be made without advance IRS permission.
10. Overall exposure before the Internal Revenue Service may be increased.
11. Additional costs - internal and external - usually are incurred.
12. Review Form 970 questions and especially computation sub-elections.
13. Other information.
14. Other matters and timetable for action.

DETAILED DISCUSSION AGENDA

1. **WRITEDOWNS FROM COST ARE NOT PERMITTED WITH LIFO. *COST* REQUIREMENT.**
   - A. Inventory writedowns in prior years must be taken into income ratably over the year of change and the next two (2) years.
   - B. Are there any writedowns from cost in last year's ending (i.e., this year's opening) inventory? Discuss.
   - C. Review and evaluate current cost accounting system.
     - (1) Are all raw material costs (including transportation costs, etc.) inventoried?
     - (2) How are labor hours applied to jobs in process to get into ending inventory? Actual vs. standard, adjustments of estimates to actual, etc.
     - (3) Absorption of overhead: are all elements of overhead being fully absorbed? Actual vs. standard, adjustments of estimates to actual, etc.
     - (4) Section 263A Uniform Cost Capitalization requirements: Discuss & what elections have been made in the past?
     - (5) Have there been any changes in inventory accounting methods in the past? If yes, discuss and review Form 3115, IRS Consent Letter and transitional computations.
     - (6) Were "bargain purchases" or "discounts" involved in any inventory acquisitions? If yes, discuss.
     - (7) Is replacement cost used for parts-type inventories? If yes, discuss.

2. **FINANCIAL STATEMENT *CONFORMITY* REQUIREMENT FOR ALL YEAR-END STATEMENTS.**
   - A. Applies to first year **AND** to all subsequent years.
   - B. All reports covering the full taxable year, whether they are annual reports to shareholders, to banks, to manufacturers or suppliers, or to any other financing source, or for any other purpose, must report on the LIFO basis at least in the primary presentation of income.
   - C. Discuss exceptions as necessary.
   - D. Discuss special traps for dealers, fiscal years, interim reports, Internal Management Reports, etc. →

3. **FORM 970 MUST BE FILED WITH TAX RETURN FOR YEAR OF LIFO ELECTION.**
   A. CONSENT requirement. Emphasize unlimited statute of limitations as it relates to inventory (valuation) matters.
   B. Complete information concerning inventories and responses to questions on Form 970 must be submitted with the income tax return filed for the year of the LIFO election.
   C. Special, additional filing requirements with IRS National Office are involved if the link-chain, index method is used. Discuss if link-chain, index filing is anticipated.

4. **ANY CONTRACTUAL RELATIONSHIP DEPENDENT UPON THE DEFINITION OF "NET INCOME" OR "NET BOOK VALUE" WILL BE AFFECTED.**
   A. Key employee/Owner bonuses and profit sharing plan contributions based on "net income" may be reduced unless those agreements are amended/clarified.
   B. Buy-sell and other shareholder purchase agreements also should be reviewed.
   C. Directors' resolution to adopt LIFO is advisable.
   D. Are there any banking relationships or loan covenants and restrictions that might be affected by reflecting lower LIFO net income in year-end statements? (See also Conformity requirement.)

5. **PROJECTED SIZE OF "FIRST YEAR" LIFO RESERVE.**
   A. "Big hit" comes in first year...later years reflect net increases or decreases based on inventory levels and inflation rates.
   B. Inventory (at cost) levels as of.
      (1) Beginning of year _____; End of year _____.
   C. Inflation rate(s) for the year. Estimated at _____.
   D. LIFO Reserve: Lower of beginning inventory or ending inventory (x) inflation rate.
   E. Tax "savings" from LIFO: Inflation rate (x) effective tax rate.
   F. How important is it to have a more accurate projection...for 4th quarter estimated tax purposes, etc.?
   G. Can year-end inventory levels be monitored to achieve more favorable LIFO results? Discuss year-end planning and projections.
   H. Reminder: Any year-end financial statements released before LIFO reserve computations are completed must reflect a projected LIFO reserve change in the statement of income.

6. **LIFO IS ONLY A DEFERRAL.**
   A. Overall price levels and/or inventory levels may eventually go down or the business may be liquidated, resulting in repayment of part or all of the cumulative tax deferral.
   B. Computational techniques and the close monitoring and planning of future year-end inventory levels could considerably lessen repayment impact.
   C. In many instances, it is not unusual at year-end for the LIFO reserve to go up (i.e., increase) even though the ending inventory level has gone down (i.e., decreased). Explain if interest warrants further discussion.

7. **TAX RATES ARE LIKELY TO BE CHANGING OVER THE YEARS.**
   A. Tax rates may go up or down.
   B. This may be especially critical for S corporation shareholders.
   C. Deferring from low tax rate years to higher tax rate years - or vice versa.
   D. Other tax considerations...Do you have any specific questions regarding tax considerations relating to LIFO election?

8. **CHANGING TAX ENTITIES MAY IMPACT LIFO CONSIDERATIONS.**
   A. S corporations - Different shareholders, different years, different tax rates.
   B. C to S corporations - Recapture of LIFO reserve when S election is made.
      (1) Section 1363(d) - Repayment of LIFO reserve as of last day of last C year. Additional tax paid over a 4-year spread.
      (2) Revenue Procedure 94-61 and "special collapsed layer" problems.

see **CONSIDERATIONS IN EVALUATING A LIFO ELECTION**, page 20

 (Continued from page 19)

8. **CHANGING TAX ENTITIES MAY IMPACT LIFO CONSIDERATIONS. (CONTINUED)**
   C. Deferring from corporate level to shareholder level and vice versa.
   D. S to C elections: Recapture consequences presently unspecified.
   E. Inadvertent S terminations: Recapture consequences...Unknown.

9. **LIFO CHANGES CANNOT BE MADE WITHOUT ADVANCE IRS PERMISSION.**
   A. LIFO election should, for all practical purposes, be regarded as permanent.
   B. Subsequent changes in any LIFO computational methods can only be made with advance IRS approval (Form 3115 filing, 180 day requirement, terms and conditions, consent agreement).
   C. Permission to terminate LIFO election usually requires advance approval (except for Rev. Proc. 88-15 situations).

10. **OVERALL EXPOSURE BEFORE THE INTERNAL REVENUE SERVICE MAY BE INCREASED.**
   A. IRS is more knowledgeable and aggressive in audits involving LIFO. Industry Specialization Groups, MSSP, ISP, etc.
   B. IRS audits of LIFO inventories are unpredictable.
   C. Audits may not necessarily be limited to (LIFO) inventory matters.
   D. Are there any IRS audits currently? If so, what is their status and is there anything that might involve the LIFO election?

11. **ADDITIONAL COSTS - INTERNAL AND EXTERNAL - USUALLY ARE INCURRED.**
   A. Evaluating and implementing LIFO involves an investment in a specialized (tax) planning effort...front-end investment in the first year.
   B. Considerable time and expense may be involved in explaining and justifying the LIFO application to the Internal Revenue Service and to bankers.

12. **REVIEW FORM 970 QUESTIONS AND ESPECIALLY COMPUTATION SUB-ELECTIONS.**
   A. Dollar value method. (Question 7)
   B. Pooling. (Question 8)
   C. Link-chain, index vs. double extension...possibly other? (Question 9)
   D. Method for valuing increments. (Question 6)

13. **OTHER INFORMATION.**
   A. How has inventory been disclosed/reported in prior year financial statements and other reports?
   B. Is there any customary business or industry classification?
   C. Description of inventory, copy of inventory printout or listing, catalogs describing materials purchased and/or other vendor information.
   D. Catalogs describing products (finished goods) sold.
   E. Is any other information on the "industry" available?
   F. Information regarding business or trade associations to which the company belongs.

14. **OTHER MATTERS AND TIMETABLE FOR ACTION.**
   A. How soon must a final decision on LIFO election be made?
   B. Timetable for decision to elect LIFO.
   C. Timetable for implementation mechanics.
   D. Identify next steps to be taken, and by whom.

15. **OTHER ADDITIONAL COMMENTS/NOTES:**
   A. _____
   B. _____

(Continued from page 1)

#2. OTHER IRS ACTIVITY ON CONFORMITY. Several recent callers have shared information to evidence the IRS' greater attention on dealer financial statement conformity matters. These conversations have revealed:

IRS ACTIVITY

- Accuracy-related penalties are now being considered,
- Revenue Procedure 92-79 "Compliance Check" agents are coming back and asking to look at **prior year** financial statements to review conformity,
- Agents asking for detailed workpapers in support of LIFO estimates placed on 12th statements, and
- IRS preference to deal with conformity problems on a dealer-by-dealer basis, rather than as an overall industry problem.

#3. DECEMBER IS ALWAYS HECTIC. In addition to a full round of LIFO seminars all over the country, the AICPA National Automobile Dealer Conference in Las Vegas...and in New Orleans...were wonderful opportunities to see many of you again and to make new acquaintances...even though the news we reported in our R.I.P. exclusive (November 7 *LIFO Lookout*) was greatly upsetting... a wake-up call... for many complacent CPAs.

We've been helping many CPAs in evaluating LIFO elections for many of their clients who are having extremely profitable years. In this issue (page 18), we've included an expanded checklist/discussion agenda that should be useful to you in sitting down with your clients and considering LIFO.

In addition, we've been busy working up year-end LIFO projections, completing our make/model analysis data base for '95 models and '94 LIFO inflation indexes, representing taxpayers in LIFO audits and trying to help NADA discuss many LIFO-related matters with the IRS.

#4. 1994-1995 MODEL/ITEM CATEGORY INFLATION SURVEY. Our special report take-out section, pages 9-16, will be helpful if you are looking for quick inflation percentages for year-end LIFO estimates. This includes our 1993-1994 survey results for added reference.

It will also give you an idea of the detailed analysis necessary to track down all the item categories for a particular model. We have accounted for the change from the total number of 1994 item categories to the total number of 1995 item categories for each manufacturer.

#5. NEW ITEM LISTS FOR 1995 MODELS. Efforts have also fallen through in NADA's attempts to work with the IRS National Office and/or MSSP to provide a timely new item list for 1995 models. The idea was for the IRS to review NADA's list before NADA distributed it to its members, so it could be used with some certainty. This initiative by NADA fell flat after mid-summer discussions with the IRS National Office and later with the IRS/MSSP.

In our analysis of 1995 models, we believe we can anticipate most of the "new items" and identify those situations where Revenue Procedure 92-79 requires some interpretation. We expect that the IRS/MSSP will treat anything questionable as a new item, as they did with the 94's.

#6. NO NEWS IS GOOD NEWS? There is nothing new to report on some earlier developments including:

- Revenue Procedure 92-79 clarification.
- Replacement cost for parts-type inventories.
- Clarification of "new item" definitions, and
- Revenue Procedure 94-61 questions regarding C to S elections.

On a related note, the IRS/MSSP just recently released its unofficial list of 1994 new items. They are working on the 1995 models and the '93 list is a lesser priority at this time. Note: the "unofficial" list of 1994 new items has not been published by the National Office as an IRS "official" interpretation of Rev. Proc. 92-79.

#7. LACK OF PRODUCT, LESS INFLATION AND LOWER INVENTORY LEVELS. Many dealers are unable to obtain inventory. This may affect their LIFO reserve balances at December 31, 1994. However, remember that in many instances, LIFO reserves may go up even though the ending inventory levels go down. This subject has been extensively covered in prior issues of the *Lookout*. See March, 1992 article and calculations and June, 1993 article: "Why LIFO Reserves Go Up Even Though Inventory Levels Go Down."

In some instances, dealers may be able to obtain additional inventory from brokers in Canada. Because these vehicles are coming from Canada, they may be required to be shown as *"used"* vehicles for financial statement classification purposes. For Alternative LIFO computation purposes, it would appear they should be classified as new vehicles since they are sold as new vehicles, except for warranty starting purposes.

#8. OTHER LIFO DEVELOPMENTS

See page 24 for several recent IRS Letter Rulings/TAMs and finalized regulations on LIFO recapture. ✻

LIFO FOR USED VEHICLES - THEORY AND PRACTICE

Dealers have been experiencing inflation in all their inventories for many years. Consequently, LIFO can be every bit as beneficial for used vehicles as it has been for new vehicles. The "problem" with used vehicle LIFO is that there is no official guidance from the IRS on how the index calculations should be made...and the Alternative LIFO Methodology in Revenue Procedure 92-79 does not apply to used vehicles.

By way of disclaimer, keep in mind that there are no official IRS pronouncements on used vehicle LIFO and this article is a general summary/compendium of conversations with practitioners over the years. As such, it is not intended to be an interpretation of any "official" IRS position nor as specific advice in any specific fact pattern.

THEORY

The same theory or concept underlying new vehicle LIFO should be applicable in determining the inflation index for a used vehicle inventory. That theory is best expressed by an example: If a dealer had a 1993 Buick Skylark in the used vehicle ending inventory at December 31, 1994, then price inflation for the year would be determined by comparing that 1993 Buick Skylark at the end of the year with a 1992 Buick Skylark at the beginning-of-the-year. In other words, the age of the vehicle at the end of the year (expressed in terms of model years) is repriced against a vehicle of comparable age at the beginning-of-the-year.

Official regional used car guides may be used for repricing purposes using the January, 1995 guide to reference the average end-of-the-year December, 1994 cost of the 1993 Buick Skylark in the example above and the January 1, 1994 regional guide (showing the December, 1993 cost) would be used to determine the beginning-of-the-year cost for the 1992 Buick Skylark. To make LIFO "work" to reflect inflation for used car inventories, the vehicles being compared are one model year apart and are considered to be of the same "age." The 2 model year old vehicle at the end of 1994 is compared with an equally (2 model year) old vehicle at the beginning of the year (i.e., at the end of 1993).

In all other respects, the computation of the inflation index for the pool would be similar to any other LIFO dollar-value, link-chain index computation. The overall index for the pool is applied to the entire current cost of the pool in order to express that current year cost in its base dollar expression as of the beginning of the year. Increments, expressed in base dollar equivalents, are valued at current cost by applying whatever method has been elected in item 6(a) on Form 970. For simplicity and practicality, many computations use the same deflator index for the pool as the inflator index for that year's increment.

PRACTICE

1. According to several Letter Ruling/TAMs, there should be two pools: Pool #1: Used automobiles and Pool #2: Used light-duty trucks.

2. One hundred percent (100%) of the total dollars in ending inventory probably should be repriced in determining the inflation index for the pool.

3. Dealers electing used vehicle LIFO should retain indefinitely all of the underlying used vehicle invoices or other information on acquisition costs capitalized. In other words, the "books and records" requirement that taxpayers retain all underlying information for all years on LIFO would apply to used vehicle LIFO computations as surely as it applies to new vehicle LIFO computations. Don't forget that inadequate books and records is a situation that "may" warrant termination of the LIFO election under Revenue Procedure 79-23.

Therefore, if there are major problems in being unable to document prior year used vehicle LIFO computations, that may be a reason for considering a change request at this time (in order to get cut-off protection) even though the required post-change methodology may be somewhat more restrictive and possibly more expensive to compute on an annual basis. In other words, curing the prior year problem may be worth the future year inconvenience.

4. In referring to the regional guides..."Average" or "Wholesale" cost should be used, rather than loan values or retail values.

5. The IRS appears to now require the dealer's actual cost at the end of the year to be used in the repricing as the end-of-the-year cost instead of substituting a regional guide cost for that year-end model vehicle. (This reflects a change from a few years ago and the TAM 8906001 era.)

6. Similarly, the IRS now appears to require that if the dealer had a comparable vehicle on hand at the beginning of the year in the used car inventory, then the dealer's actual cost for that used vehicle at the beginning of the year would be treated as the beginning-of-the-year cost (instead of substituting a regional guide cost). In other words, in both instances, wherever possible the IRS appears to prefer

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to substitute the dealer's actual cost of the used vehicle for a cost factor taken from a regional guide.

7. In referring to the regional guides, where there is a BOY-EOY lack of comparability due to significant changes in the vehicle, the beginning-of-the-year cost probably should be the same amount as the end-of-the-year cost, essentially treating the non-comparable used vehicle as a "new item." As a consequence, that vehicle would have a 1.000 line index reflecting no price reconstruction at the beginning of the year and no inflation.

8. If a vehicle is so old that it cannot be located in the comparable regional guide being used for the beginning-of-the-year cost, then that vehicle also probably should have a line index of 1.000 reflecting the end-of-the-year cost as the beginning-of-the-year cost. In some instances, more detailed information regarding significantly older model years may be obtained from the *Black Book Official Old Car Market Guide*, rather than, for simplification or practical purposes, using 1.000 in lieu of any further search efforts.

9. It has been reported that in some Form 3115, Change in Accounting Method, requests involving used vehicle LIFO computations, the IRS includes a statement to the effect that the items used in computing the taxpayer's own prior year costs and its own current year costs are required to be comparable in order for the inflation indexes "to clearly reflect income" - and this is expanded to indicate that the vehicles are required to be comparable in terms of base vehicle model, options and accessories.

Does this mean the IRS requires comparability adjustments similar to those indicated in the Coordinated Issue Position "Definition of an Item," July, 1989? If so, this greatly complicates life for "simplified," do-it-yourself used car LIFO calculations.

10. In accounting method change situations, it appears the IRS establishes the general rule that the beginning-of-the-year cost of the equivalent item is determined by the cost of that particular vehicle's previous year's model - if such were in inventory at the time. As an exception, if the item was in existence at the beginning of the year but not in the dealer's inventory, then reference to external publications (such as Kelley Blue Book, Black Book, NADA Guides) is permitted. It would be advisable to consistently use the same guide book publisher over the years.

COST

Insofar as cost is concerned, for used vehicles in the ending inventory acquired by direct purchase at auction, the actual cost plus transportation (and any internal add-ons or reconditioning) is the cost figure generally used. Profit included in transfers from the Parts Department for parts or the Service Department for labor usually is not eliminated!

For vehicles acquired by trade-in, the net residual value "booked" as the cost of the used vehicle may be reduced to a regional guide valuation at the end of the month in which the trade occurred. If this latter adjustment has been consistently made, that would appear to be a "method of accounting" in determining cost that the IRS will accept in connection with used vehicles. See Issue 6 in PLR/TAM 8906001 which states that: "(The dealer) frequently allows a higher trade-in value for a used vehicle simply as a marketing tool. We believe that the use of a common guide such as the Kelly (sic, Kelley) Blue Book to value used vehicles accepted as trade-ins is a proper method of valuing such vehicles. However, M (the dealer) must determine the cost of its used vehicles taken as trade-ins only at the time of their purchase from the customer. Any future writedowns are impermissible since a LIFO taxpayer must value its inventory at cost, not lower of cost or market."

Dealers making a writedown at the end of the calendar quarter may be stretching their luck! And definitely not at the end of the year.

Revenue Ruling 67-107 provides that used vehicles taken in trade as part payment on the sale of another vehicle may be valued at a cost equal to the amount representing the average wholesale price listed by an official used car guide at the time of the trade-in. If the dealer values his used vehicle inventory at lower of cost or market, then the inventory value of trade-ins not sold at the end of the year is adjusted to conform to the average wholesale price listed at that time. However, with used vehicles on LIFO, there could not be any further writedowns to guide values at the end of the year...and if such writedowns were made, they would have to be reversed so the ending inventory is at cost.

WHAT IF USED CAR LIFO INDEXES WERE NOT PROPERLY COMPUTED IN THE PAST?

You may want to consider filing Form 3115 for permission to change methods if you want to obtain protection from a possible IRS audit adjustment. "Problems" in the calculation method or "problems" with record retention/documentation to specifically identify used vehicles in ending inventory and their cost in prior years may generate concern. If you are not under audit when the Form 3115 is filed, LIFO changes requested under Revenue Procedure 92-20 usually are made using the cut-off method...and that may be a result well worth the filing.

OTHER RECENT LIFO DEVELOPMENTS

- ***HAMILTON INDUSTRIES* UPDATE**

In Letter Ruling 9446003, inventory acquired at a discount was required to be placed in a separate LIFO pool from similar inventory. The inventory acquired at a discount had received an allocation of less than a current dollar-for-dollar valuation under a residual allocation method. This inventory was deemed to have different cost characteristics - which were not altered through a Section 351 transfer - and thus, retained their different cost characteristics from similar goods.

- **LEASED MACHINERY WAS INVENTORY FOR LIFO PURPOSES**

In Letter Ruling 9448004, a heavy construction equipment dealer was allowed to include leased machinery in its LIFO inventory pools. This Letter Ruling involves a number of other "problems" with the LIFO computations and mechanics. However, the most significant holding in it is that prior examinations by the IRS of this taxpayer did not prevent IRS auditors from going back for more later.

- **ITEM DEFINITION CHANGE GETS CUT OFF**

In Letter Ruling 9445001, the IRS held that a change in method of defining an item can result in protecting prior LIFO computations through the use of the cut-off method.

- **COMPONENTS OF COST**

In Letter Ruling 9445004, involving a components-of-cost situation, the National Office permitted the extension of a LIFO election to labor and overhead, but held that that labor and overhead had to go into the related raw material pool. In other words, labor was not a separate item to be placed in a separate pool. This is consistent with earlier Technical Advice in Letter Ruling 9405005, which was discussed in the March, 1994 *LIFO Lookout.*

- **DUAL INDEXES FOR VALUING INCREMENTS**

In Letter Ruling 9444002, involving increment valuations, the IRS National Office held that where a dual index method was used in connection with Consumer Price Index approach, the taxpayer had to use the same index reflecting current year inflation to value any increment experienced in the current year to bring it from its base dollar equivalent up to its current cost. The taxpayer was not allowed to value an increment by using an index based on the last month of the previous year.

- **FINAL LIFO RECAPTURE REGULATIONS**

Regulations were finalized effective October 7, 1994 providing that C corporations that transfer LIFO inventories to an S corporation in a tax-free reorganization are also subject to the LIFO recapture rules of Section 1363(d). The C corporation must include the LIFO recapture amount in its gross income in the year of transfer of the LIFO inventory (and not in the transferor corporation's last year of existence).

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