

De Filipp's

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 FOR AUTO DEALERS. This is still the hottest LIFO issue facing auto dealers and their CPAs. Unfortunately, many from both groups mistakenly believe the IRS is anxious to jump right in and solve the problem for them. This is definitely not the case. Developments in the last 90 days show no progress toward any resolution. If anything, they suggest some IRS backpedaling and lack of interest.

We pointed out in December that a high percentage of auto dealers - if not virtually all of them - don't stand a chance of satisfying the IRS' recent strict interpretation of the "conformity requirement" that the LIFO reserve adjustment should be run through the Cost of Goods Sold section in the Income Statement.

A limited survey conducted by NADA came up with the startling conclusion reported by Peter Kitzmiller at the NADA Workshops in Dallas that an estimated 85% of all dealers on LIFO are in violation of the conformity requirement in past years...and this means they do not have valid LIFO elections! If anything, we believe 85% understates the statistic based on the Catalog of Conformity Nightmares compiled in our December issue.

The meeting with the IRS originally scheduled for early November, 1994 was not held until a few weeks ago. At this meeting, NADA attempted to impress upon the Internal Revenue Service the industry-threatening nature of this issue. Judging by its action to date, the IRS appears unconvinced that an industry-wide or industry-threatening problem exists. By no means is the "Service" on a "fast track" to help NADA and its dealers solve "their" LIFO problem.

Now, some agents are going back into dealerships after completing their audits - even after looking at LIFO once - and saying they need to look again at how LIFO was presented in the year-end financial statements to the manufacturer. And, the IRS seems to be stirring around in the past trying to find out what

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information NADA distributed almost 15 years ago warning dealers about these conformity problems.

One manufacturer will be changing its financial (i.e., income) statement in a few months to allow for the LIFO adjustment to be run through the Cost of Goods Sold section. Hopefully, this will specifically address the technical arguments more recently raised by the IRS. But what about past years' peccadillos?

I expressed my own views to Commissioner Richardson several months ago...see page 3.

Meanwhile, a number of technical advice requests in the National Office are on hold while the IRS keeps the conformity issue under advisement. There is always the possibility that circumstances may force some dealer to go to court fairly soon if the IRS sits on this long enough. The IRS probably would like this because many dealer situations have different fact patterns which are collectively, and loosely, referred to as "conformity" problems. Lumping these situations together in NADA's general discussions

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with the IRS, while addressing the specific technical and factual patterns one-on-one in attempting to resolve them, makes it all the more difficult to focus on what it will take to solve this problem.

What will it take to solve this problem?... Nothing less than a Revenue Procedure telling dealers specifically how and where they should report LIFO reserve changes in their Factory financial statements and granting an unconditional amnesty for all prior year reporting deficiencies. Go back and re-read the December Update page 1...this issue vitally affects each dealer on LIFO. Write your representatives in Congress to press for this result.

#2. EVALUATING LIFO & OTHER RECENT CONSULTATION EXPERIENCES.

We have summarized several consulting experiences over the last few months which you may find interesting. In several instances, what initially looked like "sure" LIFO elections for 1994 turned out to be situations where the election was concluded to be inadvisable despite strong indications that costs and prices had risen significantly. On closer analysis we found that inventory purchases during early 1994 reflected favorable purchasing contracts and the effects of those lower contract costs were still evident in inventory on hand at year-end. Consequently, even though inventory costs will be rising significantly when these favorable contracts expire, that will not really be felt until 1995...which is now the target year for reconsidering a number of LIFO elections. (See pages 16-17.)

#3. STATISTICAL SAMPLING APPLICATIONS.

We continue to find that statistical sampling can significantly eliminate work and increase reliability of results in LIFO applications. In this regard, we have recently been engaged to assist in IRS audits to try to defend the "sampling" that was done to come up with inflation indexes. In other situations we have been implementing stratified sampling for various LIFO elections using special software written for this purpose.

Many firms mistakenly apply "attribute sampling" to their LIFO calculations without having the slightest idea of why this is wrong or what they should be doing.

The article and materials in this issue on sampling were written by Kim De Filippis and explain how statistical sampling can be applied effectively in computing LIFO indexes.

#4. OTHER LIFO DEVELOPMENTS AT A GLANCE.

We continually review information coming out of the IRS, the Courts and elsewhere for developments that shed new light on our prior coverage. To help keep these items in focus (and in our rear view mirror!) see page 4 and the other new developments in "What's New, What's Hot and What's Not."

#5. ALTERNATIVE LIFO METHOD - AN UPDATE.

We have closely followed the Alternative LIFO Method for automobile dealers since its unveiling in September, 1992 as Revenue Procedure 92-79. Included in this issue (pages 20-21) is a summary of the Alternative LIFO Method prepared, in part, from recent consent letters issued by the IRS.

Informally, the IRS has indicated that a number of changes in Rev. Proc. 92-79 would be beneficial to clarify some questions of interpretation, including the question of "How far down do you have to go in determining item categories?" However, technical clarifications or interpretations of Rev. Proc. 92-79 realistically cannot be expected until the greater issue of conformity is settled.

On page 23, we have included some of the December, 1994 year-end inflation indexes we have computed for dealers using the Alternative LIFO Method. Obviously, dealers have different inventory mixes at year-end, but spread over enough applications, this information may be helpful.

#6. NEW ITEM CATEGORIES FOR 1995

MODELS: OUR "UNOFFICIAL" LIST.

In early January, we pre-released our "unofficial" listing of new item categories for the 1994-1995 new models in year-end inventories. This listing is included in this issue and it marks our third annual release of this information. As always, we welcome your comments and reactions.

#7. THANKS FOR THE KIND WORDS. Our efforts in this publication were favorably commented on by Bill Raby in his February, 1995 *Raby Report on Tax Practice*. Bill was kind enough to say: "One of the CPA tax practitioners who occupies a real tax niche in a class by himself is Willard J. De Filippis, of Mt. Prospect, Illinois. His niche? LIFO inventory. Among other things, he publishes De Filippis' *LIFO Lookout*, which is the bible when it comes to LIFO inventory for auto dealers."

We hope you will find the *LIFO Lookout* equally worthwhile when your LIFO application interests extend beyond automobile dealerships.

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MARK YOUR CALENDAR
JUNE 29 IS THE 180TH "MAGIC DAY"
FOR FILING FORM 3115 CHANGE REQUESTS
WITH THE IRS NATIONAL OFFICE
(WASHINGTON, DC)
AND THE FILING FEE IS NOW \$900



Department of the Treasury
Internal Revenue Service
Office of the Commissioner
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A LETTER TO THE COMMISSIONER

RE: LIFO FINANCIAL STATEMENT CONFORMITY FOR AUTO DEALERS REPORTING TO MANUFACTURERS

Dear Madam Commissioner:

I am writing regarding a problem area that involves thousands of automobile dealers who have elected the LIFO (Last-In, First-Out) method for valuing their inventories.

These dealers are now being threatened by examining agents who have adopted aggressive and restrictive interpretations of the regulations as they relate to the year-end financial reports that auto dealers using the LIFO method are required to submit to their manufacturers. We are told that these restrictive interpretations must result in the (retroactive) termination of the LIFO elections because the reporting requirements were violated and the Commissioner will not exercise discretion to waive the termination penalty.

This problem area warrants a close review by your Office: Historically, examining agents, District Directors and Appeals Officers have been inconsistent in interpreting and enforcing these regulations as they relate to auto dealers. Furthermore, these inconsistencies in interpretation and enforcement are continuing today in different parts of the country.

It is my understanding that uniformity and consistency in the treatment of all taxpayers in all parts of the country affected by the same issue is one of the desired "Compliance 2000" objectives. If my understanding is correct, then we have here a most egregious example of 25 years of activity that is still inconsistent with this objective.

Digressing ever so briefly to the heart of the technicality, the regulations contain no express language or guidance indicating how the term "Internal Management Reports" is to be interpreted where it overlaps with the possibility that an auto dealer's year-end financial statements may be used "for credit purposes." The regulations, when changed in 1981, simply "reserved" a definition for management reports which has never been amplified. There are simply no guidelines, examples or illustrations.

Part of the problem is that the regulations do not clearly address the complex business situation. Part of the problem is that the manufacturers requiring the submission of year-end financial reports have different reporting requirements and some do not understand - nor want - and even refuse - to be encumbered by LIFO disclosures. Still another part of the problem is that many auto dealers have changed accounting firms many times over the years and in the process, they may not always have had CPAs who read the regulations and then guessed what the current interpretations by today's aggressive agents might be...

All of this gives aggressive agents the leverage to threaten auto dealers with the retroactive termination of their LIFO elections in virtually every audit situation.

In my opinion, almost all automobile dealers stand to lose their LIFO elections if the extreme interpretations advanced by aggressive examining agents are correct or unchecked and your Office declines to grant relief or otherwise intervene in this matter.

I have been a CPA for more than 30 years, most of them working with auto dealers and their technical LIFO problems. In recent months, I have talked with several hundred CPAs and virtually none of them - upon careful reflection of the list of conformity traps on pages 6 and 7 - feels comfortable (let alone confident) with the LIFO "conformity" practices of their dealers over the years. Please reflect for a moment on the ruinous consequences from a professional liability standpoint to thousands of CPAs and their staffs who may be held accountable by their dealer clients for the loss of their LIFO elections!

Even the threat of terminating auto dealer LIFO elections based on the narrow interpretations of the conformity requirements seems to be completely inconsistent with the philosophy underlying all of the "Compliance 2000" principles and other cooperative taxpayer-compliance initiatives that the Office of the Commissioner has announced and encouraged in recent years.

We are all experiencing a tragic - and enormous - waste of time and resources over this. Uncertainty and delay only compound this misuse of time and intellect. Decisive and immediate action by your Office can halt this enormous drain and rechannel all our efforts into more productive areas.

If encouraged by your Office, reasonable clarification and guidance on a prospective basis will convert the disbelief many CPAs now have regarding "Compliance 2000" rhetoric into positive attitudes that will be carried over to countless other areas where unbiased judgment and good faith compliance efforts are called for every day.

On behalf of many automobile dealers, the thousands of dealership employees who may be out of jobs if dealerships cannot financially cope with loss of their LIFO elections, and many, many CPAs, please consider this plea to you for the exercise of discretion by your Office in this matter...

WILLARD J. DE FILIPPS, CPA
January 11, 1995

COMMISSIONER'S REPLY - SEE PAGE 24



CURRENT DEVELOPMENTS: WHAT'S NEW, WHAT'S HOT AND WHAT'S NOT

Over the past year, our feature articles have tracked several major developments. Part of knowing what's going on involves an update on whether the IRS or the Courts have added anything "new" lately.

<u>Recent Area of Interest or Concern</u>	<u>Coverage</u>	<u>Comment</u>
General		
• Components of Cost LIFO	March, 1994	Nothing New
• Replacement Cost Accounting for "Parts-Type" Inventories	June, 1994	Nothing New
• Revenue Procedure 94-61 LIFO Recapture Tax and Mechanics	Sept., 1994	Nothing New
Auto Dealer LIFO		
• Used Car LIFO	Dec., 1994	Nothing New
• LIFO Financial Statement Conformity Requirement for Auto Dealers	Dec., 1994	See Page 1 Update #1
Alternative LIFO Method		
• "New Item" Lists for 1994 and 1995 Model Vehicles	Various	See pages 20-21 See Pages 9-16
• Comparison of IRS "Unofficial" New Item Lists	June, 1994	Nothing New
• Revenue Procedure 92-79 Compliance Checks: Is Confusion Creeping Back Into The Alternative LIFO Method?	Sept., 1994	Nothing New
• How Far Should You go in Determining Item Categories?	June, 1994	Nothing New

RECENT DEVELOPMENTS: WHAT THE IRS HAS SAID LATELY PERMISSION TO TERMINATE LIFO ELECTION

Letter Ruling 9504040 describes a taxpayer who mistakenly believed that it was eligible to change its method of accounting from LIFO to FIFO under the automatic provisions of Revenue Procedure 88-15. In other words, this taxpayer wanted to terminate its LIFO election.

The procedure for terminating a LIFO election depends upon whether Revenue Procedure 92-20 or Revenue Procedure 88-15 is involved. Revenue Procedure 88-15 (1988-1 CB 683) is a more specialized procedure that allows certain taxpayers to obtain expeditious consent (which includes waiver of the user fee) to discontinue the use of LIFO. This Revenue Procedure will apply to voluntary termination requests unless the taxpayer is ineligible for its provisions, in which case Revenue Procedure 92-20 (1992-12 IRS 10) will be applicable. Revenue Procedure 92-20 is the more generalized procedure covering all changes in methods of accounting, including terminations of LIFO elections not subject to Rev. Proc. 88-15.

Usually, it is preferable for the LIFO termination to be made under Revenue Procedure 88-15 because it allows the filing of Form 3115 as late as 270 days after the start of the year of termination. Revenue Procedure 88-15 can be used by any taxpayer desiring to discontinue the use of the LIFO method for all of its inventories on LIFO and who will change to a prescribed method.

When the taxpayer discovered that it was not eligible to terminate its LIFO election by filing under Rev. Proc. 88-15, it subsequently filed its application under Rev. Proc. 92-20 - but that filing occurred well beyond the allowable 180 day period.

In this case, the IRS granted an extension of time to file Form 3115 to obtain permission to terminate the LIFO election in the current year. However, this permission was granted only after the IRS reviewed various affidavits and other evidence to determine that the taxpayer had acted reasonably and in good faith. This relief was granted under a special regulation which provides that the Commissioner may, upon good cause shown, grant a reasonable extension of time for the making of an election or application for relief...provided:

1. The time for making such election or application is not expressly prescribed by statute;
2. The request for the extension is filed with the Commissioner before the time fixed for making such election or application, or within such time thereafter as the Commissioner may consider reasonable under the circumstances; and
3. It is shown to the satisfaction of the Commissioner that the granting of the extension will not jeopardize the interests of the Government.

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EXTENSIONS OF TIME TO FILE FORM 970 TO ELECT LIFO

In **Letter Ruling 9506033**, the IRS ruled that a corporation which had received the assets and liabilities of another corporation pursuant to a transfer agreement and had failed to file Form 970 with respect to those acquired inventories, would be granted an extension of time to file a Form 970 to properly elect to use LIFO. The failure to file had been discovered by the corporation in a subsequent year when a Form 3115 was being prepared and a copy of the Form 970 (that should have been filed) could not be found.

This Letter Ruling is interesting because it involves a reorganization involving several automobile dealerships and transactions under Section 355 and 368 of the Internal Revenue Code. Interestingly enough, the Statements of Fact in the Letter Ruling indicate "a public accounting firm, Firm A, which specializes in tax matters, was engaged to prepare Corporation X's tax returns and corresponding elections. Firm A failed to prepare and include Form 970 in Corporation X's tax return for its tax year ended XXX. Notwithstanding this failure to file Form 970, Corporation X began to use the Last-In, First-Out (LIFO) method as if such method had been properly elected for both tax reporting and financial statement reporting purposes. Corporation X relied upon Firm A to notify it of any election requirements and to prepare such elections, and Corporation X was not aware of its obligation to file Form 970."

What happened was that Corporation X eventually hired another accounting firm to provide tax compliance and consulting services and it was this new firm that advised Corporation X to change its inventory method for tax purposes. In the course of preparing a Form 3115 to request permission to change its accounting method, when the new tax advisors requested a copy of the Form 970 that should have been filed by Corporation X in an earlier year when it first adopted LIFO, Corporation X could not find the Form 970 because it had never been filed in the first instance.

Note: This sort of thing happens all the time and this ruling presents a typical fact pattern: Many times a deficiency in LIFO election procedures or computation mechanics is discovered by the next accounting firm that comes along and this "discovery" is made well in advance of any audit or other intervention by the Internal Revenue Service. When this happens, action should be taken under Revenue Procedure 92-85 to request the IRS to grant an extension of time to file the Form 970 that originally should have been filed.

Section 5.01 of Revenue Procedure 92-85 provides that a taxpayer will be deemed to have acted reasonably and in good faith if the taxpayer applies for relief before the Internal Revenue Service discovers the taxpayer's failure to make the election. However, if the taxpayer's old position could subject the taxpayer to an accuracy-related penalty and the new position gives rise to the election for which the taxpayer seeks relief,

or if the taxpayer was fully informed of the election and chose not to make it, the presumptions of reasonableness and good faith do not apply. Further, the taxpayer may not use hindsight in requesting relief.

Section 5.02 of Revenue Procedure 92-85 further provides that the interests of the Government are prejudiced if granting relief would result in a taxpayer having a lower tax liability in the aggregate for all years to which the election applies than the taxpayer would have had if the election had been timely made (taking into account the time value of money).

In Ruling 9506033, the IRS did grant relief and allow the taxpayer to keep its LIFO election by filing Form 970.

SECTION 351 TRANSFERS AND THE NEED FOR FILING FORMS 970

In two similar rulings, **Letter Ruling 9507015** (November 15, 1994) and **Letter Ruling 9511016** (December 15, 1994), the IRS continued its generosity in granting requests for extension of time to file Form 970 when that filing requirement had previously been overlooked. Requests in these two Letter Rulings were made in accordance with Section 5 of Revenue Procedure 92-85 upon the discovery that Forms 970 should have been filed in connection with corporate restructurings and reorganizations.

In **Letter Ruling 9507015**, the IRS granted an extension of time for a parent company to file Form 970 on behalf of a wholly-owned, second-tier subsidiary for the first year required with regard to the subsidiary's inventory (All inventory of the first-tier subsidiary was transferred to the second-tier subsidiary in a non-taxable exchange under Section 351.)

Central to both ruling requests was the position expressed in Revenue Ruling 70-564 which holds that a transferee corporation that acquires inventories reported pursuant to the LIFO inventory method in a non-taxable exchange under Section 351(a) must file a Form 970 in order to adopt the LIFO method for those inventories. Incidentally, Revenue Ruling 70-564 also requires that the average cost method must be used to determine the opening inventory for that year.

LESSONS

- Whenever dealing with a Section 351 transaction, the necessity for filing a Form 970 should not be overlooked. Given the slightest doubt, file a Form 970 as a preventative measure.
- Failure to file Form 970 would result in the retroactive loss of the LIFO election just as surely as if a financial statement conformity violation had occurred.
- Whenever you acquire a new client who uses LIFO, immediately account for all necessary prior Forms 970.

see **CURRENT DEVELOPMENTS**, page 24



STATISTICAL SAMPLING & LIFO INVENTORY APPLICATIONS

Many CPAs are not currently taking advantage of the benefits of a LIFO election for their manufacturer and wholesaler clients' inventories, or for their retailer clients' parts inventories - especially in situations where the computer systems are not set up to completely reprice all items in ending inventory.

At least two misperceptions may be involved:

- The first misperception is that the tax benefit of a parts-type LIFO election is likely to be an insignificant dollar amount and, therefore, LIFO is not worth bothering with.
- The second misperception is that without the capacity to have the computer do all the work, it is either impossible to compute a LIFO inflation index or the effort involved in manually computing that index would far outweigh any LIFO reserve benefit that resulted.

In many cases, these perceptions simply are not true. As long as prices are increasing and inventory levels are remaining constant or growing from year to year, there are potential significant tax savings with the election of LIFO for parts or other inventories. Consequently, for a client willing to invest a modest amount in a specialized planning effort, the return on that investment can be substantial.

One of our recent statistical sampling LIFO consultations involved a retailer who had multiple pools and was using sampling to compute inflation indexes. Over a 10 year period, the company accumulated a combined LIFO reserve build-up of nearly \$900,000. Another consultation involved sampling for a retailer's relatively small parts inventory, but the end result was an initial year LIFO reserve of approximately \$20,000 with significantly larger savings anticipated in future years, with all the initial "set up" costs behind them.

In situations where a client's computer system is not equipped to handle a complete repricing of all items in ending inventory and it is impractical to use the double-extension method, Regulation Section 1.472-8(e)(1) allows for the computation of a LIFO inflation index by "double-extending a **representative portion of the inventory in a pool or by the use of other sound and consistent statistical methods.**" In other words, to obtain the benefits of a LIFO election for these inventories, it is necessary to compute the inflation index by means of a statistically sound sample.

This may appear to be a daunting task, but with some specialized guidance and properly-planned and executed procedures, the work involved can be minimized and the benefit to the client maximized. In addition, once the sampling methodology is set, and a proforma of the required documentation report is complete, the amount of time spent in future years with respect to the sampling process should be minimal.

A key requirement for all LIFO applications is the necessity of maintaining "adequate books and records" to be used in support of the LIFO computations. The use of statistical sampling to compute inflation indexes necessitates additional documentation requirements, related specifically to the sampling process itself.

Sampling software packages which are appropriate for use in LIFO applications are difficult (nearly impossible?) to obtain, yet they are an integral part of computing and evaluating the indexes accurately and cost-effectively. In our experience we have seen many CPA firms mistakenly trying to "fit" their LIFO-related sampling applications into existing audit sampling software packages, in an attempt to "make do with what's available."

While one may sympathize with this approach, it is simply incorrect and most likely will not stand up in an audit situation under close scrutiny by an IRS Computer Audit Specialist (CAS). We have found it to our advantage to have software tailor-made to our LIFO applications and current IRS "specifications." Apparently many major accounting firms also have their own sampling software packages for use with their own clients.

For illustration purposes only, attached is an abbreviated and modified version of a Documentation Report where statistical sampling was used in connection with a parts inventory. This Documentation Report outlines and describes the key steps involved in the sampling process and it explains the IRS' position on the acceptability of LIFO indexes computed via statistical sampling methods. In addition to the written narrative portion, a comprehensive documentation report package should include detailed information relating to the preliminary and final sample results (e.g., detailed index computations, statistical evaluation results), a copy of the random numbers generated, and all other supporting information.

This adds to our prior coverage on the use of sampling in LIFO applications:

- "Statistical Sampling Guidance for Parts Inventories," (September, 1993, pages 4 and 5),
- "Sampling Shortcuts: Don't Even Think About Trying These," (September, 1994, page 16), and
- "Prohibited Sampling Shortcuts Text of ISP Coordinated Issue Paper: Segment of Inventory Excluded from the Computation of the LIFO Index," (September, 1994, page 17). *



XYZ COMPANY
SAMPLING DOCUMENTATION REPORT
DECEMBER 31, 1994

**SAMPLE
REPORT**

SAMPLING PLAN

The objective of the sample was to compute a statistically valid and reliable LIFO inflation index for XYZ Company's Parts Inventory pool by the use of "sound and consistent statistical methods." This was accomplished by designing and executing a well-defined stratified random sample.

The population sampled included the total of all "AA Parts" and "BB Parts" which were in inventory at December 31, 1994. An "item" was defined as the total quantity of each unique item (based on stock number) in the taxpayer's ending inventory.

The 1994 Parts Inventory pool had an exact population size of 12,345 (i.e., there were 12,345 unique items in inventory at year-end).

The frame used for sampling purposes was the inventory listing extended by stock class at December 31, 1994. This report was 451 pages long, with no uniform number of items per page. In addition to the items included in the sample (i.e., AA Parts and BB Parts), this listing included other items such as XX Parts and YY Parts; however, these other items were not included in the sample in any way (because they were not included in the LIFO election). The sampling frame excluded all items having zero quantity on hand at the end of the year.

XYZ Company manually counted and numbered the items in the population to be sampled (i.e., AA Parts and BB Parts) in order to determine the exact (versus estimated) population size. Any items not to be sampled (e.g., XX Parts, YY Parts) were not included in the count. In addition, blank lines and lines showing additional detail for items already counted (i.e., the second line of an item description) were not included in the population count. **Consequently, only valid sampling items were included in the population count.**

STRATIFICATION

The Parts Inventory pool was stratified by dividing the pool into two segments: a "high dollar stratum" which was sampled 100%, and a stratum containing the remainder of the population, which was randomly sampled. The results of the samplings for the different strata were then combined into an overall estimate, or inflation index (using a combined ratio estimator) for the entire population.

The purpose of stratification of the population is twofold: (1) to decrease the sampling error (i.e., "precision") without increasing the sampling size and (2) to result in a more "representative" sample. If the population is divided into homogeneous groups, that is groups that have little variation in the characteristic being measured (i.e., the amount of inflation from beginning of the year to end of the year), then the variability of the overall estimate based on the stratified sample will be less than the overall sample based on a simple random sample of the population.

The population was divided into 2 strata:

Stratum 1. This stratum consisted of all items in the population which had an extended dollar value of less than \$1,000. The total number of items in this stratum was 12,301.

Stratum 2. This "high dollar" stratum consisted of all items with an extended dollar value of \$1,000 or greater. There were 44 items in this stratum.

In stratum 1, items were sampled randomly, based on random numbers generated. In other words, no judgment was used in the selection of the individual sampling units in this stratum.

All 44 items in the "high dollar" stratum (i.e.,

stratum 2) were sampled and repriced, resulting in a 100% repricing in this strata.

The following are standard requirements for stratification of a population. All requirements were met:

The population was divided into non-overlapping strata.

The combination of all strata included the entire population.

The samples selected from each strata were mutually exclusive of one another.

The total sample size of 150 items (excluding the 44 items in the high dollar sample) exceeded the minimum total sample size requirement of 100 items.

The strata sizes of 150 items and 44 items exceeded the minimum stratum size requirement of 25 items.

The sample was a valid stratified random sample.

SOURCE OF RANDOM NUMBERS

One set of random numbers was generated for the Parts inventory pool in order to draw the random sample from stratum 1.

The random starting point (seed number 49816) was chosen by the software.

A total of 150 random numbers within the range of 1 to 12,345 were generated for the preliminary sample.

PROCEDURES FOLLOWED

The random numbers generated were matched to the corresponding item number in the population. This was done by taking, in the order generated, each of the random numbers selected and locating the item from the ending inventory listing with the corre-

see **SAMPLING DOCUMENTATION REPORT**, page 8



sponding number (based on the earlier numbering which determined the exact population count). These items comprised the sample. None of the random numbers generated corresponded to an item already included in the high dollar stratum. In addition, because an exact population count was taken, there were no "invalid" items included in the population; consequently, **there were no instances of an invalid item being selected.**

A list of all 150 items (plus the 44 high dollar stratum items) selected for the preliminary sample was compiled.

XYZ Company then located beginning-of-the-year and end-of-the-year prices for each item in the sample. In any instance in which there was an item for which a beginning-of-the-year price was not available (i.e., a "new item"), the current cost of that item (i.e., end-of-the-year cost) was used as the beginning-of-the-year cost. This resulted in an LIFO inflation index of 1.000 for those items.

All items selected for the sample (150 items via random numbers + 44 "high dollar" items = 194 total items) were repriced at both beginning-of-the-year and end-of-the-year prices. All selected items were treated consistently; no items were omitted from the sample.

Upon completion of the sample repricing, a detailed spreadsheet and data file was developed. This detailed spreadsheet and data file showed the following information for each item: the random number, corresponding item number, item description, quantity at end of year, 1994 cost, 1993 cost and extensions to weight the quantity times the respective costs.

The data files were then reformatted and modified for compatibility with the sample evaluation software being used.

All 150 items for which random numbers were generated were included in the sample and repriced.

The next step was to verify the files to ensure that (1) the correct random numbers had been used, (2) all data had been transferred from the spreadsheet to the evaluation software correctly, and (3) the extended dollar amounts were calculated/weighted to correctly reflect inventory quantities.

SAMPLE EVALUATION

The sample estimate of the LIFO inflation index and corresponding precision for the preliminary sample were then calculated by using the software package, LIFO (licensed for the exclusive use of Willard J. De Filippis, CPA, P.C. by ...). Mr. ... developed and tested this software and he has developed software used by the IRS for its own sampling, as well as the programs used by the Defense Contract Audit Agency.

The program uses a combined ratio estimate for a stratified sample.

The precision was calculated using a 95% 1-sided confidence level, as required by the Internal Revenue Manual.

The preliminary sample, excluding the results of the 100% high dollar stratum resulted in an inflation index of 1.0354. The precision of the index was .020. The coefficient of variation of the index was .012.

The results of the preliminary sample fell within the determined acceptable range for a preliminary sample; consequently, it was decided that no further sampling was necessary.

The final index, precision and coefficient of variation were then calculated, based on all items sampled (i.e., the 44 items in the high dollar stratum and the 150 items in the remaining strata). The final sample results are as follows:

Sample size:	194
Dollars sampled	\$93,589
% sampled of total dollars	15%
Inflation index:	1.032417
Precision at 1-sided 95% CL:	.0168
Coefficient of variation:	.010

It should be understood that the IRS recognizes and requires the need for some control over the precision of a sampled LIFO index before allowing the use of the index point estimate. Either a prescribed sample size, a set precision or a coefficient of variation limit has been required. Failure to meet the particular standard set forth makes the sample results unacceptable to the Service.

The current LIFO regulations offer no guidelines as to the standards of accuracy which would be acceptable with regard to the precision of an estimated LIFO index. Despite this lack of guidance, there are a few official positions which deal with sampling which may offer a guide to be considered in LIFO index situations. It is further understood that meeting the requirements of any of these official positions will be treated as adequate support for use of the index estimate made by the taxpayer.

The most commonly referenced and most relevant position is found in Revenue Procedure 64-4. Rev. Proc. 64-4 requires a sampling procedure and sample size such as to provide for a precision of about 3.5% at a 95%, one-sided confidence level. If this requirement is met, the point estimate is allowed.

XYZ Company's precision of the estimated LIFO index at a 1-sided 95% confidence level is 1.68% - falling well within the requirements of Revenue Procedure 64-4.

XYZ Company has carefully controlled the precision of the sample estimate and has met the burden of proof required in order for the point estimate to be considered an acceptable LIFO inflation index.

UNUSUAL FACTORS AND/OR COMPLICATIONS

No complications or unusual factors were encountered in the sampling process.

see **SAMPLING DOCUMENTATION REPORT**, page 24



“NEW ITEM” 1995 MODELS IN DECEMBER, 1994 INVENTORIES OUR “UNOFFICIAL” LIST

We are pleased to include our "unofficial" new item categories listing for 1995 models based on our review of model change information from various sources. As you know, NADA tried to coordinate with the IRS for a timely, "official" list of new item categories for 1995 models, but this initiative fell flat.

New item categories under the Alternative LIFO Method are required to be included in the annual inflation index computation at a 1.000 factor. This is accomplished by using the end-of-the-year base cost as the beginning-of-the-year base cost. Since any number divided by itself equals 1.000, a new item contributes no inflation to the annual index.

We believe we can anticipate most of the "new item" categories and identify those situations where Revenue Procedure 92-79 requires some interpretation. We expect that in developing its own list of new items, the IRS/MSSP will treat anything debatable or questionable as a new item...thus stretching the literal wording of Revenue Procedure 92-79...to the disadvantage of auto dealers (naturally!)...just as they did with the 94's.

We repeat: **our list is not an official listing - it is simply a summary of our own conclusions.**

A new item category is described in Section 4.02(5) of Revenue Procedure 92-79 as:

NEW ITEM CATEGORY

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

(Continued on page 10)

CADILLAC REGIONAL DISTRIBUTION CENTER PROGRAM RECAPTURES DEALER LIFO RESERVES

The Regional Distribution Center (RDC) test program that Cadillac initiated last year in Florida may be expanded to other parts of the country. One consequence of the program could be detrimental from a LIFO standpoint to dealers who will have smaller year-end inventories. This creates the strong likelihood that the decreases in year-end inventory levels will be substantial enough to trigger large LIFO reserve recapture payments. As a consequence of the RDC program, one Florida dealer reportedly experienced a \$2 Million recapture in his LIFO reserves. (Ouch!...unless you've got a net operating loss about to expire unused!!)

Key questions relate to legal title and ownership of the vehicles at year-end. For tax purposes, will dealers "own" vehicles that are in the Regional Distribution "pool?" Or will vehicles in that pool be available to be claimed by any one of many dealers in the region covered by the "pool?" If a specific vehicle is not in any one dealer's inventory until an actual claim is made for that vehicle so it can be delivered to the dealership or directly to the purchaser, the application of normal inventory concepts related to "vehicles in transit" or vehicles stored off the dealer's premises may not apply or they may be altered for LIFO purposes under these unusual circumstances.

Perhaps the way to get to the heart of the "ownership" question is simply to ask: Who is legally obligated to incur the loss if a casualty occurred and destroyed all the vehicles in the pool?" Would it be the Factory that stands the loss? Or, would it be the dealer?

Even if a RDC vehicle were "titled" to a specific dealer or "owned" by a dealer, the IRS might raise certain precedents favorable to it in disallowing the inclusion of goods in inventory "for LIFO computation purposes." Cases that come to mind include *U.S. v. Ingredient Technology Corp.* (83-1 USTC ¶9140) and *Illinois Cereal Mills* (46 TCM 1001 TC, Memo 1983-469). In *Ingredient Technology Corp.*, the Court pointed out that the concept of "inventory" would be meaningless if it were to include property..."under the corporate taxpayer's dominion, control, and at its risk about as long as the pea in the proverbial shell game is under the shell."

✱



ACURA	
INTEGRA	
3-DR COUPE GS-R W/LEATHER 5-SP	DC239
3-DR COUPE SPEC. EDITION 5-SP	DC436
3-DR COUPE SPEC. EDITION AUTO	DC446
4-DR SEDAN GS-R W/LEATHER 5-SP	DB859
4-DR SEDAN SPEC. EDITION 5-SP	DB756
4-DR SEDAN SPEC. EDITION AUTO	DB766
AUDI	
90 SERIES	
4-DR SEDAN 90 QUATTRO 5-SP	8C24U5
4-DR SEDAN SPORT 90 5-SP	8C26U4
4-DR SEDAN SPORT 90 AUTO	8C26U8
4-DR SPORT 90 QUATTRO 5-SP	8C26U5
A6 SERIES	
4-DR SEDAN 5-SP	4A23X4
4-DR SEDAN AUTO	4A23U8
4-DR SEDAN QUATTRO 5-SP	4A23U5
4-DR SEDAN QUATTRO AUTO	4A23U6
4-DR WAGON AUTO	4A53U8
4-DR WAGON QUATTRO AUTO	4A53U6
S6 SERIES	
4-DR SEDAN 5-SP	4A2555
BMW	
3 SERIES	
M3 2-DR COUPE	21
5 SERIES	
540i 4-DR SEDAN 5-SP	53
7 SERIES	
740i 4-DR SEDAN AUTO	74
BUICK	
CENTURY	
4-DR SEDAN 4CYL SPEC. MARKET EDITION	G69/SJ
4-DR SEDAN SPECIAL MARKET EDITION	G69/SK
4-DR SEDAN SPECIAL MARKET EDITION	G69/SL
4-DR WAGON 4 CYL SPEC. MARKET EDITION	G35/SJ
4-DR WAGON SPECIAL MARKET EDITION	G35/SK

(continued)

BUICK (continued)	
LESABRE	
4-DR SEDAN CUSTOM MARKET EDITION	4HP69
4-DR SEDAN LIMITED MARKET EDITION	4HR69
PARK AVENUE	
4-DR SEDAN MARKET EDITION	W69/SG
REGAL	
2-DR COUPE CUSTOM MARKET EDITION	B57/SJ
2-DR COUPE GRAN SPORT MARKET ED	F57/SK
4-DR SEDAN CUSTOM MARKET EDITION	B19/SJ
RIVIERA	
2-DR COUPE	D07
ROADMASTER	
4-DR SEDAN MARKET EDITION	N69/SJ
SKYLARK	
2-DR COUPE CUSTOM - FLEET	V37F
2-DR COUPE CUSTOM MARKET EDITION	V37/SJ
2-DR COUPE GRAN SPORT MARKET ED.	V37/SL
2-DR COUPE LIMITED MARKET EDITION	V37/SK
4-DR SEDAN CUSTOM MARKET EDITION	V69/SJ
4-DR SEDAN GRAN SPORT MARKET EDITION	V69/SL
4-DR SEDAN LIMITED MARKET EDITION	V69/SK
4-DR SEDAN CUSTOM - FLEET	V69F
CHEVROLET	
BERETTA	
2-DR COUPE MARKET ED W/1SLX	1LV37SLX
2-DR COUPE MARKET ED W/1SKX	1LV37SKX
2-DR COUPE MARKET ED W/1SMX	1LV37SMX
2-DR COUPE Z26 MARKET ED W/1SNX	1LW37SNX
CAPRICE	
4-DR SEDAN MARKET ED W/1SLX	1BL19SLX
4-DR SEDAN MARKET ED W/1SMX	1BL19SMX
4-DR SEDAN MARKET ED W/1SNX	1BL19SNX
4-DR WAGON MARKET ED W/1SPX	1BL35SPX
CAVALIER	
2-DR COUPE	1JC37
4-DR SEDAN	1JC69
4-DR SEDAN LS	1JF69

(continued) →

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"New Item" 1995 Models... An "Unofficial" List

(Continued)

SUBARU (continued)	
2-DR COUPE L AWD XL 5-SP - EARLY	SMG
2-DR COUPE L AWD XL 5-SP - FINAL	SMS
2-DR COUPE L AWD XL AUTO - EARLY	SMH
2-DR COUPE L 2.2 L AWD XL AUTO - FINAL	SMT
2-DR COUPE L FWD 5-SP - EARLY	SMB
2-DR COUPE L FWD 5-SP - FINAL	SMN
2-DR COUPE L FWD AUTO - EARLY	SMC
2-DR COUPE L FWD AUTO - FINAL	SMO
4-DR SEDAN 5-SP	SJA
4-DR SEDAN AWD 5-SP	SJF
4-DR SEDAN L AWD 5-SP	SJG
4-DR SEDAN L AWD 5-SP	SJI
4-DR SEDAN L AWD 2.2L AUTO	SJH
4-DR SEDAN L SPEC ED AWD 5-SP	SNB
4-DR SEDAN L SPEC ED AWD AUTO	SNC
4-DR SEDAN L SPEC ED FWD 5-SP	SNA
4-DR SEDAN L 5-SP	SJB
4-DR SEDAN L AUTO	SJC
4-DR SEDAN LX AWD 2.2L AUTO	SJJ
4-DR WAGON AWD 5-SP	SOC
4-DR WAGON L AWD XL 5-SP	SLF
4-DR WAGON L AWD DL 5-SP	SLH
4-DR WAGON L AWD 2.2L AUTO	SLG
4-DR WAGON L SPEC ED 5-SP	SOA
4-DR WAGON L SPEC ED AUTO	SOB
4-DR WAGON LX AWD 2.2L AUTO '95	SLJ
4-DR WAGON OUTBACK 5-SP '95	SLI
4-DR WAGON OUTBACK SPEC ED 5-SP	SOC
4-DR WAGON OUTBACK SPEC ED AUTO	SOD
LEGACY	
4-DR SEDAN 5-SP '95	SAA
4-DR SEDAN L 5 SP '95	SAC
4-DR SEDAN L AUTO W/PQ '95	SAD
4-DR SEDAN L AUTO W/RN '95	SAE
4-DR SEDAN L AUTO W/DQ '95	SAF
4-DR SEDAN L AWD 5 SP '95	SAM
4-DR SEDAN L AWD AUTO W/PQ '95	SAN
4-DR SEDAN L AWD AUTO W/DQ '95	SAO
4-DR SEDAN LS AWD AUTO '95	SAP
4-DR SEDAN LSI AWD AUTO '95	SAQ
4-DR WAGON BRIGHTON AWD 5-SP '95	SBJ
4-DR WAGON BRIGHTON AWD AUTO '95	SBK
4-DR WAGON L 5-SP '95	SBC
4-DR WAGON L W/PQ AUTO '95	SBD
4-DR WAGON L W/RN AUTO '95	SBE

SUBARU (continued)	
4-DR WAGON L W/DQ AUTO '95	SBF
4-DR WAGON L AWD W/DQ 5-SP '95	SBP
4-DR WAGON L AWD W/PQ 5-SP '95	SBN
4-DR WAGON L AWD W/DQ AUTO '95	SBP
4-DR WAGON L AWD W/PQ AUTO '95	SBO
4-DR WAGON LS AWD AUTO '95	SBS
4-DR WAGON LSI AWD AUTO '95	SBT
4-DR WAGON OUTBACK AWD 5-SP '95	SBW
4-DR WAGON OUTBACK AWD AUTO '95	SBX
SVX	
2-DR COUPE L AWD AUTO	SKC
SUZUKI	
SWIFT	
3-DR HATCHBACK 5-SP	HES532
3-DR HATCHBACK AUTO	HES552
3-DR HATCHBACK W/ABS 5-SP	HES533
3-DR HATCHBACK W/ABS AUTO	HES553
TOYOTA	
AVALON	
4-DR SEDAN XL BENCH	3536
4-DR SEDAN XL BUCKETS	3534
4-DR SEDAN XLS BENCH	3546
4-DR SEDAN XLS BUCKETS	3544
CELICA	
2-DR CONVERTIBLE GT 5-SP	2183
2-DR CONVERTIBLE GT AUTO	2184
TERCEL	
2-DR SEDAN DELUXE 5-SP	1315
2-DR SEDAN DELUXE AUTO	1316
2-DR SEDAN STD 4-SP	1301
2-DR SEDAN STD AUTO	1302
4-DR SEDAN DELUXE 5-SP	1325
4-DR SEDAN DELUXE AUTO	1326
PREVIA VAN	
WAGON DX S/C ALL-TRAC AUTO	5144
WAGON DX S/C AUTO	5124
T100 PICKUP *(see Toyota Note on following page)	
2WD REG BED AUTO	8710
2WD REG BED V6 5-SP	8709

(Continued on page 12)

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FORD (continued)	
CUTAWAY VAN	
COMM CUTAWAY DRW 176 WB	E39D76
COMM CUTAWAY SRW 138 WB	E27S38
COMM STRIPPED CHASSIS DRW 124 WB	E29D24
COMM STRIPPED CHASSIS DRW 158 WB	E39D58
EXPLORER	
4X2 2-DR SPORT	U22SP
4X2 2-DR XL	U22XL
4X2 4-DR EDDIE BAUER	U32EB
4X2 4-DR WAGON LIMITED	U32LTD
4X2 4-DR XL	U32XL
4X2 4-DR XLT	U32XLT
4X4 2-DR SPORT	U24SP
4X4 2-DR WAGON EXPEDITION	U24EXP
4X4 2-DR XL	U24XL
4X4 4-DR EDDIE BAUER	U34EB
4X4 4-DR WAGON LIMITED	U34LTD
4X4 4-DR XL	U34XL
4X4 4-DR XLT	U34XLT
WINDSTAR	
VAN	A54
WAGON GL	A51GL
WAGON LX	A51LX
GMC	
JIMMY	
2WD 2-DR WAGON 100.5	S10516
2WD 4-DR WAGON 107	S10506
4WD 2-DR WAGON 100.5	T10516
4WD 4-DR WAGON 107	T10506
SAFARI	
CARGO VAN XT AWD W/YF7 RV PKG	TL11005YF7
CARGO VAN XT AWD W/R9S RV PKG	TL11005R9S
CARGO VAN XT RWD W/YF7 RV PKG	TM11005RF7
CARGO VAN XT RWD W/R9S RV PKG	TM11005R9S
VANDURA	
G2500 LWB W/YF7 RV PKG	TG21305
G2500 SWB W/YF7 RV PKG	TG21005
G3500 REG W/YF7 RV PKG	TG31305
G3500 EXTENDED VAN W/YF7 RV PKG	TG31605

HONDA	
ACCORD	
4-DR SEDAN EX 2.7 AUTO	CE666
4-DR SEDAN LX 2.7 AUTO	CE664
ODYSSEY	
WAGON LX 6 PASSENGER	RA184
WAGON LX 7 PASSENGER	RA186
WAGON EX 6 PASSENGER	RA187
HYUNDAI	
SONATA	
4-DR SEDAN 5-SP	22403
4-DR SEDAN AUTO	22402
4-DR SEDAN GL AUTO	22422
4-DR SEDAN GL V6 AUTO	22432
4-DR SEDAN GLS V6 AUTO	22452
JAGUAR	
XJ	
4-DR SEDAN	XJ6
4-DR SEDAN VANDEN PLAS	XJ6VDP
4-DR SEDAN V-12 DUAL AIR BAG	XJ12DAB
4-DR SEDAN XJR SUPERCHARGED	XJR
JEEP	
CHEROKEE	
4-DR 2WD WAGON SE - RED	XJBL74
4-DR 4WD WAGON SE - RED	XJUL74
GRAND CHEROKEE	
4-DR 2WD WAGON LIMITED	ZJTL74
4-DR 4WD WAGON ORVIS	ZJL74
LEXUS	
ES 300	
4-DR SPORTS AUTO CAN/Y	9010
LS 400 SEDAN	
4-DR LUXURY AUTO	9100
4-DR LUXURY AUTO CAN/Y	9110
LINCOLN	
CONTINENTAL	
4-DR EXECUTIVE	M97

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"New Item" 1995 Models... An "Unofficial" List

(Continued)

MAZDA	
MILLENNIA	
4-DR SEDAN W/CLOTH AUTO	MILC
4-DR SEDAN W/LEATHER AUTO	MILL
4-DR SEDAN S AUTO	MILS
PROTEGE	
4-DR SEDAN DX	PRODX
4-DR SEDAN ES	PROES
4-DR SEDAN LX	PROLX
MPV	
2WD WAGON L	LV 52L2
2WD WAGON LX	LV 52LX2
2WD WAGON LXE	LV 52LXE2
4WD WAGON LX	LV 52LX4
4WD WAGON LXE	LV 52LXE4
MERCEDES	
S CLASS	
S320 4-DR SEDAN AUTO	S320V
S350 4-DR SEDAN TURBODIESEL A	S350DW
S420 4-DR SEDAN AUTO	S420V
S500 2-DR COUPE AUTO	S500C
S500 4-DR SEDAN AUTO	S500V
S600 2-DR COUPE AUTO	S600C
S600 4-DR SEDAN AUTO	S600V
MERCURY	
MYSTIQUE	
4-DR SEDAN GS	M65
4-DR SEDAN LS	M66
MINI	
ECLIPSE	
3-DR COUPE GS 16-VAL 5-SP	EC24-H
3-DR COUPE GS 16-VAL AUTO	EC24-H-A
3-DR COUPE GS TURBO 5-SP	EC24-T
3-DR COUPE GS TURBO AUTO	EC24-T-A
3-DR COUPE GSX TURBO AWD 5-SP	EC24-U
3-DR COUPE GSX TURBO AWD AUTO	EC24-U-A
3-DR COUPE RS 5-SP	EC24-M
3-DR COUPE RS AUTO	EC24-M

(continued)

MITSUBISHI (continued)	
MIRAGE	
2-DR COUPE LS 5-SP	MG21-M
2-DR COUPE LS AUTO	MG21-M-A
2-DR COUPE S 5-SP	MG21-E
2-DR COUPE S AUTO	MG21-E-A
NISSAN	
240SX	
2-DR COUPE 5-SP	2615
2-DR COUPE AUTO	2611
2-DR COUPE SE 5-SP	2625
2-DR COUPE SE AUTO	2621
MAXIMA	
4-DR SEDAN GLE AUTO	0861
4-DR SEDAN GXE 5-SP	0845
4-DR SEDAN GXE AUTO	0841
4-DR SEDAN SE 5-SP	0825
4-DR SEDAN SE AUTO	0821
4X2 PICKUP	
KING CAB XE V-6 5-SP	5365
KING CAB XE V-6 AUTO	5361
PATHFINDER	
4-DR 4X2 LE AUTO	0931
OLDSMOBILE	
AURORA	
4-DR SEDAN	R29GS
CUTLASS CIERA	
4-DR SEDAN SL - FLEET	J69AS
4-DR SEDAN SL - SERIES I	J69/R7B
CUTLASS CRUISER	
4-DR WAGON SL - FLEET	J35AS
CUTLASS SUPREME	
2-DR CONVERTIBLE - FLEET	T67WS
2-DR COUPE S - FLEET	H47WS
4-DR SEDAN S - FLEET	H69WS
EIGHTY EIGHT	
4-DR SEDAN LS	Y69/R7D
NINETY EIGHT	
4-DR REGENCY ELITE - SERIES II	X69/R7C

(Continued on page 14)

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"New Item" 1995 Models... An "Unofficial" List

(Continued from page 13)

PLYMOUTH		
NEON		
2-DR COUPE HIGHLINE		PLPH22
2-DR COUPE SPORT		PLPS22
4-DR SEDAN		PLPL42
4-DR SEDAN HIGHLINE		PLPH42
4-DR SEDAN SPORT		PLPS42

PONTIAC		
BONNEVILLE		
4-DR SEDAN SE + 1SG CALIF. V.P.		X691SG
4-DR SEDAN SE + 1SH CALIF. V.P.		X692SH
FIREBIRD		
2-DR COUPE FIREBIRD + 1SG CALIF. V.P.		S871SG
2-DR COUPE FIREBIRD + 1SH CALIF. V.P.		S871SH
GRAND AM		
2-DR COUPE SE + 1SG CALIF. V.P.		E371SG
2-DR COUPE SE + 1SH CALIF. V.P.		E371SH
4-DR SEDAN SE + 1SG CALIF. V.P.		E691SG
4-DR SEDAN SE + 1SH CALIF. V.P.		E691SH
GRAND PRIX		
2-DR COUPE SE + 1SG CALIF. V.P.		J371SG
4-DR SEDAN SE + 1SG CALIF. V.P.		J191SG
SUNFIRE		
2-DR COUPE SE		B37S
2-DR COUPE SE + 1SG CALIF. V.P.		B37S1SG
4-DR SEDAN SE		B69S
4-DR SEDAN SE + 1SG CALIF. V.P.		B69S1SG
TRANS SPORT		
MINIVAN SE + 1SG CALIF. V.P.		M061SG

PORSCHE		
911 CARRERA SERIES		
2-DR CABRIOLET 5-SP		993630
2-DR CABRIOLET TIPTRONIC		993630
2-DR COUPE 5-SP		993330
2-DR COUPE TIPTRONIC		993330
2-DR 4 CABRIOLET 5-SP		993530
2-DR 4 COUPE 5-SP		993130

ROLLS-ROYCE		
BENTLEY		
CONTINENTAL TURBO CONVERTIBLE		BCTC
ROLLS-ROYCE		
CORNICHE S CONVERTIBLE		RRCS
FLYING SPUR		RRFS
SILVER DAWN		RRSD

SAAB		
900 SERIES		
2-DR CONVERT S 5-SP		902M
2-DR CONVERT S AUTO		902A
2-DR CONVERT SE TURBO 5-SP		952M
2-DR CONVERT SE V6 5-SP		972M
2-DR CONVERT SE V6 AUTO		972A
3-DR COUPE S 5-SP		903M
3-DR COUPE S AUTO		903A
3-DR COUPE S S/R 5-SP		903MSR
3-DR COUPE S S/R AUTO		903ASR
3-DR COUPE SE S/R 5-SP		953MSR
5-DR HATCHBACK SE S/R 5-SP		975MSR
5-DR HATCHBACK SE S/R AUTO		975ASR
9000 SERIES		
4-DR SEDAN CDE V6 AUTO		074A
4-DR SEDAN CDE V6 S/R AUTO		074ASR
5-DR H/B CS 5-SP		015M
5-DR H/B CS AUTO		015A
5-DR H/B CS LEATHER 5-SP		015ML
5-DR H/B CS LEATHER AUTO		015AL
5-DR H/B CS S/R 5-SP		015MSR
5-DR H/B CS S/R AUTO		015ASR
5-DR H/B CS S/R LEATHER 5-SP		015MSRL
5-DR H/B CS S/R LEATHER AUTO		015ASRL
5-DR H/B CSE S/R V6 AUTO		075ASR

SUBARU		
IMPREZA		
2-DR COUPE AWD 5-SP - EARLY		SMF
2-DR COUPE AWD 5-SP - FINAL		SMR
2-DR COUPE FWD 5-SP - EARLY		SMA
2-DR COUPE FWD 5-SP - FINAL		SMM
2-DR COUPE L AWD HL 5-SP - EARLY		SMI
2-DR COUPE L AWD HL 5-SP - FINAL		SMU
2-DR COUPE L AWD HL AUTO - EARLY		SMJ
2-DR COUPE LX 2.2 L AWD HL AUTO - FINAL		SMV →

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"New Item" 1995 Models... An "Unofficial" List

(Continued)

CHEVROLET (continued)	
CORSICA	
4-DR SEDAN MARKET ED W/1SPX	1LD69SPX
4-DR SEDAN MARKET ED W/1SQX	1LD69SQX
GEO METRO	
3-DR H/B COUPE	1MR08
3-DR H/B COUPE LSI	1MR08LSI
4-DR SEDAN	1MR69
4-DR SEDAN LSI	1MR69LSI
LUMINA	
4-DR SEDAN	1WL69
4-DR SEDAN LS	1WN69
MONTE CARLO	
2-DR COUPE LS	1WW27
2-DR COUPE Z34	1WX27
ASTRO VAN	
CARGO VAN AWD EXT W/YF7 RV PKG	CL11005RV
CARGO VAN RWD EXT W/YF7 RV PKG	CM11005RV
BLAZER	
2-DR 2WD TAILGATE	CS10516
2-DR 4WD TAILGATE	CT10516
4-DR 2WD TAILGATE	CS10506
4-DR 4WD TAILGATE	CT10506
CHEVY VAN	
G20 4.3 110 WB W/YF7 RV PKG	G21005
G20 4.3 125 WB W/YF7 RV PKG	G21305
G30 4.3 C5Y 125 WB W/YF7 RV PKG	G31305
G30 5.7 EXT 6CP 146 WB W/YF7 RV PKG	G31605
TAHOE	
K1500 4WD UTILITY	K10516
CHRYSLER	
CIRRUS	
4-DR SEDAN	JACP41
DODGE	
AVENGER	
2-DR COUPE	FJDH22
2-DR COUPE ES	FJDS22

(continued)

DODGE (continued)	
NEON	
2-DR COUPE COMPETITION PKG.	PLDH22CP
2-DR COUPE HIGHLINE	PLDH22
2-DR COUPE SPORT	PLDS22
4-DR SEDAN BASE	PLDL42
4-DR SEDAN HIGHLINE	PLDH42
4-DR SEDAN SPORT	PLDS42
STEALTH	
2-DR HATCHBACK R/T 5-SP	B7DS24
STRATUS	
4-DR SEDAN	JADH41
4-DR SEDAN ES	JADP41
RAM PICKUP	
2WD BR1500 CLUB CAB LWB 155	BR1L32
2WD BR1500 CLUB CAB SWB 139	BR1L31
2WD BR2500 CLUB CAB H-D 155	BR2L32
2WD BR3500 CLUB CAB DRW 155	BR3L32
4WD BR1500 CLUB CAB LWB 155	BR6L32
4WD BR1500 CLUB CAB SWB 139	BR6L31
4WD BR2500 CLUB CAB H-D 155	BR7L32
4WD BR3500 CLUB CAB DRW 155	BR8L32
EAGLE	
TALON	
3-DR L/B ESi FWD	FJXH24
3-DR L/B TSi AWD	FJFS24
3-DR L/B TSi FWD	FJXP24
FORD	
CONTOUR	
4-DR SEDAN GL	P65
4-DR SEDAN LX	P66
4-DR SEDAN SE	P67
MUSTANG	
2-DR COUPE GTS	P42
TAURUS	
4-DR SEDAN SE	P52

(Continued on page 16)

LIFO LOOKOUT EXCLUSIVE

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VOLKSWAGEN	
CABRIO	
2-DR CONVERTIBLE 5-SP	1E75Q4
2-DR CONVERTIBLE AUTO	1E75Q3
GOLF III	
2-DR HATCHBACK GTI VR6 5-SP	1H16T4
2-DR HATCHBACK SPORT 5-SP 1	1H0MQ4
2-DR HATCHBACK SPORT 5-SP 2	1H04Q4
2-DR HATCHBACK SPORT AUTO 1	1H0MQ3
2-DR HATCHBACK SPORT AUTO 2	1H04Q3
4-DR H/B PRICE LEADER 5-SP 1	1H1LQ4
4-DR H/B PRICE LEADER 5-SP 2	1H19Q4
JETTA III	
4-DR SEDAN 5-SP	1H29Q4
PASSAT	
4-DR SEDAN GLX VR6 5-SP 95	3A26Q5
4-DR SEDAN GLX VR6 AUTO 95	3A26Q8
4-DR WAGON GLX VR6 5-SP 95	3A56Q5
4-DR WAGON GLX VR6 AUTO 95	3A56Q8

VOLKSWAGEN (continued)	
CONVERSION-READY EUROVAN	
PANEL VAN 2-SEAT 5-SP	70H1M2
PANEL VAN 2-SEAT AUTO	70H1M3
VOLVO	
850 SERIES	
5-DR WAGON 5-SP	855GTO
5-DR WAGON AUTO	855GTA
900 SERIES	
940 4-DR SEDAN S AUTO	944S
940 4-DR SEDAN TURBO S AUTO	944TS
940 5-DR WAGON S AUTO	945S
940 5-DR WAGON TURBO S AUTO	945TS
960 4-DR SEDAN AUTO GLASS SUNROOF	964
960 5-DR WAGON AUTO GLASS SUNROOF	965
TOYOTA NOTE	
* Note :	
ALL T100 XTRACAB PICKUPS ARE NEW ITEMS FOR 1995.	

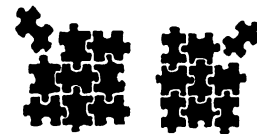
RECENT EXPERIENCES: LIFO IN ALL SHAPES AND SIZES

Summarized below are some of our recent LIFO consulting activities outside the automotive area.

INITIAL LIFO ELECTION EVALUATIONS

CASE #1: A light manufacturer decided to **postpone the election** of LIFO until 1995, when raw material prices are expected to rise significantly and both labor and overhead are expected to increase as well. Based on our analysis and preliminary projections, electing LIFO in 1994 would not have been advantageous primarily because there was considerably less inflation in raw materials and overhead costs in inventories at the end of the year. In 1995, a single pool, Natural Business Unit LIFO election will probably be beneficial to this light manufacturing/assembly operation.

CASE #2: An arts and supplies wholesaler **postponed a LIFO election** for 1994 after a deeper analysis of the underlying facts replaced more superficial initial impressions and assumptions. First, the company had purchased certain items at low promo-



tional costs during the year and this resulted in lower average costs for many items at the end of the year. Second, there was a high percentage of new items in inventory at the end of 1994 and this would create a 1.000 inflation index for a significant percentage of the total ending inventory. Third, the projected LIFO benefit for 1994 was computed to be a relatively small dollar amount. Finally, the company's current cost accounting system used a rolling average cost which included the beginning inventory average costs in the computation of the current year's average costs and this could present problems because the IRS requires that the beginning average cost amounts must be omitted from the current year's computation of average cost.

CASE #3: A lumber processor **elected** the dollar-value LIFO method for only the raw material content portion of its 1994 inventories. Preliminary thinking contemplated electing LIFO for all components of cost - raw materials, labor and overhead.

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After analysis of the entire ending inventory composition, it became clear that the initial LIFO election would be more favorable if it included only raw materials and not labor and overhead amounts. In future years, if labor and overhead costs increase significantly, a subsequent LIFO election can be made to extend LIFO to include those components as well.

CASE #4: A manufacturer of latex products decided to **postpone a LIFO election** until 1995, based on a detailed analysis of the 1994 ending inventory. The manufacturer had locked into unusually low latex prices as a result of forward purchasing contracts. Consequently, inventory costs at the end of 1994 reflected little or no inflation for the year. Most of these contracts will expire in early 1995, and this should result in significantly higher raw material costs in inventories at the end of 1995 when an evaluation of the advisability of a LIFO election will be reconsidered.

APPLICATIONS FOR CHANGES IN ACCOUNTING METHODS

CASE #5: A wholesale...distributor filed **Form 3115** to request permission to (1) consolidate existing pools, (2) change its method of valuing LIFO inventories, (3) change its method of valuing its annual inventory increments, (4) correct its treatment of new items and (5) obtain cut-off protection for existing LIFO reserve balances and computations. The company was primarily interested in switching from the double-extension method to the link-chain, index method, as well as correcting the new item treatment. The IRS granted permission to make all of the above changes, allowing the use of the cut-off method. We assisted in all phases of the activity, including evaluating the advisability of requesting permission to change, structuring the change request, preparing the Form 3115, coordinating responses to IRS requests for additional information, combining the pools, rebasing the prior indexes to reflect the cut-off method and recomputing the LIFO computations for the year of change under the new methodology.

CASE #6: In another situation, after evaluating the advisability of requesting a change, the decision was made to **postpone filing Form 3115**, primarily due to the existence of other non-LIFO potential audit problems. Consequently, the decision was to postpone the filing of a change request until the other "non-LIFO problems" were under control.

CASES 7-10: In several other engagements evaluating the advisability and ramifications of Form 3115 filings, several common problem areas were identified and brought to management's attention:

- Inconsistencies between the methods described (i.e., elected) on Form 970 and the LIFO methods actually being used in making the annual calculations.
- New items in inventory were being treated improperly or inconsistently.
- Adequate "books and records" to support the LIFO calculations for all years were not being maintained or were not available.

IRS AUDIT DEFENSE

CASE #11: We assisted a large retail chain with respect to all LIFO matters in a very complicated IRS audit representing the taxpayer at both Audit and Appellate levels. The examining agent had proposed termination of the Company's LIFO elections for all subsidiaries and all pools, retroactive to 1988. The proposed termination was based primarily on the dual claims of "inadequate books and records" and "inadequate sampling techniques".

We assisted in preparing requests for information under FOIA (the Freedom of Information Act) and in preparing correspondence and memoranda relative to sampling approaches applied by the Company's CPAs and those proposed as corrective measures by the IRS. In addition, we examined the sampling techniques employed by the company in prior years, met with the IRS Computer Audit Specialist (CAS) and subsequently designed specific, statistically sound sampling methods and procedures to be followed if recomputation of the LIFO indexes were to be required by the IRS.

After the deficiency letter was issued, we prepared the Protest, including in it the detailed sampling methods and the results of recomputations performed for the pools that were selected to be retested using the revised sampling methods. The IRS subsequently approved all of our recommendations and methodologies relating to the statistical sampling issue. Our assistance in this matter extended to preparing all of the "finalizing" LIFO inventory recomputations and the provisions in the Closing Agreement with the IRS relative to the LIFO matters.

STATISTICAL SAMPLING ASSISTANCE

CASE #12: Finally, we assisted a company in the filing of **Form 970, electing LIFO for its parts inventory, using statistical sampling methods to determine its LIFO inflation index**. This involved all phases of the sampling process, including development and implementation of tailor-made sampling procedures, computation of the LIFO inflation index, calculation and evaluation of the related statistical measures and development of the formal statistical sampling documentation report. See pages 6-8. *



PROTECTING YOUR LIFO CLIENT'S BOOKS AND RECORDS

The IRS is very serious about the requirement that taxpayers must maintain adequate books and records to substantiate their LIFO computations. Revenue Procedure 79-23 states in Section 3.01 that a LIFO election can be disallowed where the taxpayer fails to maintain adequate books and records with respect to its LIFO inventory and all computations incident thereto.

The Tax Court Memo Decision in *Boecking Machinery, Inc.* was discussed at length in the December, 1993 *Lookout*. In this case, a Caterpillar machinery and equipment dealer had its LIFO election terminated retroactively because of its failure to maintain adequate books and records.

Examining agents are fond of throwing out LIFO elections at the drop of a hat because of the slightest perceived "inadequacy" of books and records. Unfortunately, in many instances, there is less perception and more reality to support the agent's charge. The June, 1994 *LIFO Lookout* explained how the IRS computes LIFO indexes and reserves if an automobile dealer doesn't have all year-end invoices. This is done by using templates assuming an inventory mix of "one of each." Although this approach does not produce a very favorable result for the taxpayer, usually whatever result is produced is better than the terrible alternative: retroactive termination of the LIFO election and 100% repayment of the LIFO reserve in the earliest open year (along with interest...and sometimes penalties).

In one recent situation, a dealer under IRS audit was not advised by his CPA to retain all of the prior year-end invoices and these invoices were subsequently destroyed or misplaced by the client over the

course of the IRS' long drawn-out audit. In the later stages of the audit years later, the Service "looked at LIFO again" and then threatened termination of the LIFO election because the invoices, once available, could no longer be produced and, therefore, the IRS could not verify the accuracy of the LIFO computations. Eventually, the IRS backed off somewhat. Nevertheless, significant damage was done to the taxpayer because the IRS ended up with a very strong negotiating position relative not only to the LIFO calculation issues, but also with respect to other critical audit issues.

In this regard, keep in mind that it may be possible for the dealer to go back to the Factory and request it to provide copies of invoices or information relative to the year-end inventories. Another source of collaborating information relative to year-end inventory mix and composition (if the IRS will allow it) might be available through the year-end floor plan records maintained by either the dealership or by the Manufacturer's affiliated Credit Corporation.

In another recent situation, the taxpayer's controller was significantly - and justifiably - concerned because the previous CPAs for the business (A Big 6 I might add!) said they were unable to locate all of the prior year LIFO workpapers and computations (like "That's that...and its now-former client could go jump in the lake!"). We pointed out that these LIFO related computations were, in reality, the taxpayer's records, which in our opinion should not have been destroyed by the CPAs without first making copies available to the taxpayer so they could be retained for tax purposes in their own files as part of their permanent books and records.

see letter →



De Filippis' LIFO LOOKOUT

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1993:	<input type="checkbox"/> 1Q (Mar '93)	<input type="checkbox"/> 2Q (June '93)	<input type="checkbox"/> 3Q (Sep '93)	<input type="checkbox"/> 4Q (Dec '93)
1992:	<input type="checkbox"/> 1Q (Mar '92)	<input type="checkbox"/> 2Q (June '92)	<input type="checkbox"/> 3Q (Sep '92)	<input type="checkbox"/> 4Q (Dec '92)
1991:	<input type="checkbox"/> 1Q (Mar '91)	<input type="checkbox"/> 2Q (June '91)	<input type="checkbox"/> 3Q (Sep '91)	<input type="checkbox"/> 4Q (Dec '91)

NAME(S): _____

FIRM NAME: _____

ADDRESS: _____

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

Dear Former CPA Firm:

**RE: MISSING LIFO WORKPAPERS FOR PRIOR YEARS
LOSS/DESTRUCTION OF "BOOKS AND RECORDS"**

In a recent conversation, you informed us that your Firm either was unable to locate or had destroyed workpapers, price lists and other information relating to our LIFO (Last-In, First-Out) inventory computations for the years 19__ through 19__. This information is vital to our current LIFO election and to our ability to defend it should the IRS ask us to produce prior year LIFO computations for review. Therefore, we are extremely concerned by your destruction of these records without first notifying us.

As our paid professional tax advisor during these years, you were responsible for assisting us in complying with the regulations in connection with LIFO computations and in their retention. Regulation Section 1.472-2(h) states that it is necessary for taxpayers using LIFO to retain such supplemental and detailed inventory records as will enable the District Director readily to verify the taxpayer's inventory computations as well as his compliance with all other LIFO requirements. In amplifying this requirement, Section 3.01(d) of Revenue Procedure 79-23 provides that a LIFO election can be disallowed if the taxpayer fails to maintain adequate books and records with respect to its LIFO inventory and all computations incident thereto.

In many audit situations, IRS agents have threatened termination of the LIFO election where taxpayers were unable to provide copies of computations used in determining prior year LIFO reserve balances. The position of the Internal Revenue Service in these cases is that without computations in support of prior year LIFO reserve balances, it cannot be sure that the prior years' results clearly reflect income. Furthermore, the burden of proof is entirely upon the taxpayer in this matter; it is not upon the IRS. Recently, in *Boecking Machinery, Inc*, the Tax Court upheld the IRS' retroactive termination of the taxpayer's LIFO election because of inadequate "books and records."

It is our understanding that if the "records" can be reconstructed - or if by some other means it is possible to provide information satisfactory to the IRS so that the LIFO inventory values can be recalculated - it may be possible to avoid termination of the LIFO election.

Insofar as our LIFO computation workpapers constituted permanent (tax) "books and records" which XYZ Corporation is required by law to maintain indefinitely, and insofar as your Firm did not previously provide us with copies of the supporting computations each year as the LIFO computations were made, and insofar as your Firm apparently has negligently misplaced or destroyed them without first providing copies to us so we could retain them indefinitely, by this letter we are requesting you to immediately renew your efforts to locate copies of our LIFO workpaper computations which your Firm was paid to prepare and provide copies of this information to us immediately.

If that is not possible, it is our expectation that your Firm will prepare, at your expense, a reconstruction of the LIFO workpaper computations which were destroyed and provide copies, along with a letter of explanation, for our files. You may wish to provide a copy of this letter to your insurance company. Please call our attorney immediately so we can coordinate a timetable for your response to this matter.

AVOIDING MESSY PROBLEMS... AN OUNCE OF PREVENTION

Any business using LIFO should be sure that its own permanent tax files include copies of the Form 970 originally filed, any subsequent Forms 970 filed subsequently to extend LIFO to other inventories, any Forms 3115 filed (and consent approval letters received) relative to changes in methods, and copies of each year's inflation index computations and the related LIFO inventory valuations. All of these LIFO-related records should be retained permanently.



THE ALTERNATIVE LIFO METHOD: A GOOD SUMMARY

The IRS National Office has been sending out letters approving dealers' requests to change to the Alternative LIFO Method from a variety of other "less preferable" methods. In addition to their consent terms, these letters contain a description of the Alternative LIFO Method and the conditions of change which provide an excellent summary or reference checklist.

The Alternative LIFO Method is a comprehensive dollar-value, link-chain LIFO method of accounting that encompasses several LIFO sub-methods and may only be used by an automobile dealer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks to value its inventory of new automobiles and new light-duty trucks.

The comprehensive Alternative LIFO Method is designed to simplify the dollar-value computations of automobile dealers. Under the authority of section 1.446-1(c)(2)(ii) of the Income Tax Regulations, the Commissioner will waive strict adherence of the section 1.472-8 comparability requirement in applying the Alternative LIFO Method, provided a taxpayer uses the compensating sub-methods which, in the opinion of the Commissioner, are necessary to ensure that the Alternative LIFO Method clearly reflects income.

The conditions and provisions which must be complied with in changing to the Alternative LIFO Method are:

(1) That the taxpayer keeps its books and records for the year of change and for later taxable years on the LIFO inventory method; and that it uses the LIFO inventory method for all reports, including financial statements and statements for credit purposes in conformity with the provisions of section 1.472-2(e) of the regulations. For purposes of this condition, any reconciling entries (between the taxpayer's LIFO method and sub-methods used for financial statement purposes and the taxpayer's LIFO method and sub-methods used for federal tax purposes) that are necessary to compute taxable income must be maintained as part of the taxpayer's permanent books and records;

(2) That the taxpayer values its inventory of new automobiles and new light-duty trucks as of the end of the year of change and for later taxable years under the Alternative LIFO Method, unless it obtains permission to change to another recognized method;

(3) That the taxpayer files Form 970 with its federal income tax return for the year of change and otherwise complies with the provisions of section 472(d) of the Internal Revenue Code and section 1.472-3 of the regulations (also see Rev. Rul. 76-282, 1976-2 C.B. 137) to extend the LIFO election (i) to include any new automobiles and new light-duty trucks (e.g., demonstrators) and options and accessories to which the LIFO election did not previously apply but that are required to be included in LIFO pools under the Alternative LIFO Method;

(4) That the taxpayer effects the change to the Alternative LIFO Method using the cut-off method. Under the cutoff method, the value of the new automobile and new light-duty truck inventory at the beginning of the year of change shall be the same as the value of such inventory at the end of the preceding taxable year plus market value restorations, if any, required pursuant to condition (3) above;

(5) That the taxpayer combines and/or separates the dollar-value inventory pool or pools in accordance with the provisions of 1.472-8(g)(2);

(6) That in effecting the change to the proposed method, any layers of inventory increments previously determined and the LIFO value of such increments shall be retained. Instead of using the earliest taxable year for which the taxpayer adopted the LIFO method for any items in the inventory pool or pools, the year of change shall be used as the base year in determining the LIFO value of the inventory pool or pools for the year of change and later taxable years (i.e., the cumulative index at the beginning of the year of change shall be 1.00). The base-year costs of layers of increments in the pool or pools at the beginning of the year of change shall be restated in terms of the new base-year costs, using the year of change as the new base year;

(7) That the taxpayer uses the computational methodology set forth in section 4.03 of Rev. Proc. 92-79 to compute the LIFO value for each pool of its ending inventory of new automobiles and new light-duty trucks under the Alternative LIFO Method;

(8) That the taxpayer maintains and retains complete records of the computations of the LIFO inventory under the Alternative LIFO Method, as well as copies of the actual purchase invoice for each vehicle used in the computation;

(9) That for each separate trade or business, (i) all new automobiles (regardless of manufacturer), including those used as demonstrators, must be included in one dollar-value LIFO pool, and (ii) all new light-duty trucks

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(regardless of manufacturer), including those used as demonstrators, must be included in another separate dollar-value LIFO pool;

(10) That the current-year cost of the items making up a pool is determined by reference to the actual cost of the specific new automobiles or new light-duty trucks in ending inventory. Therefore, the actual cost of the specific vehicles on hand at year end will be the current-year cost of such vehicles;

(11) That an item of inventory ("item category") is determined using the entire manufacturer's base model code number that represents the most detailed description of the base vehicles' characteristics, such as model line, body style, trim level, etc. The manufacturer's base model code numbers are almost always used as part of the vehicle identification on each dealer invoice (e.g., domestic model, trim level, 4-door sedan has a specific model code; foreign model, 4-door sedan, trim level, 5-speed has a specific model code). In the case of conversion vans, an item of inventory must be determined using both (i) the entire manufacturer's base model code, as described in the preceding sentence, and (ii) the most detailed conversion package designation;

(12) That the actual base vehicle cost of each of the specific vehicles in ending inventory is used to compute the index under the Alternative LIFO Method. The base vehicle cost of each vehicle is not adjusted for any options, accessories, or other costs. The pool index computed from only the base vehicle cost of vehicles is applied to the total vehicle cost, including options, accessories, and other costs, of all vehicles in the pool at the end of the taxable year;

(13) That a new item category, which is an item category not considered in existence in the prior taxable year, is one of the following: (i) any new or reassigned manufacturer's model code, as described in section 4.02(3) of Rev. Proc. 92-79, that is caused by a change in an existing vehicle, or (ii) a manufacturer's model code, as described in section 4.02(3) of Rev. Proc. 92-79, created or reassigned because the classified vehicle did not previously exist. Additionally, if there is no change in a manufacturer's model code, but there has been a change to the platform (i.e., the piece of metal at the bottom of the chassis that determines the length and width of the vehicle and the structural set-up of the vehicle) that results in a change in track width or wheel base, whether or not the same model name was previously used by the manufacturer, a new item category is created;

(14) That the taxpayer must use the current-year base vehicle cost of the new item category as the prior-year base vehicle cost of that item category;

(15) That, if an item in ending inventory was not stocked by the taxpayer at the end of the prior year, but was in existence in the prior year, the taxpayer must determine the prior-year base vehicle cost for that item by reconstructing what the base vehicle cost for the item category would have cost using a manufacturer's price list that provides dealer purchase prices. For each such item category, the manufacturer's price list that must be used by the taxpayer is the list in effect as of the beginning of the last month of the prior taxable year;

(16) That the taxpayer uses all of the sub-methods, definitions, and special rules, and the computational methodology, of the Alternative LIFO Method;

(17) That the taxpayer was not "under examination," as defined in Section 3.02 of Rev. Proc. 92-79, on the date the Form 3115 was filed; and

(18) That on the date the taxpayer filed its Form 3115, it had no Federal income tax return(s) under consideration by an appeals office or any federal court, and there was no pending criminal investigation or proceeding concerning the taxpayer's federal tax liability.

The Alternative LIFO Method will be accepted by the Commissioner as an appropriate method of computing an inventory index, and the use of the Alternative LIFO Method to compute the value of the inventory pool or pools will be accepted as accurate, reliable, and suitable. The taxpayer's computations under the Alternative LIFO Method are, however, subject to verification by the District Director upon examination of the taxpayer's return.

The Alternative LIFO Method includes, by definition, all of its sub-methods. Individual sub-methods used alone, or in combination with some but not all of the sub-methods of the Alternative LIFO Method, may not clearly reflect income. Therefore, use of the Alternative LIFO Method is conditioned upon a taxpayer's computing its LIFO inventory using all of the sub-methods, definitions, special rules, and computational methodology provided in Rev. Proc. 92-79.

The new method of accounting will apply to the computation of alternative minimum taxable income (AMTI) unless section 56 of the Code, or the regulations thereunder, requires the use of a different method of accounting. ✱



The accompanying summary of the Alternative LIFO Method creates impressions of simplicity, calm and precision. However, CPAs and dealers using this Method should be aware of the panoply of unanswered questions and unresolved technical issues beneath this deceptive exterior.

“NEW” ITEM DETERMINATION

For an extensive discussion of the problems raised by the absence of IRS approved official lists of “new” items, see June, 1994: “Comparison of IRS’ Unofficial New Item Lists.” This article compared our “unofficial” new item lists with those of the IRS and explained that differences in lists arise because of a variety of reasons.

For many months, NADA tried to coordinate with the IRS for a timely “official” list of new item categories for 1995 models. Unfortunately, such a document was not meant to be. At the present time, there still has not been an “official” new item list released for 1993 models, 1994 models or 1995 models. 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. As a practical matter, however, the request for one official list raises other questions about whether the list should be “issued” by the National Office (which authored Revenue Procedure 92-79) or the MSSP Industry Specialists (who are further removed from the policy considerations underlying the original drafting of the Revenue Procedure.)

“ITEM CATEGORY” DETERMINATION

In applying the specific language of Revenue Procedure 92-79 to sort a dealer’s ending inventory into “item categories” for computation purposes, a number of different approaches have been followed in breaking down different makes and models into item categories. Obviously, different approaches will produce different computational results. “Averaging” will occur at different levels and therefore, “accurate” inflation indexes may not necessarily be reflected in year-end LIFO reserves.

For an extensive discussion of this problem, see March, 1993 *LIFO Lookout: How Far Do You Have To Go In Determining “Item Categories?”* These concerns, expressed over two years ago, still fester and produce compounding differences in LIFO reserves as time goes by. Informally, both the National Office and the IRS/MSSP have indicated that “you have to go as far as possible - no shortcuts.”

SHOULD CORRECTIONS BE MADE? IF SO, HOW?

Either the “new” item lists or the “item category” determination problems mentioned above create still other more troublesome problems. How should dealers be allowed to make corrections for years gone by?...or should they be required to make corrections?...or should there be some type of “amnesty” or forgiveness of the difference, if it is small? (But how would you know the difference was “small” unless you actually made a recomputation??)

Should amended returns be required for those prior years under an expedited procedure? Didn’t dealers agree to save the invoices for all vehicles in any year-end LIFO calculation under the Alternative Method? If so... what’s the problem?

Compounding any resolution of computational problems arising under the Alternative LIFO Method is the current stalemate over the conformity requirement in dealer financial statements sent to the manufacturer. Wouldn’t leniency in addressing questions under the Alternative LIFO Method without requiring recomputations call for a similar leniency (or amnesty?) on the financial statement conformity side...and/or vice-versa?

OTHER QUESTIONS

Still other questions — discussed in the March and December, 1993 issues of the *Lookout* — include:

1. When does a dealer need more than one pool for autos or one pool for trucks? What does the term “separate trades or businesses” really mean? Is there a time or are there situations where different geographic locations or different styles of operation will result in separate trades or businesses?
2. Are “minivans” cars or trucks? If so, under what circumstances? Letter Ruling 9332003 held that a dealer’s minivans belonged in an auto pool because those minivans were essentially substitutes for station wagons.
3. Is amnesty protection available for errors made in LIFO reserve computations in prior years (such as carrying back a decrement to the wrong year, incorrectly applying a base dollar amount or a current cost dollar amount to a LIFO valuation / or vice-versa, etc.)?
4. Are computational errors - as distinguished from index computation methodologies - to be protected and grandfathered in rebased layers? If not, are these errors “methods of accounting?”
5. And finally, what is the status of the so-called “compliance checks” by which various compliance grades were assigned based upon unofficial audits or reviews of taxpayers’ “compliance” with Revenue Procedure 92-79? Concerns were discussed in the September, 1994 *LIFO Lookout* in: “Confusion Creeping Back into the Alternative LIFO Method - Should “Substantial Compliance” Mean “Guessing Right?”

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INFLATION INDEXES...SOME 1994 YEAR-END INDEX RESULTS

POOL #1 - AUTOS

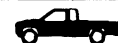
POOL #2 - TRUCKS



MAKE	UNITS	INDEX	UNITS	INDEX
ACURA	27	1.04357		
BMW	17	1.00760		
	34	0.99771		
BUICK	27	1.01100		
	60	1.01158		
	178	1.02390		
	23	1.00637		
CADILLAC	62	1.05269		
	84	1.05160		
	332	1.04387		
	57	1.03761		
	282	1.04300		
CHEVROLET /GEO	84	1.03155	75	1.03595
	88	1.02282	113	1.03667
	36	1.03457	82	1.02275
	42	1.03067	74	1.04183
	109	1.03524	121	1.04111
	107	1.04045	142	1.01478
	32	1.04477	29	1.04296
CHRYSLER	36	1.02235	2	1.01409
	41	1.02747	2	1.01409
	127	1.02579	2	1.00713
DODGE	19	1.07863	67	1.03686
	12	1.03878	31	1.06975
	37	1.03167	56	1.05042
	18	1.04383	15	1.04849
EAGLE	52	1.04087		
FORD	193	1.04373	264	1.00072
	29	1.05644	46	1.02188
	21	1.04732	48	1.00851
GMC TRUCKS			68	1.03898
			49	1.03331
			56	1.02299
			52	1.01296
HONDA	77	1.06576	9	1.01379
	63	1.05342	7	1.00000
HYUNDAI	25	1.02081		
	41	1.02393		
ISUZU			169	1.05375
			145	1.02793

POOL #1 - AUTOS

POOL #2 - TRUCKS



MAKE	UNITS	INDEX	UNITS	INDEX
JEEP			167	1.06369
			22	1.08475
			18	1.05336
KIA	53	1.01288		
	51	1.01403		
LEXUS	19	1.03158		
LINCOLN	46	1.03020		
	21	1.04503		
MAZDA	49	1.03652	25	1.02479
	63	1.05821	29	1.02337
	104	1.03681	21	1.02552
MERCURY	95	1.05991	20	1.08729
	87	1.04158	24	1.06848
MITSUBISHI	72	1.04697	15	1.12123
	51	1.02912	7	1.11468
	88	1.04820	9	1.10622
	94	1.06339	22	1.12557
NISSAN	363	1.02587	71	1.08114
OLDSMOBILE	41	1.03314		
	53	1.03983		
	38	1.02732		
PLYMOUTH	24	1.01500	47	1.04021
	45	1.01862	25	1.04821
	26	1.00234	26	1.04964
PONTIAC	123	1.04166	12	1.02996
	35	1.02913	10	1.02996
	45	1.04041	3	1.02996
	175	1.03865	9	1.02996
	42	1.03461	3	1.01998
ROLLS ROYCE	11	1.02052		
SAAB	41	1.00477		
SUBARU	37	1.00000		
	48	1.00000		
SUZUKI	59	1.00000	55	1.02758
TOYOTA	259	1.07001	182	1.06432
	88	1.02820	35	1.04733
	100	1.04169	40	1.06329
	111	1.02769	58	1.02703
	124	1.04533	38	1.06155
VOLKSWAGEN	43	1.07974	3	1.00000





COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

February 23, 1995

REPLY
FROM THE
COMMISSIONER

Mr. Willard J. De Filippis, CPA, P.C.
317 West Prospect Avenue
Mt. Prospect, Illinois 60056

Dear Mr. De Filippis:

In response to your letter of January 11, regarding application of the LIFO conformity requirement to automobile dealers, let me note briefly that we understand your concerns and will give them due consideration as part of our deliberative process.

Sincerely,

Margaret Milner Richardson

Current Developments

(Continued from page 5)

Letter Rulings 9507015 and 9511016 both reaffirmed the discussions in Section 5.01 of Revenue Procedure 92-85 relative to taxpayers being required to act reasonably and in good faith. They also reaffirmed the necessity of showing to the Commissioner's satisfaction that the granting of an extension would not jeopardize the Government's interests. In both situations, the IRS was satisfied from the information presented that the taxpayers had acted promptly and reasonably and in good faith. Consequently, extensions were granted for a period of 30 days from the date of the rulings for the filing of Forms 970. *

Sampling Documentation Report

(Continued from page 8)

SUMMARY AND CONCLUSION

A valid, statistically sound random sample was used to generate a sample estimate of the LIFO inflation index for XYZ Company's Parts Inventory pool. This LIFO index is based on weighted quantities, and the corresponding precision and reliability calculations were computed using statistical sampling software specifically tailored to LIFO inventory applications. The resulting precision and reliability amounts were found to be well within IRS prescribed guidelines. Consequently, the sample result (i.e., the estimated LIFO index) was found to be a valid estimate of the true population LIFO inflation index. *

The *De Filippis' LIFO Lookout* newsletter is a quarterly publication of LIFO News, Views and Ideas by Willard J. De Filippis, CPA, P.C., 317 West Prospect Avenue, Mt. Prospect, IL 60056. It is intended to provide accurate, general information on LIFO matters and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Readers should consult their certified public accountant, attorney and/or other competent advisors to discuss their own situations and specific LIFO questions. Mechanical or electronic reproduction or photocopying is prohibited without permission of the publisher. Annual subscription: \$325. Back issues available for \$70 each. Not assignable without consent. Any quoted material must be attributed to *De Filippis LIFO Lookout* published by Willard J. De Filippis, CPA, P.C. Editorial comments and article suggestions are welcome and should be directed to Willard J. De Filippis at (708) 577-3977; FAX (708) 577-1073. *De Filippis' LIFO Lookout* format designed by *Publish or Perish, Inc.* (708) 289-6332. © Copyright 1995 Willard J. De Filippis.

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