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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. MANY CPAs WE KNOW ARE RISKING THEIR DEALERS' LIFO ELECTIONS ... AND THEY MAY NOT EVEN BE AWARE OF IT.

You should expect any intelligent IRS agent to throw out a LIFO election if he or she finds that the dealer is not properly valuing the inventory on LIFO at cost. Rev. Proc. 79-23 is very clear on this, and it would be the starting point for the IRS position ... Not to mention Rev. Rul. 84-41 and the Regulations under Section 471.

Make no mistake about it ... This is pretty controversial. I'm aware that many readers have been swayed by comments about a dealer's "option" to make a change. But, where LIFO elections are involved, you're taking just as big a risk if you haven't insisted that your dealer make the trade discount change as you would be taking if you told your dealer to forget about the financial statement conformity requirement.

There is no gray area here... If you're doing LIFO calculations for an auto dealer who has not made the trade discount change, you're sharing with him/her the risk that the LIFO election will be thrown out by the IRS for a "cost" violation. Can you live with that? Can you afford that risk?

What I'm trying to do is to live up to the name selected for this publication years ago ... *LIFO Lookout* ... and this is definitely an issue you need to be informed about and be on the "lookout" for.

#2. STILL MORE ON TRADE DISCOUNTS. Within the past months, more than a few dealers have found themselves listening to conflicting opinions or encouragement in connection with changing accounting methods for trade discounts.

For the moment, let's set aside the technicalities and talk in a straight-forward way about the serious risk that comes with ignoring this issue.

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Try this on for size... If you're a CPA doing LIFO calculations—and signing the tax return—for an auto dealer who is not properly accounting for trade discounts, you might as well tell them to forget about the complying with the conformity requirement, as well, because in either case, their LIFO election can be terminated by the IRS. Do you really want to be the one who has put your LIFO (dealer) clients in that position?

Would you characterize compliance with the conformity requirement as optional? ... Or only to be taken seriously or complied with if it's "cost-effective" or "worthwhile?" Most CPAs, already conservative by nature, are forced to be even more conservative in their dealings with LIFO because of the huge benefits it provides.

So I find it incongruous that some of the most conservative CPAs I know still have not awakened to realize that they're potentially playing with fire over this.

see LIFO UPDATE, page 2

On pages 4-5, I've shared a recent experience involving a car dealer who was caught between such conflicting ... and irreconcilable ... professional opinions.

I've known the dealer for over 30 years and my professional relationship and connection with his dealership and its financial affairs is similar to many others, where I have maintained LIFO-related continuity with them over the years while their other needs have been serviced by local CPAs.

I know that if the IRS came along and wiped out his LIFO election because of something I did wrong, he would have every right to hold me accountable. And it troubled me that I had been unable to persuade him to make trade discount changes in the more recent years. I felt that it was time to confront the Rasputin-like advice that seemed to be preventing him from fully understanding the risk he was taking with his LIFO election.

Eventually, the importance of the proper technicalities for determining cost for inventories on LIFO may reach out and touch "trade discount" methods of accounting. Much like it has in many other issues where years of controversy peaked in some insidious IRS Revenue Procedure or Ruling, the "controversy" over trade discounts clearly has split the segment of CPA-dom that deals with auto dealerships. On this, unfortunately, one is either right or wrong, and the LIFO election could hang in the balance. There's no in-between position on this.

Who knows whether eventually the IRS will become involved in this? And, how seriously might the IRS consider this issue? Maybe in some touchy-feely way, apologetic for the need to bother with the details? Or, perhaps in a more heavy-handed punitive way, ala *Mountain State Ford* and the LIFO election termination route?

I'm more than willing to print and discuss all points of view on this. Write and let me know what you think.

#3. COMBINING LIFO POOLS WITH DIFFERENT BASE YEARS IN MERGER & OTHER SITUATIONS.

You can't be involved with LIFO calculations for very long without sooner or later becoming involved with a project that requires the combination of LIFO pools. When you run into this situation, it often involves LIFO inventory pools for which the LIFO elections were not made in the same year.

Also, when you read the Dollar-Value LIFO Regulations, you may wish they were more helpful for dealing with fact patterns like the one you're facing. Odds are that, no matter what fact pattern you're

dealing with, the Regulations will provide little, if any, helpful guidance.

This issue of the *LIFO Lookout* focuses on these problems and requirements. Our materials on this subject include... (1) an analysis of the appropriate Regulation, which has been expanded further for illustrative purposes, (2) a copy of an earlier *Lookout* article on the subject when it came up in connection with changing to the Alternative LIFO Method, and (3) a lengthy case study involving an auto dealership that faced the need to combine LIFO pools as a result of a merger.

There are a number of situations where you may need to merge or combine pools. You may already have been involved with some of them.

Many dealers are becoming involved with Q-Sub arrangements, and that process may also involve the need to combine LIFO pools with different base dates.

Several years ago, when the Alternative LIFO Method became available in Rev. Proc. 92-79, many dealers were employing LIFO methodologies that required them to combine separate LIFO pools for different makes and/or models. So, those of us who were LIFO practitioners a dozen or so years ago may have already wrestled with these interesting requirements for combining LIFO pools with different base years.

In this case study, both new automobile and new light-duty truck pools have extensive LIFO layer histories. We've included all of the reconciliations and proofs so that the serious student can better understand the underlying mechanics and/or use these schedules for future reference. Casual readers may choose to just read the *Executive Summary* on page 6.

These illustrations are not specific to auto dealers. The fact that the core computations involve an auto dealer should not be considered to be a limitation, as these procedures may be employed in other inventory situations with equally predictable results.

#4. AS WE BEGIN OUR 15th YEAR ... A LOOK BACK & A BIG "THANK YOU" FOR YOUR INTEREST & SUPPORT. Some of us go back pretty far together ... well beyond 15 years, even beyond twice 15 years. A lot of water has passed under the bridge, and I hadn't thought about it when writing the last issue of the *Lookout* that by the time this first quarter of 2005 came around, it would be **exactly 30 years ago that my first article on LIFO was published.**

The circumstances that resulted in my first article on LIFO were unique. I'd already spent about 10

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years working with LIFO after my first acquaintance with it as a "junior" in the tax department of Arthur Young and Company in Chicago. After 7 or 8 years, I left AY and went to work for a small CPA firm. It turned out that this firm had a whole lot of auto dealer clients. In 1973, I recognized the opportunity that I had in trying to find a way to apply LIFO to an auto dealer's inventories.

I took what I had learned about LIFO at Arthur Young and tried to work something out. Tax rates were far, far higher then than they are today. As some of you may recall, in 1973 price controls and limitations were in place in our economy, and despite enormous inflationary pressure, businesses simply were not allowed to raise prices. LIFO was a great idea because it allowed for the deduction of inflation in ending inventory ... and a big percent of the dollars on a dealer's balance sheet was in the new vehicle inventory account. ... But, there was just one thing missing—there was no inflation. So, I had to wait a bit—about a year—while working out the mechanics (by hand ... this was before computers) for a LIFO application for a car dealer.

Consider my predicament: I was going to apply LIFO in a new client situation, and it would result in tremendous benefits. But, there were no IRS rules or practical guidance on the subject to speak of. Yes, there were Regulations, and I read them often, and again, and then again. They still said nothing meaningful...at least to me.

Adding to my (youthful) apprehension was the fact that if I were to successfully apply LIFO to one car dealership client, most likely, our firm would be applying LIFO to all of its auto dealership clients ... some 100 dealers.

It's one thing to be wrong or in the dark and only screw up things for one isolated client. But the thought of being consistently wrong and screwing up things for 100 clients gave me pause. It didn't help matters that when I informally talked to a few practi-

tioners and a few people at the IRS, they all said the same thing ... "There's no way you can put an auto dealer on LIFO." Somehow, that sounded like a challenge to me.

One of my outlets was to write as methodically as I could about what I was going to do and put it out there "for the world to see, warts and all." Exposing my ideas and thinking to public comment and constructive criticism was one way I thought I might be able to limit my exposure to being way out in left field or off the deep end on this "new" idea.

In late 1974, I consolidated all of my views and memos and wrote what became my first published article on LIFO. This appeared in the February 1975 issue of *Cars & Trucks*, the publication of the National Automobile Dealers Association, which is now called *Automotive Executive*.

Over the years, I've read and re-read my first article on LIFO many times. And, you know, there is not a whole lot that I would change about it if I were writing it today. I put my finger on some of the significant problems that have emerged over the years ... the appropriate LIFO methodology that would become the basis for the Alternative LIFO Method for both new and used vehicles ... the critical importance of complying with the conformity requirement ... recognition that parts inventories were valued differently—at replacement cost—than were new or used vehicles ... to name but a few.

If you'd like to stroll down LIFO Memory Lane, you'll find this article beginning on page 32. I've added a few comments on page 31, given the perspective of a professional lifetime of involvement in contending with the IRS and others (both within and without the profession) for legitimate recognition of this method.

I often wonder how many dealers would be on LIFO today if I hadn't pursued what at that time seemed to many to be a "crazy" notion. *



DEALER CAUGHT BETWEEN CONFLICTING OPINIONS ABOUT THE NEED TO CHANGE ACCOUNTING METHODS FOR TRADE DISCOUNTS

**DON'T RISK
YOUR LIFO
ELECTION**

This is a true story about a dealer on LIFO who found himself caught between two opposite "professional" opinions about what he should do in connection with trade discounts. In some ways, it is the culmination of a running dialogue over a period of time in which different practitioners have voiced their opinions on the advisability of making changes in accounting method for trade discounts.

This situation involves a dealer who I put on LIFO in 1974. Over the years, I have been doing his LIFO calculations even though he has had several other CPA firms who have actually prepared income tax returns and provided other services for the dealership. So, this story ... or case study ... is absolutely authentic, and I'll make no attempt to soften the dialogues that occurred.

For the past 3 years, I had talked with this dealer about the advisability/necessity of changing his method of accounting for trade discounts. These discussions followed from the more recent issuance by the IRS of Form 3115 filing procedures that would permit automatic changes for trade discounts and the Service's acceptance of manufacturer's trade discounts as being eligible for this treatment. For a couple of years, the dealer simply said he'd prefer to just leave things alone, based on what his "regular" CPA had told him.

Late last year, I decided that to protect myself in this situation, the only thing to do was to properly warn **in writing** any dealer on LIFO that did not "want to" (for whatever reason) make the change for trade discounts, that he was risking the loss of his LIFO election (Rev. Proc. 79-23). Furthermore, if the IRS were to raise this issue, all I could say was that I had made every effort to try to get the dealer to make the change, but that the dealer had refused. We know, Dear Reader, that it really wouldn't go that far ... but, I decided it was necessary to tell the dealer in no uncertain terms, that he was playing with fire here by risking the validity of his LIFO election by violating the "inventory at cost" requirement.

I had decided that I would include a written warning as part of each transmittal letter that we sent out accompanying our year-end LIFO calculations. I developed two alternative paragraphs for transmittal letter purposes. One paragraph was used for those dealers who had made the changes, confirming to them that things were as they should be. The alterna-

tive paragraph was the warning for dealers who had, for whatever reason, resisted our professional opinion and advice that they should change their method of accounting for trade discounts.

On page 5, you can see exactly what we wrote to every dealer under these circumstances. In so many words, we told the dealer that he was risking the loss of his LIFO election and he should be aware of this risk and that it was someone else (not me) who was pushing him in this direction.

At about the same time late last year that I reached this decision, my dealer received a memo from his CPA that apparently was the basis for his decision not to change his method of accounting for trade discounts. A portion of that memo is on page 5.

The year-end / December 31, 2004 comes and goes. We do the new vehicle LIFO calculations for my dealer and send with them our transmittal letter which includes our warning. Imagine the surprise my dealer had when he read that paragraph (as I knew he would) in the transmittal letter!

He called me and said (in an understandably frustrated tone), "Will, what the hell's going on here? ... I'm caught in the middle between you and (CPA X)."

I said, "Let me tell you, (Mr. Dealer), the total LIFO reserves for both your pools is over \$1 million. If your million dollar LIFO reserve means anything to you, then you'll forget about the so-called advice you got from CPA X and change your method of accounting for trade discounts right now. ... No ifs, ands, or buts ... Right now, while you're not under IRS audit."

I made the following points with the dealer... (1) There is nothing "optional" about "deciding" whether to make a change if the proper treatment is clearly set forth **and** (2) what is involved is the risk that the IRS will interpret the failure to value the inventory on LIFO **at cost** as invalidating the LIFO election.

Furthermore, "Cost-effectiveness" and "worthwhileness" are irrelevant considerations. Although one might argue that it's not likely that the IRS would get excited about an accounting method that **overvalued** ending inventory, that argument is short-sighted and ill-informed.

We have years and years worth of proof that the IRS concerns itself with overvalued inventories staring us right in the face. Just recall the controversy

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Dealer Caught Between...

over the use of replacement cost for parts inventories and the *Mountain State Ford* decision by the Tax Court. All of this was resolved in favor of the IRS and its hypertechnical interpretation. In that case, the Judge stated emphatically that the Regulations were very clear on what constituted actual "cost," and that if one didn't like that, only Congress could change it. The Court showed absolutely no sympathy for cost-effectiveness nor practicality arguments in this case.

I pointed out to the dealer that even though he was in a "loss position," if the IRS were to challenge his LIFO election, he would be more likely than not to lose his LIFO election on account of this. If this were to happen, he would have no one to blame but himself when hit with the reversal of over a million dollars of LIFO reserve. I basically said, "Mr. Dealer, it's your call. I simply want you to know that if you lose your LIFO election on this account, there is absolutely nothing I can do but tell you 'Don't say that you weren't warned.'"

(Continued)

I added, "I can do your LIFO calculations either way for you... So, if you don't want to make the change, then go ahead and use the LIFO calculations we just sent. On the other hand, if you want to make the change, there still is time to do it right for year-end 2004 since you're not currently under audit; and the change for trade discounts can be made by filing Form 3115 when you file your tax return."

What should the dealer do? What would you do if you were the dealer? Think about it. ... Talk to your staff about it. ... In this case, the dealer decided to make the change for trade discounts effective for 2004, and he will make a second change in accounting method for advertising fees in 2005.

There is a solution. If your dealer currently is not under audit, you should make the appropriate changes in accounting method immediately. Don't wait ... Do it now.



Our Warning Concerning Accounting for Trade Discounts ... It's Mandatory

Excerpt from Transmittal Letter with LIFO Computations ... "If the dealership is not currently eliminating trade discounts (including floorplan assistance payments) from inventory costs in accordance with Reg. Sec. 1.471-3(b) and Revenue Ruling 84-41, we have, on several previous occasions, either discussed or attempted to discuss with you or your CPA the serious potential adverse tax effects of this incorrect treatment on your LIFO election and computations.

"We urge you to further initiate a discussion on this subject with your CPA so that you will be sure to understand the risks you are assuming in failing to comply with Generally Accepted Accounting Principles (which impacts your reporting to the manufacturers) and with the Internal Revenue Code (which affects your income tax returns)."

Another View on Accounting for Trade Discounts ... It's Optional

... Depending on your current accounting method ... and the manufacturer's qualifications to earn them, if any, your dealership may be entitled to reduce its taxable income for the approaching tax year end. If these 'interest' and 'advertising' credits are put into an income account or are credited against an expense account on vehicles that are in stock at the end of your tax year, Revenue Procedure 2002-9 probably applies to your dealership.

... Since there are many different ways to handle these 'interest' and 'advertising' credits on your accounting records, we would need to talk to you ... to verify the method of accounting you are using to record these items. Once this is determined, we can decide if this new Revenue Procedure is appropriate, *cost-effective and worthwhile for your dealership to adopt. In some cases, it is beneficial to the dealer, but it is not cost-effective.*

... If you decide to take advantage of this new Revenue Procedure for this tax year-end ... If you have an interest in saving and deferring some income taxes ... please call.

Comments ... Does this make it seem like it's optional? ... No mention of risk of loss of LIFO election for failing to satisfy the LIFO eligibility requirement that inventory on LIFO must be valued at actual cost. ... Also, no mention of (non)conformity with *GAAP*.



COMBINING LIFO POOLS WITH DIFFERENT BASE YEARS IN MERGER, Q-SUB & OTHER SITUATIONS

In recent years, many businesses have significantly restructured their operations or made Q-Sub elections that, in some way, shape or form, required the combination of their inventories that are on the LIFO (Last-In, First-Out) method. More often than not, the LIFO elections for the pools being combined will have been made in different years. Therefore, although the LIFO base inventory for each pool starts with a valuation factor of 1.000, the succeeding LIFO layer structures for each pool should not, cannot and must not simply be added together.

The LIFO Regulations are sketchy at best, and readers are left to fill in a number of significant gaps when they try to combine pools in accordance with the "principles" set forth in the Regulations.

An overall outline of the Dollar-Value Regulations appears on the facing page. This is just a general road map, but it may be helpful in pinpointing exactly where you need to be reading when you get involved with combining or merging LIFO pools which have different LIFO election starting dates. The relevant guidance is found in Reg. Sec. 1.472-8(g)(2) ... a long Regulation with multiple sub-parts and examples.

This issue of the *LIFO Lookout* provides a detailed analysis of the Regulations that are involved, and a lengthy case study example based on a recent, actual situation.

To assist you in an understanding, we've added two assumptions to the example in the Regulations (see page 11) in order to make it more realistic. You can see what is happening to the LIFO layers in each

(or all) of the pools being combined. This enables you to compare how these basic principles in a very simple situation carry over and apply to the more typical and complicated situations you are more likely to encounter.

Déjà vu. Readers of the *Lookout* who have applied LIFO for many years to their auto dealer clients may have already been challenged by these technicalities. When the safe-harbor Alternative LIFO Method for New Vehicles was introduced in Rev. Proc. 92-79, many dealers were using LIFO methods that involved separate LIFO pools for different makes and/or models. And, usually, these separate pools came into existence at different times because different models were deliberately introduced in different years.

At the time when the Alternative LIFO Method came in, it required that all new automobiles, regardless of manufacturer, be placed in one pool and that all new light-duty trucks be placed in a separate pool. On pages 12-13, we've reprinted the brief article written on this subject in 1993. This article was more generic and did not illustrate the combination calculations in any detail.

Following the analysis of the Regulation on pages 8-11 and the reprint of our 1993 article on pages 12-13, you will find the case study for the combination of LIFO pools in a merger situation. The fact that these computations involve an automobile dealer should not be considered in any way to be a limiting factor, as these principles and procedures for combining LIFO

see **MERGING OR COMBINING LIFO POOLS**, page 13

Executive Summary

Principles for Merging or Combining LIFO Pools With Different LIFO Election Starting Dates

- **No Recapture or Loss of LIFO Reserves ...** No amount of LIFO reserve is lost from any of the LIFO pools being combined. The LIFO reserve for the single pool after combination should be the sum of the LIFO reserves (before combination) for all LIFO pools involved.
- **LIFO Valuations Do Not Change ...** The LIFO valuations for each layer (base year and any subsequent net increments) in each pool do not change their respective dollar amounts. Where layers are blended or redetermined, what changes is the valuation factor or index that is applied to that year's (new) base dollars.
- **Oldest LIFO Pool Determines Reference Date ...** Combining the pools with different base years requires the restatement of those base years in terms of the earliest common base year.
- **Guidance ...** The governing Regulation is Reg. Sec. 1.472-8(g)(2)(iv). However, this Regulation must be read in the contexts of ... 8(g)(2)(iii) and ... 8(e)(2)(iii).



<i>At A Glance</i>	<i><u>Outline of the Dollar-Value LIFO Regulations</u></i>
<i>Regulation Section</i> <i>Reg. Sec. 1.472-8...</i>	<ul style="list-style-type: none"> • The overview below may make the first pass through the Dollar-Value LIFO Regulations a little easier for the first-time reader. • Some portions of the Dollar-Value LIFO Regulations have been in place for many years. <ul style="list-style-type: none"> • Proposed in Dec. of 1960 and adopted in Jan. of 1961. • The IPIC (or BLS) method Regulations have been modified a number of times over the years. • The portion on "LIFO Inventories Received in Certain Non-Recognition Transactions" (including bargain purchase inventories) ... was added in 2002 to apply to years after 2001.
... <i>(a)</i>	• <i>Election to use Dollar-Value (LIFO) Method.</i>
... <i>(b)</i>	• <i>Principles for establishing pools of manufacturers and processors.</i>
... <i>(b)(1)</i>	• <i>Natural business unit pools.</i>
... <i>(b)(2)</i>	• <i>Definition of natural business unit.</i>
... <i>(b)(3)</i>	• <i>Multiple pools.</i>
... <i>(b)(4)</i>	• <i>IPIC Method pools.</i>
... <i>(c)</i>	• <i>Principles for establishing pools for wholesalers, retailers, etc.</i>
... <i>(c)(1)</i>	• <i>In general.</i>
... <i>(c)(2)</i>	• <i>IPIC Method pools.</i>
... <i>(d)</i>	• <i>Determination of appropriateness of pools.</i>
... <i>(e)</i>	• <i>Methods of computation of the LIFO value of a dollar-value pool.</i>
... <i>(e)(1)</i>	<ul style="list-style-type: none"> • <i>Methods authorized.</i> <ul style="list-style-type: none"> • In this section, you will find only a brief, limited mention of the "Link-Chain" Method and no mention at all of the "Link-Chain, Index" Method.
... <i>(e)(2)</i>	• <i>Double-Extension Method, with Examples.</i>
... <i>(e)(3)</i>	• <i>Inventory Price Index Computation (IPIC) Method ... The so-called "BLS Index" Method.</i>
... <i>(f)</i>	• <i>Change to Dollar-Value Method from another method of pricing LIFO inventories.</i>
... <i>(f)(1)</i>	• <i>Consent required.</i>
... <i>(f)(2)</i>	• <i>Method of converting inventory.</i>
... <i>(g)</i>	• <i>Transitional rules.</i>
... <i>(g)(1)</i>	• <i>Change in method of pooling.</i>
... <i>(g)(2)</i>	• <i>Manner of combining or separating dollar-value pools.</i>
... <i>(g)(2)(i)</i>	<ul style="list-style-type: none"> • <i>General statement ... Each yearly layer of increment in the new pool or pools must be separately accounted for and a record thereof maintained, and any liquidation occurring in the new pool or pools subsequent to the formation thereof shall be treated in the same manner as if the new pool or pools had existed from the date the taxpayer first adopted the LIFO inventory method.</i>
... <i>(g)(2)(ii)</i>	• <i>Separating a single pool into more than one pool, with examples.</i>
... <i>(g)(2)(iii)</i>	• <i>Combining two or more pools having the same base year into one pool, with examples.</i>
... <i>(g)(2)(iv)</i>	<ul style="list-style-type: none"> • <i>Combining pools having different base years into one pool, with examples.</i> <ul style="list-style-type: none"> • <i>This is the specific Section that provides "guidance" for dealing with merger of pools situations.</i>
... <i>(g)(3)</i>	• <i>Change in methods of computation of the LIFO value of a dollar-value pool.</i>
... <i>(h)</i>	• <i>LIFO inventories received in certain non-recognition transactions.</i>
... <i>(h)(1)</i>	• <i>In general.</i>
... <i>(h)(2)</i>	• <i>Transactions to which this paragraph (h) applies.</i>
... <i>(h)(3)</i>	<ul style="list-style-type: none"> • <i>Anti-Avoidance Rule, including Bargain Purchase situations.</i> <ul style="list-style-type: none"> • Inventory is deemed acquired in a <i>bargain purchase</i> if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was less than or equal to 50% of the replacement cost of physically identical inventory. • Inventory is not considered acquired in a bargain purchase if the actual cost of the inventory (or, if appropriate, the allocated cost of the inventory) was greater than or equal to 75% of the replacement cost of physically identical inventory. • Query: What happens in situations between 50% and 75%?
... <i>(h)(4)</i>	• <i>Applicable to transfers that occur during a taxable year ending on or after Dec. 31, 2001.</i>



Regulation Guidance	Combining LIFO Pools With Different Base Years				Page 1 of 4
General Rules for Combining LIFO Pools ... Having the Same Base Year	<ul style="list-style-type: none">Reg. Sec. 1.472-8(g)(2)(iii) provides the general rules where the LIFO pools being combined are pools that have the same base year (i.e., all LIFO elections were made in the same year).<ul style="list-style-type: none">The LIFO value of the base-year inventory of each of the former pools is combined to obtain a LIFO value of the base-year inventory for the new pool.Then, any layers of increment in the various pools which occurred in the same taxable year are combined into one total layer of increment for that taxable year.Layers of increment which occurred in different taxable years may not be combined.In combining the layers of increment, a new ratio of current-year cost to base-year cost is computed for each of the combined layers of increment.				
Special Rules if the LIFO Pools Being Combined Have Different Base Years	<ul style="list-style-type: none">Reg. Sec. 1.472-8(g)(2)(iv) adds two more rules if the pools being combined have different base years (i.e., if the LIFO elections were not all made in the same year).<ul style="list-style-type: none">All base years subsequent to the earliest base year shall be treated as increments, andThe base-year costs for all pools having a base year subsequent to the earliest base year of any pool shall be redetermined in terms of the base cost for the earliest base year.The "redetermination" is the most difficult requirement to comply with, and often this will require considerable judgments, estimates and/or assumptions.The Regulation contains the example below, which consists of 5 steps.				
Comments on 5-Step Example	<ul style="list-style-type: none">In going through the example, note that there has been no change in the total LIFO valuation for the combined pool ... \$10,350 + 5,175 before the combination = \$15,525 after the combination.<ul style="list-style-type: none">No amount of LIFO Reserve for any pool being combined is lost in the process.If the example had provided actual cost for the inventory pools, the LIFO reserves could easily have been proven out in terms of all of the "usual" reconciling components.<ul style="list-style-type: none">On page 11, we have included assumed actual costs, and this allows you to see all of the necessary layer changes/dynamics, proofs and reconciliations.The example makes no mention of the need, practicality or requirement that these inflation indexes be rebased to 1.000 as of Dec. 31, 1960 for purposes of subsequent computations.				
Step 1 Gather All the Facts ... & Put Them in Tabular Form	<ul style="list-style-type: none">Assume that the taxpayer has two pools at December 31, 1960 and that these pools are to be combined into a single pool as of January 1, 1961. The LIFO inventory value of each pool at Dec. 31, 1960, is as follows:				
					Ratio of total
	Dec. 31, 1960 inventory at Jan. 1, 1956, base-year cost		current-year cost to total base-year cost	Dec. 31, 1960, inventory at	
	Pool No. 1	base-year cost	Percent	LIFO value	
	Jan. 1, 1956, base cost	\$ 7,000	100	\$ 7,000	
	Dec. 31, 1956, increment	1,000	105	1,050	
	Dec. 31, 1957, increment	500	110	550	
	Dec. 31, 1958, increment	500	110	550	
	Dec. 31, 1960, increment	1,000	120	1,200	
	Total	\$ 10,000		\$ 10,350	
				Ratio of total	
Dec. 31, 1960 inventory at Jan. 1, 1958, base-year cost		current-year cost to total base-year cost	Dec. 31, 1960, inventory at		
Pool No. 2	base-year cost	Percent	LIFO value		
Jan. 1, 1958, base cost	\$ 3,500	100	\$ 3,500		
Dec. 31, 1958, increment	1,000	110	1,100		
Dec. 31, 1959, increment	500	115	575		
Total	\$ 5,000		\$ 5,175		



Step 2

Restating the
Base Year
Costs of the
Inventory
with the
Later
LIFO Election

- The next step is to redetermine the base-year cost for the pool with the later LIFO election (in this case, Pool #2 with the LIFO election that started in 1958) in terms of the base-year cost of the pool with the earlier LIFO election (i.e., Pool #1 with the LIFO election that started in 1956).
- The example states that January 1, 1956 base-year unit cost must be "reconstructed or established in accordance with paragraph (e)(2) of this section for each item in Pool No. 2."
- Such costs are *assumed to be* \$9.00 for item A, \$20.00 for item B, and \$1.80 for item C.
- The ratio of the 1958 total base-year cost to the 1956 total base-year cost for Pool #2 is then computed:

<u>Item</u>	<u>Quantity</u>	<u>Jan. 1, 1956, base-year unit cost</u>	<u>Jan. 1, 1956, base-year total cost</u>
A	250	9.00	\$ 2,250
B	75	20.00	1,500
C	500	1.80	900
Total			<u>\$ 4,650</u>

<u>Item</u>	<u>Quantity</u>	<u>Jan. 1, 1958, base-year unit cost</u>	<u>Jan. 1, 1958, base-year total cost</u>
A	250	10.00	\$ 2,500
B	75	20.00	1,500
C	500	2.00	1,000
Total			<u>\$ 5,000</u>

Comments ...
Difficulties
Faced in Most
Real-world
LIFO
ApplicationsReconstruction
"Rules"
Under the
Double-Extension
MethodWhat Does
It Take to
Satisfy the
Commissioner?

- As stated above in connection with Step 2, the example provides that January 1, 1956 base-year unit cost must be "reconstructed or established in accordance with paragraph (e)(2) of this section for each item in Pool No. 2."
 - The reference to "paragraph (e)(2)" refers to Reg. Sec. 1.472-8(e)(2)(iii) which specifically deals with (only) *the Double-Extension Method*.
 - At this point, the Regulation simply states what amounts it has assumed to be the equivalent base date costs. In the real world, or at least - all LIFO applications - this is where the difficulties or troubles begin.
 - Note further that these base year costs are to be determined ... *for each item (i.e., for every item) in the pool*.
- Reg. Sec. 1.472-8(e)(2)(iii) provides the following ... Under the double-extension method, a base-year unit cost must be ascertained for each item entering a pool for the first time subsequent to the beginning of the base year.
 - In such a case, the base-year unit cost of the entering item shall be the current-year cost of that item unless the taxpayer is able to reconstruct or otherwise establish a different cost.
 - If the entering item is a product or raw material *not in existence on the base date*, its cost may be reconstructed, that is, the taxpayer using reasonable means may determine what the cost of the item would have been had it been in existence in the base year.
 - If the item was *in existence on the base date but not stocked by the taxpayer*, he may establish, by using available data or records, what the cost of the item would have been to the taxpayer had he stocked the item.
 - If the base-year unit cost of the entering item is either reconstructed or otherwise established *to the satisfaction of the Commissioner*, such cost may be used as the base-year unit cost in applying the double-extension method.
- If the taxpayer does not reconstruct or establish *to the satisfaction of the Commissioner* a base-year unit cost, but does reconstruct or establish to the satisfaction of the Commissioner the cost of the item at some year subsequent to the base year, he may use the earliest cost which he does reconstruct or establish as the base-year unit cost.



Regulation Guidance	Combining LIFO Pools With Different Base Years				Page 3 of 4			
Step 3 Compute the Ratio to Be Used for Restatement Purposes	<ul style="list-style-type: none">The ratio of the 1956 total base-year cost to the 1958 total base-year cost for Pool No. 2 is 4,650 / 5,000 or 93 percent.The January 1, 1958 base cost and each yearly layer of increment at 1958 base-year cost is multiplied by this ratio. The table below shows this computation.							
		Dec. 31, 1960 inventory at Jan. 1, 1958, base-year cost		Ratio Percent	Dec. 31, 1960, inventory restated at Jan. 1, 1956, base-year cost			
	Jan. 1, 1958, base cost	\$	3,500	93	\$	3,255		
	Dec. 31, 1958, increment		1,000	93		930		
	Dec. 31, 1959, increment		500	93		465		
	Total	\$	5,000		\$	4,650		
	<ul style="list-style-type: none">"Disappearing" or "Lost" Base Dollars ... At this point, it can readily be seen that there will be a loss of base dollars in the amount of \$350 [\$5,000 x (1.000 - .93)] ... \$5,000 x 7%].							
	Step 4 Set Up a Worksheet to Show All Layers Involved in the Combination	<ul style="list-style-type: none">The purpose Step 4 is to show in a logical, reviewable schedule, how the different annual LIFO layers are being combined and those layer combinations which will produce new LIFO valuation ratios.The computation of the ratio of the total current-year cost to the total base-year cost for the base year (1956) and each yearly layer of increment in the new pool is shown below.Note: the Jan. 1, 1958 base cost equivalent is shown in the schedule as a 1957 layer.						
			Base year 1956	Dec. 31, 1956	Dec. 31, 1957	Dec. 31, 1958	Dec. 31, 1959	Dec. 31, 1960
		Pool						
No. 1		Base-year cost	\$ 7,000	\$ 1,000	\$ 500	\$ 500	\$ -	\$ 1,000
		LIFO value	7,000	1,050	550	550	-	1,200
Pool								
No. 2		Base-year cost as restated	-	-	3,255	930	465	-
		LIFO value	-	-	3,500	1,100	575	-
Total, base-year cost		\$ 7,000	\$ 1,000	\$ 3,755	\$ 1,430	\$ 465	\$ 1,000	
Totals, LIFO value		7,000	1,050	4,050	1,650	575	1,200	
Ratio of total current-year cost to total base-year cost (percent)		100.00	105.00	107.86	115.38	123.66	120.00	
Step 5 Restate the Newly-Combined LIFO Layers with Their Appropriate (Blended) Valuation Factors	<ul style="list-style-type: none">On the basis of the foregoing, computation, the LIFO inventory of the new/combined pool at December 31, 1960, is restated as follows:							
		Dec. 31, 1960 inventory at Jan. 1, 1956, base-year cost	Ratio of total current-year cost to total base-year cost Percent		Dec. 31, 1960, inventory at LIFO value			
	Pool No. 1							
	Jan. 1, 1956, base cost	\$	7,000	100.00	\$	7,000		
	Dec. 31, 1956, increment		1,000	105.00		1,050		
	Dec. 31, 1957, increment		3,755	107.86		4,050		
	Dec. 31, 1958, increment		1,430	115.38		1,650		
	Dec. 31, 1959, increment		465	123.66		575		
	Dec. 31, 1960, increment		1,000	120.00		1,200		
	Total	\$	14,650		\$	15,525		



COMBINING LIFO POOLS WITH DIFFERENT BASE YEARS ... EXAMPLE - REG. SEC. 1.472-8(g)(2)(iv)**Composition & Proof of LIFO Reserves Before Combination as of Dec. 31, 1960**

Pool #1 - Layers	Base Dollars	Valuation Factor	LIFO Valuation	Actual Cost	Factor			Base	LIFO Reserve
					(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
Jan. 1, 1956, base cost	7,000	1.000000	7,000		(1.200000 - 1.000000)		0.200000	7,000	1,400
Dec. 31, 1956, increment	1,000	1.050000	1,050		(1.200000 - 1.050000)		0.150000	1,000	150
Dec. 31, 1957, increment	500	1.100000	550		(1.200000 - 1.100000)		0.100000	500	50
Dec. 31, 1958, increment	500	1.100000	550		(1.200000 - 1.100000)		0.100000	500	50
Dec. 31, 1960, increment	1,000	1.200000	1,200		(1.200000 - 1.200000)		-	1,000	-
Totals	10,000		10,350	12,000				10,000	
LIFO Reserve				1,650					1,650

Pool #2 - Layers	Base Dollars	Valuation Factor	LIFO Valuation	Actual Cost	Factor			Base	LIFO Reserve
					(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
Jan. 1, 1958, base cost	3,500	1.000000	3,500		(1.200000 - 1.000000)		0.200000	3,500	700
Dec. 31, 1958, increment	1,000	1.100000	1,100		(1.200000 - 1.100000)		0.100000	1,000	100
Dec. 31, 1959, increment	500	1.150000	575		(1.200000 - 1.150000)		0.050000	500	25
Dec. 31, 1960, increment	-	1.200000	-	6,000	(1.200000 - 1.200000)		-	-	-
Totals	5,000		5,175	6,000				5,000	
LIFO Reserve				825					825

Note: The following two assumptions have been added to the facts in the example in order to illustrate the principles involved ... (1) Actual costs of inventory at Dec. 31, 1960 for Pool #1 is \$12,000 and for Pool #2 is \$6,000 ... (2) The cumulative inflation rate for Pool #2 as of Dec. 31, 1960 is 1.20000.

Combination of LIFO Pools & Composition & Proof of LIFO Reserve After Combination

Year	POOL #1			POOL #2			Disappearing or Lost Base Dollars	COMBINED POOL			COMPOSITION & PROOF OF LIFO RESERVE POOL - COMBINED POOL				
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	Base Dollars	Valuation Factor	LIFO Valuation		Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$
											(A)	(B)	(C) = (A-B)		
Jan. 1, 1956, base cost	7,000	1.000000	7,000	-	-	-	-	7,000	1.000000	7,000	(1.228669 - 1.000000)		0.228669	7,000	1,601
Dec. 31, 1956 incr.	1,000	1.050000	1,050	-	-	-	-	1,000	1.050000	1,050	(1.228669 - 1.050000)		0.178669	1,000	179
Dec. 31, 1957 incr.	500	1.100000	550	3,500	1.000000	3,500	(245)	3,755	1.078562	4,050	(1.228669 - 1.078562)		0.150107	3,755	564
Dec. 31, 1958 incr.	500	1.100000	550	1,000	1.100000	1,100	(70)	1,430	1.153846	1,650	(1.228669 - 1.153846)		0.0748228	1,430	107
Dec. 31, 1959 incr.	-	-	-	500	1.150000	575	(35)	465	1.236559	575	(1.228669 - 1.236559)		(0.0078902)	465	(4)
Dec. 31, 1960 incr.	1,000	1.200000	1,200	-	-	-	-	1,000	1.200000	1,200	(1.228669 - 1.200000)		0.0286689	1,000	29
Total Base Dollars	10,000			5,000			(350)	14,650						14,650	2,475
Total LIFO Valuation			10,350			5,175				15,525					
Actual Cost			12,000			6,000				18,000					
LIFO Reserve			1,650			825				2,475					2,475

Note: This Schedule reflects the adjustments to equalize base dollars due to different LIFO election starting dates. In this regard, the Jan. 1, 1958 base date inventory for Pool #2 is reflected as an increment for 1957 (i.e., the previous year).

The revised proof factor after adjusting for different LIFO starting dates and disappearing or "lost" base dollars was determined by dividing the total actual cost of the inventories at Dec. 31, 1960 (\$12,000 + 6,000 = 18,000) by the combined net redetermined base dollars (\$10,000 + 5,000 - 350 [lost dollars] = \$14,650 net) ... Equals 1.228669



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

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

COMBINATION OF PRIOR POOLS BY MAKE OR MODEL

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

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

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

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

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

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

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

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

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



Combining Multiple LIFO Pools

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

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

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

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

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

(Continued)

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

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

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

Merging or Combining LIFO Pools

pools are transferable to all other inventory situations with equal results and without exception. In other words, our case-study calculations are not specific to auto dealers by any means.

We have included a letter or memo (pages 14-19) that explains to the client exactly what is required and what has been done. This is followed by 12 supporting schedules. We have included the calculations for both pools of the two merging automobile dealerships. XYZ Motors started its LIFO election in

(Continued from page 6)

1974—so it has the earlier/longer/older LIFO election in place—and it is the entity into which ABC Sales, whose LIFO election started in 1984, was merged as of April 30, 2005. The inventory layer histories for the pools have been expanded in order to better illustrate all of the underlying principles and reconciliation mechanics.

Hopefully, this material will allow anyone who seriously studies it to be able to easily do the same thing when faced with a similar assignment. ✱





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cpawjd@aol.com

Date _____, 2005

Mr. CPA
CPA Firm
Address
City, State, Zip

***Re: XYZ (The Surviving Company) & ABC (The Merged Company)
Combination of LIFO Inventory Pools Resulting from Merger
As of April 30, 2005***

Dear Mr. CPA:

Enclosed are the LIFO computations for Pool #1 - New Automobiles and Pool #2 - New Light-Duty Trucks for XYZ and for ABC reflecting the combination of their respective LIFO inventories as of the date of the merger of ABC into XYZ. Our computations are based upon your Firm's computations of the LIFO reserves for XYZ as of December 31, 2004 and for ABC as of April 30, 2005.

There are three absolutes or certainties in the process of merging/combining LIFO pools in accordance with the governing Regulation which is Reg. Sec. 1.472-8(g)(2)(iv):

- (1) No amount of LIFO reserve of either dealership has been lost in the process,***
- (2) The LIFO valuations for each layer (base year and any subsequent net increments) in each pool do not change their respective dollar amounts, and***
- (3) Combining the pools with different base years requires the restatement of those base years in terms of the earliest common base year.***

Different Starting Dates for Dealerships' LIFO Elections

The combination of the LIFO inventories as of the merger date is complicated by the fact that the dealerships' LIFO elections were made at different dates. XYZ has the *earlier*/longer/older LIFO election starting date (Jan. 1, 1974). ABC has the later/*shorter*/more recent LIFO election starting date (1984; i.e., its LIFO election was made effective as of January 1, 1984). Therefore, as a result of this 10-year separation in time (1/1/1974 to 1/1/1984), the LIFO reserve balances of the companies cannot simply be combined or "added across" as of the merger date.

(Continued)



Reg. Sec. 1.472-8(g)(2)(iv) provides that the LIFO pools are to be combined reflecting 1974 as the common base date, with appropriate adjustments to the base dollar amounts recorded by the entity (ABC) that has made the LIFO election at a later date. Accordingly, this adjustment is intended to compensate for the time factor (the 10-year period from January 1, 1974 through December 31, 1983) difference between the start of the dealerships' respective LIFO elections.

Adjustment Factors

Pool #1 ... In Schedule 5, the base year costs for the ABC Pool #1 are to be redetermined in terms of the base cost for the corresponding XYZ pool. The cumulative inflation index for the new automobiles in Pool #1 (for XYZ) at the end of 1983 was .650000, according to the information that you provided. This factor does not appear as a separate amount in Schedule 1 because, with respect to the year 1983, there was a liquidation in this LIFO pool.

Note that when the dealerships elected to change to the Alternative LIFO Method for New Vehicles in 1992, one of the conditions of change was that they were required to restate their inflation indexes to 1.000 as of Dec. 31, 1991/Jan. 1, 1992. This rebasing did not result in the loss of any LIFO reserve as of Dec. 31, 1991. Instead, all of the cumulative inflation factors were simply restated with respect to January 1, 1992, which date became a new base date for computational purposes in the succeeding years.

For purposes of the adjustment we are required to make here to redetermine base year costs for ABC's LIFO inventory, the respective indexes of XYZ of .329340 for the valuation of its Jan. 1, 1974 base date inventory and .650000 for the valuation factor at the end of 1983 (i.e., immediately before ABC made its LIFO election) are the valuation factors which result in the adjustment for purposes of the merger/combination of the LIFO pools. These figures are found in the Schedule 1 data for XYZ's Pool #1.

Accordingly, the adjustment factor for ABC's Pool #1 is the ratio of XYZ's .329340 to .650000. This factor equals .506677.

The "redetermined" amount of base dollars in ABC Pool #1 as of April 30, 2005 is \$291,335. This amount is the result of multiplying the total original base dollar amount of \$574,991 by the redetermination factor of .506677. Accordingly, the "disappearing" or "lost" base dollars from the ABC Pool #1 resulting from this process is \$283,656 ... (\$574,991 minus \$291,335 equals \$283,656).

Pool #2 ... Similarly, in Schedule 6, the base year costs for the ABC Pool #2 are to be redetermined in terms of the base cost for the corresponding XYZ pool. The adjustment factor is .428599. The cumulative inflation index in Pool #2 for XYZ at the end of 1983 was .662390 and the adjustment factor for Pool #2 is the ratio of .283900 to .662390, which equals .428599. These figures are found in the Schedule 1 data for XYZ's Pool #2.

The "redetermined" amount of base dollars in ABC Pool #2 as of April 30, 2005 is \$1,313,552. This amount is the result of multiplying the total original base dollar amount of \$3,064,758 by the redetermination factor of .428599. Accordingly, the "disappearing" or "lost" base dollars from the



ABC Pool #2 resulting from this process is \$1,751,206 ... (\$3,064,758 minus \$1,313,552 equals \$1,751,206).

One further refinement: Reg. Sec. 1.472-8(g)(2)(iv) treats the base inventory of the entity with the later LIFO election in the combination (i.e., ABC) as an increment incurred in the previous year. Accordingly, the base inventory layers for the ABC LIFO pools are reflected in the various combining schedules as having been incurred in 1983 (and they do not appear on the 1984 year line that otherwise corresponds to the first year of ABC's LIFO election).

Other Technical Considerations

Reg. Sec. 1.381(c)(5)-1(e)(2) provides that the combination of LIFO inventories is to be made "in accordance with the principles set forth in paragraph (g)(2) of Regulation Section 1.472-8." All base year inventories or layers of increment which occur in taxable years including the same December 31 shall be combined.

Reg. Sec. 1.381(c)(5)-1(e)(2) also further provides that a layer of increment occurring in a final (short) taxable year of a distributor or transferor shall be merged with and be considered as a layer of increment of its immediately preceding taxable year.

As a result of this requirement, the amounts of increment shown in the calculations for ABC for the short period January 1, 2005 to April 30, 2005 are reflected in the various combining schedules as having been incurred in 2004. That is why (other than in Schedules 3 & 4) they do not appear on a separate line that would otherwise correspond to the January 1 - April 30, 2005 short period in a chronological listing of LIFO layers by years.

After reflecting the above adjustments, Schedules 7 & 8 and 9 & 10 show the combined LIFO inventories as of Dec. 31, 2004.

Previous Rebasing of LIFO Inventories to 1.000 in 1992

As mentioned previously, in 1992, both dealerships elected to change to the Alternative LIFO Method for New Vehicles when that "safe-harbor" LIFO methodology first became available to auto dealerships. At that time, the respective LIFO indexes for each pool were rebased to 1.000 as of January 1, 1992 in accordance with the requirements of Revenue Procedure 92-79 which allowed that change in LIFO accounting method for new vehicles. As discussed in the paragraphs below, in connection with the current merger of the dealerships, it becomes necessary to rebase (again) the LIFO indexes as of the merger date.

Accordingly, the valuation factors for the combined base layers of both pools resulting from the merger now reflect several rebasings over the course of the LIFO elections.



Rebasing of Indexes to 1.0000 as of Merger Date

After making the necessary adjustments as of the merger date to account for the difference in LIFO election starting dates, Schedules 11 & 12 show the resulting combined LIFO indexes for each pool as rebased to 1.0000 as of the merger date.

Although the Regulations and the IRS provide no guidance or authoritative support for this rebasing, it is the consensus of certain commentators and/or authorities (including *Schneider, Federal Income Taxation of Inventories*) that this rebasing is necessary ... or at least should be done ... in order to assist in proper LIFO accounting in subsequent years in keeping track of increments and decrements and for computational simplicity.

<i>No LIFO Reserves Have Been "Lost" or Repaid</i>		
	<i>New Autos Pool #1</i>	<i>New L/D Trucks Pool #2</i>
<i>XYZ (Schedule 1)</i>	\$ 2,928,231	\$ 2,292,668
<i>ABC (Schedule 2)</i>	173,367	649,894
<i>Total LIFO Reserves Before Combination</i>	<u>\$ 3,101,598</u>	<u>\$ 2,942,562</u>
<i>Total LIFO Reserves After Merger Combination & Rebasing of Indexes to 1.000 (Schedules 11 & 12)</i>	<u>\$ 3,101,599</u>	<u>\$ 2,942,561</u>

Consistent with general rebasing principles, the "rebased" amount of base dollars of inventory for each pool as of the merger date equals the actual cost of the ending inventory as of the combination dates. For Pool #1 this amount is \$10,403,375 (\$9,703,375 + 700,000). For Pool #2 this amount is \$9,672,082 (\$5,672,082 + 4,000,000).

Because the inventory calculations for XYZ as of December 31, 2004 provide the layers into which the ABC LIFO layers are being merged at their April 30, 2005 adjusted base dollar and adjusted valuation factor amounts, the December 31, 2004 cumulative index for each LIFO pool has been rebased to 1.0000 as of that date.

The Final Results

After all of the computations and rebasings to reflect the merger of the pools have been made, Pool #1 (New Autos) contains 15 layers and Pool #2 (New Light-Duty Trucks) contains 17 layers. Note that the layer composition for Pool #2 reflects 10 layers which contribute negative amounts to the LIFO reserve and the more recent of these layers (i.e., those for the years 2002-02-04) present the opportunity for some practical planning to maximize the benefits of your LIFO election for this pool.

The schedules on the following page give you the final bird's eye view of the LIFO pools, based on the center sets of columns in Schedules 11 and 12.



AFTER REBASING TO 1.0000 AS OF DEC. 31, 2004

(Combined) Pool #1 - New Automobiles

Year	Base Dollars	Valuation Factor	LIFO Valuation	Contribution to LIFO Reserve
1974	1,319,788	0.235235	310,461	1,009,328
1977	868,827	0.310276	269,576	599,251
1979	1,493,164	0.356095	531,709	961,455
1983	114,189	1.019408	116,405	(2,216)
1984	658,129	0.525315	345,725	312,404
1985	25,482	1.053995	26,858	(1,376)
1987	45,745	1.103597	50,484	(4,739)
1988	12,081	1.118949	13,518	(1,437)
1990	25,639	1.242476	31,856	(6,217)
1991	446,871	0.714262	319,183	127,688
1998	420,658	0.886728	373,009	47,649
2000	6,845	0.895663	6,131	714
2002	111,904	1.521169	170,225	(58,321)
2003	1,494,705	0.964621	1,441,824	52,881
2004	3,359,346	0.980790	3,294,813	64,533 ₂
Total Base Dollars	10,403,375			3,101,599
Total LIFO Valuation			7,301,776	
Actual Cost - Merger Date			10,403,375	
LIFO Reserve - Merger Date			3,101,599	3,101,599

(Combined) Pool #2 - New Light-Duty Trucks

Year	Base Dollars	Valuation Factor	LIFO Valuation	Contribution to LIFO Reserve
1/1/1974 Base	3,137,060	0.164483	515,992	2,621,069
1974	345,887	0.189152	65,425	280,462
1976	10,529	0.211139	2,223	8,306
1983	259,286	0.886286	229,802	29,485
1984	62,349	0.998194	62,236	113
1985	48,971	1.010703	49,495	(524)
1987	87,911	1.058252	93,032	(5,121)
1988	23,218	1.072894	24,911	(1,692)
1990	67,689	1.191391	80,644	(12,955)
1995	407,939	1.464742	597,526	(189,587)
1996	191,141	1.500553	286,817	(95,676)
1997	263,920	1.537451	405,765	(141,844)
1999	2,926,724	0.710635	2,079,833	846,891
2001	579,362	0.738248	427,713	151,649
2002	654,833	1.173392	768,375	(113,543)
2003	547,281	1.712895	937,435	(390,154)
2004	57,982	1.764264	102,296	(44,314) ₍₂₎
Total Base Dollars	9,672,082			2,942,561
Total LIFO Valuation			6,729,521	
Actual Cost - Merger Date			9,672,082	
LIFO Reserve - Merger Date			2,942,561	2,942,561



Supporting Schedules

For each pool, we have enclosed identical supporting schedules and computations. These schedules include analyses of the composition and proof of the LIFO reserves which clearly show that no detriment has been incurred (i.e., there has been no loss of any LIFO reserve in any pool) as a result of these computational procedures.

These supporting schedules are listed below. Each provides a format so that similar computations in succeeding years can be easily made and reconciled.

<u>Sch. #</u>	<u>Description</u>
1	<i>XYZ</i> composition and proof of LIFO reserves as of Dec. 31, 2004.
2	<i>ABC</i> composition and proof of LIFO reserves as of April 30, 2005.
3 & 4	<i>XYZ</i> & <i>ABC</i> LIFO layer histories based on different LIFO election starting dates <i>before</i> common base year adjustments. (Pool #1 - Schedule 3 and Pool #2 - Schedule 4)
5 & 6	<i>ABC</i> ... Computation of adjustment of base dollars resulting in disappearing or lost base dollars in LIFO layer history due to difference in LIFO election starting dates (i.e., 1974 - the earlier LIFO election by <i>XYZ</i> vs. 1984 - the later LIFO election by <i>ABC</i>). <ul style="list-style-type: none">• Pool #1 - Schedule 5 ... Disappearing or Lost Base Dollars = \$ 283,656• Pool #2 - Schedule 6 ... Disappearing or Lost Base Dollars = \$ 1,751,206
7 & 8	Combination of link-chain, index pools with 1974 and 1984 base years showing adjustment for disappearing or lost base dollars and resulting revised ratios of LIFO valuation factors for affected years. <i>Note:</i> These Schedules are set up in the format shown in the example in Reg. Sec. 1.472-8(g)(2)(iv)(d). (Pool #1 - Schedule 7 and Pool #2 - Schedule 8)
9 & 10	Combined LIFO layer histories <i>after</i> combination and adjustments to equalize base dollars as of merger date. (Pool #1 - Schedule 9 and Pool #2 - Schedule 10)
11 & 12	Computation showing rebasing of all post-merger adjusted LIFO indexes to 1.0000 as of merger date. (Pool #1 - Schedule 11 and Pool #2 - Schedule 12)
* Key:	<i>XYZ</i> is the surviving corporation after the merger. <i>ABC</i> is the entity/corp. that ceased to exist when it was merged into <i>XYZ</i> as of April 30, 2005.

After you have a chance to review all of this, I look forward to discussing any questions that you may have on any of this.

* * *



XYZ MOTORS... THE SURVIVING ENTITY WITH THE EARLIER LIFO ELECTION
NEW VEHICLE LIFO INVENTORIES
COMPOSITION & PROOF OF LIFO RESERVES AS OF DEC. 31, 2004*

Schedule I

Layer	POOL #1 - NEW AUTOS			COMPOSITION & PROOF OF LIFO RESERVE AT 12/31/2004				
	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$
				(A)	(B)	(C) = (A-B)		
1/1/1974 Base	942,675	0.329340	310,461	(1.359130 - 0.329340)		1.029790	942,675	970,757
12/31/1977 Increment	620,570	0.434400	269,576	(1.359130 - 0.434400)		0.924730	620,570	573,860
12/31/1979 Increment	1,066,511	0.498550	531,709	(1.359130 - 0.498550)		0.860580	1,066,511	917,818
12/31/1984 Increment	446,904	0.698030	311,952	(1.359130 - 0.698030)		0.661100	446,904	295,448
12/31/1991 Increment	319,183	1.000000	319,183	(1.359130 - 1.000000)		0.359130	319,183	114,628
12/31/1998 Increment	300,460	1.241460	373,009	(1.359130 - 1.241460)		0.117670	300,460	35,355
12/31/2000 Increment	4,889	1.253970	6,131	(1.359130 - 1.253970)		0.105160	4,889	514
12/31/2002 Increment	13,676	1.313090	17,958	(1.359130 - 1.313090)		0.046040	13,676	630
12/31/2003 Increment	1,057,316	1.340950	1,417,808	(1.359130 - 1.340950)		0.018180	1,057,316	19,222
12/31/2004 Increment	2,367,218	1.359130	3,217,357	(1.359130 - 1.359130)		-	2,367,218	-
Total Base Dollars	7,139,402						7,139,402	
Total LIFO Valuation			6,775,144					
Actual Cost - 12/31/2004			9,703,375					
LIFO Reserve - 12/31/2004			2,928,231					2,928,232

Layer	POOL #2 - NEW L/D TRUCKS			COMPOSITION & PROOF OF LIFO RESERVE AT 12/31/2004				
	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$
				(A)	(B)	(C) = (A-B)		
1/1/1974 Base	1,817,512	0.283900	515,992	(1.322120 - 0.283900)		1.038220	1,817,512	1,886,977
12/31/1974 Increment	200,396	0.326480	65,425	(1.322120 - 0.326480)		0.995640	200,396	199,522
12/31/1976 Increment	6,100	0.364430	2,223	(1.322120 - 0.364430)		0.957690	6,100	5,842
12/31/1983 Increment	23,082	0.662390	15,289	(1.322120 - 0.662390)		0.659730	23,082	15,228
1/1/1992 Alt LIFO Rebase	-	1.000000	-	(1.322120 - 1.000000)		0.322120	-	-
12/31/1999 Increment	1,695,650	1.226570	2,079,833	(1.322120 - 1.226570)		0.095550	1,695,650	162,019
12/31/2001 Increment	335,664	1.274230	427,713	(1.322120 - 1.274230)		0.047890	335,664	16,075
12/31/2002 Increment	211,738	1.289040	272,939	(1.322120 - 1.289040)		0.033080	211,738	7,004
Cumul. Index at 12/31/2004	-	1.322120	-	(1.322120 - 1.322120)		-	-	-
Total Base Dollars	4,290,142						4,290,142	
Total LIFO Valuation			3,379,414					
Actual Cost - 12/31/2004			5,672,082					
LIFO Reserve - 12/31/2004			2,292,668					2,292,667

* Note: XYZ Motors elected to change to the Alternative LIFO Method for new vehicles in 1992. As a result, it was required to rebase its LIFO layers to 1.0000 as of December 31, 1991.

In the year 2004, XYZ Motors incurred a LIFO liquidation in Pool #2.



ABC SALES... THE DISAPPEARING ENTITY WITH THE SHORTER LIFO ELECTION
NEW VEHICLE LIFO INVENTORIES
COMPOSITION & PROOF OF LIFO RESERVES AS OF APRIL 30, 2005*

Schedule 2

Layer	POOL #1 - NEW AUTOS			COMPOSITION & PROOF OF LIFO RESERVE AT 4/30/2005				
	Base	Valuation	LIFO	Factor			Base	LIFO Reserve
	Dollars	Factor	Valuation	(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
1/1/1984 Base	160,972	0.723140	116,405	(1.217410 - 0.723140)	0.494270		160,972	79,564
12/31/1984 Increment	45,735	0.738450	33,773	(1.217410 - 0.738450)	0.478960		45,735	21,905
12/31/1985 Increment	35,922	0.747680	26,858	(1.217410 - 0.747680)	0.469730		35,922	16,874
12/31/1987 Increment	64,486	0.782870	50,484	(1.217410 - 0.782870)	0.434540		64,486	28,022
12/31/1988 Increment	17,031	0.793730	13,518	(1.217410 - 0.793730)	0.423680		17,031	7,216
12/31/1990 Increment	36,144	0.881360	31,856	(1.217410 - 0.881360)	0.336050		36,144	12,146
1/1/1992 Alt LIFO Rebase	-	1.000000	-	(1.217410 - 1.000000)	0.217410		-	-
12/31/2002 Increment	130,759	1.164490	152,268	(1.217410 - 1.164490)	0.052920		130,759	6,920
12/31/2003 Increment	20,319	1.181950	24,016	(1.217410 - 1.181950)	0.035460		20,319	721
4/30/2005 Increment	63,623	1.217410	77,455	(1.217410 - 1.217410)	-		63,623	-
Total Base Dollars	574,991						574,991	
Total LIFO Valuation			526,633					
Actual Cost - 4/30/2005			700,000					
LIFO Reserve - 4/30/2005			173,367					173,368

Layer	POOL #2 - NEW L/D TRUCKS			COMPOSITION & PROOF OF LIFO RESERVE AT 4/30/2005				
	Base	Valuation	LIFO	Factor			Base	LIFO Reserve
	Dollars	Factor	Valuation	(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
1/1/1984 Base	296,640	0.723140	214,512	(1.305160 - 0.723140)	0.582020		296,640	172,650
12/31/1984 Increment	84,282	0.738430	62,236	(1.305160 - 0.738430)	0.566730		84,282	47,765
12/31/1985 Increment	66,196	0.747700	49,495	(1.305160 - 0.747700)	0.557460		66,196	36,902
12/31/1987 Increment	118,835	0.782870	93,032	(1.305160 - 0.782870)	0.522290		118,835	62,066
12/31/1988 Increment	31,385	0.793720	24,911	(1.305160 - 0.793720)	0.511440		31,385	16,052
12/31/1990 Increment	91,501	0.881350	80,644	(1.305160 - 0.881350)	0.423810		91,501	38,779
1/1/1992 Alt LIFO Rebase	-	1.000000	-	(1.305160 - 1.000000)	0.305160		-	-
12/31/1995 Increment	551,442	1.083570	597,526	(1.305160 - 1.083570)	0.221590		551,442	122,194
12/31/1996 Increment	258,380	1.110060	286,817	(1.305160 - 1.110060)	0.195100		258,380	50,410
12/31/1997 Increment	356,760	1.137360	405,765	(1.305160 - 1.137360)	0.167800		356,760	59,864
12/31/2002 Increment	391,161	1.266580	495,437	(1.305160 - 1.266580)	0.038580		391,161	15,091
12/31/2003 Increment	739,798	1.267150	937,435	(1.305160 - 1.267150)	0.038010		739,798	28,120
4/30/2005 Increment	78,378	1.305160	102,296	(1.305160 - 1.305160)	-		78,378	-
Total Base Dollars	3,064,758						3,064,758	
Total LIFO Valuation			3,350,106					
Actual Cost - 4/30/2005			4,000,000					
LIFO Reserve - 4/30/2005			649,894					649,893

* Note: ABC Sales elected to change to the Alternative LIFO Method for new vehicles in 1992. As a result, it was required to rebase its LIFO layers to 1.0000 as of December 31, 1991.

ABC Sales valued its new inventories at LIFO as of the date of merger, April 30, 2005.

ABC Sales' LIFO inventory values as of the date of merger will be combined with the LIFO inventory of XYZ Motors.



XYZ & ABC
POOL #1 - NEW AUTOMOBILES
RESPECTIVE LIFO LAYER HISTORIES BASED ON DIFFERENT LIFO ELECTION STARTING DATES
BEFORE COMMON BASE YEAR ADJ. - AS OF MERGER DATE

Schedule 3

Layer	XYZ - POOL #1			XYZ - COMPOSITION & PROOF OF LIFO RESERVE AT 12/31/2004					ABC - POOL #1			ABC - COMPOSITION & PROOF OF LIFO RESERVE AT 4/30/2005					POOL #1 TOTAL LIFO Reserve Composition By Year
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$	
				(A)	(B)	(C) = (A-B)						(A)	(B)	(C) = (A-B)			
1/1/1974	942,675	0.329340	310,461	(1.359130 - 0.329340)		1.029790	942,675	970,757	-	-	-	(1.217410 - -)		1.217410	-	-	970,757
1974	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1975	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1976	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1977	620,570	0.434400	269,576	(1.359130 - 0.434400)		0.924730	620,570	573,860	-	-	-	(1.217410 - -)		1.217410	-	-	573,860
1978	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1979	1,066,511	0.498550	531,709	(1.359130 - 0.498550)		0.860580	1,066,511	917,818	-	-	-	(1.217410 - -)		1.217410	-	-	917,818
1980	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1981	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1982	-	-	-	(- - -)		-	-	-	-	-	-	(1.217410 - -)		1.217410	-	-	-
1983	-	-	-	(- - -)		-	-	-	160,972	0.723140	116,405	(1.217410 - 0.723140)		0.494270	160,972	79,564	79,564
1984	446,904	0.698030	311,952	(1.359130 - 0.698030)		0.661100	446,904	295,448	45,735	0.738450	33,773	(1.217410 - 0.738450)		0.478960	45,735	21,905	317,353
1985	-	-	-	(- - -)		-	-	-	35,922	0.747680	26,858	(1.217410 - 0.747680)		0.469730	35,922	16,874	16,874
1986	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1987	-	-	-	(- - -)		-	-	-	64,486	0.782870	50,484	(1.217410 - 0.782870)		0.434540	64,486	28,022	28,022
1988	-	-	-	(- - -)		-	-	-	17,031	0.793730	13,518	(1.217410 - 0.793730)		0.423680	17,031	7,216	7,216
1989	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1990	-	-	-	(- - -)		-	-	-	36,144	0.881360	31,856	(1.217410 - 0.881360)		0.336050	36,144	12,146	12,146
1991	319,183	1.000000	319,183	(1.359130 - 1.000000)		0.359130	319,183	114,628	-	-	-	(- - -)		-	-	-	114,628
1992	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1993	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1994	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1995	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1996	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1997	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
1998	300,460	1.241460	373,009	(1.359130 - 1.241460)		0.117670	300,460	35,355	-	-	-	(- - -)		-	-	-	35,355
1999	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
2000	4,889	1.253970	6,131	(1.359130 - 1.253970)		0.105160	4,889	514	-	-	-	(- - -)		-	-	-	514
2001	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
2002	13,676	1.313090	17,958	(1.359130 - 1.313090)		0.046040	13,676	630	130,759	1.164490	152,268	(1.217410 - 1.164490)		0.052920	130,759	6,920	7,549
2003	1,057,316	1.340950	1,417,808	(1.359130 - 1.340950)		0.018180	1,057,316	19,222	20,319	1.181950	24,016	(1.217410 - 1.181950)		0.035460	20,319	721	19,943
2004	2,367,218	1.359130	3,217,357	(1.359130 - 1.359130)		-	2,367,218	-	63,623	1.217410	77,455	(1.217410 - 1.217410)		-	63,623	-	-
4/30/2005	-	-	-	(- - -)		-	-	-	-	-	-	(- - -)		-	-	-	-
Total Base Dollars	7,139,402						7,139,402	2,928,232	574,991						574,991	173,366	3,101,599
Total LIFO Valuation			6,775,143								526,633						
Actual Cost - 12/31/2004			9,703,375						Actual Cost - 4/30/2005		700,000						
LIFO Reserve - 12/31/2004			2,928,232					2,928,232	LIFO Reserve - 4/30/2005		173,367					55,024	3,101,599

XYZ HAS THE EARLIER LIFO ELECTION STARTING DATE (1/1/1974).
 ABC HAS THE LATER LIFO ELECTION STARTING DATE (1/1/1984).

RESPECTIVE POOLS #1 ARE TO BE COMBINED REFLECTING 1974 AS THE COMMON BASE DATE, WITH APPROPRIATE ADJUSTMENTS TO BASE DOLLARS AS REQUIRED BY REG. SEC. 1.472-8(g)(7)(i).
 THE LIFO VALUATIONS FOR EACH LAYER IN EACH POOL DO NOT CHANGE THEIR RESPECTIVE DOLLAR AMOUNTS.

THE MERGER OF ABC (ABC) INTO XYZ (XYZ) REFLECTS THE COMBINATION OF
 THE LIFO LAYERS OF ABC AS OF APRIL 30, 2005 WITH THE LIFO LAYERS OF XYZ AS OF DECEMBER 31, 2004.

REG. SEC. 1.472-8(g)(7)(ii) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION (I.E., ABC) AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR.
 THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE
 AS AN INCREMENT (INCURRED BY XYZ) IN 1983, THE PREVIOUS YEAR.

REG. SEC. 1.381(c)(3)-1(e)(2) PROVIDES THAT A LAYER OF INCREMENT OCCURRING IN A FINAL (SHORT) TAXABLE YEAR OF A DISTRIBUTOR OR TRANSFEROR SHALL BE MERGED
 WITH AND CONSIDERED A LAYER OF INCREMENT OF ITS IMMEDIATELY PRECEDING TAXABLE YEAR.



XYZ & ABC
POOL #2 - LIGHT-DUTY TRUCKS
RESPECTIVE LIFO LAYER HISTORIES BASED ON DIFFERENT LIFO ELECTION STARTING DATES
BEFORE COMMON BASE YEAR ADJ. - AS OF MERGER DATE

Schedule 4

Layer	XYZ - POOL #2			XYZ - COMPOSITION & PROOF OF LIFO RESERVE AT 12/31/2004					ABC - POOL #2			ABC - COMPOSITION & PROOF OF LIFO RESERVE AT 4/30/2005					TOTAL LIFO Reserve Composition By Year
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$	
				(A)	(B)	(C) = (A-B)						(A)	(B)	(C) = (A-B)			
1/1/1974	1,817,512	0.283900	515,992	(1.322120 - 0.283900)	1.038220	1,817,512	1,886,977	-	-	-	(- - - -)	-	-	-	-	1,886,977	
1974	200,396	0.326480	65,425	(1.322120 - 0.326480)	0.995640	200,396	199,522	-	-	-	(- - - -)	-	-	-	-	199,522	
1975	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1976	6,100	0.364430	2,223	(1.322120 - 0.364430)	0.957690	6,100	5,842	-	-	-	(- - - -)	-	-	-	-	5,842	
1977	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1978	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1979	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1980	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1981	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1982	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1983	23,082	0.662390	15,289	(1.322120 - 0.662390)	0.659730	23,082	15,228	296,640	0.723140	214,512	(1.305160 - 0.723140)	0.582020	296,640	172,650	187,878		
1984	-	-	-	(- - - -)	-	-	-	84,282	0.738430	62,236	(1.305160 - 0.738430)	0.566730	84,282	47,765	47,765		
1985	-	-	-	(- - - -)	-	-	-	66,196	0.747700	49,495	(1.305160 - 0.747700)	0.557460	66,196	36,902	36,902		
1986	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1987	-	-	-	(- - - -)	-	-	-	118,835	0.782870	93,032	(1.305160 - 0.782870)	0.522290	118,835	62,066	62,066		
1988	-	-	-	(- - - -)	-	-	-	31,385	0.793720	24,911	(1.305160 - 0.793720)	0.511440	31,385	16,052	16,052		
1989	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1990	-	-	-	(- - - -)	-	-	-	91,501	0.881350	80,644	(1.305160 - 0.881350)	0.423810	91,501	38,779	38,779		
1991	-	1.000000	-	(- - - -)	-	-	-	-	1.000000	-	(- - - -)	-	-	-	-	-	
1992	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1993	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1994	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1995	-	-	-	(- - - -)	-	-	-	551,442	1.083570	597,526	(1.305160 - 1.083570)	0.221590	551,442	122,194	122,194		
1996	-	-	-	(- - - -)	-	-	-	258,380	1.110060	286,817	(1.305160 - 1.110060)	0.195100	258,380	50,410	50,410		
1997	-	-	-	(- - - -)	-	-	-	356,760	1.137360	405,765	(1.305160 - 1.137360)	0.167800	356,760	59,864	59,864		
1998	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
1999	1,695,650	1.226570	2,079,833	(1.322120 - 1.226570)	0.095550	1,695,650	162,019	-	-	-	(- - - -)	-	-	-	-	162,019	
2000	-	-	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
2001	335,664	1.274230	427,713	(1.322120 - 1.274230)	0.047890	335,664	16,075	-	-	-	(- - - -)	-	-	-	-	16,075	
2002	211,738	1.289040	272,939	(1.322120 - 1.289040)	0.033080	211,738	7,004	391,161	1.266580	495,437	(1.305160 - 1.266580)	0.038580	391,161	15,091	22,095		
2003	-	-	-	(- - - -)	-	-	-	739,798	1.267150	937,435	(1.305160 - 1.267150)	0.038010	739,798	28,120	28,120		
2004	-	1.322120	-	(- - - -)	-	-	-	-	-	-	(- - - -)	-	-	-	-	-	
4/30/2005	-	-	-	(- - - -)	-	-	-	78,378	1.305160	102,296	(1.305160 - 1.305160)	-	78,378	-	-	-	
Total Base Dollars	4,290,142					4,290,142	2,292,668	3,064,758					3,064,758	649,893	2,942,561		
Total LIFO Valuation			3,379,415							3,350,106							
Actual Cost - 12/31/2004			5,672,082						Actual Cost - 4/30/2005		4,000,000						
LIFO Reserve - 12/31/2004			2,292,667				2,292,668		LIFO Reserve - 4/30/2005		649,894			649,893	2,942,561		

XYZ HAS THE EARLIER LIFO ELECTION STARTING DATE (1/1/1974).
 ABC HAS THE LATER LIFO ELECTION STARTING DATE (1/1/1984).

RESPECTIVE POOLS #1 ARE TO BE COMBINED REFLECTING 1974 AS THE COMMON BASE DATE, WITH APPROPRIATE ADJUSTMENTS TO BASE DOLLARS AS REQUIRED BY REG. SEC. 1.472-4(g)(2)(i)-(ii).
 THE LIFO VALUATIONS FOR EACH LAYER IN EACH POOL DO NOT CHANGE THEIR RESPECTIVE DOLLAR AMOUNTS.

THE MERGER OF ABC INTO XYZ REFLECTS THE COMBINATION OF
 THE LIFO LAYERS OF ABC AS OF APRIL 30, 2005 WITH THE LIFO LAYERS OF XYZ AS OF DECEMBER 31, 2004.

REG. SEC. 1.472-4(g)(2)(ii) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION (I.E., ABC) AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR.
 THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE
 AS AN INCREMENT (INCURRED BY XYZ) IN 1983, THE PREVIOUS YEAR.

REG. SEC. 1.381(c)(5)-(e)(2) PROVIDES THAT A LAYER OF INCREMENT OCCURRING IN A FINAL (SHORT) TAXABLE YEAR OF A DISTRIBUTOR OR TRANSFEROR SHALL BE MERGED
 WITH AND CONSIDERED A LAYER OF INCREMENT OF ITS IMMEDIATELY PRECEDING TAXABLE YEAR.

ABC
POOL #1 - NEW AUTOMOBILES
COMPUTATION OF ADJUSTMENT/REDUCTION OF ABC BASE DOLLARS
DUE TO DIFFERENT LIFO ELECTION STARTING DATES

Schedule 5

Year	ABC POOL #1 - AUTOS			Adjustment Factor*	Redetermined Base Dollars	LIFO Valuation Unchanged (F) = (C)	Redetermined Valuation Factor (G) = F/E	Disappearing "Lost" Base Dollars (H) = (A) - (E)
	Base Dollars	Valuation Factor	LIFO Valuation					
	(A)	(B)	(C)		(E) = (A) x (D)			
1983	160,972	0.72314	116,405	0.50668	81,561	116,405	1.42722	79,411
1984	45,735	0.73845	33,773	0.50668	23,173	33,773	1.45744	22,562
1985	35,922	0.74768	26,858	0.50668	18,201	26,858	1.47565	17,721
1987	64,486	0.78287	50,484	0.50668	32,674	50,484	1.54511	31,812
1988	17,031	0.79373	13,518	0.50668	8,629	13,518	1.56654	8,402
1990	36,144	0.88136	31,856	0.50668	18,313	31,856	1.73949	17,831
2002	130,759	1.16449	152,268	0.50668	66,253	152,268	2.29829	64,506
2003	20,319	1.18195	24,016	0.50668	10,295	24,016	2.33275	10,024
2004	63,623	1.21741	77,455	0.50668	32,236	77,455	2.40273	31,387
4/30/2005**	-	-	-	-	-	-	-	-
(**Treated as 2004 Increment)								
Totals	574,991				291,335	526,633		283,656
Total LIFO Valuation			526,633					
Actual Cost - 4/30/2005			700,000					
LIFO Reserve - 4/30/2005			173,367					

* ADJUSTMENT FACTOR FOR POOL #1 EQUALS 0.32934 DIVIDED BY .65000 = .506677

REG. SEC. 1.472-8(g)(2)(iv) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR. THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE AS AN INCREMENT IN THE YEAR 1983, THE PREVIOUS YEAR.





ABC
POOL #2 - NEW LIGHT-DUTY TRUCKS
COMPUTATION OF ADJUSTMENT/REDUCTION OF ABC BASE DOLLARS
DUE TO DIFFERENT LIFO ELECTION STARTING DATES

Schedule 6

Year	ABC POOL #2			Adjustment Factor*	Redetermined Base Dollars	LIFO Valuation Unchanged	Redetermined Valuation Factor	Disappearing "Lost" Base Dollars
	Base Dollars	Valuation Factor	LIFO Valuation					
	(A)	(B)	(C)		(E) = (A) x (D)	(F) = (C)	(G) = F/E	(H) = (A) - (E)
1983	296,640	0.723140	214,512	0.428599	127,140	214,512	1.687218	169,500
1984	84,282	0.738430	62,236	0.428599	36,123	62,236	1.722892	48,159
1985	66,196	0.747700	49,495	0.428599	28,372	49,495	1.744521	37,824
1987	118,835	0.782870	93,032	0.428599	50,933	93,032	1.826579	67,902
1988	31,385	0.793720	24,911	0.428599	13,452	24,911	1.851894	17,933
1990	91,501	0.881350	80,644	0.428599	39,217	80,644	2.056351	52,284
1995	551,442	1.083570	597,526	0.428599	236,347	597,526	2.528167	315,095
1996	258,380	1.110060	286,817	0.428599	110,741	286,817	2.589973	147,639
1997	356,760	1.137360	405,765	0.428599	152,907	405,765	2.653669	203,853
2002	391,161	1.266580	495,437	0.428599	167,651	495,437	2.955163	223,510
2003	739,798	1.267150	937,435	0.428599	317,077	937,435	2.956493	422,721
2004	78,378	1.305160	102,296	0.428599	33,593	102,296	3.045177	44,785
4/30/2005**	-	-	-	0.428599	-	-	-	-
(**Treated as 2004 Increment)								
Totals	3,064,758				1,313,552	3,350,106		1,751,206
Total LIFO Valuation			3,350,106					
Actual Cost - 4/30/2005			4,000,000					
LIFO Reserve - 4/30/2005			649,894					

* ADJUSTMENT FACTOR FOR POOL #2 EQUALS 0.283900 DIVIDED BY 0.662390 = .428599

REG. SEC. 1.472-8(g)(2)(iv) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR. THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE AS AN INCREMENT IN THE YEAR 1983, THE PREVIOUS YEAR.



Schedule Z

XYZ & ABC
POOL #1 - NEW AUTOS
COMBINATION OF LINK-CHAIN LIFO POOLS WITH 1974 & 1984 BASE YEARS
AS OF MERGER DATE

Year	XYZ POOL #1 - AUTOS													Total	
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Base Dollars	LIFO Valuation
1974	942,675	0.37934	310,461											942,675	
1975	620,570	0.49455	310,461											820,570	
1976	1,066,511	0.49855	531,709											1,066,511	
1977															
1978															
1979															
1980															
1981															
1982															
1983															
1984															
1985															
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1987															
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1993															
1994															
1995															
1996															
1997															
1998															
1999															
2000															
2001															
2002															
2003															
2004															
Total Base Dollars	7,139,402													7,139,402	
Total LIFO Valuation															
Actual Cost - 12/31/2004															
LIFO Reserve - 12/31/2004															

Year	ABC POOL #1 - AUTOS													Total	
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983	Base Dollars	LIFO Valuation
1974	160,972	0.72314	116,405											160,972	
1975	45,715	0.71645	33,773											45,715	
1976	35,922	0.72758	26,838											35,922	
1977	64,486	0.78387	50,484											64,486	
1978	17,031	0.79373	13,518											17,031	
1979	36,144	0.88136	31,856											36,144	
1980															
1981															
1982															
1983															
1984															
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1987															
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1991															
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1994															
1995															
1996															
1997															
1998															
1999															
2000															
2001															
2002															
2003															
2004*															
Total Base Dollars	574,991													574,991	
Adjustment to Expense Base Year Cost															
Expended Base Year Cost															
Total LIFO Valuation															
Actual Cost - 4/30/2005															
LIFO Reserve - 4/30/2005															
Combined Base Year Costs															
Combined LIFO Valuations															
Ratio of LIFO Valuation to Base Year Cost															

* Increment for 4/30/2005 is treated as an increment for the year 2004

XYZ & ABC
POOL #2 - L/D TRUCKS
COMBINATION OF LINK-CHAIN LIFO POOLS WITH 1974 & 1984 BASE YEARS
AS OF MERGER DATE

Schedule 8

Year	XYZ POOL #1 - L/D TRUCKS				Base Year 12/31											Total Base Dollars	Total LIFO Valuation
	Base Dollars as Adjusted	Valuation Factor	Valuation	LIFO Valuation		12/74	12/75	12/76	12/77	12/78	12/79	12/80	12/81	12/82	12/83		
1/1/1974 Base	1,817,512	0.28390	515,991	515,991	1,817,512												
1974	200,396	0.28390	56,845	56,845	200,396												
1975	21,082	0.28390	5,981	5,981		6,100	23,002										
1976																	
1977																	
1978																	
1979																	
1980																	
1981																	
1982																	
1983																	
1984																	
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1996																	
1997																	
1998																	
1999																	
2000																	
2001																	
2002																	
2003																	
2004																	
Total Base Dollars	4,390,142																
Total LIFO Valuation																	
Actual Cost - 12/31/2004																	
LIFO Reserve - 12/31/2004																	

Year	ABC POOL #1 - L/D TRUCKS				Base Year 12/31											Total Base Dollars	Total LIFO Valuation
	Base Dollars as Adjusted	Valuation Factor	Valuation	LIFO Valuation		12/74	12/75	12/76	12/77	12/78	12/79	12/80	12/81	12/82	12/83		
1/1/1974 Base	296,640	0.72314	214,512	214,512	296,640												
1974	84,282	0.72314	60,933	60,933													
1975	118,835	0.72314	85,933	85,933													
1976	31,385	0.72314	22,732	22,732													
1977	91,501	0.88155	80,644	80,644													
1978	551,442	1.00357	552,326	552,326													
1979	258,380	1.10066	284,817	284,817													
1980	356,760	1.13736	405,765	405,765													
1981																	
1982																	
1983																	
1984																	
1985																	
1986																	
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1996																	
1997																	
1998																	
1999																	
2000																	
2001																	
2002																	
2003																	
2004																	
Total Base Dollars	3,064,758																
Total LIFO Valuation																	
Actual Cost - 12/31/2004																	
LIFO Reserve - 12/31/2004																	

* Increment for 4/30/2005 is treated as an increment for the Year 2004

XYZ
POOL #1 - NEW AUTOS
AFTER COMBINATION WITH ABC
AS OF MERGER DATE *

Schedule 9

Year	XYZ POOL #1 - AUTOS			ABC POOL #1 - AUTOS			Disappearing or Lost Base Dollars	COMBINED POOLS #1 - NEW AUTOS			COMPOSITION & PROOF OF LIFO RESERVE POOL #1 - AUTOS				
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	Base Dollars	Valuation Factor	LIFO Valuation		Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$
											(A)	(B)	(C) = (A-B)		
1974	942,675	0.32934	310,461	-	-	-	-	942,675	0.329340	310,461	(1.400046 - 0.329340)	1.0707062		942,675	1,009,328
1977	620,570	0.43440	269,576	-	-	-	-	620,570	0.434400	269,576	(1.400046 - 0.434400)	0.9656462		620,570	599,251
1979	1,066,511	0.49855	531,709	-	-	-	-	1,066,511	0.498550	531,709	(1.400046 - 0.498550)	0.9014962		1,066,511	961,456
1983	-	-	-	160,972	0.72314	116,405	(79,411)	81,561	1.427218	116,405	(1.400046 - 1.427218)	(0.0271714)		81,561	(2,216)
1984	446,904	0.69803	311,952	45,735	0.73845	33,773	(22,562)	470,077	0.735465	345,725	(1.400046 - 0.735465)	0.6645807		470,077	312,404
1985	-	-	-	35,922	0.74768	26,858	(17,721)	18,201	1.475642	26,858	(1.400046 - 1.475642)	(0.0755959)		18,201	(1,376)
1987	-	-	-	64,486	0.78287	50,484	(31,812)	32,674	1.545086	50,484	(1.400046 - 1.545086)	(0.1450403)		32,674	(4,739)
1988	-	-	-	17,031	0.79373	13,518	(8,402)	8,629	1.566580	13,518	(1.400046 - 1.566580)	(0.1665334)		8,629	(1,437)
1990	-	-	-	36,144	0.88136	31,856	(17,831)	18,313	1.739523	31,856	(1.400046 - 1.739523)	(0.3394763)		18,313	(6,217)
1991	319,183	1.00000	319,183	-	-	-	-	319,183	1.000000	319,183	(1.400046 - 1.000000)	0.4000462		319,183	127,688
1998	300,460	1.24146	373,009	-	-	-	-	300,460	1.241460	373,009	(1.400046 - 1.241460)	0.1585862		300,460	47,649
2000	4,889	1.25397	6,131	-	-	-	-	4,889	1.253970	6,131	(1.400046 - 1.253970)	0.1460762		4,889	714
2002	13,676	1.31309	17,958	130,759	1.16449	152,268	(64,506)	79,929	2.129707	170,225	(1.400046 - 2.129707)	(0.7296610)		79,929	(58,321)
2003	1,057,316	1.34095	1,417,808	20,319	1.18195	24,016	(10,024)	1,067,611	1.350514	1,441,824	(1.400046 - 1.350514)	0.0495319		1,067,611	52,881
2004*	2,367,218	1.35913	3,217,357	63,623	1.21741	77,455	(31,387)	2,399,454	1.373151	3,294,812	(1.400046 - 1.373151)	0.0268953		2,399,454	64,534
Total Base Dollars	7,139,402			574,991			(283,656)	7,430,737						7,430,737	3,101,599
Total LIFO Valuation			6,775,143			526,633				7,301,776					
Actual Cost			9,703,375			700,000				10,403,375					
LIFO Reserve			2,928,232			173,367				3,101,599					3,101,599

NOTE: THIS SCHEDULE REFLECTS THE ADJUSTMENTS TO EQUALIZE BASE DOLLARS DUE TO DIFFERENT LIFO ELECTION STARTING DATES

THE REVISED PROOF FACTOR AFTER ADJUSTING FOR DIFFERENT LIFO STARTING DATES AND DISAPPEARING OR "LOST" BASE DOLLARS WAS DETERMINED BY DIVIDING THE TOTAL INVENTORIES AT THE RESPECTIVE DATES (12/31/2004 & 4/30/2005) AT ACTUAL COST (\$10,403,375) BY THE COMBINED NET REDETERMINED BASE DOLLARS (\$7,430,737) ... EQUALS 1.400046.

NOTE: IN 1992, BOTH DEALERSHIPS (XYZ & ABC) ELECTED TO CHANGE TO USE THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES. AT THAT TIME, THE LIFO POOL INDEXES WERE REBASED TO 1.000 AS OF JANUARY 1, 1992 IN ACCORDANCE WITH THE REQUIREMENTS OF REV. PROC. 92-79.

* Increment for 4/30/2005 is treated as an increment for the Year 2004.



XYZ
POOL #2 - NEW L/D TRUCKS
AFTER COMBINATION WITH ABC
AS OF MERGER DATE *

Schedule 10

Year	XYZ POOL #2 - L/D TRUCKS			ABC POOL #2 - L/D TRUCKS			Disappearing or Lost Base Dollars	COMBINED POOLS #2 - NEW L/D TRUCKS			COMPOSITION & PROOF OF LIFO RESERVE POOL #2 - L/D TRUCKS				
	Base Dollars as Adjusted	Valuation Factor	LIFO Valuation	Base Dollars	Valuation Factor	LIFO Valuation		Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base Dollars	LIFO Reserve (C) x Base \$
											(A)	(B)	(C) = (A-B)		
1/1/1974 Base	1,817,512	0.28390	515,992	-	-	-	-	1,817,512	0.283900	515,992	(1.726019 - 0.283900)	1.4421186		1,817,512	2,621,068
1974	200,396	0.32648	65,425	-	-	-	-	200,396	0.326480	65,425	(1.726019 - 0.326480)	1.3995386		200,396	280,462
1976	6,100	0.36443	2,223	-	-	-	-	6,100	0.364430	2,223	(1.726019 - 0.364430)	1.3615886		6,100	8,306
1983	23,082	0.66239	15,289	296,640	0.72314	214,512	(169,500)	150,222	1.529746	229,802	(1.726019 - 1.529746)	0.1962724		150,222	29,484
1984	-	-	-	84,282	0.73843	62,236	(48,159)	36,123	1.722901	62,236	(1.726019 - 1.722901)	0.0031175		36,123	113
1985	-	-	-	66,196	0.74770	49,495	(37,824)	28,372	1.744493	49,495	(1.726019 - 1.744493)	(0.0184741)		28,372	(524)
1987	-	-	-	118,835	0.78287	93,032	(67,902)	50,933	1.826563	93,032	(1.726019 - 1.826563)	(0.1005448)		50,933	(5,121)
1988	-	-	-	31,385	0.79372	24,911	(17,933)	13,452	1.851836	24,911	(1.726019 - 1.851836)	(0.1258177)		13,452	(1,692)
1990	-	-	-	91,501	0.88135	80,644	(52,284)	39,217	2.056363	80,644	(1.726019 - 2.056363)	(0.3303448)		39,217	(12,955)
1995	-	-	-	551,442	1.08357	597,526	(315,095)	236,347	2.528173	597,526	(1.726019 - 2.528173)	(0.8021540)		236,347	(189,587)
1996	-	-	-	258,380	1.11006	286,817	(147,639)	110,741	2.589983	286,817	(1.726019 - 2.589983)	(0.8639643)		110,741	(95,676)
1997	-	-	-	356,760	1.13736	405,765	(203,853)	152,907	2.653669	405,765	(1.726019 - 2.653669)	(0.9276503)		152,907	(141,844)
1999	1,695,650	1.22657	2,079,833	-	-	-	-	1,695,650	1.226570	2,079,833	(1.726019 - 1.226570)	0.4994486		1,695,650	846,890
2001	335,664	1.27423	427,713	-	-	-	-	335,664	1.274230	427,713	(1.726019 - 1.274230)	0.4517886		335,664	151,649
2002	211,738	1.28904	272,939	391,161	1.26658	495,437	(223,510)	379,389	2.025297	768,375	(1.726019 - 2.025297)	(0.2992785)		379,389	(113,543)
2003	-	-	-	739,798	1.26715	937,435	(422,721)	317,077	2.956490	937,435	(1.726019 - 2.956490)	(1.2304715)		317,077	(390,154)
2004*	-	-	-	78,378	1.30516	102,296	(44,785)	33,593	3.045153	102,296	(1.726019 - 3.045153)	(1.3191345)		33,593	(44,314)
Total Base Dollars	4,290,142			3,064,758			(1,751,205)	5,603,695						5,603,695	2,942,561
Total LIFO Valuation			3,379,415			3,350,106				6,729,520					
Actual Cost			5,672,082			4,000,000				9,672,082					
LIFO Reserve			2,292,667			649,894				2,942,561					2,942,561

NOTE: THIS SCHEDULE REFLECTS THE ADJUSTMENTS TO EQUALIZE BASE DOLLARS DUE TO DIFFERENT LIFO ELECTION STARTING DATES

THE REVISED PROOF FACTOR AFTER ADJUSTING FOR DIFFERENT LIFO STARTING DATES AND DISAPPEARING OR "LOST" BASE DOLLARS WAS DETERMINED BY DIVIDING THE TOTAL INVENTORIES AT THE RESPECTIVE DATES (12/31/2004 & 4/30/2005) AT ACTUAL COST (\$9,672,082) BY THE COMBINED NET REDETERMINED BASE DOLLARS (\$5,603,695) ... EQUALS 1.726019.

NOTE: IN 1992, THOMAS DODGE OF HIGHLAND, INC. ELECTED TO CHANGE TO USE THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES. AT THAT TIME, THE LIFO POOL INDEXES WERE REBASED TO 1.000 AS OF JANUARY 1, 1992 IN ACCORDANCE WITH THE REQUIREMENTS OF REV. PROC. 92-79.

* Increment for 4/30/2005 is treated as an increment for the Year 2004.



XYZ
POOL #1 - NEW AUTOS
COMPUTATION SHOWING REBASING OF ALL POST-MERGER ADJUSTED LIFO INDEXES TO 1.0000
AS OF MERGER DATE

Schedule 11

Year	BEFORE REBASING TO 1.0000			AFTER REBASING TO 1.0000			COMPOSITION & PROOF OF LIFO RESERVE POOL #1 - AUTOS				
	(COMBINED) POOL #1 - AUTOS			(COMBINED) POOL #1 - AUTOS			AFTER ALL ADJUSTMENTS INCLUDING REBASING INDEXES TO 1.0000				
	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base	LIFO Reserve
							(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
1974	942,675	0.329340	310,461	1,319,788	0.235235	310,461	(1.0000000 - 0.235235)	0.7647649		1,319,788	1,009,328
1977	620,570	0.434400	269,576	868,827	0.310276	269,576	(1.0000000 - 0.310276)	0.6897245		868,827	599,251
1979	1,066,511	0.498550	531,709	1,493,164	0.356095	531,709	(1.0000000 - 0.356095)	0.6439046		1,493,164	961,455
1983	81,561	1.427218	116,405	114,189	1.019408	116,405	(1.0000000 - 1.019408)	(0.0194079)		114,189	(2,216)
1984	470,077	0.735465	345,725	658,129	0.525315	345,725	(1.0000000 - 0.525315)	0.4746851		658,129	312,404
1985	18,201	1.475642	26,858	25,482	1.053995	26,858	(1.0000000 - 1.053995)	(0.0539954)		25,482	(1,376)
1987	32,674	1.545086	50,484	45,745	1.103597	50,484	(1.0000000 - 1.103597)	(0.1035966)		45,745	(4,739)
1988	8,629	1.566580	13,518	12,081	1.118949	13,518	(1.0000000 - 1.118949)	(0.1189489)		12,081	(1,437)
1990	18,313	1.739523	31,856	25,639	1.242476	31,856	(1.0000000 - 1.242476)	(0.2424756)		25,639	(6,217)
1991	319,183	1.000000	319,183	446,871	0.714262	319,183	(1.0000000 - 0.714262)	0.2857378		446,871	127,688
1998	300,460	1.241460	373,009	420,658	0.886728	373,009	(1.0000000 - 0.886728)	0.1132720		420,658	47,649
2000	4,889	1.253970	6,131	6,845	0.895663	6,131	(1.0000000 - 0.895663)	0.1043366		6,845	714
2002	79,929	2.129707	170,225	111,904	1.521169	170,225	(1.0000000 - 1.521169)	(0.5211693)		111,904	(58,321)
2003	1,067,611	1.350514	1,441,824	1,494,705	0.964621	1,441,824	(1.0000000 - 0.964621)	0.0353788		1,494,705	52,881
2004*	2,399,454	1.373151	3,294,813	3,359,346	0.980790	3,294,813	(1.0000000 - 0.980790)	0.0192101		3,359,346	64,533
										2	
Total Base Dollars	7,430,737			10,403,375						10,403,375	3,101,599
				After Rebasing							
Total LIFO Valuation			7,301,776			7,301,776					
						No Change					
Actual Cost - Merger Date			10,403,375			10,403,375					
LIFO Reserve - Merger Date			3,101,599			3,101,599					3,101,599

THE REBASING FACTOR AS OF THE MERGER DATE AFTER ADJUSTING FOR DIFFERENT LIFO STARTING DATES AND DISAPPEARING OR "LOST" BASE DOLLARS WAS DETERMINED BY DIVIDING THE TOTAL INVENTORIES AT ACTUAL COST (\$10,403,375) BY THE COMBINED NET REDETERMINED BASE DOLLARS (\$7,430,737) ... EQUALS THE COMPUTED REBASING FACTOR FOR POOL #1 OF 1.400046

IN 1992, BOTH DEALERSHIPS (XYZ & ABC) ELECTED TO CHANGE TO USE THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES. AT THAT TIME, THE LIFO POOL INDEXES WERE REBASED TO 1.000 AS OF JANUARY 1, 1992 IN ACCORDANCE WITH THE REQUIREMENTS OF REV. PROC. 92-79.

REG. SEC. 1.472-4(p)(2)(iv) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR. THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE AS AN INCREMENT IN 1983, THE PREVIOUS YEAR.

* Increment for 4/30/2005 is treated as an increment for the Year 2004.



XYZ
POOL #2 - NEW L/D TRUCKS
COMPUTATION SHOWING REBASING OF ALL POST-MERGER ADJUSTED LIFO INDEXES TO 1.0000
AS OF MERGER DATE

Schedule 12

Year	BEFORE REBASING TO 1.0000 (COMBINED) POOL #2 - L/D TRUCKS			AFTER REBASING TO 1.0000 (COMBINED) POOL #2 - L/D TRUCKS			COMPOSITION & PROOF OF LIFO RESERVE POOL #2 - L/D TRUCKS AFTER ALL ADJUSTMENTS INCLUDING REBASING INDEXES TO 1.0000				
	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Valuation Factor	LIFO Valuation	Factor			Base	LIFO Reserve
							(A)	(B)	(C) = (A-B)	Dollars	(C) x Base \$
1/1/1974 Base	1,817,512	0.283900	515,992	3,137,060	0.164483	515,992	(1.0000000 - 0.164483)	0.8355175		3,137,060	2,621,069
1974	200,396	0.326480	65,425	345,887	0.189152	65,425	(1.0000000 - 0.189152)	0.8108480		345,887	280,462
1976	6,100	0.364430	2,223	10,529	0.211139	2,223	(1.0000000 - 0.211139)	0.7888610		10,529	8,306
1983	150,222	1.529746	229,802	259,286	0.886286	229,802	(1.0000000 - 0.886286)	0.1137143		259,286	29,485
1984	36,123	1.722901	62,236	62,349	0.998194	62,236	(1.0000000 - 0.998194)	0.0018065		62,349	113
1985	28,372	1.744493	49,495	48,971	1.010703	49,495	(1.0000000 - 1.010703)	(0.0107032)		48,971	(524)
1987	50,933	1.826563	93,032	87,911	1.058252	93,032	(1.0000000 - 1.058252)	(0.0582520)		87,911	(5,121)
1988	13,452	1.851836	24,911	23,218	1.072894	24,911	(1.0000000 - 1.072894)	(0.0728943)		23,218	(1,692)
1990	39,217	2.056363	80,644	67,689	1.191391	80,644	(1.0000000 - 1.191391)	(0.1913907)		67,689	(12,955)
1995	236,347	2.528173	597,526	407,939	1.464742	597,526	(1.0000000 - 1.464742)	(0.4647423)		407,939	(189,587)
1996	110,741	2.589983	286,817	191,141	1.500553	286,817	(1.0000000 - 1.500553)	(0.5005530)		191,141	(95,676)
1997	152,907	2.653669	405,765	263,920	1.537451	405,765	(1.0000000 - 1.537451)	(0.5374506)		263,920	(141,844)
1999	1,695,650	1.226570	2,079,833	2,926,724	0.710635	2,079,833	(1.0000000 - 0.710635)	0.2893647		2,926,724	846,891
2001	335,664	1.274230	427,713	579,362	0.738248	427,713	(1.0000000 - 0.738248)	0.2617520		579,362	151,649
2002	379,389	2.025297	768,375	654,833	1.173392	768,375	(1.0000000 - 1.173392)	(0.1733921)		654,833	(113,543)
2003	317,077	2.956490	937,435	547,281	1.712895	937,435	(1.0000000 - 1.712895)	(0.7128954)		547,281	(390,154)
2004*	33,593	3.045153	102,296	57,982	1.764264	102,296	(1.0000000 - 1.764264)	(0.7642639)		57,982	(44,314)
										(2)	
Total Base Dollars	5,603,695			9,672,082						9,672,082	2,942,561
				After Rebasing							
Total LIFO Valuation			6,729,521			6,729,521					
						No Change					
Actual Cost - Merger Date			9,672,082			9,672,082					
LIFO Reserve - Merger Date			2,942,561			2,942,561					2,942,561

THE REBASING FACTOR AS OF THE MERGER DATE AFTER ADJUSTING FOR DIFFERENT LIFO STARTING DATES AND DISAPPEARING OR "LOST" BASE DOLLARS WAS DETERMINED BY DIVIDING THE TOTAL INVENTORIES AT ACTUAL COST (\$9,672,082) BY THE COMBINED NET REDETERMINED BASE DOLLARS (\$5,603,695) ... EQUALS THE COMPUTED REBASING FACTOR FOR POOL #2 OF 1.726019.

IN 1992, BOTH DEALERSHIPS (XYZ & ABC) ELECTED TO CHANGE TO USE THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES.

AT THAT TIME, THE LIFO POOL INDEXES WERE REBASED TO 1.000 AS OF JANUARY 1, 1992 IN ACCORDANCE WITH THE REQUIREMENTS OF REV. PROC. 92-79.

REG. SEC. 1.472-8(g)(2)(iv) TREATS THE BASE INVENTORY OF THE ENTITY WITH THE LATER LIFO ELECTION IN THE COMBINATION AS AN INCREMENT INCURRED IN THE PREVIOUS YEAR. THEREFORE, ALTHOUGH THE LIFO ELECTION MADE BY ABC WAS EFFECTIVE JANUARY 1, 1984, THE AMOUNT OF THAT BASE INVENTORY IS REFLECTED IN THE CONSOLIDATING SCHEDULE AS AN INCREMENT IN 1983, THE PREVIOUS YEAR.

* Increment for 4/30/2005 is treated as an increment for the Year 2004.

Selected Comments	<p style="text-align: center;"><i>30 Years Later ...</i></p> <p style="text-align: center;"><i>Confessions of a LIFO Link-Chain Enthusiast</i></p>
General	<ul style="list-style-type: none"> • "How LIFO Works" was written over 30 years ago, so it is obviously dated in some respects. • Pretend like these comments are the equivalent of a voice-over on a current DVD for which the intent is not to intrude on the content, but rather to offer some additional perspective.
<p style="text-align: center;"><i>Introduction</i></p> <p style="text-align: center;"><i>(Page 2 of 7)</i></p>	<ul style="list-style-type: none"> • Early on, I was aware that there was a definite combination of LIFO sub-methodologies that would produce the best result for an auto dealer. This combination involved the methodology used by many of the real-world CPAs (at least in the Big 8 firms) ... and that was the Link-Chain, Index Method. Ironically, this methodology was not (and still is not) even mentioned in the Regulations. • "A taxpayer adopting LIFO computes a 'personalized' index or estimated measure of the effect of inflation on his own ending inventory." <ul style="list-style-type: none"> • Here, I put my finger on a real sore spot with the IRS and many other perfectionists by recognizing that the nature of any LIFO computations would inherently result in an <i>estimated</i> - rather than an exact - computation. • In listing various factors affecting the complexity of the calculations, I observed that the presence of certain price relationships could, would or should suggest "short-cuts to reduce clerical work without materially changing the end result." This was the basis for not computing separate inflation indexes for options and accessories, but rather, attributing to them the index computed for the base vehicle. This is where some LIFO critics, always seeking exactitude, had a field day.
<p style="text-align: center;"><i>Pooling & Valuing Increments</i></p> <p style="text-align: center;"><i>(Page 3 of 7)</i></p>	<ul style="list-style-type: none"> • From the very beginning, I always advocated ... and used ... a single, broad pool for all new vehicles. <ul style="list-style-type: none"> • This position was successfully defended in countless IRS audits, notwithstanding <i>Fox Chevrolet</i> which came along later and in which the Tax Court was (in my opinion) wrong. • Continuing an aggressive posture, where permitted within the "computational context," in most dealer LIFO applications, I/we employed the so-called dual-index or earliest acquisitions approach for valuing increments. <ul style="list-style-type: none"> • I still remember the enormous increases in LIFO reserves that this method produced on top of the already-generous inflation-created results. • So generous were these increases, that when the IRS eventually figured out what was going on, it prohibited the use of dual indexes in the Alternative LIFO Method for New Vehicles.
<p style="text-align: center;"><i>Detailed Analyses</i></p> <p style="text-align: center;"><i>(Page 4 of 7)</i></p>	<ul style="list-style-type: none"> • Remember, all my LIFO computations in the early years were done by hand. • While I was not at all inhibited in being aggressive in computational areas (as evidenced by my positions on pooling and dual-index increment valuations), I wanted my calculations to reflect reasonable estimates and efforts on my part. <ul style="list-style-type: none"> • For example, in the listing of workpapers, note the "schedule showing by model an estimate of the adjustments necessary to reflect the costs attributable to options ... that became standard. On other models, some options or equipment that were standard ... became optional. <i>An estimate of the cost attributable to these changes should be posted to this workpaper.</i>" • While I really was a glutton for punishment, on many occasions, pulling out this workpaper seemed to convince an IRS agent that I really had tried to not leave out factors that could influence the inflation index being computed.
<p style="text-align: center;"><i>Link-Chain Technique</i></p> <p style="text-align: center;"><i>(Page 6 of 7)</i></p>	<ul style="list-style-type: none"> • In this section, I tried to present the best arguments or justification I could make for the need to use a link-chain methodology, rather than the Double-Extension Method seemingly preferred by the Regulations. <ul style="list-style-type: none"> • At times, the theoretical debates over the use of this method were enormous and often, flat-out rejected by the IRS • Note in the article, the observation that "The income tax regulations impose a very important extra filing requirement on taxpayers who elect to apply the link-chain method." <ul style="list-style-type: none"> • In all LIFO applications where the Link-Chain, Index Method was used, whether for auto dealers or in other situations, in all the years, we've always made this extra filing, fearful that failing to make this filing might be the basis for the IRS terminating the LIFO election.
<p style="text-align: center;"><i>LIFO Conformity Warning</i></p> <p style="text-align: center;"><i>(Page 7 of 7)</i></p>	<ul style="list-style-type: none"> • Note the clear warning, given over 30 years ago about the need to reflect LIFO on financial statements sent "to the Factory for credit purposes." <ul style="list-style-type: none"> • It took the IRS over 20 years to get around to making a mountain out of this mole hill. In the meantime, the IRS destroyed countless dealer LIFO elections because the dealer CPAs were ignorant of this requirement.
Visionary ... ?	<ul style="list-style-type: none"> • Note the many similarities between the methodology I suggested for auto dealer LIFO 30 years ago and the "safe harbor" - Alternative LIFO Method for New Vehicles that the IRS permitted in 1992, some 17 years later. It's been a long and interesting 30-year experience.



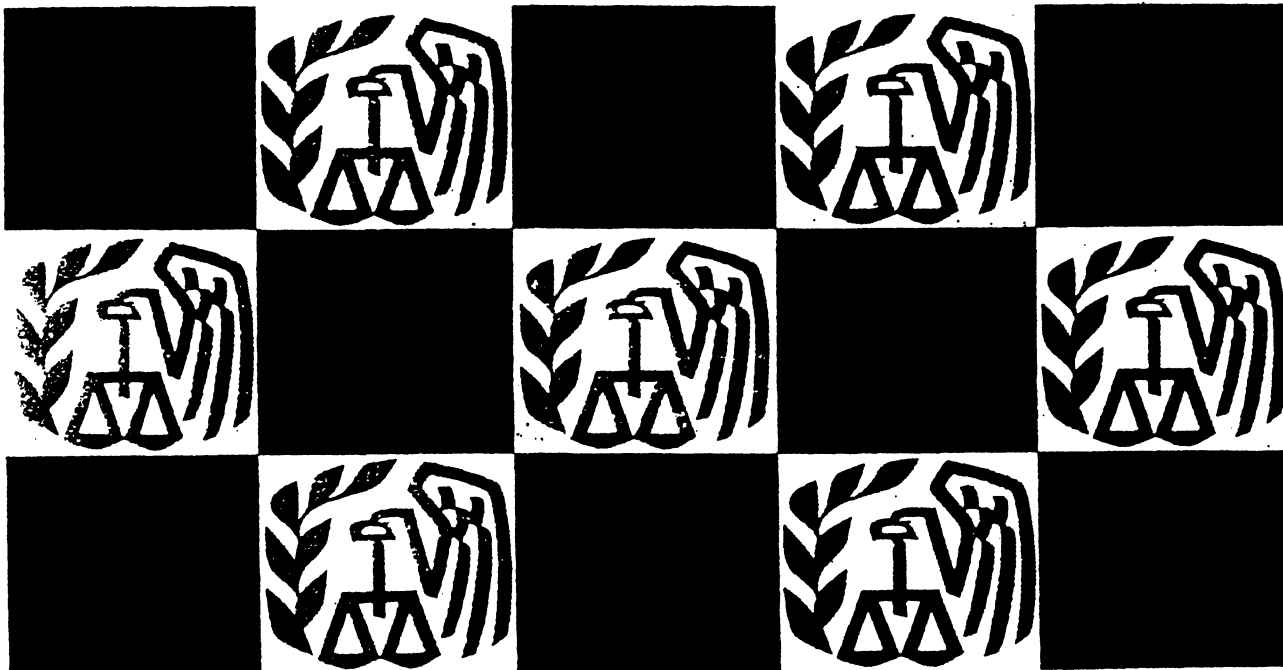
How LIFO Works

By Willard J. De Filippis
Partner, Wolf and Co.

The "last in, first out" inventory costing practice is one of the hottest issues on the business scene today. This two-part series should help the dealer decide whether LIFO will work for his business and, if so, how to best utilize it.

The following article is a practical survey of how the last in, first out method of inventory costing can be applied to the franchised new car or truck dealership. It was written by Willard J. De Filippis who is a partner in the Chicago office of Wolf and Co., Certified Public Accountants, a distinguished firm with considerable experience in the dealership field. Mr. De Filippis' article is a product of his sound theoretical knowledge of LIFO and his years of practical experience in the audit of dealerships. Next month, two partners of a firm of similar distinction and experience in the automotive field, A.M. Pullen & Co., will discuss the pros and cons of making the LIFO election.

MANY GENERAL discussions on the subject of LIFO can be found in intermediate textbooks and current financial literature. However, little is available on how an automobile dealer can convert to LIFO. This may be due to the relatively recent emergence of the severe conditions now focusing attention on LIFO in situations where previously it was ignored. Perhaps another reason is that a LIFO conversion requires choices among numerous alternatives and sub-elections, and the appropriate



(page 1 of 7 of article)



choices vary from case to case. This tends to invalidate any one approach as a "uniform" or "standardized" method applicable to all dealerships.

In considering the computational aspects of LIFO for automobile dealers, there seems to be a definite combination of choices which generally are more favorable for the dealer, regardless of the type of dealership. This article discusses these choices, and explains one approach for actually "putting a pencil to it." Although any category of an automotive inventory is adaptable to LIFO, this article discusses only the LIFO conversion of new cars, demonstrators, and light trucks carried by automobile dealers.

The application of LIFO to heavy truck and/or implement inventories would probably deviate somewhat from the basic approach suggested herein. This might happen because there may be a relatively smaller number of units in inventory. Also, there may be more significant variations between the percentage of total cost consisting of chassis costs and of attachment costs, combined with differing price increase rates.

A dealer's LIFO computations should satisfy three essential conditions. They should be *practical*, they should *prolong* the LIFO benefits as much as possible, and they should *promote* IRS acceptance by being logical and realistic. This will be discussed more fully after some background comment.

A dealer must first decide whether or not to adopt LIFO. Once made, this decision cannot be revoked without considerable complication. And there is relatively little time in which to decide. As discussed in many other articles, there are many advantages, disadvantages, and considerations which make the initial decision difficult. This article assumes a decision to convert, and discusses the application of LIFO to new car, demonstrator, and small truck inventories. The challenge at hand—for the dealer and his accountant—is to somehow, somehow evaluate or estimate the effect of inflation on that inventory.

LIFO stands for "last in-first out." It is permitted by Section 472 of the tax law, and it is an accountant's short-hand way of describing an assumption used in calculating inventory values that treats the flow of cost as if the last goods purchased were the first ones sold. This assumption can be used for tax purposes even though it is possible to trace and identify the purchase of the actual goods in the ending inventory.

When prices rise, as they did at unprecedented rates during 1974, the LIFO inventory method produces lower income taxes by including the effect of inflation to some degree as an expense in the cost of goods sold. A taxpayer adopting LIFO computes a "personalized" index or estimated measure of

the effect of inflation on his own ending inventory.

This is done by valuing his actual ending inventory in at least two ways, and comparing the results. It takes two of anything to make a comparison. Similarly, the ending inventory has to be valued at least twice to "compare" or estimate inflation's impact.

For LIFO purposes, the ending inventory must be valued at "base" prices and at "current" prices. Although there are many ways to make such a determination, the income tax regulations offer limited guidance on how to approach this task. The regulations do not contain specific procedural guidance for automobile dealers. Instead, they provide that LIFO computations are subject to review and approval by the Internal Revenue Service, and that the computations must "clearly reflect income"—whatever that means.

Against this background, the prerequisites for LIFO calculations center around practicality, preservation or prolongation of LIFO advantages, and prevention of IRS reversal upon audit. The consequences of decisions and sub-elections to be made in the course of working through a LIFO application must be synchronized with the nature of the automobile dealer's inventory and his business. In other words, they must be practical.

The combination of these methods should shortcut the overall clerical processes as much as possible. In addition, they should have the likelihood of preserving in succeeding years, as much as possible, the advantages initially sought by the adoption of LIFO. Everyone knows that LIFO is attractive when prices are rising. But if inventory levels are not maintained, or if price levels fall in future years, LIFO will report higher taxable income in those years and reduce some of the benefits initially secured. It is possible to minimize this reduction in future years by initially selecting the alternatives expected to boomerang least.

Under the combination of procedures suggested herein, the LIFO deferral is practical because it does not terminate each year with the introduction of new models. Under the dollar-value method, one pool would be established for all models and all model-year units. This pool combines all new cars, demonstrators, and light (smaller) trucks. Thus, 1974 and 1975 new car models all go into the same pool, and the introduction of 1975 models does not result in the recapture of the reserve established in connection with 1974 models, provided they have been replaced with 1975 models.

If the December 31, 1974, ending inventory consists of only 1975 models, it is still possible to establish a reserve for calendar year 1974 even though the inventory at January 1, 1974, consisted

of 1973 and 1974 models. As will be seen, this is done by repricing the 1975 models at the prices of comparable models on hand at the beginning of the year (i.e., at January 1, 1974).

Assuming stable or slightly increasing future inventory quantities and prices, the LIFO deferral for 1974 would carry over indefinitely from year to year. The LIFO deferral might even grow in future years if inventory quantities remained about the same and prices continued to rise. If prices declined, the initial deferral would be reduced, but this would not be detrimental overall unless the prices declined below those in effect at January 1, 1974.

The careful combination of pooling and dollar-value techniques results in better chances of preserving the LIFO benefit, despite changes in model mix in future years. Over the lifetime of the business, the same aggregate income will be reported regardless of whether the dealer uses LIFO, FIFO, or specific identification methods.

Needless to say, the preservation of documentation to support each step through the LIFO computations is mandatory. The logic, realism, and completeness of the steps and computations should withstand reversal upon eventual examination by the Internal Revenue Service.

In any given dealership, the extent of the LIFO computations will vary depending on many factors, including:

1. The adequacy and availability of dealership cost records, invoice files, and factory price information;
2. The model mix;
3. The presence of certain price relationships suggesting shortcuts to reduce clerical work without materially changing the end result;
4. The willingness of the dealer to do a little more "homework" now, and to assemble and retain the supporting data which the Internal Revenue Service may eventually request and audit;
5. Whether the computations will be done manually or computerized for greater detail; and,
6. Whether the CPA is to render an opinion on the financial statements or merely "adjust the books and prepare a tax return."

This article contains the following discussions:

1. Suggestions for Sub-Elections;
2. The Dollar-Value Method of Applying LIFO;
3. Inventory Pools: A Single Broad Pool for All New Vehicles and Demonstrators;
4. Computing the LIFO Inflation Index: Steps Common to Automotive LIFO Conversions;
5. Valuing the Ending Inventory at "Current" Costs;
6. Link-Chain is the LIFO Valuation Technique Best Suited for Dealers;
7. Making the LIFO Election; and,

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8. Related Tax Forms and Cash Flow Improvement from the LIFO Election.

Sub-Elections. There are several sub-elections and decisions to be made in a LIFO conversion. The major ones are summarized below.

As to these sub-elections, it is suggested that:

1. A dealer should elect to use the dollar-value method for pricing LIFO inventories;

2. A dealer should elect LIFO only for certain parts of his inventory, not for the inventory as a whole. Although other separate LIFO pools might be considered for parts and accessories, and for used vehicles, a discussion of these is beyond the scope of this article;

3. New vehicles and demonstrators should be combined into a single broad pool. When a dealer also sells small trucks (for example, a Ford dealer selling Rancheros and Broncos), these should also be included in the single pool to maximize results. There should be no sub-pools within the single broad pool suggested above. To simplify and better organize the underlying computations, it would be logical to list and/or summarize the beginning and ending inventories by make and model. These work-paper groupings for underlying computational purposes are not, by themselves, indicative of sub-pools—they merely better assist in keeping track of the inventory changes and model mix;

4. A dealer should elect to use the link-chain index method for computing the LIFO value of his dollar-value pool for new vehicles and demonstrators. This method is *not* the one preferred by the regulations, and a separate informational filing requirement is imposed upon taxpayers adopting any link-chain and/or index method; and,

5. For purposes of valuing the ending inventory at "current cost" to determine the numerator in the current year's price index, the field of realistic alternatives narrows down to two. Consequently, current cost should be determined either by (a) using the earliest purchases method or (b) by specific identification of the actual ending inventory invoices which should approximate the "most recent purchases" method. The selection of the preferable alternative depends on many factors (see above), and no general recommendation can be made.

Dollar-Value Method. The LIFO cost method may be applied in either of two basic ways: (a) the unit (specific goods) method or (b) the dollar-value method. The latter is suggested because it treats the inventory as representing an investment of dollars rather than an aggregate of individual items.

The dollar-value method uses "base year" costs expressed in terms of total dollars invested in the inventory as its unit of measurement. This unit of meas-

urement is applied to groupings, or categories, of inventory referred to as "pools." The term "base year cost" is the aggregate of the cost of all items in a pool determined as of the beginning of the year when the LIFO method is first adopted. The taxable year in which LIFO is first adopted is the "base year." The inventory at the beginning of that first year is the "base inventory."

An increment in a dollar-value LIFO pool occurs when the year-end inventory for the pool, expressed in terms of base year cost, exceeds the beginning of the year inventory for that pool, also expressed in base year cost. To determine the ending inventory LIFO value for a pool, any increment is adjusted for changing unit costs by reference to a percentage, relative to base year cost, determined for the pool as a whole.

Liquidations and increments of specific items contained within the pool are ignored; what counts is whether there is a net liquidation or increment for the pool as a whole. Thus, fluctuations may occur in quantities of various items within the pool. New items which properly fall within the pool may be added (i.e., 1975 models), and old items may disappear from the pool (i.e., 1973 and 1974 models) without necessarily changing the dollar value of the pool as a whole.

The dollar-value method is therefore preferable to the unit or specific goods method since it permits the partial or complete liquidation of one type of item in the pool (1974 models) to be offset by an increase in investment in another type (1975 models). It also copes with the situation presented when certain models are not continued in succeeding years (for example, Ford dropped its 1974 model Custom 500s and Galaxie 500s) or when "new" 1975 models are introduced (Ford, again, introducing Elites and Granadas).

Inventory Pools. As mentioned above, under the dollar-value method, goods contained in the inventory for which LIFO is elected are grouped into a pool or pools. The categorization or "pooling" is very important because the dollar-value calculations applied to a pool as a whole are separately applied to each pool. The more pools there are, the greater the likelihood that even though the dollar amount of inventory investment might remain constant, some items within the inventory will be completely liquidated from some pools while different and new items are added to other pools.

The regulations state that retailers shall place their inventory into pools by major lines, types, or classes of goods. In determining such groupings, the retailer's customary business classifications are an important consideration. The regulations cite the department in the department store as an example of customary business classification. In



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such cases, practices are relatively uniform throughout the trade, and departmental grouping is peculiarly adapted to the customs and needs of the business.

The Internal Revenue Service has issued pronouncements applicable only to retail department stores and certain specialty stores that price their inventories using the "retail" method. No detailed pronouncements have been issued for other types of retailers.

Consequently, taxpayers usually want to use as few inventory pools as possible where the primary purpose of LIFO is to minimize income tax. A single broad pool for all new vehicles and demonstrators is suggested. The inclusion of demonstrators in this pool seems logical, but there is no formal indication by the IRS that demonstrators must be included in the pool.

As far as pooling is concerned, the options and accessories included on any automobile should not have to be given any special treatment. Options and accessories certainly do make a difference in physical appearance and comfort in driving a car. However, the general requirement in the regulations is that pools be set up to represent "customary business classifications of the particular trade in which the taxpayer is engaged."

Since dealers do not separately report or account for options or accessories sold as part of new cars and demonstrators, this seems to support ignoring the net difference that the cost of options actually makes in the car for pooling purposes. Options usually account for between 10 and 20 percent of a new car's price, and recent price bulletins list dozens of options available on 1975 models.

This multiplicity suggests that as a matter of expediency, the options can be lumped in with vehicles without any significant distortion. Also, the Price and Profit Margin Regulations issued under the Economic Stabilization Program would support the general appropriateness of pooling all new vehicles and demonstrators without further regard for model and/or option differences.

For automobile dealers, a major question is whether this pooling arrangement will eventually be acceptable to the Internal Revenue Service or possibly upheld in court. If each model-year or model were treated as a separate pool, there would be a continuous series of partial or complete liquidations of multiple model-year pools while the total inventory at base year cost might remain relatively constant. However, as each model or model-year pool were liquidated, the removal of lower cost from inventory would result in increased taxable income.

Consequently, the use of a single broad pool for new vehicles and demonstrators is important to the long-range prolongation of benefits from a LIFO

election. We believe this to be a practical arrangement, consistent with the concept of considering the inventory as representing an investment of dollars. We understand that, in certain areas, the Internal Revenue Service has accepted upon audit the concept of a single pool for new cars and demonstrators. Should the Internal Revenue Service formally rule that separate pools by model-years, by models, or other categories were required, this formal ruling would be a matter of interest to all dealers.

Computing The LIFO Index. If the computations are to be done manually, it is suggested that a listing first be prepared from the factory model introduction price lists showing all of the possible model variations. Two-door models should be listed separately from four-door models. If this listing is overlaid on columnar workpaper and photocopied several times, this will eliminate the need to recopy the same information onto several other schedules and thereby standardize the format of the workpapers.

Working upon this standardized listing or format, the following should be prepared:

1. A detailed analysis of all units in each model category in the beginning inventory—in quantities and in dollars;

2. A detailed analysis of all units in each model category in the ending inventory—in quantities and in dollars;

3. A schedule showing the base vehicle prices at which the models were purchased during the year. Although the introductory prices for 1974 and for 1975 models are probably most significant, other interim price increase information may also be posted to provide a more complete analysis of price changes; and,

4. A schedule showing by model an estimate of the adjustments necessary to reflect the costs attributable to options on 1974 models that became standard equipment on 1975 models. On other models (for example, certain Buick models) some options or equipment that were standard on 1974 models became optional on 1975 models. An estimate of the cost attributable to these changes should be posted to this workpaper, so that the net change can be added to the beginning of the year cost determined for each model. The presence of catalytic converters, high-energy ignition systems, steel-belted radial tires, and other changes on 1975 models should be quantified or approximated so that comparing the price of a 1975 model will be meaningful when compared to the "adjusted" price of the same 1974 model. Hopefully, these adjustments can be determined from factory price lists for options and accessories, delete option data and other information provided by the factory, or from knowledgeable people in the dealership or in the factory.

It is advisable to separately save one copy of the factory invoice underlying each unit in the beginning and in the ending inventory. These invoices will show the prices paid for the units in inventory; the respective option mixes and the costs of the options; changes in transportation charges; and, other relevant data.

The detailed analysis of the beginning inventory will indicate the dollars affected by changes in the model mix when compared with a similar analysis of the ending inventory. Also, this beginning inventory analysis will help *where or if* a weighted average base period (beginning of the year) price will be used.

In the process of reviewing and comparing the model mix in the beginning and ending inventory analyses, decisions and assumptions will have to be made to deal with the changes between the 1974 and the 1975 model line offerings. Here, using "body type" information may provide a reliable continuity. The Internal Revenue Service will have to be satisfied as to the propriety of these assumptions upon audit.

The dollar-value method allows the taxpayer to compute the LIFO value of the current year's physical increase or decrease in the inventory investment in terms of base date (i.e., constant purchasing power) dollars. Therefore, the next step is to compute the change, by valuing the year-end inventory twice: once at base cost and a second time at current cost. There are several alternative ways of computing the current year cost valuation of the ending inventory, as will be discussed later in the next section. However, for the time being it will be assumed that the current year "cost" is determined from the actual invoices for the units making up the ending inventory.

This double valuation or "double-extension" process to compute the price increase ratio is necessary in order:

1. To determine the ratio of total current year costs to total base period cost;

2. To determine the physical increase in the current year's inventory in terms of dollars of constant purchasing power (i.e., base period cost); and,

3. To value the current year's inventory layer—the physical increase or decrease—by multiplying the change computed in terms of base period cost by the ratio of total current year cost to total base year cost.

After the ending inventory has been extended at current and at base costs, the current year price index or ratio is determined by dividing the "current" valuation by the "base" valuation. This ratio or index can then be applied to the total dollars in the ending inventory pool in order to restate the ending inventory at base date cost.

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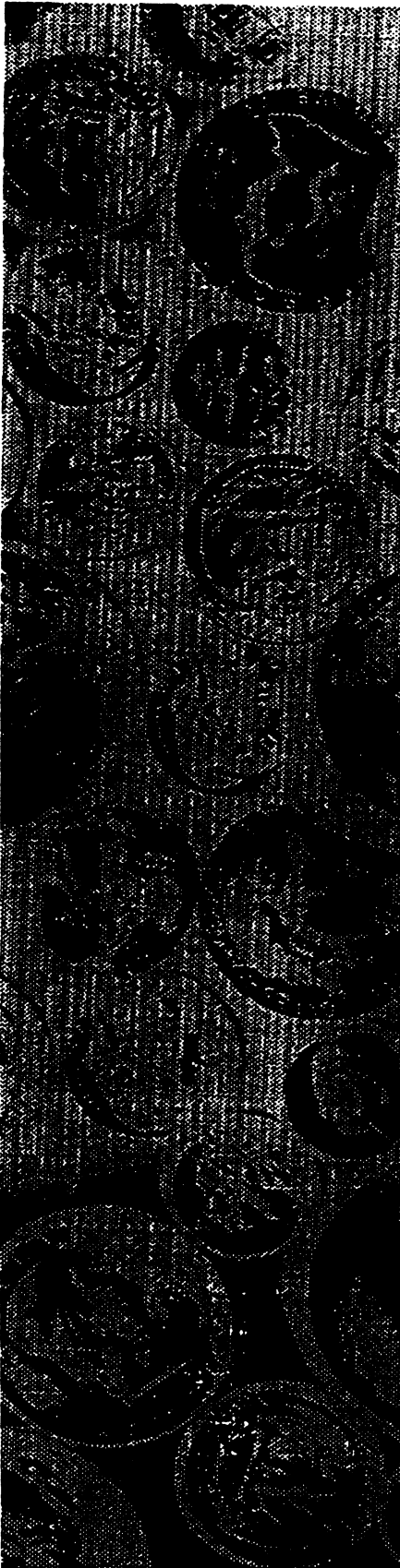
Under this procedure, the index has been developed by reference only to the change in base vehicle costs. The total dollars reflected in the ending inventory pool consists not only of that cost component, but also of the dollars attributable to the options and accessories on the vehicles and to destination and preparation charges. If the overall index developed by double-extending all of the base vehicle prices is then applied to the total dollars in inventory, this implies a similar rate increase for option prices and transportation charges.

Either of these assumptions can be independently tested by using the actual price list for options and accessories and other factory information. This can be an alternative to double-extending some or all of the (significantly large) optional equipment items.

The above approach represents in essence an "index" approach because each unit in inventory has been evaluated through its base vehicle cost component, rather than more perfectly through a repricing of all of the possible options and accessories as well. Hence, this approach of working principally with the base vehicle costs accounts for substantially all of the dollars tied up in the new vehicle pool without actually testing in detail every possible option and accessory on the units in ending inventory. With a computer programmed with the appropriate price lists, a complete repricing of all options, as well as base vehicle prices, would be possible.

The steps after determining the index are as follows: By dividing the end of the year inventory by the current year index or ratio, the end of the year inventory priced at base date cost is determined. This lower amount when compared with the beginning of the year inventory shows whether there has been an increase or decrease during the current year in terms of base date inventory dollars. As stated earlier, an increase or increment in the dollar value LIFO pool occurs when the end of the year inventory expressed in terms of base year cost exceeds the beginning of the year inventory expressed at base period cost.

To determine the inventory value for LIFO purposes of that pool, the current year increment is adjusted by multiplying the actual increase by the current year index or ratio. For example, if the increment were computed to be \$100,000 and the current year index were 125 percent, the increment would be valued for LIFO purposes at \$125,000. This valuation of the current year's increment, when added to the base inventory (i.e., the beginning of the year inventory), would result in the LIFO valuation of the ending inventory. The LIFO "reserve" would be the difference between this LIFO valuation and the valuation if LIFO had not been adopted (i.e., by specifically identifying and to-



talling all of the invoices underlying the units in ending inventory).

Valuing The Ending Inventory. As indicated above, in calculating the LIFO inflation index there is yet another subelection to be made. This has to do with the calculation of the numerator of the index or ratio fraction. However, the regulations provide that the current year cost of items making up a pool may be determined under one of four methods. These methods are:

1. By reference to the actual cost of the goods purchased during the taxable year in order of acquisition (earliest purchases method);

2. By reference to the actual cost of goods most recently purchased (most recent purchases method);

3. By application of an average unit cost; or,

4. Pursuant to any other proper method which, in the opinion of the Commissioner of the Internal Revenue Service, clearly reflects income.

The use of the earliest purchase method is most consistent with the overall LIFO concept. For automobile dealers reporting a calendar year basis, this would probably avoid the new model introduction price increases and produce a lower increment and valuation of that current year increment than would be determined under the other methods.

There may be situations where the alternative of determining current cost on a LIFO basis—that is, using the earliest purchases or order of acquisition method would provide greater tax benefits. This would be the case where it is anticipated that the inventory will increase over a period of years. In many situations, the earliest purchase method may be preferable because it maximizes the LIFO reserve in the year of adoption.

However, in other situations it may be preferable (where a dealer may not necessarily want to show the largest possible LIFO reserve) or necessary (because of inadequate records or time pressures) to select a method using the actual invoices underlying the ending inventory units to determine the "current cost" of the ending inventory. This would be very similar but not necessarily exactly the same as the most recent purchases method.

Although this would be theoretically inconsistent with the LIFO concept, this approach does tie the development of the index back to the actual ending inventory cost records on a specific identification basis. Also, it involves less clerical work since the information is readily available and avoids the "third" extension of the inventory otherwise necessary under the earliest purchases method. However, the additional work involved in the "third" extension might well be worth the effort if it results in a much larger LIFO reserve.

This choice has to be evaluated



separately in each specific situation. It is not possible to determine which alternative for computing current cost would be preferable in the majority of cases.

Link-Chain Technique. Still another sub-election to be made involves selecting the method to be used in computing the LIFO value of the dollar-value pool. Again, there are several ways to make this computation. However, the choice usually narrows down to using either (a) the method preferred by the tax regulations and referred to therein as the "double-extension" method or (b) using the "link-chain" method. Either method produces the same results in the first year LIFO is adopted. However, after the first year, the procedures are different for treating new items coming into inventory. For the reasons indicated below, the link-chain method is suggested for dealers because it is better suited for dealing with the continuing technological changes evident in new car models every year and expected in the future.

Whenever a new item that was not in the initial LIFO year inventory enters the pool in a subsequent year, its price as of the base date must be either determined or reconstructed in order to develop the current year's price index or ratio. Under the "double-extension method" preferred by the regulations, new items usually are repriced or price reconstructed as of the first day of the composition of the pools used, the 1, 1974, for calendar taxpayers adopting LIFO in 1974. Over time, this date recedes farther into the past and will probably result in a greater amount of guesswork in future years when it is necessary to reprice subsequent models at equivalent base date (i.e., January 1, 1974) cost.

On the other hand, under the link-chain method, the base date reference point for costing new items in a pool in subsequent years would not be January 1, 1974. Instead, under the link-chain method, that base date each year would be updated to January 1 of that subsequent year. This automatic updating of the base date reference should be a real advantage in that it would be necessary to identify costs changes over only the span of a single model year.

Thus, for 1974, the base date would be the same under either method—that is, it would be January 1, 1974. However, in calendar 1975, the base date under the "double-extension" method would be January 1, 1974; although under the link-chain method, that base date would become January 1, 1975.

Looking to some future year, for example 1978, it would probably be easier, then, to determine the increase in 1978 by comparing the prices of 1979 models with the prices of 1978 models, rather than by repricing 1979 models at prices developed in 1974 and carried forward and adjusted each year through

model-year 1975, 1976, 1977, and 1978 model changes.

Under the link-chain method, the ending inventory (priced at current costs) is repriced at beginning of the year costs rather than base date costs. The repricing may be accomplished for all items in the inventory or for a representative portion of the items constituting an acceptable sample. The aggregate end-of-year and beginning-of-year costs are compared and a ratio of price level movement from the beginning of the year to the end of the year is calculated. The procedure is repeated each year so that an index of current year price level movement is available for the year of election and subsequent years.

A cumulative index of price level movement for two consecutive years is obtained by multiplying the indices for each of the two years. A cumulative index from the beginning of the year of the LIFO election to the end of every following year can be obtained by multiplying each year's index of current year price level movement by the prior year's cumulative index. The derived cumulative index is then applied to the total ending inventory at current costs to restate the inventory at base-dollar costs and to price the current year's inventory increment.

Despite its obvious practical advantages, the regulations state that the link-chain method will be approved by the IRS only in those cases where the taxpayer can satisfactorily demonstrate that the use of either a direct-index method or the double-extension method would be "impractical or unsuitable in view of the nature of the pool."

Satisfying the Internal Revenue Service on this point may not be easy. However, anticipated technological change will make it almost impossible or at least impractical to determine a base year price for any given make or model many years from now. Economic and environmental pressures on automobile manufacturers are already evident in many ways. Catalytic converters, other emission control and pollution control changes—changes because of safety standards—and fuel conserving changes are but a few.

The construction of the price change link on a year-by-year basis under the link-chain method seems to be a better practical way to deal with the technological changes expected to occur in the future. Thus, the link-chain method seems justified because of anticipated technological changes and because the price pattern of items presently within the inventory pool are similar. Price patterns of items expected to be added to the pool in future years should also be similar.

The income tax regulations impose a very important extra filing requirement on taxpayers who elect to apply the link-chain method. The regulations re-



quire a taxpayer using either an index or the link-chain method to file a complete statement detailing the particular method used in determining the index. This statement must be filed separately with the Commissioner of Internal Revenue, Attention: P:R:Washington 25, D.C. This special requirement is apparently intended to highlight the election of this method for review by the LIFO specialists in the Washington, D.C., National Office.

Making The LIFO Election. In order to elect the LIFO method, it is necessary to file a statement of election as part of the (corporate) income tax return filed for the election year. This statement of election is made on Form 970, and the form is entitled "Application to Use LIFO Inventory Method." Form 970 must be filed in duplicate and signed by the corporation and an officer.

This form and the instructions should be reviewed thoroughly by the dealer and his tax advisor. The form states, and the taxpayer agrees upon executing the form to be bound by the following statement: "The taxpayer hereby agrees to such adjustments incident to the change to (or from) the LIFO method, or to the use of such method in the inventories of prior taxable years or otherwise, as the District Director of Internal Revenue upon examination of the taxpayer's return for the years involved may deem necessary in order to clearly reflect income."

This binds the taxpayer to any adjustments necessary to state his beginning inventory at cost, as well as other adjustments which may be successfully contended by the IRS upon examination.

In connection with filing the Form 970, it is also necessary to submit analyses of the inventory as of the end of the initial year of change and the two preceding years. Thus, for a calendar year taxpayer, inventory analyses would be required for December 31, 1972, 1973, and 1974.

The IRS has the further authority to require the extension of LIFO to inventory categories not initially selected or necessarily desired under the circumstances where the extended application is necessary "in order to more clearly reflect income."

As indicated throughout this article, regulations do not tell an automobile dealer specifically how to apply LIFO to his inventories. Consequently, the initiative lies with the dealer and his tax advisor, subject to eventual review by the Internal Revenue Service. Regulations do state that the number and the composition of the pools used, the appropriateness of such pools; the propriety of all computations incidental to the use of the pools; and, all other aspects relating to the LIFO conversion are subject to examination and must be approved by the Internal Revenue Service. Adequate records must be main-

tained to support all computations.

Once the LIFO election has been approved by the Internal Revenue Service, the numerous computational elections or alternatives selected must be followed in subsequent years unless permission to change is granted by the Commissioner. Consequently, once a taxpayer elects LIFO, he is "locked in" to continue the procedures until he gets permission to change. All of this underscores the need for initial careful consideration of the sub-elections and computational alternatives and the significance of properly completing Form 970.

Tax Forms And Cash Flow. Usually the basic reason for considering LIFO is that it will reduce the dealership's (corporate) taxes for the year of change.

There are a few ramifications that follow from this. First, the corporation may have significantly overpaid its 1974 estimated income tax once the LIFO adjustment is taken into account. Where this occurs, the excess 1974 estimated tax payments are refundable, and the refund process can be speeded up. Where a corporation has overpaid its 1974 estimated tax payments for whatever reason, it should consider filing Form 4466 ("Corporate Application for a Quick Refund of Overpayment of Estimated Tax").

This form must be filed within two and one-half months after the end of the taxable year and before the corporation files its income tax return. For a calendar year dealership corporation, this form must be filed by March 15, 1975. This form can be filed by any corporation that has overpaid its estimated tax if the overpayment is (a) at least 10 percent of the expected tax liability and (b) at least \$500. This form has instructions printed on its reverse side, and it should be filed with the Internal Revenue Service Center where the corporation files its tax return.

In many situations, the election of LIFO may create or increase a net operating loss for 1974. The net operating loss may be carried back to the three preceding taxable years and forward to the five succeeding years. The order of application is that a 1974 operating loss first goes back against 1971 income tax, then forward next to 1972, and then to 1973 before it is carried forward to 1975 through 1979.

Where the dealership has paid corporate taxes in 1971-2-3, Form 1139 can be prepared to speed up the refund of those prior years' corporate tax payments. Form 1139 is entitled "Corporate Application for Tentative Refund from Carryback of Net Operating Loss. . ." This form can be filed within one year after the year in which the net operating loss occurs. In other words, it can be filed anytime before December 31, 1975, by a 1974 calendar year taxpayer. The usual practice is that it is prepared


and filed when the corporate return is filed; however, it should be filed *separately* from the income tax return to expedite processing by the Internal Revenue Service.

Finally, LIFO provides a "breather" in terms of 1975 quarterly estimated tax payments. A corporation may base its 1975 estimated tax payments on the amount of tax shown to be due on its 1974 tax return. Consequently, to the extent LIFO reduces the 1974 tax liability, it correspondingly reduces the amount of quarterly estimated tax payments during 1975 of 1975 expected tax liability.

Conclusion. This article has discussed the major procedural aspects and the importance of carefully selecting alternatives to reflect the adoption of LIFO. Many factors affect the overall decision of whether to adopt LIFO. Some of these factors involve subjective considerations, the impact of which varies according to personalities and anticipated attitudes.

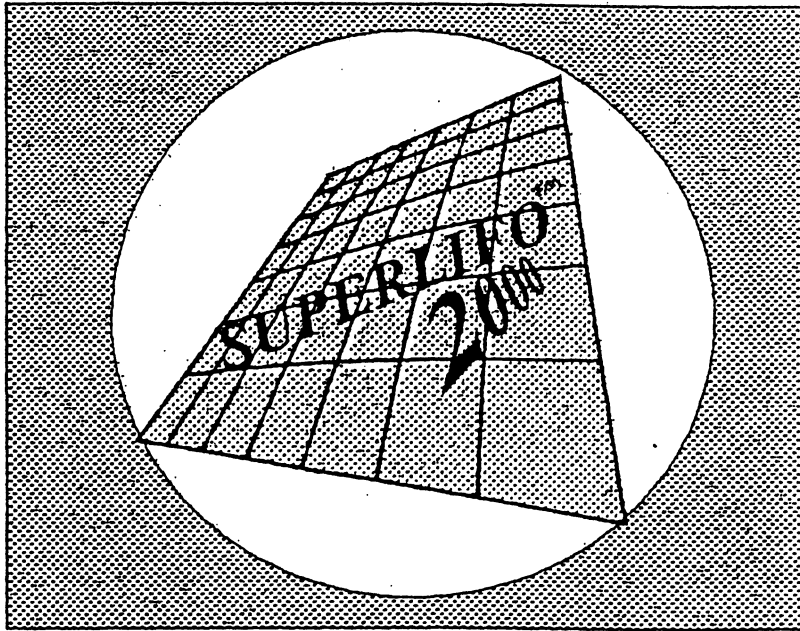
The results of the computations discussed in this article must be considered against the various basic considerations and front-end costs of switching to LIFO. The considerations are summarized briefly below:

1. Amended returns for the year prior to the change are required if inventory write-downs from cost were made;
2. Executive and other bonuses, profit sharing plan contributions, buy-sell agreements, and other contracts may be affected;
3. Complete information concerning inventories has to be submitted to the Internal Revenue Service;
4. Overall exposure before the Internal Revenue Service is increased and not necessarily limited to inventory matters;
5. All reports covering the full taxable year, whether they are annual reports to shareholders, to banks, to the factory for credit purposes, or to any other financing source, must be reported on the LIFO basis. This reporting consistency is a requirement in the tax law;
6. Considerable time and expense may be involved in explaining and justifying the LIFO application to the Internal Revenue Service and to the factory; and,
7. Overall price levels and/or inventory levels may go down, thereby requiring a repayment of some (or all) of the cumulative tax savings.

These and other factors all interrelate with each other to complicate arriving at a decision. For the dealer who has evaluated these with his tax advisor and decided to go ahead with LIFO, LIFO can present a Legitimate Inventory Financial Opportunity. It is hoped this article will help those who have decided to go ahead with LIFO for 1974. 



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