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A Quarterly Update of LIFO - News, Views and Ideas

LIFO LOOKOUT

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LIFO UPDATE

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

#1. LIFO FOR USED VEHICLES ... THE IRS-APPROVED SAFE-HARBOR METHOD. This issue of the *Lookout* focuses almost entirely on the nitty-gritty details of the IRS-approved LIFO method in Revenue Procedure 2001-23. If you're not interested in this application, this issue of the *Lookout* will be a quick read.

Shortly after the Rev. Proc. was released, the IRS Motor Vehicle Technical Advisor followed up with an *Automotive Alert*. It's a good summary and the full text of the *Alert* and our related comments are side-by-side on pages 6-9. There's lots more other detail throughout the issue.

Repeating our previous advice, most dealers should probably change to the IRS-approved method. Changing voluntarily at this time to the new method guarantees that the IRS will not challenge how dealers built up their LIFO reserves in previous years. Unless you can come up with a good reason for not changing to it, then changing now would seem advisable for many reasons. For more on this, see the evaluation on page 4.

For dealers who now want to change over to the 2001-23 method, a complete Form 3115 pro forma filing package appears on pages 14-25. This includes a sample letter to dealers already using LIFO recommending that they make the change to the new method right away.

Although these materials must be tailored to the specifics of your situation, hopefully, they will be useful and save you from trying to reinvent the wheel. We'd appreciate your comments one way or the other on their usefulness.

As *Lookout* subscribers, please call at any time if we can help you or if you have any questions.

LOOKOUT LOOKS INTO

#2. IRS MAY PAY MORE ATTENTION TO YEAR-END USED VEHICLE VALUATIONS REGARDLESS OF WHETHER LIFO IS USED. ***Warning***... Don't let not being on LIFO give you a false sense of security. The IRS may not be very pleased with how some dealers are valuing used vehicles, especially those acquired as customer trade-ins.

Revenue Procedure 2001-23 requires that the "current cost" for used vehicles taken ***in trade*** is to be determined by reference to a wholesale price listing from an *Official Used Car Guide* that covers the day of acquisition of that specific vehicle for a "similarly equipped, comparable base vehicle that reflects the trade-in vehicle's actual mileage and conditions." That cost "also must include prices reflected in the guide for installed options and accessories, if any."

see **LIFO UPDATE**, page 2

This appears to be the cost determination standard against which IRS agents will compare year-end trade-in valuations under the lower of cost or market method in situations where the dealer is not using the LIFO method.

Although all of this more detailed information must be considered in determining the ***current cost*** of a used vehicle, in contrast, only the base price of the vehicle needs to be taken into account in computing the year-end ***LIFO inflation index*** for that vehicle.

Material from the IRS *Audit Guide for Independent Used Car Dealers* indicates that the Service is capable of understanding and enforcing the lower of cost or market (LCM) rules whether or not a dealer has elected LIFO. For more on this, see page 27.

It's just a matter of chance ... or the audit lottery ... whether dealers who are more aggressively writing down their used vehicles at year end will be audited by a sharp IRS agent who wants to really pursue the matter.

#3. LIFO STILL A VERY GOOD THING FOR DEALERS WHO ELECTED IT AT THE RIGHT TIME. Over the last two years, some have written about the relative unattractiveness of LIFO for used vehicles because used vehicle prices were not reflecting much inflation. In fact, in many instances, used vehicle prices were reflecting price deflation.

Nevertheless, for those dealers who elected LIFO for used vehicles a few–or many–years ago, the more recent period of less inflation is only a minor nuisance or setback when viewed against the longer term perspective of increasing used vehicle LIFO reserves.

The relatively small compliance cost involved in computing LIFO indexes and reserves each year is greatly overshadowed by used vehicle LIFO reserves of hundreds of thousands of dollars. Selecting just one example–out of numerous that are readily available–an election made by one dealer in 1992 has resulted in a LIFO reserve of over $480,000, even though, at its highest point (at the end of 1999), the reserve was $580,000 and the dealer had a $100,000 payback of the reserve in the year 2000.

Just keep in mind two overriding principles that apply across the board to all LIFO elections. ***First***, the LIFO election is attractive if it is anticipated that over a period of years, the net trend in prices will be upward. Inflation over a long period of time, even though there may be intermittent years of no inflation–or even price deflation–will still yield ***favorable cumulative results over the long run***.

Second, the power of compounding becomes evident after a few years when current year price increases are factored upward to become significantly greater in the LIFO computation under the link-chain, index method approach.

Some dealers may find this to be the right time to elect LIFO for used vehicles. For them, a completed pro forma Form 970, excluding attachments, to make that election using the Rev. Proc. 2001-23 method appears on page 26.

#4. TAX COURT & IRS UPHELD IN THROWING OUT A LIFO ELECTION. In the Sept. 1998 *Lookout*, we reported the case in which the Tax Court upheld the IRS in disallowing the LIFO election of Consolidated Manufacturing, Inc. The Company lost its LIFO election because it ran afoul of the IRS in trying to "pick and choose" what inventory goods it put on LIFO.

Consolidated elected LIFO for certain cost components for which it experienced inflation. Other inventories, including used cores, used engines and other used parts, were not put on LIFO. Instead, these were written-down to scrap value at year-end. In short, Consolidated was trying to get the best of both worlds: LIFO reserve deductions for inventory that experienced inflation...and write-downs for inventory that did not.

Recently, the U.S. Appeals Court for the Tenth Circuit upheld the IRS and the Tax Court on all of the LIFO issues in this case.

The one ***non***-LIFO issue involved the proper accounting method for customer cores. The Appeals Court remanded the case to the Tax Court for further proceedings *only* on the ***non***-LIFO issue.

With this decision now supporting the IRS on all of the LIFO issues, the Service has significantly extended its winning streak. As you know, we have been following this case closely and plan to report further on the Appeals Court decision in the next issue.

#5. CONTRIBUTION OF LIFO INVENTORIES BY S CORPORATION TO AN LLC DOES NOT TRIGGER LIFO RECAPTURE. In Letter Ruling 200123035, the IRS ruled that an S Corporation that wanted to provide special incentives to retain the general manager of three auto dealerships would not trigger the recapture of those dealerships' LIFO reserves when the S Corp. contributed the net assets of those dealerships to a newly formed Limited Liability Company.

For more on this, see page 3.

NO LIFO RECAPTURE TRIGGERED WHEN S CORPORATION CONTRIBUTES AUTO DEALERSHIPS' LIFO INVENTORIES TO A NEWLY FORMED LIMITED LIABILITY COMPANY

An S Corporation owned several dealerships and wanted to provide special incentives to retain the general manager of three of them. It only wanted the general manager of the three dealerships in question to acquire an interest in those three dealerships. Thus, it had a legitimate business purpose for considering the transaction.

Moreover, it wanted to be sure that if it set up these three dealerships in a separate entity, it would not be forced to recapture the dealerships' LIFO reserves as one cost of making that change.

In LTR 200123035, the IRS ruled that the S Corporation would not trigger the recapture of the dealerships' LIFO reserves when it contributed the net assets of those dealerships to a newly formed LLC (Limited Liability Company) in exchange for a membership interest.

After contributing the assets of the three dealerships to the LLC, the S Corp. stayed in existence and maintained a majority ownership interest in the profits and capital of the LLC. It also continued to operate the remaining auto dealerships as separate divisions.

After the net assets were transferred, the general manager would have supervisory authority over the same personnel and locations as he had before the transfer. It was expected that the general manager would contribute cash to the LLC for an ownership interest commensurate with the amount of his capital contribution compared to the total value of the capital of the LLC.

ANALYSIS OF PARTNERSHIP RULES

The S Corp. represented that the LIFO cost of the transferred inventory did not include any bargain purchase elements, obviously referencing *Hamilton Industries, Inc.* It also indicated that the LLC would be classified as a partnership for Federal income tax purposes. This brought into play an analysis of the partnership provisions in Subchapter K of the Internal Revenue Code.

The IRS held that, under Section 721(a), the S Corp. would not recognize gain or loss on the contribution of assets to the LLC in exchange for a membership interest. It held further that, to the extent that the manager's membership interest was received in exchange for cash contributed to the LLC, the manager would not recognize any gain or loss on the contribution.

The Ruling states "The contribution of the LIFO inventory property to the LLC formed to qualify for partnership tax treatment will not trigger recapture of the LIFO reserve." It added, "In order to adopt the dollar-value LIFO inventory method, the transferee LLC must file a Form 970 and otherwise comply with the provisions of Section 472 and the Regulations thereunder."

The IRS determined that, for LIFO inventory ***item*** classification purposes, the LLC could treat physically identical goods acquired after the transfer in the same way as the ***items*** that were in the inventory goods received in the transfer from the S Corp. In other words, separate ***item*** treatment for after-acquired goods was not required by the LLC just because the transferred inventory of similar goods had a relatively low carryover basis.

LIFO RESERVE ALLOCATIONS

The S Corp. had represented that after the asset transfer, the amount of the LIFO reserve allocated to the inventories of the transferred dealerships would approximate the same percentage of the actual cost as existed before the transfer.

Often there is a variation between the basis of property (contributed) to a partnership and the fair market value of that property at the time of the contribution. When a variation exists, Section 704(c) requires that income, gain, loss and deductions with respect to that property shall be shared among the partners so as to take account of that variation.

The Service held that the LIFO inventories contributed to the LLC constituted Section 704(c) property, and any built-in gain or loss attributable to the inventories contributed by the Company must be allocated back to the Company when the LLC recognizes that gain or loss. The S Corp. agreed that the LLC would make necessary elections under the Section 704 Regulations to aggregate each item of inventory for purposes of making allocations under that Section.

EVALUATING THE "NEW AND IMPROVED" LIFO METHOD FOR USED VEHICLES

2001-23 EVALUATION

Good news came in with the New Year ... on January 19, 2001 ... for dealers applying LIFO to their used vehicle inventories. Effective for taxable years ending on or after December 31, 2000, the IRS announced an acceptable, safe-harbor method for used vehicle LIFO computations. It is available to all dealers who satisfy the requirements spelled out in Revenue Procedure 2001-23 (2001-10 I.R.B. 1).

Essentially, vehicle prices used to compute inflation or deflation for LIFO index computation purposes are determined by reference to prices published in one of the industry's ***official used vehicle guides***. These references are based on ***comparable*** vehicles in ***average*** condition, without adjustment for mileage, options, accessories and other costs.

The IRS method requires two pools: one for used automobiles and the other for used light-duty trucks. Sport utility and other hybrid vehicles may be placed in either pool. However, whatever pool treatment is selected for SUVs and other hybrids must be consistently followed.

Generally, IRS permission to change over to use the newly announced method will be automatic. Dealers already on LIFO for used vehicles simply file Form 3115, and no IRS processing fee is required for filing this Form. However, if the dealer is already under audit by the IRS and its used vehicle LIFO method is being questioned, then change to the IRS-approved method may not be automatic.

DEALERS SHOULD CHANGE NOW

The biggest reason a dealer should change to this new method now is that the IRS agrees that it will not challenge prior year LIFO computation methods which were used to build up the LIFO reserves before the year of change.

Many LIFO methods previously employed would have no prayer or chance of standing up to tough IRS scrutiny ... especially if those methods did not (1) fully reprice all options and accessories on the vehicle, (2) consider wear and tear and mileage on the vehicle, (3) consider ***every*** vehicle and (4) possibly even trace back the index comparison intervals for ***each*** vehicle to the exact months of acquisition in the current year and in the preceding year.

All these fears or concerns (real or imagined) over whether the IRS would accept prior year LIFO calculations are wiped away for any dealer who changes now to the new method.

However, this change can be made automatically ... without IRS advance approval ... ***only*** if it is made for the first or second taxable year ending on or after December 31, 2000. For any changes to the new method made after this "window of opportunity," the cut-off method will not be permitted. Instead, an onerous Section 481(a) recalculation adjustment for all LIFO years will be required.

LESS COSTLY & MORE SIMPLIFIED

There are other reasons for dealers to change right away. First, the dealer should end up paying far less for the annual computations under the new method. Computations readily accessing official guide *electronic* databases are far less expensive and time consuming. They are also more accurate because they avoid the element of human error inherently built into any process involving going back and forth between different paper guide books and mentally adjusting for different model years.

Other advantages are really derivatives of the liberal approach allowed by the new method.

- Options and accessories on the vehicles are not required to be separately repriced.
- Separate databases are not required to price used vehicles acquired by trade-in differently from those acquired by purchase at auction.
- In making the time-interval comparisons, it is not necessary to count back exactly 52 weeks in the prior year to match acquisition dates in current and prior year ... as one dealer was required to do under the "52-week" method in LTR 9853003.

OTHER CONSIDERATIONS

The Revenue Procedure does contain special definitions, rules and requirements for determining the ***cost*** for used vehicles in ending inventory. However, these are neither unrealistic nor unduly burdensome. In fact, these requirements for determining cost reflect what dealers should be following as a matter of sound business practice anyway.

As a procedural requirement, the LIFO indexes for all years prior to the year of change are required to be rebased to 1.000 as of the beginning of the year of change.

Finally, the Revenue Procedure is not without certain technical implementation problems. However, as a practical matter, these should not be insurmountable and the IRS has evidenced a very cooperative attitude in informally discussing approaches for dealing with them.

AT A GLANCE	USED VEHICLE ALTERNATIVE LIFO METHOD REVENUE PROCEDURE 2001 - 23
WHAT IT IS	• An alternative method for LIFO computations for valuing used vehicle inventories that the IRS will accept if the dealer properly satisfies all requirements.
HOW IT WORKS	• Essentially, vehicle prices used to compute inflation or deflation for LIFO index computation purposes are determined by reference to an ***official used vehicle guide*** selected by the taxpayer. • Reference is to ***comparable*** vehicles in ***average*** condition, without adjustment for mileage, options and accessories, etc.
ADVANTAGES	• *Audit protection:* IRS agrees not to challenge prior year LIFO computation methods which built up used vehicle LIFO reserves. • *Cut-off method applies:* Sec. 481(a) recalculation adjustment is not required. • *Simplification* Do not have to separately reprice options and accessories on the vehicles. Separate databases are not required to price used vehicles acquired by trade-in differently from used vehicles acquired by purchase at auction. So-called "52-week" method set forth in TAM 9853003 is not required. Not required to count back exactly 52 weeks in prior year to match acquisition date in current year.
DISADVANTAGES	• Specific requirements must be satisfied for determining *cost* of used vehicles in ending inventory. • Dual index (earliest acquisitions) method can't be used for valuing increments.
POOLING	• Two pools are required ... one for autos, the other for light-duty trucks • Sport utility and special vehicles may be placed in either pool. However, pool treatment selected for these vehicles must be consistently followed.
OTHER SPECIAL RULES	• Vehicles which are not comparable and/or cannot be repriced are given a 1.000 index so that all used vehicles in ending inventory are considered in the determination of the LIFO inflation (deflation) index for the year. • The LIFO index at the beginning of the year of change is converted to 1.0000, and all indexes for prior years are to be rebased accordingly. • All invoices for vehicles in inventory must be retained. • Special transition rules apply if the dealer is using the IPIC method.
EFFECTIVE DATE	• Applies to taxable years ending on or after December 31, 2000.
PERMISSION TO CHANGE ASPECTS	• Generally, IRS permission to change will be automatic. See Rev. Proc. 99-49 • Dealers already on used vehicle LIFO file Form 3115. No filing fee is required • If dealer is under audit and used vehicle LIFO has been questioned by the IRS, then change to the IRS-approved method will not be automatic.
CITATION	• Revenue Procedure 2001-23 published January 19, 2001. (2001-10 I.R.B. 1)

IRS SUMMARY OF R.P. 2001-23 LIFO METHOD FOR USED VEHICLES

IRS MVTA AUTOMOTIVE ALERT DATED JAN. 25, 2001*

TEXT of IRS ALERT	*COMMENTS*

Introduction

On January 19, 2001, the Internal Revenue Service published the long awaited Used Vehicle Alternative LIFO Method; Revenue Procedure 2001-23. The new method incorporates a computational methodology similar, although with some significant differences, to the method used in Revenue Procedure 97-36, Alternative LIFO for New Vehicles. The publication of the *simplified method* is part of a major initiative by the Service to provide specific guidance to taxpayers on industry issues.

- Rev. Proc. 97-36, which contains the specifics of the Alternative LIFO Method for New Vehicles, was originally issued in 1992 as Rev. Proc. 92-79. The 1997 Rev. Proc. deletes all of the cumbersome transitional rules that were necessary in 1992 ... Other than that, there were no changes in any of the technical details.
- "*Simplification*" relates to the IRS not requiring a more comprehensive repricing of all of the vehicle cost elements in determining the year-end inflation indexes.

Overview of the Method

The Used Vehicle Alternative LIFO Method applies to taxpayers that sell used automobiles or used light-duty trucks and is effective for tax years ending on or after December 31, 2000. For purposes of the revenue procedure, used automobiles and used light-duty trucks are defined as previously titled vehicles and do not include demonstrator vehicles typically used in new car dealerships.

- Dealers with any fiscal year ending in 2001 may want to make the change immediately if their LIFO reserves are very large.
- If they want to make the change effective for their current year, dealers do not have to wait until *after* the end of their current year to file Form 3115 with the IRS National Office. This may be a good preventative measure to consider.

The new method is an *elective*, comprehensive *link-chain method* that includes several special rules and required sub-methods. In the opinion of the Commissioner, provided that dealers properly implement and apply the method described in Revenue Procedure 2001-23, income from the sale of used vehicles will be clearly reflected and the method will be accepted as an accurate, reliable, and suitable method of computing a LIFO inventory index. However, all computations under the Used Vehicle Alternative LIFO Method remain subject to verification upon examination of the dealer's tax return.

- I have always been a proponent of describing the methodology the IRS now accepts in both Revenue Procedures 97-36 and 2001-23 as a ... "*link-chain, index*" method. Note the insertion of the word "*index*" to indicate that less than every cost element has been repriced in determining the rate of inflation.
- As long as the IRS accepts the method... Frankly, it doesn't matter what they call it now.

General Rules and Definitions

In general, dealers that elect the Used Vehicle Alternative method will compute the LIFO index by reference to average *base vehicles* that correspond to the vehicles in the dealership's ending inventory. The LIFO index computed using the base costs and the methodology in the Revenue Procedure is applied to the *current-year cost* of the dealership's ending inventory.

- The result produced by dividing (1) the current-year cost (i.e., the carrying value as per the general ledger) by (2) the cumulative index at the end of the current year, equals (3) the end-of-the-year inventory expressed in terms of constant base dollars.

Section 4.02(l) of the Revenue Procedure defines base *vehicle* as "...the most relevant combination of (a) a detailed base model description, consisting of model line, body style, and trim level ... and (b) an associated manufacturers base model code number..." When computing the LIFO index, dealers must determine base vehicle prices by reference to an *official used vehicle guide*.

- Under Rev. Proc. 97-36 for the new vehicle LIFO method, the finest level of detail that must be used is an "item category" determined by the most precise breakdown found on the manufacturer's price list.
- Under Rev. Proc. 2001-23, the equivalent level of detail to be used in computing the year-end inflation index will be determined by the detail found in the official used vehicle guide selected for this purpose.

* *MVTA = Motor Vehicle Technical Advisor*

TEXT of IRS ALERT	*COMMENTS*

The Revenue Procedure provides a specific definition of ***current-year cost*** for purchased vehicles and for trade-in vehicles (Section 4.02(4)(a) and (b)). The current-year cost of trade-in and purchased vehicles includes the vehicle's purchase price plus reconditioning costs, delivery charges, and any other costs properly allocated to the vehicle, i.e., Section 263A costs.

- In most instances, proper and more practical Sec. 263A elections made by dealers will ***not*** result in any Section 263A costs being directly allocable to the specific vehicles (i.e., units) in ending inventory. Rather, the Section 263A costs will be allocable as a total dollar amount to the respective years' LIFO layers.

"Cost" for a vehicle acquired by purchase is easily identified by reference to the sales documents. However, the "cost" of a trade-in vehicle is not as clear. Section 4.02(4)(b) specifically defines the "cost" of a trade-in vehicle by reference to Revenue Ruling 67-107, i.e., the wholesale price of a comparable vehicle reflecting the actual vehicle's actual mileage, condition, options and accessories.

- The full text of Rev. Rul. 67-107 appears on page 11.
- Note: Rev. Rul. 67-107 is over 30 years old.

As a simplifying measure, the revenue procedure provides for the use of an ***"official used vehicle guide"*** in the computation of the LIFO index. "Official used vehicle guide" is defined as a guide that is "...widely recognized and utilized in the used vehicle dealer industry." The selected guide must be used consistently and must be the appropriate guide for the dealers region.

- Official used vehicle guides include
  - *Black Book*
  - *Kelley Blue Book*
  - *NADA*
  - *Others*

When determining current-year cost of trade-in vehicles, the guide must cover the day of acquisition of each specific vehicle. When computing the LIFO index, current-year cost must be determined using the guide in effect on the last day of the dealers current taxable year. Prior-year cost must be determined by reference to the guide covering the last day of the dealers preceding taxable year.

- It is permissible to use one publisher's official used car guide for purposes of determining cost during the year ... and a *different* publisher's official guide for purposes of computing the inflation indexes at the end of the year.
- If the dealer is not on LIFO, it is ***not*** permissible to use one publisher's official used car guide for purposes of determining cost during the year ... and a ***different*** publisher's official guide to determine lower of cost or market values for writedowns at the end of the year.

It is important to note that any change in the particular used vehicle guide or any change in the precise manner in which the guide is used represents a change in method of accounting. Accounting method changes generally require the Commissioner's consent. (Section 4.02(2))

- Although this seems reasonable, technical problems may be created if publishers of official used car guides change the level of descriptive detail in their Guides between years.

Revenue Procedure Section 4.02(3) requires dealerships to establish two used vehicle ***pools*** for each separate trade or business. The pools consist of a pool for all used light-duty trucks, regardless of manufacturer and a pool for used automobiles, regardless of manufacturer.

- Rev. Proc. 2001-23 ... just like Rev. Proc. 97-36 ... does not provide any specifics on what is meant by the term "*separate trades or businesses*." The generally accepted interpretation of this term as applied to auto dealers is that the entire dealership constitutes a single trade or business.

TEXT of IRS ALERT	COMMENTS

The Revenue Procedure also provides some of the first guidance on where to pool the new generation of hybrid vehicles. Section 4.02(3) provides that "used sport utility vehicles and used hybrid vehicles... may be included initially in either the used automobile or the used light-duty truck...pool." The original selection is a method of accounting and any deviation requires the consent of the Commissioner.

- This seems to be a very fair and sensible approach.
- Although not specifically referred to, "sport wagons" would appear to fall within this flexible initial treatment for pooling purposes.
- This removes any controversy over how PT Cruisers should be treated (when drivers start trading them in).

General Index Guidelines

To compute the annual LIFO index for each pool, the dealership must compare the current and prior year base costs for each vehicle in ending inventory. The properly determined current-year base vehicle price (as defined in Section 4.02) is matched to a comparable base vehicle of the same age and in average condition in the prior year. When no comparable prior-year base vehicle exists, the current-year base vehicle cost is also used as the prior-year base vehicle cost, i.e., that vehicle receives an index of 1.000. *The current-year cost and prior-year cost are also identical if there is a change in the vehicle's wheel base or track width, regardless of whether the base vehicle code and description has changed.*

- The last sentence is problematic. However, it is not a misprint.
- What it and the Revenue Procedure really say is this: If the Official Guide fails to treat a platform change as a change that renders a comparison (of the vehicle model prices between years) invalid, then the prior year price in the Official Guide should be disregarded. Instead, that vehicle should be treated as having an index of 1.000 for index computation purposes.
- In other words, the IRS expects the taxpayer to police the accuracy of the publisher of the Official Used Vehicle Guide they select.
- Informal discussions with the IRS confirm that the foregoing describes their intention.

Changing to the Used Vehicle Alternative LIFO Method

Dealerships must follow the automatic change provisions of Revenue Procedure 99-49, with some modifications, to change to the Used Vehicle Alternative LIFO Method. With one exception, if the change is made for the first or second taxable year ending on or after 12/31/00, the taxpayer may change to the new method automatically even if the dealership is under examination.

- The exception referred to is described in the next paragraph of text relating to a pending issue already raised on audit concerning the used vehicle LIFO method.
- There are other limited exceptions for certain changes involving users of the IPIC (Inventory Price Index Computation) method.

Caution: If the dealership is under examination and used car LIFO is a pending issue, the automatic change provisions do not apply. An issue is pending if the Service has provided written notification indicating that an adjustment is being made or will be made regarding a method of accounting. The exact amount of the adjustment may not yet have been determined. The definition of pending issue can be found in Section 6.01(6) of Revenue Procedure 2000-38.

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TEXT of IRS ALERT	COMMENTS

Changes to the Used Vehicle Alternative LIFO Method are made on a cut-off basis which requires that the value of the used vehicle inventory at the beginning of the year of change must be the same as the inventory value at the end of the prior year. Note: The Revenue Procedure contains special rules if the dealer has previously improperly accounted for a bulk bargain purchase or uses the IPIC method. For further information see Section 5.02(2) and Section 5.03(2).

- If a dealer does not change to the R.P. 2001-23 method for the first or second year ending on or after December 31, 2000 ... the "window of opportunity," ... then the favorable cut-off method cannot be used in connection with making the change. Instead, an adjustment under Section 481(a) will be required.

Conditions of Change

Dealerships must also comply with several conditions in order to use the Used Vehicle Alternative LIFO Method including compliance with the conformity requirements of Treasury Regulation 1.472-2(e).

- Adjustments *must* be made on all year-end financial statements, including all Factory financial statements, to reflect either (1) a reasonable estimate, or (2) the actual computed amount, of the change in year-end LIFO reserves.
- See Rev. Rul. 97-42 for acceptable LIFO disclosures.

Electing dealerships must maintain complete books and records of the computations under the method. Records must include the used vehicle guides used in the index computation.

- Dealers using this method must retain copies of invoices for all vehicles in ending inventory. These should be retained as permanent Corporate tax records.

LIFO inventory cost increments and the values of the increments must be retained. The year of change to the new method becomes the new base year (Section 5.01(3)).

- This *rebasing* requirement that prior LIFO indexes be rebased to 1.000 as of the beginning of the year of change is actually found in Section 5.02(3).

The dealership's LIFO election must be reviewed to determine whether the initial election included used vehicles. If not, the dealership must file a Form 970 electing LIFO for used vehicles.

- The instructions to Schedule B of the Form 3115 require that copies of Forms 970 making the LIFO elections are to be attached to the Forms 3115 filed.
- For more on this requirement, see the 3115 pro forma package.

Prior to adopting the new method, dealerships should also insure that vehicles are properly pooled and if necessary combine or separate pools to comply with the Revenue Procedure's requirements.

- If the old LIFO method had multiple pools for each make, those pools must be combined into two pools.
- If old method had a single pool for all used vehicles, that pool must be separated into two pools.

Conclusion

Revenue Procedure 2001-23 includes additional information not addressed by this publication such as specific computational steps and complete instructions on how to elect Used Vehicle Alternative LIFO.

Used Vehicle Alternative LIFO is a significant milestone in our goal to provide clear and specific guidance to taxpayers in the motor vehicle industry. If you have any questions please contact the Motor Vehicle Technical Advisor at 616-235-1655, by e-mail at Terri.S.Harris.irs.gov or MVTA team member Tim Coyle at 616-235-1664, or by e-mail at Timothy.Coyle@irs.gov.

** MVTA = Motor Vehicle Technical Advisor*

REV. PROC. 2001-23	***SUB METHODS & SPECIAL RULES*** ***USED VEHICLE ALTERNATIVE LIFO METHOD***
USE OF BASE VEHICLE PRICES ***Section 4.02(1)***	• In general, indexes must be computed using prices for base vehicles that best relate, under the guidelines specified in this revenue procedure, to the used vehicles actually held by the taxpayer. • Base vehicle is defined for purposes of this revenue procedure as the most relevant combination of (a) a detailed base model description, consisting of model line, body style, and trim level (e.g., Honda Accord 4D Sedan EX), and (b) an associated manufacturer's base model code number that appears in the official used vehicle guide utilized by the taxpayer and relates to a used vehicle held by the taxpayer.
USE OF OFFICIAL USED VEHICLE GUIDES ***Section 4.02(2)***	• "***Official Used Vehicle Guides***" are defined as those that (a) are widely recognized and utilized in the used vehicle dealer industry for business purposes in the regions involved, and (b) are regularly and consistently used by the taxpayer in valuing inventory for federal income tax purposes. • Any change in the particular used vehicle guide utilized by a taxpayer in connection with the Used Vehicle Alternative LIFO Method or any change in the precise manner of its utilization (e.g., a change in the specific guide category that a taxpayer uses to represent vehicles of average condition for purposes of section 4.02(5)(a) of this Revenue Procedure) represents a change in method of accounting for which the taxpayer must secure the consent of the Commissioner in accordance with the requirements of Rev. Proc. 97-27, 1997-1 C.B. 680 (or its successor).
TWO LIFO POOLS ***Section 4.02(3)***	• A taxpayer that uses the Used Vehicle Alternative LIFO Method must establish, for each trade or business that sells used vehicles, a dollar-value LIFO pool ***for all used automobiles*** (regardless of manufacturer) and another separate dollar-value LIFO pool for ***all used light-duty trucks*** (regardless of manufacturer). • Used sport utility vehicles and used hybrid vehicles (e.g. vans and mini-vans) may be included initially in either the used automobile or the used light-duty truck dollar-value LIFO pool; however, once a choice is made, all like vehicles must be similarly treated in subsequent years.
DETERMINATION OF THE CURRENT-YEAR COST OF VEHICLES IN ENDING INVENTORY ***Section 4.02(4)***	• ***Purchased vehicles.*** The current-year cost for each used vehicle purchased includes its purchase price plus reconditioning costs, delivery charges, and all other costs properly allocated to that particular vehicle under the taxpayer's method of accounting (which includes the taxpayer's method of accounting for section 263A costs). • ***Trade-in vehicles.*** The current-year cost for each used vehicle acquired via trade-in includes its "cost" plus reconditioning costs and all other costs properly allocated to that particular vehicle under the taxpayer's method of accounting (which includes the taxpayer's method of accounting for section 263A costs). • ***The cost of a vehicle acquired via trade-in*** must be determined by reference to the wholesale price listing, as permitted by Rev. Rul. 67-107, 1967-1 C.B. 115, in an official used vehicle guide for a similarly equipped, comparable base vehicle that reflects the trade-in vehicle's actual mileage and condition. The cost of a trade-in vehicle also must include prices reflected in the guide for installed options and accessories, if any. • The official used vehicle guide from which prices are drawn to determine the cost of a trade-in vehicle must be the ***guide that covers the day of acquisition of that specific vehicle.***

USING DIFFERENT OFFICIAL GUIDE BOOKS FOR DIFFERENT PURPOSES

The Revenue Procedure introducing the Used Vehicle Alternative LIFO Method incorporates the industry-wide practice of using Official Used Car Guides in several ways. It recognizes that dealers use Car Guides in many ways: (1) in discussions with customers, (2) in determining vehicle cost for book purposes, (3) in determining writedowns at year-end if the dealer is not on LIFO, and (4) in determining inflation indexes based on comparable beginning and end-of-the-year prices.

The following paragraphs indicate those situations where the IRS requires the use of the same Official Used Car Guide and those situations where different Official Used Car Guides can be used for different purposes.

Salespersons (on the lot, in negotiating the deal with the customer) can use book #1 or #2 or any other book, even though a ***different book*** is used to determine (1) ***cost*** as of the date of acquisition, and/or (2) ***value*** as of end-of-the-year if LIFO is not used and the ending inventory is valued at lower of cost or market (LCM).

It is the position of the IRS that where the dealer has not elected LIFO and at year-end is valuing used vehicles at LCM, ... the ***same book*** (i.e., the same *Official Used Car Guide*) must be used (1) to determine cost of that vehicle as of the date of acquisition, and (2) to determine the LCM (lower of cost or market) value of that vehicle in ending inventory.

In other words, if the dealer is using *Black Book* to determine the cost of the vehicle when it is acquired, then that cost stays on the books and remains its cost (unless increased by other cost elements, such as transportation, reconditioning, etc.) until at year-end when that vehicle's cost carrying value is written down to LCM by a writedown that must be determined from the year-end *Black Book*. Values for year-end LCM adjustments cannot be determined from a different source (i.e., *NADA* or *Kelley*) if *Black Book* is used to determine cost during the year.

Revenue Procedure 2001-23, Section 4.02(5)(a), permits a dealer to use ... a ***different book*** at the end of the year to reprice vehicles at their beginning-of-the-year and end-of-the-year prices in order to compute a LIFO inflation/deflation index. In other words, a dealer could use *Black Book* to determine acquisition cost during the year and (he could use) a book other than *Black Book* at the end of the year in order to compute the LIFO inflation/deflation indexes.

REVENUE RULING 67-107

Below is the full text of Revenue Procedure 67-107 which is cited in Revenue Procedure 2001-23, Section 4.02(4)(b) as permitting the cost of a vehicle acquired by trade-in to be determined by reference to the wholesale price listing in an Official Used Vehicle Guide for a similarly equipped, comparable base vehicle that reflects the trade-in vehicle's actual mileage and condition. It contains two further requirements: (1) the cost of the trade-in vehicle also must include prices reflected in the Guide for installed options and accessories, if any, and (2) the Official Used Vehicle Guide from which prices are drawn to determine the cost of a trade-in vehicle must be the Guide that covers the day of acquisition of that specific vehicle.

"Advice has been requested concerning the proper method of valuing for inventory purposes used cars taken in trade by a car dealer.

"A car dealer files his returns on a calendar year basis employing an accrual method of accounting and values his inventories at the lower of cost or market.

"It is a common practice for the car dealer to sell a car and as part of the payment to take in trade the purchaser's old car. The dealer values the car taken in trade at cost which is an amount representing the average wholesale price listed by an official used car guide at the time of trade-in. If not sold, the used car is carried in inventory at the cost figure until the end of year. The inventory value is then adjusted to conform to the average wholesale price listed at that time. This is the practice recommended by the auto industry and used by nearly all car dealers.

"Section 471 of the Internal Revenue Code of 1954 provides that inventories must conform as nearly as may be to the best accounting practice in the trade or business and must clearly reflect income. Section 1.471-2(c) of the Income Tax Regulations provides that the bases of valuation most commonly used by business concerns and which meet the requirements of Section 471 are (1) cost and (2) cost or market, whichever is lower. Section 1.471-4(a) of the Regulations defines 'market' as the 'the current bid price prevailing at the date of inventory for the particular merchandise in the volume in which usually purchased by the taxpayer.'

"Accordingly, ***a car dealer may value his used cars for inventory purposes at valuations comparable to those listed in an official used car guide as the average wholesale prices for comparable cars.***"

Citation: Revenue Ruling 67-107 (1967-1 C.B. 115)

REV. PROC. 2001-23	**GUIDELINES FOR INVENTORY POOL INDEXES USED VEHICLE ALTERNATIVE LIFO METHOD**
COMPUTATION OF AN INVENTORY POOL INDEX ***Section 4.02(5)(a)***	• For each inventory pool, current-year and prior-year base vehicle prices for each used vehicle in ending inventory are totaled and the totals are used to compute a current-year index for the pool under the Used Vehicle Alternative LIFO Method. These base vehicle prices must be determined by reference to prices reported in an official used vehicle guide for ***comparable base vehicles of the same age and in average condition, unadjusted for options, accessories, reconditioning costs, or other costs.*** • "Average condition" is defined ... as the category that best represents a vehicle in average condition in the taxpayer's official used vehicle guide. Thus, although "average" prices would be used for guides in which this category does appear, it would be appropriate to select and use a comparable category, e.g., "clean" prices, in the case of other used vehicle guides in which there is no average category. • Current-year indexes for each inventory pool are then multiplied by prior-year cumulative indexes for that pool to compute a current-year cumulative index. • Once a current-year cumulative index is computed for each inventory pool using base vehicle prices, that index is then applied to the total current-year cost (as determined under section 4.02(4), including options, accessories, reconditioning costs, and other costs) of all vehicles in the pool at the end of the taxable year in order to determine whether an inventory increment or decrement has occurred.
DETERMINATION OF COMPARABLE BASE VEHICLE PRICES FOR INDEX COMPUTATIONS ***Section 4.02(5)(b)***	• Current-year base vehicle prices for all vehicles in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer's current taxable year for the specific vehicles held in inventory. • Prior-year base vehicle prices for comparable vehicles of the same age as those in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer's preceding taxable year. In a short taxable year, see section 4.02(5)(d). • Example: A calendar year 2000 taxpayer that had a 1998 Vehicle X (a particular model, body style and trim level) in ending inventory would determine associated base vehicle prices for its index computation as follows: the current-year base vehicle price for this vehicle would be the base price (without adjustment for any options, accessories, reconditioning costs, or other costs) for a 1998 Vehicle X in average condition from the guide covering December 31, 2000; the associated prior-year base vehicle price would be the base price for a 1997 Vehicle X in average condition (a comparable vehicle of the same age) from the guide covering December 31, 1999.
IF A PRIOR-YEAR COMPARABLE BASE VEHICLE LISTING DOES NOT EXIST ***Section 4.02(5)(c)***	• When no prior-year base vehicle price for a comparable vehicle of the same age as a vehicle in ending inventory appears in the official used vehicle guide covering the last day of the taxpayer's preceding taxable year (e.g., Vehicle X was introduced for the first time in the 1998 model year, and thus there was no corresponding 1997 Vehicle X), ***current-year base vehicle price must be used as prior-year base vehicle price in index computations.*** • ***Special 1.000 requirement.*** Current-year base vehicle price must also be used as prior-year base vehicle price in the event that a change in wheelbase or track-width from one year to the next has occurred for a particular type of vehicle without a corresponding change in the relevant official used vehicle guide combination of detailed base model description and associated manufacturer's base model code number.
SHORT TAXABLE YEARS ***Section 4.02(5)(d)***	• All current-year indexes must be adjusted in the case of a short taxable year (i.e., a return for a period of less than 12 months). • This adjustment involves adjusting the current-year index, as computed on a full year basis, as follows: current-year index for short taxable year = 1 + [(current-year index for full year - 1) x (number of months in short year / 12)]. • For example, a new calendar year taxpayer that came into existence on July 1, 2000, would use official used vehicle guides covering December 31, 1999, and December 31, 2000, in its index calculations to compute a full year index for 2000 and then adjust that index by the number of months actually contained in its short taxable year (i.e., six months).

REV. PROC 2001-23	***EIGHT STEP CALCULATION METHODOLOGY USED VEHICLE ALTERNATIVE LIFO METHOD***
STEP 1	• Determine the ***detailed*** base model description and associated manufacturer's base model code number combination that applies ***to each vehicle*** in ending inventory by using an *Official Used Vehicle Guide.*
STEP 2	• Determine the current-year cost of each vehicle in ending inventory in accordance with Section 4.02(4). • Then, for each pool, calculate the total current-year cost of all vehicles in ending inventory.
STEP 3	• For each vehicle in ending inventory, using the related description and code number from ***Step 1***, determine current-year and prior-year base vehicle price as indicated in Section 4.02(5) ... (i.e., "for comparable base vehicles of the same age and in average condition, unadjusted for options, accessories, etc.")
STEP 4	• For each pool, calculate the total current-year base vehicle price and the total prior-year base vehicle price for ***all*** vehicles in ending inventory by adding the respective numbers from ***Step 3***. • Divide the total current-year base vehicle price of all vehicles by the total prior-year base vehicle price of all vehicles to determine the current-year pool index. • In the case of a short taxable year, pro-rate this index in accordance with Section 4.02(5)(d) of the Revenue Procedure.
STEP 5	• For each pool, compute the cumulative index for the current taxable year by multiplying the cumulative index from the immediately preceding taxable year by the current-year index from ***Step 4***. For the first taxable year in which the Used Vehicle Alternative LIFO Method is used, the cumulative index for the immediately preceding taxable year is 1.000.
STEP 6	• For each pool, calculate the ending inventory at base-year cost by dividing the total current-year cost from ***Step 2*** by the cumulative index from ***Step 5***.
STEP 7	• For each pool, determine whether there is an inventory increment or decrement by comparing ending inventory at base-year cost for the current year from ***Step 6*** to beginning inventory at base-year cost (from ***Step 6*** of the prior-year calculation), or, for the first taxable year in which this method is used, to the beginning inventory (as determined under Section 5.02(3) ... if applicable in order to reflect all appropriate vehicles and costs in the respective pools). • If the ending inventory at base-year cost is greater, there is an increment. Multiply this increment by the cumulative index from ***Step 5*** to calculate the LIFO value of the increment (i.e. the layer of increment). • Alternatively, if the ending inventory at base-year cost is less than beginning inventory at base-year cost, a liquidation (also referred to as an inventory decrement) has occurred. Reduce the prior-year LIFO layers of increment in reverse chronological order until the liquidation is fully absorbed.
STEP 8	• For each pool, add together the current year's layer of increment, if any, at current-year cost and the remaining prior years' layers of increment at each prior year's historical current-year cost to compute the total LIFO value of the inventory pool.
SAVE ALL INVOICES	• Under the ***Used Vehicle Alternative LIFO Method***, the inflation index is computed by reference to the *invoices for every vehicle in ending inventory* - no sampling, no shortcuts in this regard. *Copies of invoices for every vehicle in ending inventory should be saved **indefinitely** as permanent (corporate) tax records.*

FORM 3115 PRO FORMA FILING PACKAGE FOR DEALERS CHANGING TO THE USED VEHICLE ALTERNATIVE LIFO METHOD ... REV. PROC. 2001-23

In general, it is very easy for dealers who already are valuing their used vehicle inventories on LIFO to change to the "new" IRS-approved alternative method. Except in a few isolated instances, the change to the new method does not require advance IRS permission, nor does it require payment to the IRS of a $1,200 filing fee. If the change is made for the first or second taxable year ending on or after December 31, 2000, just follow the automatic accounting method change provisions found in Revenue Procedure 99-49.

Prepare Form 3115 in triplicate. The ***original*** of Form 3115 must be attached to the taxpayer's timely filed (including extensions) original Federal income tax return for the year of change. One ***copy*** of the Form 3115 must be filed with the IRS National Office in Washington, DC no earlier than the first day of the year of change and no later than when the original is filed with the Federal tax return for the year of change. The second ***copy*** should be retained by the taxpayer as a permanent corporate tax record.

Warning: This discussion and the related attachments apply in what is likely to be the more common situation: (1) the dealer is not currently under audit by the IRS and there is no pending used vehicle LIFO valuation issue and (2) the dealer is not changing from an existing LIFO method where it is currently using the IPIC method.

Form 3115 is one of the more lengthy, complex and challenging forms any practitioner has to deal with. The current form bears a May, 1999 revision date and contains 8 pages. Applicants filing under the automatic change procedures are required to complete Parts I through IV (the first three pages) and Schedule B (page 5).

THREE SPECIAL OBSERVATIONS

1. ***Special legend required.*** The following ***MUST*** be typed or written at the very top of page 1 of Form 3115:

   "FILED UNDER REVENUE PROCEDURE 2001-23."

2. ***General narrative should suffice.*** In connection with providing the detailed information called for by Schedule B, it should not be necessary to recite back to the IRS all of the specific and technical rules and conditions set forth in Rev. Proc. 2001-23 that the taxpayer will follow in changing to the new method. Instead, a more general narrative should be sufficient. If an IRS agent, upon examination, should require more particulars, they would naturally have to be provided at that time.

3. ***Copies of previous Forms 970 are required to be attached to Form 3115.*** The instructions for Schedule B - at the top of the page - include the following:

   "ATTACH A COPY OF ALL FORMS 970 FILED TO ADOPT OR EXPAND THE USE OF THE LIFO METHOD."

   This should be interpreted to mean that all Forms 970, electing LIFO for any class of goods (i.e., new vehicles, used vehicles and/or parts and accessories) should be filed. However, some may file only a copy of the Form 970 by which the election was made to apply LIFO to used vehicles inventories.

   This requirement may be problematic if the taxpayer cannot locate either the Form 970 on which the LIFO election for used vehicles was made and/or the taxpayer is unable to locate all of the other 970s that may have been filed. (See Rev. Proc. 92-85.) If the dealer first elected LIFO for new vehicles and in a later year elected LIFO for used vehicles, that subsequent election was technically an expansion or extension of the LIFO method to another class of goods.

4. ***The key point:*** The Form 3115 should make it obvious to the IRS that the dealer is changing to the Used Vehicle Alternative LIFO Method under Revenue Procedure 2001-23.

FORM 3115 PRO FORMA FILING PACKAGE

1. ***Narrative statement attachment.*** Note: You will need to extract and modify appropriate statements in order to complete your own narrative supporting disclosure. There can be significant variation in past practices and methods for dealers filing Forms 3115 to elect the Used Vehicle Alternative LIFO Method. Therefore, no single "pro forma" Form 3115 can be expected to fit all situations.

   Any attachments to Form 3115 must show the taxpayer's name and identification number and be referenced as attachments to Form 3115. The suggested wording can be tailored to your own fact pattern and style. In several of these statements you will need to select the appropriate disclosures from several alternatives listed. ***Accordingly, these attachments cannot be used as they appear without some further modification by you to reflect your specific facts and circumstances.***

2. ***Additional comments and explanations*** - to be considered in connection with completing Forms 3115 and 970. The obvious lack of coordination between the current Form 3115 (May, 1999 revision) and the Revenue Procedure 2001-23 issued in January of 2001 means there will be different interpretations over how certain schedules and attachments to Form 3115 should be completed, or how certain questions might be answered.

3. ***Form 3115, Pages 1 through 3 and Schedule B (page 5) are reproduced on pages 20-23.*** All other Form 3115 pages (i.e., 4, 6, 7 or 8) are not applicable, are not required to be filed with the IRS and have not been reproduced.

IRS – APPROVED LIFO METHOD FOR USED VEHICLE INVENTORIES

SAMPLE LETTER

Mr./Ms. Dealer and/or CFO
XYZ Dealership Group

February , 2001

Dear _____________:

Many of the dealers we have been involved with over the years already have their used vehicles on LIFO. By now, they have generated very sizable LIFO reserves amounting to hundreds of thousands of dollars.

The IRS recently spelled out the details of what it would consider as an acceptable way of computing LIFO for used vehicles. This new IRS-accepted method is a significant simplification over its previous statements which were more burdensome and unrealistic. All of the specifics are in Revenue Procedure 2001-23, dated January 19, 2001.

We recommend that any dealers for whom we are presently doing used vehicle LIFO calculations change to the recently announced IRS-approved method at the end of the year.

Probably the best reason to make this change is that the IRS will automatically accept all prior used vehicle LIFO calculations if a dealer agrees to use the new method on a going-forward basis. This means that we won't have to defend previous calculations because of the "audit protection" the IRS will give to any dealer who voluntarily changes over to the new method.

The new procedures require you to select an "official" used vehicle guide to use on a consistent basis for determining year-end inflation and cost valuations for used vehicles. There are certain other conditions to which you must agree, essentially relating to how you will determine cost for your inventories. However, these conditions should not be onerous if proper procedures are currently being employed.

As to the type of documentation necessary, a copy of your used vehicle inventory detail that shows the make, model, body style, trim level, etc. of each vehicle in inventory and the amount carried as the vehicle's cost will be sufficient. Also, you should retain a copy of the invoice for each used vehicle in ending inventory.

IF YOU'RE NOT ALREADY ON LIFO FOR USED VEHICLES

Basically, if you expect that used vehicle prices will be increasing over time, then it makes sense to elect LIFO for your used vehicle inventories at year-end. Many dealers who recently (i.e., in the last two years) elected LIFO for used vehicles experienced price deflation and negative results because they jumped on the bandwagon too late. For your dealership, the key consideration is whether you expect used vehicle prices to trend upward over the long run.

The advantage of electing LIFO for used vehicles, instead of taking traditional write-downs at year-end, is simply that these write-downs reverse immediately in the next year. The LIFO reserve, on the other hand, compounds over time and is a more permanent deferral.

Other considerations are involved; this letter only covers the highlights. With a used vehicle inventory of roughly $2 million, if inflation were only 2% for the year 2001, you could expect a used vehicle LIFO reserve of roughly $40,000 in the first year. At 3% inflation, the first year LIFO reserve would be closer to $60,000.

PLANNING AT YEAR – END TO ELECT LIFO FOR USED VEHICLES

Our experience in doing used vehicle LIFO calculations for dealers' Dec. 31, 2000 inventories has been that their used ***automobile pools*** showed little, if any, inflation (and sometimes even a small amount of deflation). However, their used ***light-duty truck pools*** tended to show significant inflation (2 to 3+%). Therefore, overall, for a dealer with a large investment of dollars in these inventories, used vehicle LIFO provided a significant tax deduction in 2000 as well as one that was superior to simply taking write-downs that reversed in a matter of months.

In many cases we have simply done a trial calculation at year-end, and if that showed "sufficient" inflation and a large enough LIFO reserve for the used vehicles, then the LIFO election was made.

TWO OTHER IMPORTANT CONSIDERATIONS

WRITEDOWNS. First, if you've taken write-downs in used vehicles at the end of the preceding year, you may be able to take advantage of the way the Internal Revenue Code (not the new Revenue Procedure 2001-23) is written and end up with a significant timing benefit. This is because the IRC says that write-downs taken against the vehicles in the prior year ending inventory must be restored over a three-year period...even though the reality is that you've already sold all of the vehicles on which the write-downs were taken by the end of the next year.

PUT AN ESTIMATE OF LIFO ON ALL YEAR-END FINANCIAL STATEMENTS. Second, if you are even thinking about electing LIFO for used vehicles, in order to keep this option open for tax purposes, you must provide an estimate on your year-end (Factory and all other) financial statements. In other words, you must satisfy the LIFO financial statement conformity requirement on all year-end statements even though you may have not made the decision to elect LIFO before you have to release those statements.

We look forward to discussing all of this further with you at your convenience.

TAXPAYER ______________________________ EI# ____________

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

W/R/T FISCAL/CALENDAR YEAR ENDING ______________, 200__

FILED UNDER REV. PROCs. 2001-23 & 99-49

STATEMENT RE: AUTOMATIC CHANGE & WAIVER OF USER FEE

This Form 3115 is filed under Section 5.02 of Revenue Procedure 2001-23. Taxpayer is a automobile dealer engaged in the trade or business of selling and servicing new and used automobiles and light-duty trucks. The Taxpayer is changing to the *Used Vehicle Alternative LIFO Method* described in Revenue Procedure 2001-23 in order to bring its LIFO calculations for its used vehicle inventories into compliance with the "safe-harbor" methodology described therein.

Taxpayer's year of change from its prior LIFO method for used vehicle inventories is its current fiscal /calendar year ending ______________, 200___.

The Taxpayer is not currently under audit by the Internal Revenue Service. Accordingly, there are no pending used vehicle LIFO valuation issues. Also; the Taxpayer is not changing from an existing LIFO method which involves the use of the Inventory Price Index Computation (IPIC) method. Therefore, this change within the LIFO accounting method is being made under the automatic change provisions of Revenue Procedure 99-49. Per Form 3115 instructions, applicants filing under an automatic change procedure are not required to pay a user fee to the IRS.

The *Used Vehicle Alternative LIFO Method* to which the Taxpayer is changing (with automatic consent approval) is a dollar-value, link-chain (index) method employing the sub-methods, definitions, special rules, eight step computational methodology, and other procedures, all of which are set forth in detail in Revenue Procedure 2001-23.

The Taxpayer has previously elected to value its used vehicle inventories under the LIFO method for the fiscal/calendar year ended ______________ by filing Form 970, ***a copy of which is attached/or is not readily available.***

Taxpayer has previously elected to value certain other inventories (***new vehicles (including demonstrators) and/or parts and accessories inventories***) under the LIFO method by filing Form(s) 970 at the appropriate times. Copies of the Form(s) 970 filed for these inventories other than used vehicles ***are attached/or are not readily available.***

Alternative Wording Re: Forms 970

A copy of the original Form 970 LIFO election made by the Taxpayer for its fiscal/calendar year ending __________, ______ ***is attached/or is not readily available.***

Subsequently, the Taxpayer elected to extend LIFO to its used vehicle inventories by filing another Form 970 for its fiscal/calendar year ending __________, ______, a copy of which ***is attached/or is not readily available.***

Statement Re: LIFO Methods Used Prior to the Change

The Taxpayer's prior methods of applying Last-In, First-Out (LIFO) to its used vehicle inventories ***are indicated on the attached Form 970.***

Note: ***if you cannot locate a copy of the original Form 970*** filed to elect LIFO for used vehicles, then describe the prior methods used in order to indicate which method(s) are currently being employed ... i.e., *dollar-value link-chain, index method or dollar-value double extension method or specific goods/unit method, employing a (select one: most recent purchases, (separate) earliest acquisitions, average cost or other) index method to value increments.*

(Continued)

TAXPAYER ______________________________ *EI#* __________

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

W/R/T FISCAL/CALENDAR YEAR ENDING ______________ *, 200* __

FILED UNDER REV. PROCs. 2001-23 & 99-49

Where prior Form 970 cannot be located: If the prior Form 970 electing LIFO for used vehicles cannot be located, see Revenue Procedure 92-85 (I.R.B. 1992-42). In this regard, if applicable, you should include and sign the following representation in connection with the missing Form 970 as part of the Form 3115 narrative statement:

> I certify that to the best of my knowledge and belief (name of applicant______________) properly elected the LIFO inventory method for used vehicle inventories by filing Form 970 with its return for the tax year(s) ended (insert date(s)__________________) and otherwise complied with the provisions of Section 472(d) and Regulations Section 1.472-3.

PAGE 3, PART III - SECTION 481(a) ADJUSTMENTS

Cut-Off Method. Under Section 5.02(2) of Revenue Procedure 2001-23, the dealer must effect the change to the *Used Vehicle Alternative LIFO Method* using the cut-off method. Therefore, no Section 481(a) adjustment is required. Under the cut-off method, the value of the used automobile and used 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 cost restorations, if any are required.

In effecting the change in LIFO methodology, Taxpayer will retain without change any layers of inventory increments previously determined and the corresponding LIFO values of such increments. The base-year costs of the layers of increments in the pools at the beginning of the year of change will be restated in terms of the new base-year costs, using the year of change as the new base year.

No Section 263A Changes. In making these LIFO changes, Taxpayer contemplates no changes in connection with its method of accounting for the capitalization of inventory costs under Section 263A.

PAGE 3, PART IV - ADDITIONAL INFORMATION

Forms 3115 filed within four years. Within a four-year period, the Taxpayer ***has not*** requested or made any other changes in accounting method requiring the filing of Forms 3115.

Alternative Wording Re: Prior Changes in Method(s)

Forms 3115 filed within four years. Within a four-year period, the Taxpayer ***has*** requested or made other changes in accounting method(s) requiring the filing of Forms 3115. Such changes are not material or relevant to the change the Taxpayer is currently making to the *Used Vehicle Alternative LIFO Method* under Revenue Procedure 2001-23. Copies of Forms 3115 filed for these changes are/are not attached.

Note: Item 23 on page 3, Part IV of Form 3115, asks whether the Taxpayer, its predecessor, or a related party has requested or made (under either an automatic change procedure or a procedure requiring advance consent) a change in accounting method or accounting period in the past four years. Technically, changes in accounting methods ... such as Forms 3115 filed to change to the Alternative LIFO Method under Rev. Proc. 97-36, to the SWIM method, for changes in treatment of advertising credits, interest, etc. ... all fall within the scope of this question ... if they were made within the past four years. You may, or you may not, wish to more fully disclose any and all of these changes and attach copies of the related Forms 3115 that were filed.

(Continued on page 24)

FORM 3115 ADDITIONAL FILING COMMENTS AND CAUTIONS

As mentioned previously, preparers of Forms 3115 electing to change to the Used Vehicle Alternative LIFO Method will have to suffer with the lack of coordination and direction on exactly how detailed responses must be. What should be clear from the overall Form 3115 filing is that the LIFO method change being made is to the Used Vehicle Alternative LIFO Method.

If any further information might be required by the IRS in connection with the Form 3115, that additional information can be provided without necessarily affecting the taxpayer's eligibility to elect to use the Used Vehicle Alternative LIFO Method.

REQUIRED LEGEND AT TOP OF PAGE 1

The following ***MUST*** be typed or written at the very top of page 1 of Form 3115:

"FILED UNDER REVENUE PROCEDURE 2001-23."

PAGES 1-3: DEALER VARIABLE INFORMATION

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

- Page 1, top portion above Part I. All of the boxes need to be completed with the appropriate information. In the box where the accounting method change being requested is to be identified, check the "Other" box and add "***REV. PROC. 2001-23.***"
- Question 1: Check "Yes" box ... On third line, enter Rev. Proc. 2001-23.
- Question 2: Check "No" box.
- Question 3: Check "No" box if there are no IRS audits in progress.
- Question 4: Check "No" box if there is no involvement with the IRS Appeals Office
- Signatures: Don't forget all appropriate signatures and identification at the bottom of page 1.

  The copy of Form 3115 should be mailed to the IRS National Office:

  Commissioner of Internal Revenue
  Attention: CC:IT&A
  P. 0. Box 7616
  Benjamin Franklin Station
  Washington, DC 20044
- Question 5: Check "No" box if there is no involvement with a Federal Court.
- Question 6: Check "No" box if taxpayer is not a member of an affiliated group filing a consolidated return. Otherwise, identify other members, etc.
- Question 7: Check "No" box if described partnership relationships and issues are not involved.
- Question 8: Check "No" box.
- Question 9-14: ***Narrative statement attachment*** is intended as response.

(continued)

FORM 3115 ADDITIONAL FILING COMMENTS AND CAUTIONS

- Question 15: Check "No" box ... IRS has recognized that generally an auto dealership does not have more than one trade or business.
- Question 16: This question does not apply unless taxpayer is a member of an affiliated group filing a consolidated return.
- Question 17: No response required: This question is not applicable.
- Question 18: No response required: This question is not applicable.
- Question 19: No amount should be entered on the indicated line. Instead, enter: "N/A Not Applicable - Cut-Off Method Applies."
- Question 20: No response required: This question is not applicable.
- Question 21: No response required: This question is not applicable.
- Question 22: No response required: This question is not applicable.
- Question 23: "Yes" or "No" response depends on your facts and circumstances and should be consistent with disclosures you decide to make in the ***narrative statement attachment*** under the caption Page 3, Part IV.
- Question 24: Check "No" box if there are no pending requests for rulings.
- Question 25: Answer "Yes" or "No" depending on whether Form 2848, Power of Attorney, is attached.
- Question 26: No response required: This question is not applicable because IRS consent is automatic.
- Question 27: No amount should be entered on the indicated line. Instead, enter: "Not applicable - Automatic Change Request."
- Question 28: No response required: This question is not applicable.
- Page 4: Schedule A is not applicable and this page does not need to be attached to the Form 3115 filed.
- Page 5: Schedule B should be attached to the Form 3115 filed.
    - Responses to all requested information are included in ***narrative statement attachment***.
    - Note requirement to attach copy of all Forms 970.
- Page 6: Schedule C is not applicable and this page does not need to be attached to the Form 3115 filed.
- Page 7: Continuation of Schedule C is not applicable and this page does not need to be attached to the Form 3115 filed.
- Page 8: Schedule D is not applicable and this page does not need to be attached to the Form 3115 filed.

"FILED UNDER REVENUE PROCEDURE 2001-23."

Form **3115**
(Rev. May 1999)
Department of the Treasury
Internal Revenue Service

Application for Change in Accounting Method

▶ See page 1 of the instructions for the Automatic Change Procedures.

OMB No. 1545-0152

Name of applicant (If a joint return is filed, also give spouse's name.)	Identification number (See page 3 of the instructions.)
Number, street, and room or suite no. (If a P.O. box, see page 3 of the instructions.)	Tax year of change begins (mo., day, yr.) and ends (mo., day, yr.)
City or town, state, and ZIP code	District director's office having jurisdiction
Name of person to contact (If not the applicant, a power of attorney must be submitted.)	Contact person's telephone number/Fax number /

Check the appropriate box to indicate who is filing this form.

- ☐ Individual
- ☐ Corporation
- ☐ Cooperative (Sec. 1381)
- ☐ Qualified Personal Service Corporation (Sec. 448(d)(2))
- ☐ Exempt organization. Enter code section ▶
- ☐ Partnership
- ☐ S Corporation
- ☐ Insurance Co. (Sec. 816(a))
- ☐ Insurance Co. (Sec. 831)
- ☐ Other (specify) ▶

Check the appropriate box to indicate the type of accounting method change being requested. (See page 3 of the instructions.)

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☒ Other (specify) ▶ *"REV. PROC. 2001-23"* - LIFO

Part I **Eligibility To Request Change** (All applicants complete Parts I through IV.) (See page 2 of the instructions.)

		Yes	No
1	Is the applicant changing its method of accounting under a revenue procedure or other published guidance that provides for an automatic change? (See page 1 of the instructions.) . . . . If "Yes," enter the citation of the revenue procedure or other published guidance ▶ Rev. Proc. 2001-23	X	
2	Is the applicant changing its method of accounting under sections 263A, 447, 448, 460, or 585(c) for the first tax year the applicant is required to change? . . . . If "Yes," the applicant is required to make the change in accounting method under the automatic change procedures set forth in the applicable regulations.		X
3a	Does the applicant have any Federal income tax returns under examination by the IRS? See section 3.07 of Rev. Proc. 97-27, 1997-1 C.B. 680 . . . . If "Yes," complete line 3b.		X
b	Is the method of accounting the applicant is requesting to change: (i) an issue under consideration or (ii) an issue placed in suspense by the examining agent(s)? See sections 3.08(1) and 6.01 of Rev. Proc. 97-27 . . . . If "Yes," the applicant is not eligible to request the change in accounting method. If "No," complete lines 3c through 3e.		
c	Indicate the "window period" the applicant is filing under or state if the change is being requested with the consent of the district director. ▶ ________ See section 6.01 of Rev. Proc. 97-27.		
d	Has a copy of this Form 3115 been provided to the examining agent(s) for all examinations that are in process? See section 6.01 of Rev. Proc. 97-27		
e	Enter the name(s) and telephone number(s) of the examining agent(s). ▶ ________ See section 6.01 of Rev. Proc. 97-27.		
4a	Is the applicant before an appeals office with respect to any Federal income tax return issue? . . . . If "Yes," complete line 4b.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by the appeals office? See sections 3.08(2) and 6.02 of Rev. Proc. 97-27 . . . . If "Yes," the applicant is not eligible to request the change in accounting method. If "No," complete lines 4c and 4d.		
c	Has a copy of this Form 3115 been provided to the appeals officer? See section 6.02 of Rev. Proc. 97-27		
d	Enter the name and telephone number of the appeals officer. ▶ ________ See section 6.02 of Rev. Proc. 97-27.		

Signature — All Applicants *(See page 3 of the instructions.)*

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

Applicant	Parent corporation (if applicable)
X Officer's signature and date	Parent officer's signature and date
X Name and title (print or type)	Name and title (print or type)
X Signature(s) of individual or firm preparing the application and date	Name of firm preparing the application

For Privacy Act and Paperwork Reduction Act Notice, see page 1 of the instructions. Form **3115** (Rev. 5-99)
ISA

Part I Eligibility To Request Change (continued)

		Yes	No
5a	Is the applicant before a Federal court with respect to any Federal income tax issue? If "Yes," complete line 5b.		X
b	Is the method of accounting the applicant is requesting to change an issue under consideration by the Federal court? See sections 3.08(3) and 6.03 of Rev. Proc. 97-27. If "Yes," the applicant is not eligible to request the change in accounting method. If "No," complete line 5c and 5d.		
c	Has a copy of this Form 3115 been provided to the counsel for the government? See section 6.03 of Rev. Proc. 97-27.		
d	Enter the name and telephone number of the counsel for the government. ▶ ______ See section 6.03 of Rev. Proc. 97-27.		
6a	Is the applicant a member of an affiliated group filing a consolidated return for the year of change?		X
b	If "Yes," attach a statement listing the parent corporation's (1) name, (2) identification number, (3) address, and (4) tax year.		
c	Has the applicant ever been a member of a consolidated group other than the current group? If "Yes," complete line 6b for each group of which the applicant was formerly a member.		
d	If the applicant is (or was formerly) a member of a consolidated group, is any consolidated group under examination, before an appeals office, or before a Federal court for a tax year(s) that the applicant was a member of the group? See sections 3.07(1) and 4.02(5) of Rev. Proc. 97-27. If "Yes," complete lines 3b through 3e, 4b through 4d, or 5b through 5d (whichever are applicable).		
7	If the applicant is an entity (including a limited liability company) treated as a partnership or an S corporation for Federal income tax purposes, is the method of accounting the applicant is requesting to change an issue under consideration in an examination of a partner, member, or shareholder's Federal income tax return or an issue under consideration by an appeals office or by a Federal court with respect to a partner, member, or shareholder's Federal income tax return? See sections 3.08 and 4.02(6) of Rev. Proc. 97-27. If "Yes," the applicant is not eligible to request the change in accounting method.	NOT APPLICABLE	

Part II Description of Change

		Yes	No
8	Is the applicant requesting to change its **overall** method of accounting? If "Yes," check the appropriate boxes below to indicate the applicant's present and proposed methods of accounting. Also complete Schedule A on page 4 of the form.		X

Present method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)
Proposed method: ☐ Cash ☐ Accrual ☐ Hybrid (attach description)

9 If the applicant is **not** changing its overall method of accounting, attach a description of each of the following:
a The item being changed.
b The applicant's present method for the item being changed. PLEASE SEE
c The applicant's proposed method for the item being changed. *Narrative statement attachment*
d The applicant's present overall method of accounting (cash, accrual, or hybrid).

10 Attach an explanation of the legal basis supporting the proposed method for the item being changed. Include all authority (statutes, regulations, published rulings, court cases, etc.) supporting the proposed method. The applicant is encouraged to include a discussion of any authorities that may be contrary to the proposed method.

11 Attach a description of the applicant's trade or business, including the goods and services it provides and any other types of activities it engages in that generate gross income.

12 Attach a copy of all documents directly related to the proposed change. (See page 3 of the instructions.)

13 Attach a statement of the applicant's reasons for the proposed change.

14a Attach an explanation of whether the proposed method of accounting will be used for the taxpayer's books and records and financial statements. (Insurance companies, see page 3 of the instructions.)

b Attach an explanation of whether the proposed method of accounting conforms to generally accepted accounting principles (GAAP) and to the best accounting practice in the applicant's trade or business.

		Yes	No
15a	Does the applicant have more than one trade or business as defined in Regulations section 1.446-1(d)?		X
b	If "Yes," is each trade or business accounted for separately? If "Yes," for each trade or business, attach a description of the type of business, the overall method of accounting, whether the business has changed any accounting method in the past 4 years, and whether the business is changing any accounting method as part of this application or as a separate application.		
16	If the applicant is a member of an affiliated group filing a consolidated return for the year of change, do all other members of the consolidated group use the proposed method of accounting for the item being changed? If "No," attach an explanation.	NOT APPLICABLE	
17	If the applicant is changing to the cash method, or to the inventory price index computation (IPIC) method under Regulations section 1.472-8(e)(3), or is changing its method of accounting under sections 263A, 448, or 460, enter the gross receipts for the 4 tax years preceding the year of change. (See page 3 of the instructions.)	N/A	

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

Part II Description of Change (continued)

18 Attach a statement addressing whether the applicant has entered (or is considering entering) into a transaction to which section 381(c)(4) or (c)(5) applies (e.g., a reorganization or merger) during the tax year of change determined without regard to any (potential) closing of the year under section 381(b)(1). Also include in the statement an explanation of any changes in method of accounting that resulted (or will result) from the transaction(s). NOT APPLICABLE

Part III Section 481(a) Adjustment

		Yes	No
19	Enter the net section 481(a) adjustment for the year of change. Indicate whether the adjustment is an increase (+) or a decrease (−) in income. ▶ $ N/A Not Applicable - Cut-Off Method Applies*		
20	Has the section 481(a) adjustment been reduced by a pre-1954 amount?	N/A	
21a	If the section 481(a) adjustment is less than $25,000 (positive or negative), does the applicant elect to take the entire amount of the adjustment into account in the year of change?	N/A	
b	If "No," (or if the applicant declines to elect to take the entire amount of the adjustment into account in the year of change), enter the applicable period over which the applicant proposes to take the adjustment into account. ▶ ______		
22	Is any part of the section 481(a) adjustment attributable to transactions between members of an affiliated group, a controlled group, or other related parties? If "Yes," attach an explanation.	N/A	

Part IV Additional Information

		Yes	No
23	Has the applicant, its predecessor, or a related party requested or made (under either an automatic change procedure or a procedure requiring advance consent) a change in accounting method or accounting period in the past 4 years? If "Yes," attach a description of each change and the year of change. *see narrative statement* If the application was withdrawn, not perfected, or denied, or if a Consent Agreement was sent to the taxpayer but was not signed and returned to the IRS, or if the change was not made, include an explanation.		- ?
24	Does the applicant, its predecessor, or a related party currently have pending any request for a private letter ruling, a request for change in accounting method or accounting period, or a request for technical advice? If "Yes," for each request, indicate the name(s) of the taxpayer, the type of request (private letter ruling, request for change in accounting method or accounting period, or request for technical advice), and the specific issue in the request.		X
25	Has the applicant attached **Form 2848,** Power of Attorney and Declaration of Representative? (See the instructions for line 25 and "Person To Contact" on page 3 of the instructions.)		- ?
26	Does the applicant request a **conference of right** at the IRS National Office if the IRS proposes an adverse response?	N/A	
27	Enter the amount of **user fee** attached to this application. ▶ $ NONE - not applicable. Automatic Change Request (See page 2 of the instructions.)		
28	If the applicant qualifies for a reduced user fee for identical accounting method changes, has the information required by section 15.07 of Rev. Proc. 99-1, 1999-1 I.R.B. 6, been attached?	N/A	

* *FILED UNDER REVENUE PROCEDURE 2001-23*

Schedule B — Changes Within the LIFO Inventory Method (See page 4 of the instructions.)

Part I General LIFO Information

Complete this section if the requested change involves changes within the LIFO inventory method. Also, attach a copy of all **Forms 970**, Application To Use LIFO Inventory Method, filed to adopt or expand the use of the LIFO method.

1 Attach a description of the applicant's present and proposed LIFO methods and submethods for each of the following items.

a Valuing inventory (e.g., unit method or dollar-value method).

b Pooling (e.g., by line or type or class of goods, natural business unit, multiple pools, raw material content, simplified dollar-value method, pooling method authorized under inventory price index computation (IPIC) method, etc.).

c Pricing dollar-value pools (e.g., double-extension, index, link-chain, link-chain index, IPIC method, etc.).

d Figuring the cost of goods in the closing inventory over the cost of goods in the opening inventory (e.g., most recent purchases, earliest acquisitions during the year, average cost of purchases during the year, etc.).

2 If any present method or submethod used by the applicant is not the same as indicated on Form(s) 970 filed to adopt or expand the use of the method, attach an explanation.

3 If the proposed change is not requested for all the LIFO inventory, specify the inventory to which the change is and is not applicable.

4 If the proposed change is not requested for all of the LIFO pools, specify the LIFO pool(s) to which the change is applicable.

5 Attach a statement addressing whether the applicant values any of its LIFO inventory on a method other than cost. For example, if the applicant values some of its LIFO inventory at retail and the remainder at cost, the applicant should identify which inventory items are valued under each method.

Part II Change in Pooling Inventories

1 If the applicant is proposing to change its pooling method or the number of pools, attach a description of the contents of, and state the base year for, each dollar-value pool the applicant presently uses and proposes to use.

2 If the applicant is proposing to use natural business unit (NBU) pools or requesting to change the number of NBU pools, attach the following information (to the extent not already provided) in sufficient detail to show that each proposed NBU was determined under Regulations section 1.472-8(b)(1) and (2):

a A description of the types of products produced by the applicant. If possible, attach a brochure.

b A description of the types of processes and raw materials used to produce the products in each proposed pool.

c If all of the products to be included in the proposed NBU pool(s) are not produced at one facility, the applicant should explain the reasons for the separate facilities, indicate the location of each facility, and provide a description of the products each facility produces.

d A description of the natural business divisions adopted by the taxpayer. State whether separate cost centers are maintained and if separate profit and loss statements are prepared.

e A statement addressing whether the applicant has inventories of items purchased and held for resale that are not further processed by the applicant, including whether such items, if any, will be included in any proposed NBU pool.

f A statement addressing whether all items including raw materials, goods-in-process, and finished goods entering into the entire inventory investment for each proposed NBU pool are presently valued under the LIFO method. Describe any items that are not presently valued under the LIFO method that are to be included in each proposed pool.

g A statement addressing whether, within the proposed NBU pool(s), there are items sold to others and transferred to a different unit of the applicant to be used as a component part of another product prior to final processing.

3 If the applicant is engaged in manufacturing and is proposing to use the multiple pooling method or raw material content pools, attach information to show that each proposed pool will consist of a group of items that are substantially similar. See Regulations section 1.472-8(b)(3).

4 If the applicant is engaged in the wholesaling or retailing of goods and is requesting to change the number of pools used, attach information to show that each of the proposed pools is based on customary business classifications of the applicant's trade or business. See Regulations section 1.472-8(c).

Part III Change to Inventory Price Index Computation (IPIC) Method (See page 4 of the instructions.)

If changing to the IPIC method, attach the following items.

1 A completed Form 970.

2 A statement indicating which indexes, tables, and categories the applicant proposes to use.

TAXPAYER IS CHANGING TO THE USED VEHICLE ALTERNATIVE LIFO METHOD

UNDER REVENUE PROCEDURE 2001-23

PLEASE SEE NARRATIVE STATEMENT ATTACHED

TAXPAYER ________________ EI# ________

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

W/R/T FISCAL/CALENDAR YEAR ENDING ________, 200__

FILED UNDER REV. PROCs. 2001-23 & 99-49

DISCLOSURES CONCERNING CERTAIN POOLING SITUATIONS

Applicable only where a single pool is being split: As required by the LIFO methodology incident to electing the *Used Vehicle Alternative LIFO Method*, a single pool (consisting of all used vehicles) previously employed is being split into two pools:

POOL #1: All used automobiles (regardless of manufacturer).

POOL #2: All used light-duty trucks (regardless of manufacturer).

Applicable only where more than two pools are being consolidated: As required by the LIFO methodology incident to electing the *Used Vehicle Alternative LIFO Method*, multiple pools (i.e., by make, model, body style, or other pooling classification, etc.) previously employed are being combined/consolidated into the two pools required by Section 4.02(3):

POOL #1: All used automobiles (regardless of manufacturer).

POOL #2: All used light-duty trucks (regardless of manufacturer).

*FURTHER NOTE re: **special treatment for used sport & hybrid vehicles***: Section 4.02(3) of Rev. Proc. 2001-23 provides that used sport utility vehicles and used hybrid vehicles (i.e., vans and mini-vans, etc.) may be included initially in ***either*** the used automobile pool or in the used light-duty truck pool. However, once a choice is made, all like vehicles must be similarly treated in subsequent years.

You may, or you may not, wish to include in this statement whether used sport & hybrid vehicles are included in the used autos (pool #1) or the used light-duty trucks (pool #2).

DISCLOSURE OF OFFICIAL USED VEHICLE GUIDE CHOICE(S)

You may, or may not, wish to disclose (in the Form 3115 filed) which Official Used Vehicle Guide(s) have been selected by the Taxpayer to be used for cost determination purposes during the year and for LIFO inflation index computation purposes at the end of the year.

Since the Internal Revenue Service has not indicated any preference, priority or choice as to which Official Used Vehicle Guide is selected, as long as the Guide selected is an "*Official*" guide, it would not appear to be mandatory to inform the Service of this selection on the Form 3115.

(End)

FORM 3115 LETTER OF TRANSMITTAL TO BE MAILED TO THE IRS NATIONAL OFFICE

DEALERSHIP LETTERHEAD

* Commissioner of Internal Revenue
Attention: CC:DOM:IT&A (Automatic Rulings Branch)
P. O. Box 7604
Benjamin Franklin Station
Washington, D.C. 20044

Date: ____________, 200_

Re: ____________________________ EI # ______________________
(Dealership Name)

Form 3115: Application for Change within the LIFO Accounting Method to the ***Used Vehicle Alternative LIFO Method***
under Revenue Procedures 2001-23 and 99-49
For The Fiscal/Calendar Year Ending ______________

Dear Sir or Madam:

Enclosed is a copy of the Form 3115 for the dealership identified above reflecting the dealership's request for permission to change to the ***Used Vehicle Alternative LIFO Method*** provided by Revenue Procedure 2001-23 in connection with its use of the Last-In, First-Out (LIFO) inventory valuation method for its used automobile and used light-duty truck inventories.

This change is being made under Revenue Procedure 99-49 which contains the procedures for ***automatic*** accounting method changes.

The original of Form 3115 was/will be attached to the taxpayer's timely filed (including extensions) original Federal income tax return for the year of change. This copy of Form 3115 is being filed at this time with the National Office pursuant to Section 6.02(2)(a) of Revenue Procedure 99-49.

On the date this Form 3115 is being filed with the National Office, the taxpayer is <u>not</u> under audit examination and it has no Federal income tax return(s) under consideration by any IRS Appeals Officer or by any Federal Court.

Taxpayer will not compute any Section 481(a) adjustment because Section 5.02(2) of Rev. Proc. 2001-23 requires that the cut-off method must be used for a change made to the ***Used Vehicle Alternative LIFO Method*** if that change is being made under the provisions of Revenue Procedure 99-49.

No User Fee is required to be paid to the IRS in connection with this filing.

Respectfully submitted,

TAXPAYER NAME

____
(Authorized Officer), President

* This is the addressee designation per Section 6.02(5) of Revenue Procedure 99-49.

Form **970**
(Rev. August 1998)
Department of the Treasury
Internal Revenue Service

Application To Use LIFO Inventory Method

▶ Attach to your tax return.

OMB No. 1545-0042

Name

Identifying number (See instructions.)

Number, street, and room or suite no. (If a P.O. box, see instructions.)

City or town, state, and ZIP code

CHECK ONE:
☐ First Election
☒ Subsequent Election

Part I Statement of Election

		Yes	No
A	The taxpayer elects to adopt and use the LIFO inventory method provided by section 472. The taxpayer will use (or expand) the LIFO inventory method for the first tax year ending (month, day, year) ▶ ______ for the following goods (see instructions): USED VEHICLES - NEW VEHICLES ALREADY ON LIFO		
B	The taxpayer agrees, as required by Regulations section 1.472-4, to make any adjustments that the District Director of Internal Revenue may require, on the examination of the taxpayer's income tax return, to clearly reflect income for the years involved in the change to or from the LIFO inventory method or due to the use of the LIFO inventory method.		
C	Was the beginning inventory for the items specified in Item A above valued at cost (as required by section 472(d)) for the first tax year this application applies? If "No," attach an explanation		X
D	Will inventory be taken at actual cost regardless of market value? If "No," attach an explanation	X	

Part II Other Information

		Yes	No
1	Nature of business ▶ AUTOMOBILE DEALERSHIP - SALES & SERVICE		
2	Inventory method used until now ▶ LOWER OF COST OR MARKET FOR USED VEHICLES		
3	Will any adjustment that resulted from the change to the LIFO method be included in income over a 3-year period? If "No," attach an explanation.	X	
4a	List goods subject to inventory that will not be inventoried under the LIFO method ▶ PARTS & ACCESSORIES AND ALL OTHER MISCELLANEOUS INVENTORIES		
b	Were the goods specified in Item A above treated as acquired at the same time and at a unit cost equal to the actual cost of the total divided by the number of goods on hand? If "No," attach an explanation SPECIFIC IDENTIFICATION		X
5a	Did you issue credit statements or reports to shareholders, partners, other proprietors, or beneficiaries covering the first tax year to which this application relates?	X	
b	If "Yes," state to whom and on what dates ▶ MANUFACTURER, CREDIT CORP.		
c	Show the inventory method used to determine income, profit, or loss in those statements ▶ LIFO FOR A ABOVE		

6a Check method used to figure the cost of the goods in the closing inventory over those in the opening inventory. (See instructions.)
☐ Most recent purchases ☐ Earliest acquisitions during the year
☐ Average cost of purchases during the year ☒ Other—Attach explanation REV. PROC. 2001-23

6b The taxpayer selects the month of ______ as the representative month used in selecting the index or indexes used to determine the current-year cost of the taxpayer's inventory pool(s) under Regulations section 1.472-8(e)(2)(ii) (see instructions). This applies only to taxpayers using the Inventory Price Index Computation Method.

7 Method used in valuing LIFO inventories: ☐ Unit method ☒ Dollar-value method (See instructions.)

8 If you use pools, check the box that indicates the pooling method. List and describe the contents of each pool in an attached statement.
☒ By line, type, or class of goods authorized by Regulations section 1.472-8(c) (retailer, wholesaler, jobber, or distributor)
☐ Pooling method authorized by Regulations section 1.472-8(e)(3)(iv) (retailer, wholesaler, jobber, or distributor) 2 POOLS:
☐ Natural business unit authorized by Regulations section 1.472-8(b)(1) (manufacturer or processor) °ONE POOL FOR ALL USED
☐ Multiple pools authorized by Regulations section 1.472-8(b)(3)(i) (manufacturer or processor) AUTOS AND
☐ Raw material-content authorized by Regulations section 1.472-8(b)(3)(ii) (manufacturer or processor) °ONE POOL FOR ALL USED
☐ Simplified Dollar-value method under section 474 (see General Instructions) LIGHT-DUTY TRUCKS
☐ Other (describe and justify) REV. PROC. 2001-23

9 Method used in computing LIFO value of dollar-value pools (see instructions and attach required information):
☐ Double-extension (describe) ☐ Published Price Index (describe) ☐ Index (describe and justify)
☐ Link-chain (describe and justify) ☐ Alternative LIFO ☒ Other method (describe and justify)

10 Attach a statement briefly describing the cost system used. SEE STATEMENT ATTACHED LINK CHAIN INDEX METHOD - R.P. 2001-23

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

12 Did you ever use the LIFO inventory method before? ☒ Yes ☐ No
If "Yes," attach a statement listing the tax years you used LIFO and explain why you discontinued it. TAXPAYER IS STILL USING LIFO FOR NEW VEHICLES

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

Applicant's signature and date ______ Parent officer's signature (if applicable) and date ______

Name and title (print or type) ______ Name and title (print or type) ______

For Paperwork Reduction Act Notice, see instructions on back. Form 970 (Rev. 8-98)

TAXPAYER IS ELECTING TO USE THE USED VEHICLE ALTERNATIVE LIFO METHOD UNDER REVENUE PROCEDURE 2001-23

YEAR-END USED VEHICLE INVENTORIES ... WRITEDOWNS & LIFO

The following material comes directly from the *IRS/MSSP Audit Guide for Independent Used Car Dealers* issued as Training Document 3147-106, dated April, 1996.

"SPECIFIC AUDIT TECHNIQUES" FOR INVENTORY

If the lower of cost or market method is used, the agent should be satisfied as to whether the method used to determine inventory values is at the acceptable industry market values. The IRS Manual acknowledges that an accepted industry guide book may be used in arriving at this valuation, listing two of the most common industry valuation guides as the *NADA Official Used Car Guide* and the *Kelley Blue Book.*

However, the IRS Manual emphasizes that the agent should assure that the valuation guides are used ***properly and consistently***. "The dealer should be using (the) same guide for valuing all inventory items, and not using a different guide for different cars because of a lower value shown in one guide for a certain car." Agents are reminded to "compare the subsequent sale of inventory items to the year-end inventory value. If the sales price is more than the inventory value, the writedown would appear to be improper. (Cost was lower than market.)"

YEAR-END WRITEDOWNS TO LCM

Year-end write-downs on used vehicles are allowable when certain requirements are met. Revenue Ruling 67-107 allows a car dealer to value used cars for inventory purposes at valuations comparable to those listed in an official used car guide adjusted to conform to the average wholesale price listed at that time. (See also *Brooks-Massey Dodge, Inc.*, 60 T.C. 884 (1973).) Although this is a practice recommended by the industry and used by nearly all car dealers, there are some additional requirements.

Reg. Section 1.446-1(a)(2) states in part that a method of accounting which reflects the ***consistent*** application of generally accepted accounting principles in a particular trade or business in accordance with accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income. Treas. Reg. Section 1.471-2(d) provides that the method must be applied with reasonable consistency to the entire inventory of the taxpayer's trade or business. According to the IRS, ***there is a "lack of consistency" if more than one official valuation guide is used simultaneously.***

IRC Section 471 provides that inventories must conform as nearly as may be to the best accounting practice in the trade or business and must clearly reflect income. These regulations under IRC Section 471 prescribe two instances where inventory may be written down below cost to market. The first instance allows a taxpayer to write down purchased goods to replacement cost (Reg. Section 1.471-4(a)).

The second instance is described in Reg. Section 1.471-4(b) which states in part that inventory may be valued at lower than replacement cost with correctness determined by actual sales for a reasonable period before and after the date of inventory. Prices which vary materially from the actual market prices during this period will not be accepted as reflecting market. (See also *Thor Power Tool Co. v. Commissioner*, 439, U.S. 522 (1979) and *Saul S. Pearl v. Commissioner*, T.C. Memo 1977-262.)

"Review the sales of vehicles that have been written down and not unusually large profits."

LIFO PROCEDURES FOR USED VEHICLES

The Inventory chapter contains a discussion stating that the Service holds that a taxpayer may use an official used car guide such as the *Kelley Blue Book* in determining its LIFO cost of trade-in vehicles. ***The taxpayer must make the determination of value at the time of trade-in and no future write-downs are permitted.***

With respect to the taxpayer's LIFO index computation method, the Manual states that "the proper method for computing the (inflation) index for used vehicles is:

1. To use the taxpayer's own cost (actual for vehicles purchased and *Blue Book* value as of the trade-in date for vehicles obtained in a trade-in); and
2. To use the taxpayer's own cost (as described in #1) for the same type vehicle in the ending inventory of the preceding year, or, if there was no such vehicle in the ending inventory of the preceding year, use the "reconstruction" techniques contained in Reg. Section 1.472- 8(e)(2)(iii) for items not in existence and items not stocked in the prior year—that is, the *Blue Book* value for the same type of vehicle at the beginning of the year.

Dealers using LIFO for their used car vehicle inventory are to be asked: In determining the yearly LIFO index, what is the vehicle in ending inventory compared to in the ending inventory of the preceding year (that is, the taxpayer's own cost for the same type of vehicle or a "reconstructed" cost from an official valuation guide for the same type of vehicle at the beginning of the year)? ... and then: "Explain how these vehicles are comparable."

Problem Areas: The IRS Manual explains: "As with any method, (unforeseen) problems can and do arise... Included among these are program cars with a much higher value than 'book' and there is no requirement to increase trade-in value to equal 'book' value. In addition, the costs of improvements are expensed and there is difficulty with objectively defining a comparable vehicle. If you find a LIFO inventory case, request assistance from a resource person."

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