Willard J. De Filipps, CPA, PC

www.defilipps.com

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. THIS ISSUE COMPLETES OUR 15th YEAR ... AND WE THANK YOU FOR YOUR INTEREST & SUPPORT. A quick glance shows that this is Vol. 15, No. 4 of the *LIFO Lookout*. I can't believe how quickly the time has gone by, nor can I express how much I have enjoyed ... and continue to enjoy ... preparing each issue. We thank you for your continued interest and support and look forward to reporting LIFO news and developments in the future.

#2. ARE YOUR DEALERS' LIFO RESERVES GOING TO GET WHACKED? In the last issue, we discussed a number of factors suggesting that dealers needed to be looking ahead to see how they might be impacted by either lower inventory levels or adverse price changes.

We have seen a number of situations where dealers facing significant decreases in their year-end inventory levels will experience virtually no repayment of their LIFO reserves. Why? Because their LIFO layer histories show that in 2004, they built up their inventory levels significantly and the anticipated (lower) inventory levels at the end of 2005 will simply return them to the approximate levels they were at at the end of 2003.

There have been a few instances, however, where dealers who have been on LIFO for many years will have significant repayments because the inventory drop at the end of 2005 will go all the way back to some very old layers which have very high repayment potential ... some as much as 65 to 70 cents on the dollar.

Hopefully, your LIFO layer histories and reconciliations make it easy for you to spot and diagnose these situations very quickly and accurately.

Our database of dealer price information shows very little inflation for most makes this year. Accordingly, LIFO reserves should not be jumping up or down significantly on account of inflation or deflation. (For more, see item #5 below.)

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#3. FORM 970 IS ABOUT TO GET A REAL FACE-LIFT. Form 970 is the form you include in the tax return when the taxpayer is electing LIFO. For longer than most of us can remember, it has been a relatively innocuous-looking 1-page form. It has been changed slightly over the years, but none of these revisions have been major. That's about to change.

The Service has not officially released the new Form 970. The draft dated October 24, 2005 is on pages 2-3, and it is significantly different from its predecessor. The Form expands to 2 pages. It introduces several new developments. And, it appears to reflect a significant policy change by the IRS towards the use of the dual-index method.

It's likely that the new Form will have to be used to make LIFO elections in calendar year 2005 tax returns. When the revised Form becomes "official" and related instructions for the Form are released, we will analyze them fully (most likely in the next / March 2006 issue of the *LIFO Lookout*).

see **LIFO UPDATE**, page 4

Form **970**
(Rev. November 2005)
Department of the Treasury
Internal Revenue Service

Application To Use LIFO Inventory Method

► Attach to your tax return.

OMB No. 1545-0042

Attachment Sequence No. **122**

Name of filer (name of parent corporation if a consolidated group) (see instructions) | **Filer's identification number** (see instructions)

Name of applicant(s) (if different from filer) and identification number(s)

Part I Statement of Election under Section 472

Yes | No

1 The applicant elects to use the LIFO inventory method for the tax year ending (enter month, day, year) ► ____________ for the following goods (enter here): ____________
See instructions and attach a statement if necessary.

2 In an attached statement, identify and describe the inventory method(s) used by the applicant in the prior tax year for the goods covered by this election.

3a Is the applicant already using the LIFO inventory method for any other goods? . . . .

b If "Yes" to line 3a, attach a statement identifying and describing the goods and the LIFO methods used.

4a Has the applicant ever used the LIFO inventory method for the goods covered by this election? . . . . . .

b If "Yes" to line 4a, attach a statement listing the tax years for which the LIFO inventory method was used and explaining why the LIFO inventory method was discontinued.

5 The applicant will not use the LIFO inventory method to account for the following goods (enter here): ► ____________
Attach a statement if necessary.

Part II LIFO Inventory Requirements

Yes | No

6a Did the applicant value the closing inventories of goods covered by this election at cost for the tax year immediately preceding the tax year specified on line 1? . . . .

b If "No" to line 6a, did the applicant value the beginning inventories of goods covered by this election at cost for the tax year specified on line 1 as required by section 472(d)? . . . .
If "No" to line 6b, attach an explanation.

c If "Yes" to line 6b, will the applicant account for the adjustment required by section 472(d) over a 3-year period?
If "No" to line 6c, attach an explanation.

7a When determining the beginning inventories of goods covered by this election, did the applicant treat those goods as being acquired for a unit cost that is equal to the total cost of those goods divided by the total number of units on hand? . . . .

b If "No" to line 7a, attach an explanation.

8a Did the applicant (or any member of the same group of financially related corporations as defined in section 472(g)) issue credit statements or reports to shareholders, partners, other proprietors, or beneficiaries covering the tax year specified on line 1? . . . .

b If "Yes" to line 8a, attach a statement describing the recipient(s), the date(s) of issuance, and the inventory method(s) used to determine income, profit, or loss in those statements.

9a Will the applicant determine beginning and ending inventories at cost regardless of market value? . . . . .

b If "No" to line 9a, attach an explanation.

10a As a condition of adopting the LIFO inventory method, Regulations section 1.472-4 requires a taxpayer to agree to make any adjustments incident to the change to, the change from, or the use of, the LIFO inventory method that, upon the examination of the taxpayer's income tax return, the IRS determines are necessary to clearly reflect income. Does the applicant agree to this condition? . . . .

b If "No" to line 10a, the applicant is not eligible to use the LIFO inventory method.

Part III Specific Goods (Unit) Method

11 Under Regulations section 1.472-1, the types of goods in the opening inventory must be compared with similar types of goods in the closing inventories. Attach a list of the types or categories of goods that will be compared, describe the goods that will be included in each type or category, and identify the unit of measure (pounds, barrels, feet, etc.) used for each type or category.

For Paperwork Reduction Act Notice, see the instructions. Cat. No. 17057T Form **970** (Rev. 11-2005)

Part III Specific Goods (Unit) Method (Continued)

12 Check the box corresponding to the method that the applicant will use to determine the cost of the goods in the closing inventories over the cost of the goods in the opening inventories (see instructions):

☐ Actual cost of goods most recently purchased or produced
☐ Average cost of goods purchased or produced during the tax year
☐ Actual cost of goods purchased or produced in the order of acquisition
☐ Other (attach explanation)

Part IV Dollar-Value Method

13 Attach a statement describing the applicant's method of defining "items."

14a Did the applicant acquire any of the goods covered by this election at below-market prices? . . . . ☐ Yes ☐ No

b If "Yes" to line 14a, attach a statement explaining whether the applicant did, or will, account for the goods purchased at below-market prices and similar goods produced or acquired at market prices as separate items. If the applicant did, or will, account for both types of goods as the same item, explain and justify.

15 Attach a statement describing the method of pooling the applicant will use for the goods covered by this election. If the applicant will use more than one dollar-value pool, list and describe the contents of each dollar-value pool (see instructions).

16 Identify or describe the method the applicant will use to compute the LIFO value of each dollar-value pool containing goods covered by this election (for example, double-extension method, link-chain method, or index method). ______________________

If the applicant's method is neither the double-extension method nor the Inventory Price Index Computation method, attach a statement describing the method in detail and justifying the applicant's use of the selected method (see instructions).

17 Check the box corresponding to the method the applicant will use to determine the current-year cost of goods in the closing inventories and to value the LIFO increments of the dollar-value pool(s) (see instructions).

☐ Actual cost of goods most recently purchased or produced
☐ Average cost of goods purchased or produced during the tax year
☐ Actual cost of goods purchased or produced in the order of acquisition
☐ Other (attach explanation)

Part V Inventory Price Index Computation (IPIC) Method

18 Check the box corresponding to the method the applicant will use to compute the LIFO value of each dollar-value pool containing goods covered by this election (see instructions).

☐ Double-extension IPIC method
☐ Link-chain IPIC method

19 Check the box corresponding to the table from which the applicant will select Bureau of Labor Statistics (BLS) price indexes (see instructions).

☐ Table 3 of the Consumer Price Index (CPI) Detailed Report
☐ Table 6 of the Producer Price Index (PPI) Detailed Report
☐ Other table of the PPI Detailed Report

If the applicant will use "Other table of the PPI Detailed Report," attach a statement explaining why the other table is more appropriate than Table 6.

20 Will the applicant use the 10 percent method (see instructions)? . . . . ☐ Yes ☐ No

21 If the applicant elects to use a representative month for selecting BLS price indexes from the applicable Detailed Report, enter the representative month elected for each dollar-value pool. ______________________
See instructions and attach a statement if necessary.

Part VI Other Information

22 Attach a statement describing the applicant's method of determining the cost of inventory items (for example, standard cost method, actual invoice cost, joint product cost method, or retail inventory method).

23 Did the applicant receive IRS consent to change the method of valuing inventories for the tax year specified on line 1 (see instructions)? . . . . ☐ Yes ☐ No

Form **970** (Rev. 11-2005)

#4. LIFO CONFORMITY: WATCH THOSE YEAR-END FINANCIAL STATEMENTS. Properly electing LIFO by filling out Form 970 is just one of four LIFO eligibility requirements. Valuing the inventory at cost, maintaining adequate books and records to support the LIFO calculations and reflecting the use of LIFO in year-end financial statements round out the other three requirements.

Each requirement has a multitude of ramifications. But, the financial statement conformity requirement seems to be the one that is most troublesome for taxpayers on LIFO and their advisors.

One of the reasons is because there are many conformity requirements, rather than just one. And, violation of any one of these conformity requirements would allow the IRS to take the position that the LIFO election must be terminated, although asserting that harsh penalty is discretionary with the IRS Commissioner.

One can't overdo reminders about year-end projections, estimates and the importance of placing proper LIFO disclosures in the year-end financial statements. To this end, we urge you to read our updated coverage of these topics in the article beginning on page 5.

#5. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX ASSUMPTION. As we do every year in our 4th quarter issue, we've included detailed information to help you estimate changes in your dealers' LIFO reserves before you do the final calculations after year-end. To assist in making year-end projections, each year we provide a listing for *new* vehicle LIFO inventories showing weighted average inflation (deflation) information for each model.

The summaries are on pages 20-23 and the detail lists appear on pages 24-31.

#6. ARE YOU REALLY RISKING YOUR LIFO ELIGIBILITY IF YOU'RE NOT ELIMINATING TRADE DISCOUNTS FROM INVENTORY COSTS? Well ..., maybe.

We have continually warned that failure to eliminate trade discounts from inventory costs could be interpreted by the IRS to constitute a violation of the cost requirement. In March 2005 (Update #1), we strongly stated the case that "Many CPAs we know are risking their dealers' LIFO elections ... and they may not even be aware of it."

Although we may be criticized for this (arch) conservative position, we feel it is correct. However, in two separate conversations with individuals in the IRS, we have been told that it is unlikely that *"the IRS"* (whoever or whomever that is) would take a taxpayer off of LIFO if their inventory did not reflect a reduction for trade discounts. Ms. Terri Harris, the IRS Motor Vehicle Technical Advisor, told attendees at the AICPA Dealership Conference in Baltimore in October that she had "spoken with an individual in the National Office" and received that informal opinion/conclusion.

In a separate informal conversation with an IRS inventory specialist, I was told essentially the same thing. I have suggested informally to Ms. Harris that it would be helpful if her office would issue a Motor Vehicle *Automotive Alert!* to this effect.

Clearly, it is beneficial for LIFO taxpayers to treat trade discounts properly and in accordance with the Regulations and the Revenue Ruling. (We won't rehearse all of the reasons why here again.)

Until the National Office officially expresses a position on this matter (and the *Automotive Alert!* is not necessarily the expression of a binding official position), we believe the only proper advice LIFO taxpayers can be given is that their LIFO elections could be at risk if the IRS decides to give this issue the same kind and degree of attention it has given other LIFO requirements.

We recently received an e-mail that referred to Terri Harris' answer at the AICPA conference. The reader said that the question asked of Ms. Harris was ... "If a dealer is not taking advantage of the *advertising and interest credits method,* are they technically violating their LIFO election?" The reader, of course, "heard" that the answer to that question was, "No."

In fact, I was the person at the AICPA dealership conference who asked the question (in writing). I definitely did not inquire about "advertising and interest credits;" I asked only and specifically about the elimination of trade discounts.

In my response to the reader, I told him that I had heard Terri Harris' answer, and I believe that whoever gave her that answer in the National Office is incorrect.

I added that the handling of advertising fees and expenses is different from the handling of trade discounts. The elimination of trade discounts from inventory cost is mandatory. The elimination of advertising fees and credits from inventory cost is an elective decision.

Over the last month, since that exchange of correspondence, I've reconsidered my conclusion ... and I still think there's too much at risk. Given the kind of nitpicking we've observed the IRS to be capable of over the last15 years (not to mention the previous 25 years preceding that), I would never risk my client's LIFO election on hearsay... even though I might like the "informal or unofficial" answer I heard.

SPECIAL LIFO CHALLENGES: CONFORMITY REPORTING REQUIREMENTS AND PROJECTIONS FOR YEAR-END PLANNING

YEAR END ALERT

Taxpayers using Last-In, First-Out (LIFO) for valuing their inventories are often under great pressure to issue their financial statements as quickly after the year-end as possible. Whether under great time pressure or not, any taxpayer using LIFO must be sure that all year-end statements satisfy all of the LIFO conformity requirements. If they do not, the taxpayer risks the loss of its LIFO election.

There are many year-end LIFO conformity requirements, and there are many kinds of businesses using LIFO. All taxpayers using LIFO must comply with all of the year-end financial statement conformity reporting requirements in order to remain eligible to use the method.

As emphasized throughout the discussions on the following pages of the special rules and IRS guidance for auto dealerships, taxpayers outside the scope of that guidance should be careful ***not*** to rely on that guidance as if the IRS had generalized or intended it to be applicable in their own different situations or industries. Similarly, auto dealerships - although benefiting from some clarification by the IRS

see **CONFORMITY REPORTING REQUIREMENTS**, page 6

SPECIAL YEAR-END CHALLENGES FOR LIFO USERS

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on certain reporting issues - should be careful ***not*** to rely on that guidance as if the IRS had generalized or intended it to be applicable beyond the carefully worded "scope" sections in Revenue Ruling 97-42 and in Revenue Procedure 97-44.

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

First: the bigger picture, of which conformity is only a part. The IRS can disallow a taxpayer's LIFO election if it finds a violation of any one of four eligibility requirements. The four requirements involve cost, conformity, consent, and the maintenance of adequate books and records.

TERMINATION SITUATIONS

1. Failure to value LIFO inventory at cost for tax purposes for the year preceding the year of LIFO election, the election year, and in all subsequent years ***(Cost).***
2. Violation of the financial statement reporting conformity requirements for the election year and all subsequent years ***(Conformity).***
3. Failure to properly elect LIFO, including the failure to file Form 970 ***(Consent).***
4. Failure to maintain adequate books and records with respect to the LIFO inventory and all computations related to it ***(Adequate Books & Records).***

In 1999, in *Mountain State Ford Truck Sales v. Commissioner*, the Tax Court held that the taxpayer's use of replacement cost for valuing parts inventories could not be employed as a substitute for actual cost in connection with LIFO inventories ... nor for any other non-LIFO inventories. Although the IRS subsequently issued Revenue Procedure 2002-17, effectively negating the Tax Court's holding in *Mountain State*, this case serves as a warning that whenever the IRS chooses, it can take a very aggressive position, threatening the very existence of a longstanding LIFO election.

If a violation of any one of the four eligibility requirements occurs, the Internal Revenue Service has the discretionary power to allow the LIFO election - if it can be persuaded to exercise that power in the taxpayer's favor. For example, Revenue Procedure 79-23 reflects the position of the Service that a LIFO election can be disallowed if the taxpayer fails to maintain adequate books and records with respect to the LIFO inventory and computations related to it.

However, if a taxpayer is able to reconstruct the information necessary to calculate the LIFO inventory amount properly, it ***may*** be possible to avoid termination of the LIFO election for a violation of the "books and records" requirement.

Revenue Procedure 79-23 (1979-1 C.B. 564) states that in other circumstances where disputes with the IRS arise over computational errors, incorrect pool selection or item determination, or differences in the levels of costing inventories between financial statements and tax returns - the IRS is not authorized to terminate the taxpayer's LIFO election.

However, where the LIFO violations involve cost, conformity, Form 970 consent matters or "inadequate books and records," the Service usually looks to invoke this more dramatic measure. In *Mountain State Ford Truck Sales*, the Tax Court expressed the position that the list of four "termination situations" in Rev. Proc. 79-23 was not an exclusive listing ... In other words, other circumstances or situations might support the Service taking the position that a LIFO election should be terminated.

Revenue Procedure 97-44, which allowed certain taxpayers (automobile dealerships) with conformity violations to avoid termination of their LIFO elections by paying a 4.7% penalty amount, should also be regarded as a very limited exception to the IRS general approach of terminating a LIFO election whenever it uncovers an eligibility violation.

FORM 970 QUESTIONS REGARDING CONFORMITY

Form 970 is the LIFO election form which is required to be included with the tax return for the first LIFO year. One of the significant traps for the unwary is that Form 970 asks only whether the year-end financial statements *for the election year* have satisfied certain conformity requirements.

On its face, Form 970 does not warn taxpayers that these conformity requirements must be satisfied for every year-end financial statement for as long as the LIFO method is being used. This requirement is spelled out in Reg. Sec. 1.472-2(e)(1).

Worse yet, the relatively limited Form 970 instructions give no hint of the many troublesome interpretations that can arise under the Regulations. As evidenced by the debacle that auto dealers and their CPAs floundered through for nearly a decade (and that resulted in Rev. Proc. 97-44), it would seem that many practitioners have never even looked at, much less attempted to study in detail, the Regulations dealing with this critical issue.

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CONFORMITY REQUIREMENTS... THERE ARE MANY

There are many conformity requirements. They exist as restrictions on a taxpayer's general desire to pay lower taxes using a LIFO method for valuing inventories, while reporting more income to shareholders or banks and other creditors using a non-LIFO method. To prevent this from happening, the Treasury says that LIFO must be used in all reports covering a full year to insure that the use of LIFO for tax purposes conforms as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income.

It is often stated that LIFO must be used to compute income in the year-end ***financial statements***. However, it is more technically correct to state that the IRS only requires LIFO to be used in the primary presentation of income (i.e., in the Income Statement). For most taxpayers, the LIFO conformity requirements pose at least two general sets of requirements:

TWO SETS OF REQUIREMENTS

FIRST, they require that any year-end financial statements ***issued in the traditional report form*** by the business to creditors, shareholders, partners or other users must reflect the year-end results on LIFO.

SECOND, they also require all year-end ***manufacturer-formatted financial statements*** sent by certain dealers to a manufacturer/supplier/creditor (12th, 13th and any other fiscal year-end statements) to reflect LIFO results.

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

Accordingly, a LIFO reserve, no matter how large, can be completely and abruptly lost if careful attention is not paid to the conformity requirements in year-end, manufacturer-formatted financial statements sent to the Factory/Manufacturer/Supplier...as well as in the more conventional year-end statements issued in report form by CPAs.

EVERY YEAR, ALL OF THE CONFORMITY REQUIREMENTS MUST BE MET

To remain eligible to use LIFO, ***every year***, the last monthly statement for the year sent to the manufacturer and/or any other credit source must reflect an estimate of the year-end change in the LIFO reserve if the actual change cannot be computed before the statement has to be released.

If a taxpayer is thinking about making a LIFO election for the year, then it should place an estimate of the year-end LIFO reserve ...or the actual amount if it has been calculated... in the year-end statements (including those issued to the Factory/Manufacturer or issued to any other party) in order to preserve its ability to elect LIFO when it files Form 970 as part of its Federal income tax return for the year at a later date.

Also, the expansion of the conformity requirements to other classes of goods should not be overlooked if a taxpayer is already on LIFO for one class of inventory (such as new vehicles or equipment) and is considering extending LIFO to another class of inventory (such as used vehicles, equipment or parts). In this situation, the year-end Income Statements should also reflect an estimate of the LIFO reserve expected to be produced by extending the LIFO election(s) to the additional classes of goods under consideration.

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

This section deals with reports issued by CPAs, where the CPA controls the release, content and format of the financial statements, notes and supplementary information. These are unlike monthly statements which may be prepared internally by the taxpayer's accounting department or controller and sent out to a manufacturer, supplier or other creditor without direct CPA involvement or review.

The LIFO conformity requirement as it relates to reports issued by CPAs requires that in the primary presentation of income (i.e., the Income Statement), the results disclosed must only be the net-of-LIFO results. The primary Income Statement *cannot* show results before LIFO, followed by either an addition or subtraction for the net LIFO change, coming down to a final net income or loss after-LIFO figure. This means that during a period of rising prices, a business using LIFO will usually be reporting lower operating results in order to comply with the conformity requirements. Very strict disclosure limitations existed with no room for deviation for many years.

The Regulations were liberalized in 1981 and they now allow LIFO taxpayers to disclose non-LIFO operating results in *supplementary financial statements*, as long as those supplementary non-LIFO financial statements satisfy two tests: ***First***, they must be issued as part of a report which includes the

see **CONFORMITY REPORTING REQUIREMENTS**, page 8

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primary presentation of income on a LIFO basis. ***Second***, each non-LIFO financial statement must contain on its face a warning or statement to the reader that the non-LIFO results are supplementary to the primary presentation of income which is on a LIFO basis. Accordingly, in CPA-prepared year-end financial statements, a LIFO taxpayer's results on a non-LIFO basis can be fully disclosed as supplementary information if both of these requirements are met.

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

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

DEALERSHIP YEAR-END STATEMENTS SENT TO MANUFACTURER/SUPPLIER/CREDITORS

Many CPAs serving automobile dealerships are now aware that the Regulations contain several year-end LIFO reporting restrictions which apply to the specially formatted financial statements sent by auto dealerships and other businesses immediately after year-end to the Manufacturer/Supplier/Creditors. Some of those CPAs who were not had a rude awakening when their (former) dealer clients - through their attorneys - asked them to reimburse the dealers for their payments of the 4.7% penalty "settlement amounts" due under Revenue Procedure 97-44.

For automobile dealerships, and for any other LIFO users who have similar year-end reporting fact patterns or requirements, these restrictions on year-end dealership-issued statements pose fatal LIFO traps that are much harder to deal with than those for year-end reports issued by CPAs.

The Regulations provide that any Income Statement that reflects a full year's operations must report on a LIFO basis. This requirement applies regardless of whether the Income Statement is the last in a series of interim statements, or a December statement which shows two columns, one for the current month results and another for the year-to-date cumulative results.

The Regulations further provide that a series of credit statements or financial reports is considered a single statement or report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period. See Reg. Sec. 1.472-2(e)(6). If one can combine or "aggregate" a series of interim or partial-year statements to disclose the results of operations for a full year, then the last Income Statement must reflect income computed using LIFO to value the inventory.

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

The IRS National Office confirmed dealers' worst fears during 1995 in LTR 9535010. In this Letter Ruling, a calendar year dealership raised the conformity question in the context of what happens when the monthly statements, including the December year-end statement, are not on LIFO but the CPA prepares annual audited financial statements for the dealership which do reflect LIFO.

Here, the taxpayer's argument was that the CPA's audited statements reflecting LIFO were the primary financial statements, while the monthly statements sent by the dealership to the manufacturer and to the credit corporation were "supplementary statements." The IRS concluded that the dealer in LTR 9535010 had violated the LIFO conformity requirement because:

IRS TESTS

1. The dealership used an inventory method other than LIFO in ascertaining its income in the monthly financial statements,
2. The financial statements ascertained income for the "taxable year,"
3. The financial statements were "for credit purposes," and
4. The financial statements were not within any of the exceptions to the LIFO conformity requirements that are provided in the Regulations.

With respect to the use of the financial statements "for credit purposes," the IRS found that a debtor-creditor relationship did exist between the dealership and the manufacturer and the credit corporation. The IRS stated that if the taxpayer's "operations began to deteriorate, it is doubtful that Corp. X (the manufacturer) and Corp. Y (the Credit Corporation) would ignore these reports and continue to

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extend credit to T (the taxpayer) as though nothing has changed." The IRS noted that the taxpayer was unable to provide any explanation of what purpose other than credit evaluation the credit subsidiary might have for requesting the dealer's financial statements.

In a companion letter ruling, LTR 9535009, the IRS "officially" restated its position with respect to a dealer who reported for tax purposes using a fiscal year. The IRS employed the same four-step analysis as above to determine whether the fiscal year dealership had violated the LIFO conformity requirements. In connection with the second "test" related to whether the dealership's financial statement to the Factory ascertained the taxpayer's income for the taxable year, the IRS noted that the year-to-date column information readily provides this computation for the reader. Even without year-to-date accumulations on the face of the monthly Income Statement, any series of months could simply be added together to reflect a complete 12-month period of anyone's choice.

LTR 9535009 states that the fiscal year dealer taxpayer issued a financial statement (in January, 19xx) that ascertained its income for the entire prior calendar year, and that calendar year statement is considered a statement covering the "taxable year" because it covers a 1-year period that both begins and ends in a taxable year or years for which the taxpayer used the LIFO method. This is the IRS' interpretation of Reg. Sec. 1.472-2(e)(2) which covers *one-year periods other than a taxable year.*

WARNING

- This would seem to be the position of the IRS for all taxpayers whose fact patterns fall under the Regulation.
- Only the special and limited relief afforded to certain dealers in Revenue Ruling 97-42 and Revenue Procedure 97-44 (discussed next) saved some taxpayers from the consequences of this narrow and harsh interpretation.

REV. RUL. 97-42: DISCLOSURE GUIDELINES FOR CERTAIN DEALERS

On September 25, 1997, the IRS issued Revenue Ruling 97-42 which provides special interpretations allowing auto dealers to satisfy the LIFO conformity requirements. ***These special interpretations apply only to a year-end financial statement prepared in a format required by an automobile manufacturer on preprinted forms supplied by the automobile manufacturer.***

Placement in the Income Statement. LIFO adjustments must appear in the twelfth month Income Statement. However, they do ***not*** have to be reflected in the Cost of Goods Sold section through the inventory valuation accounts. As long as the LIFO adjustments are reflected somewhere in the determination of net income on the Income Statement, that conformity requirement will be satisfied.

Revenue Ruling 97-42 makes it clear that if a LIFO reserve adjustment is posted directly to the retained earnings account and reflected on the dealership's Balance Sheet, that treatment of the LIFO reserve change will ***not*** satisfy the conformity requirement. For years ending after October 14, 1997, it is thus imperative that the LIFO adjustment be properly reflected in the Income Statement prepared for the last month of the year.

Use of estimates. A "reasonable estimate" of the change in the LIFO reserve for the year may be reflected instead of the actual change..., as long as that "reasonable estimate" is reflected somewhere in the year-end Statement of Income.

No one knows what the IRS will accept as a "reasonable estimate." Similarly, no one knows what procedures the IRS will accept as being "reasonable" in the preparation of an estimate of the change of the LIFO reserve for the year.

Fiscal year taxpayers. If an auto dealer employs a fiscal taxable year, and reflects the LIFO change in Cost of Goods Sold or anywhere else in the Income Statement, the LIFO conformity requirements can be satisfied in either of two ways: ***First***, the dealer may make an adjustment for the change in the LIFO reserve that occurred during the calendar year in the month and year-to-date column of the ***December*** Income Statement.

Alternatively, the dealer may make an adjustment for the change in the LIFO reserve that occurred during the fiscal year in the month and year-to-date columns of the Income Statements provided for the ***last month of the fiscal year.***

In other words, the IRS does not require the change in the LIFO reserve to be updated twice in the fiscal year-end... calendar year-end sequence. The IRS will permit a timing mismatch under these limited circumstances. For example, in a situation where a dealer has a September fiscal year-end and December (calendar) reporting year to the manufacturer: If the dealer reflects the (reasonable estimate) change in the LIFO reserve in the September monthly and year-end statement, that dealer does not need to recompute and update a LIFO change for the three month period from October 1 through December 31 and reflect a 3-month change in the December statement.

The dealer may simply carry through the annual LIFO reserve change effect reflected in the Septem-

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ber fiscal year-end Income Statement without modification in the December Income Statement. Note that the December Income Statement must reflect the charge against income for the prior fiscal year-end LIFO reserve change and that prior September fiscal year-end LIFO reserve change should ***not*** be reversed so that the December Statement of Income does not reflect any LIFO reserve charge for the twelve month period ending December 31.

REV. PROC. 97-44: LIMITED RELIEF FOR CERTAIN DEALERS

Revenue Procedure 97-44 provided "relief" to auto dealers whose year-end Factory statements failed to satisfy the conformity requirements at any time during a six-year "look-back" period. These dealers were allowed to keep their LIFO elections if they paid a 4.7% penalty/settlement tax based on the amount of their LIFO reserves as of the last taxable year ended on or before October 14, 1997 (i.e., as of December 31, 1996 for most calendar-year auto dealers). These dealers were also required to satisfy certain other conditions as terms of the settlement.

In Revenue Procedure 98-46, the IRS extended this relief for similar conformity violations to all medium and heavy-duty truck dealers, providing them with a slightly different series of payments dates.

One of the major traps that practitioners and auto dealers now face is in the lack of synchronization between the language in Revenue Ruling 97-42 and the language in Revenue Procedure 97-44. Revenue Ruling 97-42 applies to the issuance of statements to a "credit subsidiary." In contrast, Revenue Procedure 97-44 contains broader language in its scope (Section 3) referring to the providing "for credit purposes" ... of an Income Statement in the format required by the franchisor.

See the analyses of Revenue Procedure 97-44 in the September, 1997 and December, 1997 issues of the *LIFO Lookout* for discussions of the settlement amount 4.7% penalty payment and many questions that still remain unanswered.

SPECIAL INTERPRETATIONS CLARIFIED ONLY FOR AUTO DEALERS ... ALL OTHER LIFO USERS BEWARE

Different year-ends for book and tax purposes (fiscal years). LIFO conformity problems are multiplied where a taxpayer has a different year-end for reporting to a manufacturer, supplier, or creditor (calendar year-Dec. 31) than the fiscal year it uses to report for income tax return purposes and for other financial statement reporting purposes.

For these fiscal year taxpayers... other than auto dealers and light, medium & heavy-duty truck dealers... in order to satisfy another strict conformity requirement, the full-year Income Statements must reflect LIFO at the end of *both* twelve month annual reporting periods or years (Reg. Sec. 1.472-2(e)(2)).

This Regulation states that the conformity rules also apply to (1) the determination of income, profit, or loss for a one-year period other than a taxable year, and to (2) credit statements or financial reports that cover a one-year period other than a taxable year, but only if the one-year period both begins and ends in a taxable year or years for which the taxpayer uses the LIFO method for Federal income tax purposes. For example,...in the case of a calendar year taxpayer, the requirements...apply to the taxpayer's determination of income for purposes of a credit statement that covers the period October 1, 1981, through September 30, 1982, if the taxpayer uses the LIFO method for Federal income tax purposes in taxable years 1981 and 1982.

Placement of LIFO change in the year-end Statement of Income. In fighting with auto dealers over conformity, in 1994 the IRS informally indicated that on the last monthly (i.e., twelfth) statement, the LIFO adjustment had to be run through the Cost of Goods Sold section (via the beginning-of-the-year and the end-of-the-year inventory valuations), rather than through an other income/deductions account...or else dealers would not be in compliance with the LIFO year-end conformity requirement. The IRS subsequently retreated on this "placement" issue in Revenue Ruling 97-42.

For LIFO taxpayers other than those dealers indicated above, where and how the year-end LIFO adjustment is placed on the Income Statement is still critical. The IRS "only-through-Cost-of-Goods-Sold" interpretation could result in countless LIFO election terminations in situations where the (projected) change in the LIFO reserve at year-end was placed in some other section of the Income Statement, such as with an *Other Income* or *Other Deductions*. Fortunately, in Revenue Ruling 97-42, the IRS said (to certain dealers only) that the LIFO adjustment could be placed anywhere on the Income Statement.

Unfortunately, the IRS "guidance" for franchised auto dealers in Revenue Ruling 97-42 and the "relief" for prior conformity violations under Revenue Procedures 97-44 and 98-46 ***do not apply*** to any other types of taxpayers issuing what might be "similar" statements under "similar circumstances" to other manufacturers, suppliers or credit sources. No one can be sure what these other businesses with LIFO

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violations should do in light of what is now understood to be the IRS interpretation of these Regulations.

WARNING

All taxpayers ... other than automobile and truck dealerships ... using LIFO who issue monthly statements to manufacturers, suppliers or creditors are not protected by the special rules in Revenue Ruling 97-42 which modify the Regulations only for special reporting situations faced by auto dealers.

What should these businesses/taxpayers be told about their LIFO elections? Are they subject to retroactive termination of their LIFO elections at any time, literally at will, by the IRS? What responsibility does the CPA practitioner have as preparer of the tax return now that the IRS position has been more clearly set forth in Revenue Ruling 97-42? These are the questions that (should) haunt practitioners and their clients today.

CONFORMITY VIOLATIONS CANNOT BE CORRECTED ONCE THE YEAR-END FINANCIAL STATEMENTS HAVE BEEN RELEASED

What if year-end financial statements are issued (in a hurry) and the conformity requirements have been overlooked?

The position of the IRS is that once a year-end Income Statement has been issued or released on a non-LIFO basis, that statement cannot be recalled and corrected to reflect LIFO by the re-issuance of statements satisfying the conformity requirement. Furthermore, it then becomes discretionary with the IRS Commissioner as to whether or not the Commissioner chooses to terminate the taxpayer's LIFO election as a penalty for the violation.

The *William Powell Company* decision (81-1 USTC ¶ 9449) illustrates one taxpayer's success (or possibly good fortune) in avoiding termination of its LIFO election when it came down to "all-or-nothing" on this issue. This case, decided in 1981, involved what would have been the termination of a LIFO election made in 1973 because at the end of the first LIFO year, the taxpayer had issued non-LIFO statements and then later made a LIFO election when it filed its tax return.

In that case, the taxpayer recalled its previous non-LIFO statements and replaced/reissued LIFO statements to all the banks, creditors and shareholders before the income tax return for the first year was filed. The taxpayer probably would have lost its LIFO election if it had litigated the issue in the Tax Court, but the taxpayer chose to litigate this issue in the District Court in Ohio.

The taxpayer took the position that it had not "used" FIFO within the meaning of Section 472(c). Its position with respect to Section 472(c)(2) was that non-LIFO "worksheets" were not used for "credit purposes," since the credit had been extended prior to the delivery of the worksheets. The District Court accepted the taxpayer's arguments. With respect to Section 472(c)(1), Powell contended that *use* is determined at the time of the LIFO election and that this election need not be made until the taxpayer files its return. At the time Powell elected LIFO, it was no longer *using* the FIFO statements, inasmuch as they had been recalled prior to the election and LIFO statements had been reissued.

The District Court, while agreeing that Powell's activities seemed to violate the plain language of Section 472(c)(2), was hesitant to strictly apply the "plain meaning rule" in this case. The Court said that it is the general rule that the words of a revenue statute are interpreted "in their ordinary, everyday senses," and a rigid application of this rule would not be consistent with the Commissioner's ongoing interpretation of the conformity requirement.

HOW SOME BUSINESSES GET AROUND THE LIFO CONFORMITY LIMITATIONS

Many businesses using LIFO - especially publicly-held companies reporting to the SEC - would like to reduce taxes by reporting lower taxable income/earnings in tax returns while at the same time reporting higher earnings/more income to their shareholders and creditors for financial and market valuation purposes. This can be done easily, thanks to loopholes conveniently provided in the Regulations. But one has to know they are there.

The Regulations allow taxpayers to legitimately avoid the intent of the conformity requirement by allowing them to use LIFO methods and sub-elections in their financial statements that are different from those LIFO sub-elections and methods that are used in their income tax return computations. That's right: ***Different LIFO methods may be used for book and for tax purposes.*** It is not necessary for the year-end financial statements to use the same exact LIFO sub-elections that are used in the tax return LIFO calculations. The Regulations simply require that both sets of financial statements (i.e., those included in the financial reports and those inherent in the income tax returns) must report using LIFO methods.

This allows some companies to use more pools ...in one case, several hundred more pools... for financial reporting purposes than for income tax purposes. Others use link-chain or link-chain, index

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(dollar-value) methods to lower LIFO income for tax purposes, while they use double-extension (dollar-value) LIFO methods for financial reports. Still others reconstruct long distant base prices for new items in their tax return LIFO calculations while they price new items at current cost in their financial statements. These companies enjoy the best of both worlds without violating the fine print of the "conformity" requirements.

Based on the foregoing, we continue to question the wisdom of the *advice* given by Wall Street to dealer groups going public in connection with terminating their LIFO elections. How many millions of dollars of LIFO deferral tax savings have been thrown away needlessly in exchange for the perceived benefit of higher earnings per share and hopefully higher market valuations? The significant - if not Draconian - penalties the investing marketplace exacts from businesses that miss their earnings per share projections by even a penny suggest that sacrificing real millions of LIFO tax deferral dollars "just for show" can be costly, if not almost unnecessary.

INTERIM REPORTS

Interim reports covering a period of operations that is less than the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement for tax purposes. The Regulations are completely clear and unambiguous on this point. Although generally accepted accounting principles may present some difficulties in this regard, the Income Tax Regulations clearly do not.

OTHER CONCERNS: *INSILCO* & SEC. 472(g)

For another example of how seriously the Treasury/IRS polices the LIFO conformity requirement, consider the origin of Code Section 472(g). This subsection was added because the IRS lost the *Insilco* decision in the Tax Court. This case involved a subsidiary using LIFO who reported to its parent corporation using LIFO, but the parent corporation reported its consolidated earnings (which included those of the LIFO-user subsidiary) to its own shareholders on a non-LIFO basis.

In upholding the taxpayer in *Insilco*, the Tax Court told the IRS that if it didn't like the result, it should get Congress to change the law. And that's exactly what the IRS/ Treasury did! After its loss, the Treasury persuaded Congress to change the law (which it did by adding subsection (g) to Section 472) so that taxpayers in the future couldn't get around the conformity requirement the way Insilco had.

Section 472(g) provides that all members of the same group of financially related corporations shall be treated as one taxpayer for purposes of the conformity provisions of the Internal Revenue Code. For purposes of these provisions, affiliated groups are determined by using a lower 50% ownership threshold (than 80%). Furthermore, Section 472(g)(2)(B) provides that any other group of corporations which consolidate or combine for purposes of financial statements...shall be treated as one taxpayer for purposes of the conformity provisions.

"CONFORMITY" ... WHERE FOREIGN CORPORATIONS ARE INVOLVED

As we have seen, collectively, Sections 472(c) and (e)(2) require that in the first year on LIFO ... and in all subsequent years ... financial statements must reflect the use of the LIFO method for valuing inventories. These requirements affect all financial statements covering a full year's operations that are issued to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.
The taxpayer may be required to discontinue the use of the LIFO inventory method if this requirement is violated.

Compliance with these requirements becomes more complicated when ***affiliated and/or consolidated groups*** exist. Section 472(g) provides that all members of the same group of financially related corporations are treated as a single taxpayer for purposes of the LIFO conformity requirements. The term "group of financially related corporations" means any affiliated group as defined in Section 1504(a), determined by substituting 50% for 80% each place where it appears, and any group of corporations that consolidate or combine for purposes of financial statements.

When ***foreign corporations*** are mixed in with U.S. corporations in various parent-subsidiary arrangements, compliance with these conformity rules and with Revenue Ruling 78-246 becomes even more complicated.

In Letter Ruling 200540005, dated June 20, 2005, the IRS addressed a situation involving the LIFO conformity requirement application to consolidated financial statements and foreign operations and subsidiaries.

A summary of Rev. Rul. 78-246 (1978-1 C.B. 146) and more details on LTR 200540005 appear on the facing page.

In this Ruling, the Service held that ...

1. For the parent's fiscal year in issue, the parent had substantial foreign operations within the meaning of Revenue Ruling 78-246, and

see **CONFORMITY REPORTING REQUIREMENTS**, page 14

Rev. Rul. 78-246

Foreign Corporations & Foreign Operations

Financial Statement Conformity Requirements & the 30% Test or Threshold

Background

- The LIFO financial statement reporting requirements were enacted to ensure that the LIFO method "conforms as nearly as may be to the best accounting practice in the trade or business. ..." (H. Rep. No. 2330, 75th Cong., 3d Sess. 34 (1938)).
- The legislative history of Section 472 indicates that the conformance "to the best accounting practice" is to be made on the basis of United States standards of accounting practice.
- Congress was concerned solely with domestic accounting practice. Therefore, the conformity requirements of Section 472 should not be extended to determine what is the "best accounting practice" in foreign countries.

Are Operating Assets of "Substantial Value" Used in the Foreign Operations?

- If a foreign parent owns ***operating assets of substantial value which are used in foreign operations,*** the LIFO financial statement conformity requirements ***do not apply*** to the consolidated financial statements.
  - This applies to ownership by the parent either directly or indirectly through members of its group.
- Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that ... (1) are members of the consolidated group, (2) are ***foreign*** corporations, (3) ***do not use the LIFO method*** of accounting for Federal income tax purposes, and (4) ***engage in a business outside the United States.***
- For purposes of this test, operating assets are all the assets necessary for the conduct of an active operating company.

30% or More Threshold

- The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes ***<u>30% or more</u>*** of the total operating assets of the consolidated group.
- This determination will be made annually.
- This determination ***will normally be made on the basis of the asset valuation*** reflected in the consolidated financial statements of the group for the year.

Facts & Circumstances

- ***If the consolidated group does not satisfy the 30% test,*** the IRS may waive the 30% test and make a determination on the basis of all of the ***facts and circumstances*** presented.

LTR 200540005 ... Dated June 20, 2005

LTR Summary

- In LTR 200540004, the IRS was dealing with a foreign parent corporation that had to issue consolidated financial statements to its shareholders and creditors in which it was reporting its own operations and the operations of subsidiaries acquired by its own wholly-owned U.S. subsidiary.
- The taxpayer persuaded the IRS that, although it failed to have operating assets in excess of the 30% threshold, it should be considered to have satisfied the alternative "facts and circumstances" test.
- As a result, the parent was permitted to issue consolidated financial statements on a non-LIFO basis without violating the LIFO financial statement conformity requirements ... ***but only for the one year in question.***

LTR Facts

- The parent (a foreign corporation, not reporting under U.S. GAAP) made an agreement whereby the taxpayer (its wholly-owned U.S. subsidiary) would acquire all of the outstanding stock of a group of new subsidiaries.
  - Prior to the acquisition, the taxpayer also had other wholly-owned U.S. subsidiaries ("old subs").
  - Following the acquisition, the activities of the parent, the taxpayer, and the taxpayer's subsidiaries (old subs and new subs) would be reported in the consolidated financial statements of the Parent.
- Prior to the acquisition, the new subs used LIFO for valuing their inventories. The parent and the taxpayer used a non-LIFO method for valuing inventory for U.S. and for the parent's foreign country tax purposes.

LTR Discussion

- The taxpayer conceded that it did not meet the more than 30% test for establishing substantial foreign operations under Rev. Rul. 78-246. However, it said that it should be allowed to make certain distinctions in order to qualify under the alternative "facts and circumstances" test.
- The taxpayer argued that as a result of the stepped-up basis in the assets involved in the acquisition, financial statement comparisons did not fairly represent its situation. The assets of the new subsidiaries reflected current value because the acquisition was recorded as a purchase pursuant to U.S. GAAP.
- Accordingly, the taxpayer argued that it should be allowed to compare the higher ***market values*** (i.e., instead of the lower asset book values) of the foreign operations to its total operations.
  - In determining the market value of new subsidiaries, the taxpayer proposed to use the purchase price of the new subsidiaries.
  - For the market value of the remainder of the Group, the taxpayer proposed to use EBITDA (earnings before interest, taxes, depreciation and amortization) as a basis for allocating the Group's market value, prior to the acquisition, between its foreign and domestic operations.
- As a result of this alternative analysis, the computed percentage of assets used in foreign operations (to total operations) would only be slightly less than the 30% minimum threshold set forth in Rev. Rul. 78-246.

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2. Consequently, for the fiscal year in question, the issuance of consolidated financial statements by the parent reporting the new subsidiaries' operations on a non-LIFO basis would not violate the LIFO conformity requirements.

This Ruling did not come without several limitations and restrictions. It applied only to the ***one*** taxable year in issue. ***It did not apply to any subsequent taxable year.*** In addition, the IRS expressed no opinion as to whether the parent might have substantial foreign operations for subsequent years, or whether the parent may issue consolidated financial statements for subsequent years reporting new subsidiaries' operations on a non-LIFO basis without violating the LIFO conformity requirements. Finally, this PLR was not to be construed as approving the use of the taxpayer's market value analysis for subsequent years (in connection with determining its compliance with the 30% threshold of Rev. Rul. 78-246).

CONCLUDING CONFORMITY WARNINGS

The *William Powell Company* and the *Insilco* decisions are the only recorded cases where taxpayers contested the IRS termination of their LIFO elections in court. The bottom line is that the IRS takes all of these conformity requirements seriously. On many audits, instead of assuming that the taxpayer has complied, the IRS asks for proof that financial statements at year-end were not in violation of the LIFO conformity requirements.

The first year of the LIFO election is very often the easiest one for the IRS to find a conformity violation in. This is because by the time the election is "officially" made in the tax return many months after year-end, the financial statements for the year are long gone out the door.

In these situations, the IRS asserts that there is no statute of limitations preventing it from inquiring as to a taxpayer's compliance with the conformity requirement ... and that the Service can look into this as far back as the initial LIFO election year. Furthermore, the burden of proof is on the taxpayer - not on the IRS - in these inquiries.

The IRS position is that there is no limit on its ability to go back to ***any*** prior year...no matter how far distant...to terminate a LIFO election because of a violation of any one of the many conformity requirements discussed above. The IRS supports its argument by reminding taxpayers that they have explicitly agreed to this result right on the Form 970 that they included in their tax returns when they elected LIFO!

The only exception to this is the IRS' uncharacteristic and somewhat voluntary self-imposed limitation in 1997 for certain retail auto and truck dealers. Consequently, LIFO users cannot be too cautious or careful in dealing with conformity matters.

YEAR-END PROJECTIONS FOR STATEMENT CONFORMITY OR FOR INCOME TAX PLANNING PURPOSES

Projections for statement conformity purposes. Revenue Ruling 97-42 states explicitly that, when the pressure is great to issue the financial statements before detailed LIFO computations can be made, the conformity requirement should be satisfied by using a reasonable estimate of the change in the LIFO reserve in lieu of the actual amount.

As mentioned previously, another alternative might be to use a different LIFO computation methodology for the financial statements than the one used for tax purposes.

Projections for income tax planning purposes. It is unrealistic to attempt any serious planning for a business that uses LIFO without first projecting the change in the LIFO reserves for year-end.

Make projections early. These projections should be made early enough so that management can consider not only the financial impact of what is likely to happen, but also whether legitimate steps, motivated by sound business reasons, can be undertaken to produce a result different from that shown by the projections.

One thing is certain: After year-end, it will be too late to change the results that might have been avoided by proper planning with adequate timing.

Even if it is concluded that nothing can be done to avoid the LIFO reserve payback consequences, it is far better to know the extent of the impending "hit" so that other buffering actions can be taken, than it is to be caught entirely off-guard or without any idea of how large the LIFO reserve recapture is going to be.

PROJECTION MECHANICS, STEP-BY-STEP

Projecting year-end changes in LIFO reserves need not be too difficult nor time-consuming.

Making these LIFO reserve change projections involves ***only two estimates:***

1. The ending inventory level, and
2. The overall inflation percentage for the year.

All other necessary factors are known at the time the projections are made because they are ***four facts related to the beginning of the year:***

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Conformity Reporting Requirements

(Continued)

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

The computation of the projected change in a LIFO reserve is made by plugging in the estimates of (1) the year-end inventory level and (2) the current year's rate of inflation or inflation index ... and then "working backwards." These eight steps are detailed in the table below.

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

Taxpayers using LIFO are often surprised when they find out that even though their year-end inventory levels are projected to be lower than they were at the beginning-of-the-year, their LIFO reserves are expected to increase. And often these increases are very large. The *Practice Guide* on the following page explains why LIFO reserves change the way they do.

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

When a liquidation or decrement situation is anticipated, the starting point is to calculate the payback potential from a series of reduced inventory levels. In other words, as the year-end inventory drops, how much more (or less) is the LIFO reserve going to change? These calculations determine what the real LIFO recapture vulnerability will be as the anticipated current-year's decrement is carried-back on a LIFO basis against the prior LIFO layers that have been built up over the years.

This recapture potential will be different for every pool, since each pool has its own history and characteristics. For auto dealers, this recapture impact will be different for the new auto pool compared to what it will be for the new light-duty truck pool. The LIFO reserve repayment potential impact should be computed for ***each*** LIFO pool and expressed as a readily understandable dollar amount. For an example of this type of successive calculation, see "GM Dealers

PROJECTIONS STEP-BY-STEP

1. ***Determine*** the cumulative index as of the end-of-the-year—this is the estimated current year inflation index times (i.e., multiplied by) the beginning-of-the-year cumulative index,
2. ***Divide*** the end-of-the-year estimated (or, if known, actual) inventory dollars by the year-end cumulative index—to determine the end-of-the-year inventory stated or expressed in base dollars,
3. ***Compare*** the end-of-the-year inventory expressed in base dollars with the beginning-of-the-year inventory stated in base dollars to determine whether there is an increment or a decrement projected for the year,
4. ***Value*** the projected increment under the method already selected for valuing increments on Form 970.

   Alternatively, if a decrement is projected for the year, carry back the decrement (expressed in base dollars) against prior years' increments (also expressed in base dollars) on a LIFO or reverse-chronological-order basis. This means that the most recent/last layer built up is the first one eliminated, and then prior years' layers are eliminated in reverse-chronological order. In other words, a decrement in 1999 is carried back first against any 1998 increment, then against 1997, then against 1996, then against 1995, etc. until the entire amount of the 1999 decrement (expressed in base dollars) has been fully accounted for. In some instances, a decrement may end up being carried all the way back to the original first LIFO year base layer.
5. ***Add*** all the resulting layers of inventory at their respective LIFO valuations to get the end-of-the-year inventory stated at its LIFO valuation,
6. ***Subtract*** the ending inventory at its LIFO valuation from the ending inventory at its actual or estimated current non-LIFO cost to determine the projected LIFO reserve as of the end-of-the-year,
7. ***Subtract*** the *actual* LIFO reserve as of the beginning-of-the-year from the projected LIFO reserve as of the end-of-the-year. The result determined in this final step is the estimate of the change in the LIFO reserve for the year.
8. ***Reconcile and prove out*** the projected changes to understand why the reserve is going up or down. See accompanying *Practice Guide:* ***Why LIFO Reserves Change the Way They Do***.

see **CONFORMITY REPORTING REQUIREMENTS**, page 17

<table>
<tr><th>Practice Guide</th><th>WHY LIFO RESERVES CHANGE THE WAY THEY DO</th></tr>
<tr><td>Background</td><td>
• Taxpayers using LIFO are often surprised when they find out that even though their year-end inventory levels are (projected to be) lower than they were at the beginning-of-the-year, their LIFO reserves (are expected to) increase.
♦ Often these (projected) increases in LIFO reserves are very large.</td></tr>
<tr><td>Change Factors</td><td>
• The net amount of change in the LIFO reserve for any year is the result of two complementing and/or offsetting factors.
• This variation analysis simply involves ...
♦ Price changes, i.e., inflation or deflation ... prices either increased or decreased, and
♦ Quantity changes, i.e., changes in the dollar amount of the inventory investment levels.</td></tr>
<tr><td colspan="2">Upward influences ... causing increases (i.e., factors causing the LIFO reserve to go up) ...</td></tr>
<tr><td>Upward ... Increases</td><td>
• Price increases ...inflation.
• Quantity increases, if a dual index LIFO methodology/approach is used for valuing increments.
• Certain decreases in inventory investment levels - To the extent that a current-year quantity decrease (referred to as a "decrement") is carried back against an increment built up in a prior year or years, any pay-back of the previously built-up LIFO increment and its related contribution to the LIFO reserve will increase the current year's LIFO reserve if ...
♦ There was deflation in the prior year(s)'s layers that are now being invaded, and
♦ The layers being invaded are/were contributing "negatively" or negative amounts to the LIFO reserve at the end of the preceding year.
♦ Stated another way ... The layers of inventory being invaded by the carryback of a decrement (expressed in base dollars) are contributing negative amounts toward the overall LIFO reserve balance; Accordingly, to the extent that any carryback of the current-year's decrement eliminates these negative effects, that leaves only inventory layers contributing positive amounts toward the overall LIFO reserve balance ... or fewer inventory layers still contributing negatively toward the overall LIFO reserve balance.</td></tr>
<tr><td colspan="2">Downward influences ... causing decreases (i.e., factors causing the LIFO reserve to go down) ...</td></tr>
<tr><td>Downward ... Decreases</td><td>
• Price decreases ...deflation.
• Decreases in inventory investment levels - i.e., pay-backs of previously built-up LIFO reserves to the extent resulting from the carryback of a current-year inventory quantity decrease (referred to as "decrements") against increases ("increments") built up in prior years.
• Decreases in inventory investment levels ... But not always ... Sometimes no payback.
♦ An inventory decrease/decrement may not necessarily cause, or result in, any pay-back of some or any of the LIFO reserve at the beginning of the year. Whether or not there is a "pay-back" depends the order in which the prior year layers were built up over time and how they were valued for LIFO purposes.</td></tr>
<tr><td>No Effect</td><td>
• If the decrement in the current year is less than the amount of the increment in the immediately preceding year, there will be no dollar change in the LIFO reserve due to the carryback of that decrement against that prior year's increment.
• This result will occur under any LIFO method that values a current-year increment by using the cumulative inflation index (factor) at the end of the year.
♦ Alternative LIFO Methods for New and/or Used Vehicles</td></tr>
<tr><td>Articles Analyzing Changes in LIFO Reserves</td><td>
• "Why Do Some LIFO Reserves Go Up Even Though Inventory Levels Go Down?" in the March 1992 LIFO Lookout
• "Another Rebasing Example - With Proofs: Why LIFO Reserves Go Up Even Though Inventory Levels Go Down and Despite Rebasing Indexes to 1.000 in Between" in the June 1993 LIFO Lookout.
• "Strange ... But Explainable ... Results from the Wacky World of Negative LIFO Reserves," in the December 1998 LIFO Lookout. This article, with supporting schedules, analyzes pay-back mechanics where negative LIFO reserves are involved.
• "Dealers Who've Remained on LIFO Through a Few Years of Deflation Are Finally Rewarded by Inflation & Big LIFO Reserve Increases" in the June 2004 LIFO Lookout.
♦ This article, with supporting schedules, analyzes LIFO reserve changes where some of the more recent years' LIFO layers reflect general price deflation, but not to the point where overall negative LIFO reserve balances have been created.</td></tr>
</table>

Low on LIFO Inventory May Face Stiff Recapture ... Planning May Lessen the Blow," in the June 1998 *Dealer Tax Watch*.

Armed with this diagnostic information, taxpayers anticipating a liquidation may be able to lessen the anticipated LIFO recapture in at least three ways. The second and third considerations below are discussed in the June 1998, *Dealer Tax Watch* article referenced above.

ALTERNATIVES

1. ***Manage inventory levels.*** Attempt to increase or "manage" the inventory level through transactions that might not otherwise have been considered, but which still have some degree of business justification (other than solely attempting to minimize the impact of LIFO layer liquidations).
2. ***Year-end change.*** If eligible, change to a fiscal year-end that is prior to the year-end expected to be adversely affected by the significant inventory reduction.
3. ***Switch to the IPIC/BLS method.*** Consider changing to the IPIC/BLS method under the recent changes...and expeditious consent procedure ... available in Section 10.04 of the Appendix to Revenue Procedure 2002-9.

   The IPIC Method LIFO Regulations (Reg. Sec. 1.472-8(e)(3)) were finalized in January, 2002, and contain several taxpayer-friendly changes that make use of the IPIC method more attractive in several situations. (See *Highlights of the Final IPIC LIFO Regulations*, pages 8-10 in the December, 2002 issue of the *LIFO Lookout.*)

If a business using LIFO is trying to avoid a significant year-end reserve reduction, steps to increase the inventory level should be completed and documented before year-end. These actions should be considered only if they make sense from a business standpoint, after considering carrying costs, insurance, expected ability to sell the additional inventory and the possibility of challenge by the IRS.

Despite cautions that inventory purchasing decisions should be based on sound business judgment and not solely on the desire to reduce projected LIFO pay-backs, some taxpayers may still wish to pursue more aggressive strategies and to take their chances in this regard.

As discussed in the next section, the IRS has been successful in challenging transactions that appeared to be motivated by the desire to avoid LIFO recapture impact. In these cases, the IRS ignored the last-ditch efforts that resulted in inventory on hand at

(Continued from page 15)

year-end which was not "intended to be sold or placed in the normal inventory channels."

Ideas dealers might consider if faced with significant projected decrements. A dealer might attempt to increase or "manage" the year-end inventory level by considering some transactions that otherwise would not have entered his mind. These may be rationalized under the "Nothing ventured, nothing gained" generalization. However, they may not necessarily be justified ***if*** the IRS digs deeply into them and sees them as motivated solely by liquidation-avoidance. Therefore, these strategies should be regarded by dealers and their advisors as aggressive and not without the likelihood of challenge by the IRS. They are only generalized here, and they should be carefully and more fully evaluated by the dealer's advisors before any further action is taken.

1. After determining which pool (new automobiles or new light-duty trucks) has the greater LIFO repayment potential, a dealer may simply try to have more inventory dollars in the pool with the greater repayment potential.

In other words, if the dealer can have only $2,000,000 worth of inventory, if the LIFO repayment payback potential is 30% on the dollar in the new automobile pool and 60% on the dollar in the new light-duty truck pool, the dealer should try to have more inventory dollars at year-end in the new light-duty truck pool than in the new automobile pool.

2. Attempt to purchase new vehicles of other makes (for resale to retail customers) to put into inventory.

Under the Alternative LIFO Method, all new automobiles, regardless of manufacturer, including those used as demonstrators, must be included in a dollar-value LIFO pool, and all new light-duty trucks regardless of manufacturer, must be included in another separate LIFO pool. Thus, the Alternative LIFO Method would appear to contemplate all new automobiles being placed in one pool, regardless of manufacturer. Accordingly, a GM dealer who has other non-GM franchises in the same selling entity as the GM franchise(s) might try to stock up on the non-GM new vehicles to the extent possible.

3. Similarly, a dealer might simply attempt to purchase (for retail sale) some very expensive makes (Lamborghini or Rolls Royce) and put them in the new automobiles pool. ("A few will do.") Does a dealer have to have that franchise to sell those vehicles? What about creating a special joint venture, or flow-through type entity with another *franchised* dealer?

see **CONFORMITY REPORTING REQUIREMENTS**, page 18

(Continued from page 17)

How far can the "retail resale" aspect be pushed? Will this pass muster with the IRS? One cannot be sure.

Caution: Section 4.02 of Revenue Procedure 97-36 does contain some troublesome language relating to LIFO pools. It states that *"for each separate trade or business,"* all autos, regardless of manufacturer, must be placed in one pool. No one really knows what *"for each separate trade or business"* really means, and the IRS has yet to define or explain it. If these words don't mean anything, why are they there? Might the IRS assert some specialized interpretation for this term under these circumstances?

In TAM 19991'1044, the IRS gave some indication of its interpretation of the "for each separate trade or business" language. In this TAM, the National Office allowed an auto dealer to keep all new autos in one pool and all new light-duty trucks in a separate pool, even though that dealer was involved with two manufacturers, five franchises and three locations, all of which were in the same city. For more on this TAM, see "Automobile Dealer with Multiple Franchises & Locations Can Use One Pool for all New Cars," *LIFO Lookout*, June 1999.

4. A dealer might actively seek out another dealer with less of a LIFO recapture impact potential and attempt to purchase inventory from that dealer, perhaps paying a "premium" or offering that dealer some other considerations for that inventory that makes the transaction economically attractive to both parties.

5. Dealers with multiple franchises in different entities should make similar LIFO recapture impact calculations for all their LIFO pools in all entities... to determine whether a shifting of inventory from one entity to another, if feasible, might create a favorable recapture-avoidance result.

6. Finally, although it may seem heresy, a dealer might consider not closing sales until after the end of the year. For some dealers, what they hope to realize in gross profit and potential customer loyalty may be smaller than the real dollar outflow that *definitely* will result from the reduction of inventory by sales which will *definitely* trigger the LIFO recapture. Some dealers may simply be unable to make the right decision on this.

SOMETIMES THE IRS REVERSES YEAR-END LIQUIDATION AVOIDANCE MEASURES

In 1996, the Tax Court observed that taxpayers often "desire a higher base-year cost of ending inventory in a given year to avoid liquidating a LIFO layer, causing a match of historical costs against current revenues" (see *E. W. Richardson*, Tax Court Memo Decision 1996-368).

The Court's observation was made in the context of three other cases and Revenue Ruling 79-188. All of these collectively stand for the proposition that the IRS may successfully overturn and even penalize year-end inventory transactions that are solely LIFO-benefit motivated.

1. ***Ingredient Technology Corporation*** (Su Crest Corporation, 83-1 USTC 9140, January 5, 1983). Tax fraud convictions by means of LIFO inventory overstatements.

2. ***Illinois Cereal Mills***, (86-1 USTC 9371 affirming T.C. Memo 1983-469, Dec. 40,342(M), 46 TCM 1001, August, 1983). Legal ownership of the goods did not justify inclusion in the taxpayer's inventory because the taxpayer did not intend to use the corn in its milling business.

3. ***Ballou and Company, Inc.***, (85-1 USTC 9290, U.S. Claims Court, No. 247-82T; March 29, 1985). The Court upheld the IRS' removal of year-end gold purchases from LIFO inventory calculations because the IRS adjustments removed only the amounts of gold that the taxpayer had purchased in order to temporarily inflate inventory levels solely for income tax/LIFO purposes at year end.

Revenue Ruling 79-188 can be given a positive spin and interpreted to indirectly suggest some planning considerations:

PLANNING CHECKLIST

1. Attempt to document that sales during the year are at levels that justify the purchase of year-end inventory levels in the ordinary course of business.
2. It helps if the inventory acquired at year-end can be sold to regular customers in due course or to a third party, rather than back to original supplier. This helps to avoid the "cast" as a resale.
3. The inventory acquired at year-end should be paid for before its subsequent sale, again in an effort to demonstrate an intent to receive and use the goods in the ordinary course of the business.
4. The specific mechanics of taking possession and title prior to reselling the inventory should also be considered. But note, even doing all this legally did not stop the IRS in *Illinois Cereal Mills*.

TAM 9847003 provides evidence of how closely the IRS scrutinizes year-end inventory levels and transactions. In this case, the IRS concluded that an affiliated group had engaged in inventory-level manipulation stating: "The Group simply used Y (one →

affiliated member) as a purchasing and holding company so that it could manipulate the quantity of goods in X's (another affiliated member) ending inventory, thereby artificially inflating X's cost of good sold ... This purchasing arrangement was designed to artificially reduce the Group's taxable income and avoid taxes; it had no independent purpose ... Although papers were drawn up to place formal ownership with Y, the ***objective economic realities*** indicate that X had effective command over the Y purchases."

Accordingly, the IRS National Office concluded that X was the owner of the Y purchases and should have included them in its inventory.

In this TAM, the IRS pursued the adjustment to correct the year-end inventory levels through the Group's corporate restructuring, holding that

1. X's method of accounting for the Y purchases carried over to the taxpayer created in the merger process,
2. the treatment of the purchases in inventory constituted an unauthorized change in method of accounting, and
3. corrections could be made by changing the new taxpayer's method of accounting and making adjustments pursuant to Section 481(a).

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

Any LIFO taxpayer aggressively planning to avoid year-end LIFO layer liquidations should realize that even satisfying the apparent "boundaries" set forth in Revenue Ruling 79-188 and these other cases may not be enough. Taxpayers' year-end transactions may not prevail if year-end purchases are structured to involve subsequent re-sales back to the same source shortly after year-end or just to otherwise look good on paper.

Other practical considerations should be weighed in the balance if aggressive year-end planning techniques are going to be discussed with LIFO clients. The Internal Revenue Service may seek to impose penalties, or higher statutory interest rates, if it considers the actions taken to avoid LIFO layer invasions and recapture to be without any support or merit.

Circular 230...? Furthermore, consideration needs to be given to Treasury Department Circular 230 which regulates written communications about Federal tax matters between tax advisors and their clients. Practitioners need to be extremely careful in how they go about discussing various layer-invasion minimization techniques with their clients and how they document or formalize their recommendations in this regard.

Correspondence with clients may or may not be intended to constitute written tax advice communications, and it may or may not constitute what Circular 230 defines as a full "covered opinion." Other issues under Circular 230 may be raised if the client is asking the advisor to reach a conclusion involving confidence levels regarding the success of the actions under consideration.

Accordingly, where appropriate, LIFO taxpayers may need to be told - in writing - that planning advice (regarding avoidance of LIFO layer invasions) is not intended and cannot be used for the purpose of avoiding penalties that may be imposed by the Internal Revenue Service.

YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON A "ONE-OF-EACH" MIX ASSUMPTION

Most auto dealers are under great pressure to release their year-end financial statements before their actual LIFO calculations can be completed. To assist in making year-end projections, each year we provide a listing for *new* vehicle LIFO inventories showing weighted average inflation (deflation) information for each model.

The summaries are on pages 21-22-23. For this year-end, again there is not a whole lot of inflation in the new vehicle indexes, based on our one-of-each item category compilations.

This low inflation is due to competitive pressures among the manufacturers and currency pressures. Also, this year some manufacturers changed option packages either to or from standard base vehicles.

There is some subjective language built into the tests under the Alternative LIFO Method for determining whether or not a vehicle is a "new" item or a "continuing" item. Our one-of-each inflation indexes for each manufacturer reflect all of these factors as well as our interpretations.

Our "one-of-each item category" report compares everything in our *SUPERLIFO* database as of December 9, 2005 ... with intro-2006 model prices, unless the 2006 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2004 is the reference date for the equivalent of the calendar year 2005 beginning of the year date; i.e., December 31, 2004/January 1, 2005.

The weighted averages are determined by taking all of the underlying item categories (for which information is currently available) and simplistically assuming that a dealer at year-end would have an inventory mix of one-of-each item category.

These simplified, one-of-each inflation indexes may be used in year-end projections as a substitute for some other arbitrary or assumed inflation rate (like 1%, 2% or 3%) or by some other guesswork.

Warning & Limitations. If you are going to use this information, please be aware of the following limitation. ... Our database is not entirely complete at this time because not all manufacturers have made their information available as we go to press. Notwithstanding this limitation, some readers have found our one-of-each inflation indexes to be useful in estimating LIFO reserve changes or in comparing their results with ours. The detailed analyses for each make and model appear on pages 24 to 31.

Reasonable Estimates. If you're going to reflect an *estimate* of the LIFO change for the year in a year-end Income Statement, that *estimate* should be a *reasonable* estimate in order to satisfy the IRS guidance found in Revenue Ruling 97-42.

Unfortunately, no one really has any idea of what the IRS will accept as reasonable...or reject as unreasonable. So be careful, and save your projection calculations just in case the IRS ever wants to see them.

When the year-end LIFO computations are made using all of the actual year-end invoices, the results based on detailed item categories may be significantly different from the projections based on one-of-each weighted averages. Also, a dealer's beginning-of-the-year average cost for an item category may be considerably lower than the intro dealer cost used in compiling the intro-to-intro averages, and this could result in a slightly higher inflation index.

The Best Way. A more accurate way to project LIFO changes is to input all of the dealer's invoices on hand as of a date close to the end of the year. By doing this, a more accurate weighted model mix is factored into the year-end LIFO reserve change projection. In addition, this process also factors in the actual average beginning-of-the-year item category costs for all of the continuing models.

We use this information in connection with many of our year-end LIFO reserve projection activities. In the December 2004 *LIFO Lookout*, we included an extensive look at how we do year-end projections including ***Practice Guides*** and sample formats showing ...

1. How you can come up with a LIFO projection for a new (i.e., first year) LIFO election without using special LIFO software.

2. Worksheet approach for determining a blended inflation rate to apply to an auto dealer's pool which contains multiple makes.

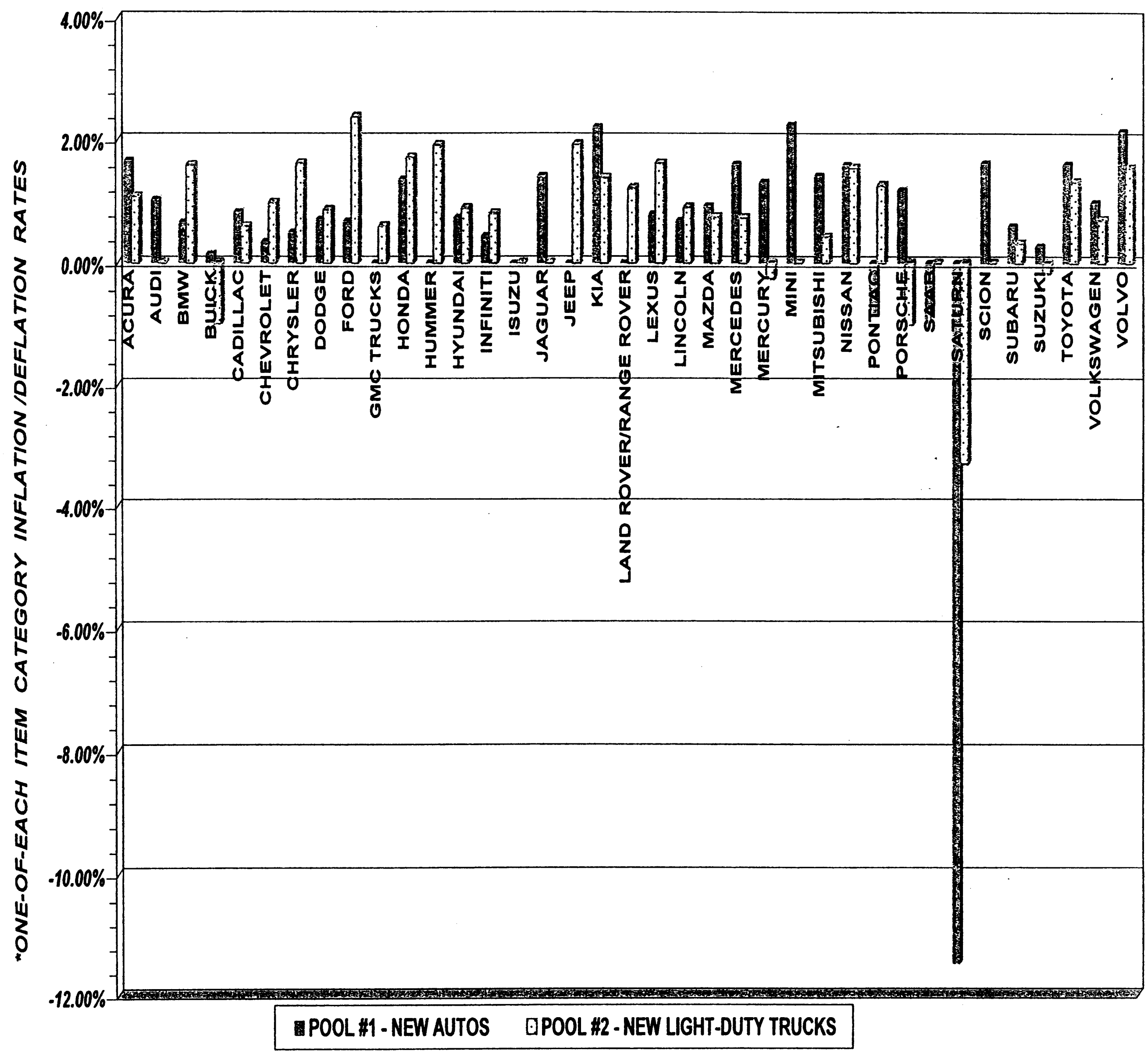
3. Schedule formats and correspondence that we use to summarize LIFO projection information for our clients.

MODEL/ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES DEALER COST FOR THE YEAR ENDED 12/31/05

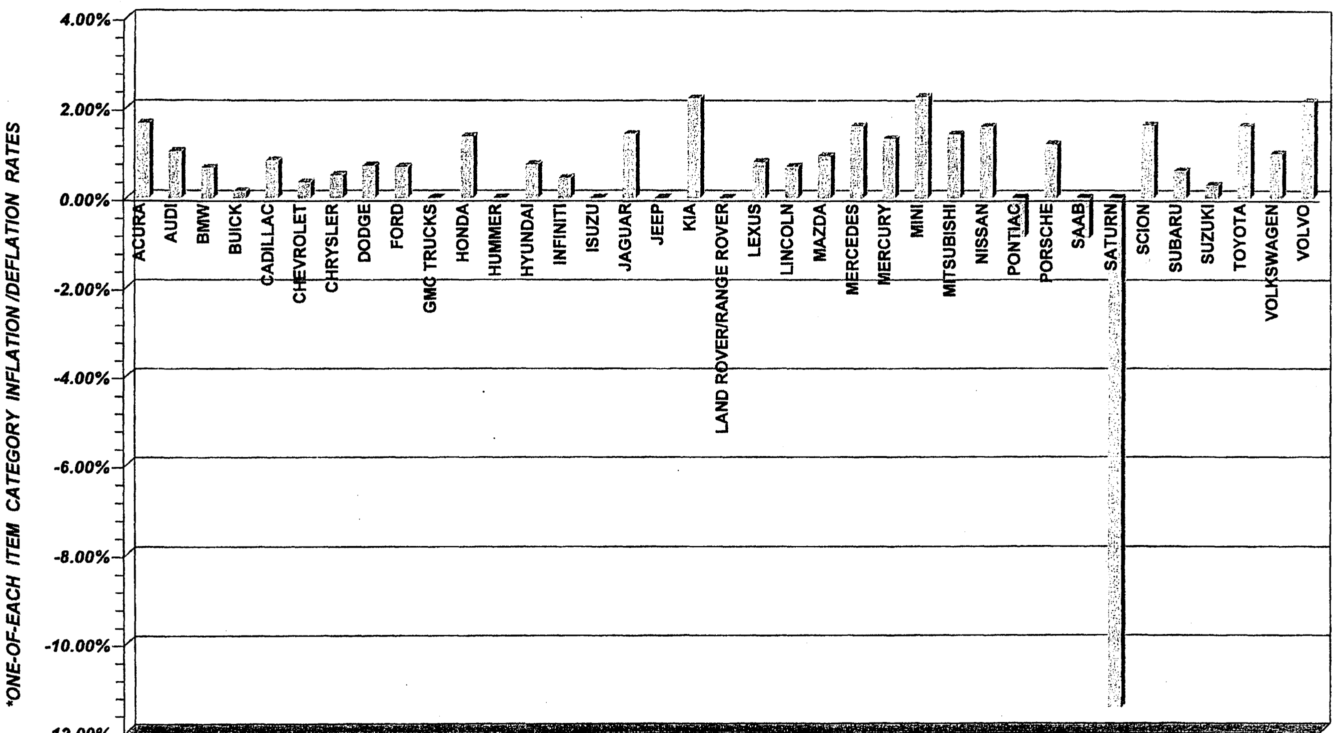
INFLATION ESTIMATE REPORT BY MAKE BASED ON INFORMATION AVAILABLE

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS
ACURA	1.66%	1.08%
AUDI	1.03%	0.00%
BMW	0.66%	1.59%
BUICK	0.15%	(0.98)%
CADILLAC	0.83%	0.60%
CHEVROLET	0.35%	0.98%
CHRYSLER	0.50%	1.62%
DODGE	0.71%	0.86%
FORD	0.68%	2.38%
GMC TRUCKS	0.00%	0.60%
HONDA	1.36%	1.72%
HUMMER	0.00%	1.92%
HYUNDAI	0.74%	0.89%
INFINITI	0.44%	0.81%
ISUZU	0.00%	0.00%
JAGUAR	1.42%	0.00%
JEEP	0.00%	1.93%
KIA	2.21%	1.39%
LAND ROVER/RANGE ROVER	0.00%	1.22%
LEXUS	0.79%	1.62%
LINCOLN	0.69%	0.90%
MAZDA	0.93%	0.75%
MERCEDES	1.60%	0.73%
MERCURY	1.31%	(0.25)%
MINI	2.25%	0.00%
MITSUBISHI	1.42%	0.43%
NISSAN	1.59%	1.54%
PONTIAC	(0.88)%	1.27%
PORSCHE	1.19%	(1.00)%
SAAB	(0.90)%	0.00%
SATURN	(11.48)%	(3.31)%
SCION	1.62%	0.00%
SUBARU	0.60%	0.32%
SUZUKI	0.28%	(0.16)%
TOYOTA	1.60%	1.32%
VOLKSWAGEN	0.98%	0.71%
VOLVO	2.15%	1.55%

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/05

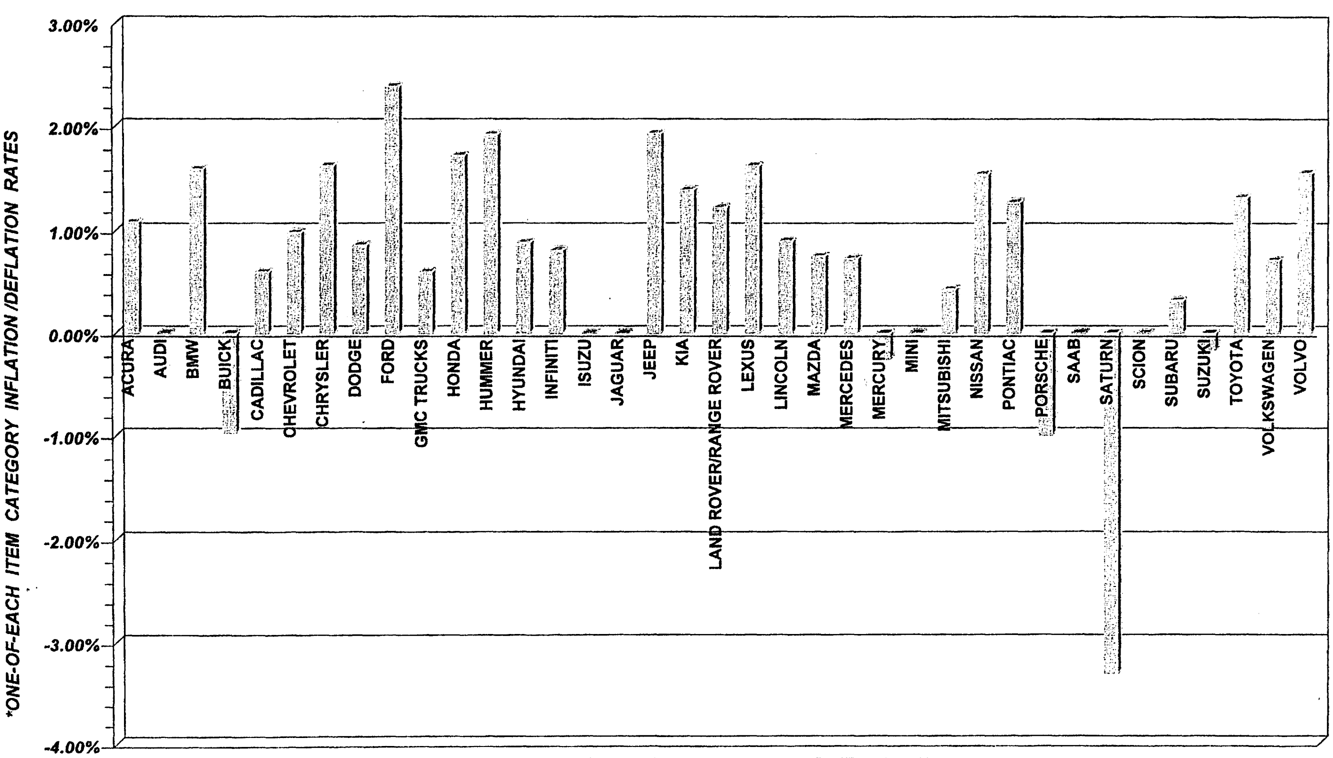


WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/05



POOL #1 - NEW AUTOS

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/05



POOL #2 - NEW LIGHT-DUTY TRUCKS

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
NSX-T	0	0	0				0	N/A%
RL	1	0	1	43,536		43,907	371	0.85%
RSX	5	0	5	98,673		99,682	1,009	1.02%
TL	6	0	6	185,719		188,131	2,412	1.30%
TSX	4	0	4	102,050		105,386	3,336	3.27%
TOTAL NEW AUTOS	16	0	16	429,978		437,106	7,128	1.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	5	0	5	183,132		185,117	1,985	1.08%
TOTAL NEW L-D TRUCKS	5	0	5	183,132		185,117	1,985	1.08%
TOTAL ACURA	21	0	21	613,110		622,223	9,113	1.49%
AUDI								
NEW AUTOS - POOL #1								
A3	0	3	3		79,009	79,009	0	0.00%
A4	2	11	13	73,826	330,874	407,288	2,588	0.64%
A6	2	2	4	86,240	80,059	170,259	3,960	2.38%
A8	3	0	3	234,805		238,993	4,188	1.78%
ALLROAD	0	0	0				0	N/A%
S4	2	5	7	100,402	230,558	332,242	1,282	0.39%
TT	6	0	6	211,392		214,120	2,728	1.29%
TOTAL NEW AUTOS	15	21	36	706,665	720,500	1,441,911	14,746	1.03%
TOTAL AUDI	15	21	36	706,665	720,500	1,441,911	14,746	1.03%
BMW								
NEW AUTOS - POOL #1								
3 SERIES	0	9	9		298,480	298,480	0	0.00%
5 SERIES	2	3	5	78,900	132,100	213,405	2,405	1.14%
6 SERIES	0	2	2		137,090	137,090	0	0.00%
7 SERIES	2	2	4	206,755	134,360	344,065	2,950	0.86%
M SERIES	2	1	3	93,825	73,910	169,955	2,220	1.32%
Z4	0	0	0				0	N/A%
TOTAL NEW AUTOS	6	17	23	379,480	775,940		7,575	0.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	1	0	1	33,035		33,510	475	1.44%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
X5	3	0	3	149,785		152,210	2,425	1.62%
TOTAL NEW L-D TRUCKS	4	0	4	182,820		185,720	2,900	1.59%
TOTAL BMW	10	17	27	562,300	775,940	1,348,715	10,475	0.78%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	3	0	3	70,003		70,277	274	0.39%
LUCERNE	0	4	4		111,055	111,055	0	0.00%
TOTAL NEW AUTOS	3	4	7	70,003	111,055	181,332	274	0.15%
NEW LIGHT-DUTY TRUCKS - POOL #2								
RAINIER	2	0	2	65,518		62,358	(3,160)	(4.82)%
RENDEZVOUS	2	0	2	51,359		51,587	228	0.44%
TERRAZA	4	0	4	112,334		113,026	692	0.62%
TOTAL NEW L-D TRUCKS	8	0	8	229,211		226,971	(2,240)	(0.98)%
TOTAL BUICK	11	4	15	299,214	111,055	408,303	(1,966)	(0.48)%
CADILLAC								
NEW AUTOS - POOL #1								
CTS	3	0	3	103,183		105,773	2,590	2.51%
DTS	0	4	4		168,609	168,609	0	0.00%
STS	2	0	2	80,984		81,900	916	1.13%
XLR	1	1	2	70,147	73,057	143,801	597	0.42%
TOTAL NEW AUTOS	6	5	11	254,314	241,666	500,083	4,103	0.83%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	5	0	5	266,741		270,628	3,887	1.46%
SRX	2	0	2	81,840		80,058	(1,782)	(2.18)%
TOTAL NEW L-D TRUCKS	7	0	7	348,581		350,686	2,105	0.60%
TOTAL CADILLAC	13	5	18	602,895	241,666	850,769	6,208	0.74%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	6	0	6	62,979		64,008	1,029	1.63%
COBALT	6	2	8	92,297	34,034	127,535	1,204	0.95%
CORVETTE	2	1	3	83,260	57,525	142,556	1,771	1.26%
IMPALA	0	6	6		135,036	135,036	0	0.00%
MALIBU	3	4	7	59,040	75,855	134,011	(884)	(0.66)%
MALIBU MAXX	3	1	4	61,341	22,260	83,300	(301)	(0.36)%
MONTE CARLO	0	5	5		111,675	111,675	0	0.00%
TOTAL NEW AUTOS	20	19	39	358,917	436,385	798,121	2,819	0.35%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	3	0	3	94,767		96,855	2,088	2.20%
COLORADO	10	1	11	177,918	14,831	200,787	8,038	4.17%
COLORADO CHASSIS CAB	0	1	1		16,359	16,359	0	0.00%
EQUINOX	4	0	4	84,741		87,408	2,667	3.15%
EXPRESS CARGO VAN	12	0	12	282,057		289,870	7,813	2.77%
EXPRESS CUTAWAY VAN	3	0	3	65,095		67,335	2,240	3.44%
EXPRESS PASSENGER VAN	5	0	5	126,398		127,736	1,338	1.06%
HHR	0	2	2		29,779	29,779	0	0.00%
SILVERADO 1500	36	14	50	918,352	407,948	1,339,933	13,633	1.03%
SILVERADO 2500HD	38	8	46	1,057,877	251,384	1,323,213	13,952	1.07%
SILVERADO 3500	30	19	49	880,577	560,862	1,452,980	11,541	0.80%
SILVERADO 3500 CHASSIS CABS	2	0	2	44,174		44,583	409	0.93%
SSR	1	0	1	39,789		36,783	(3,006)	(7.55)%
SUBURBAN	4	2	6	141,644	68,674	213,026	2,708	1.29%
TAHOE	2	4	6	64,392	129,218	195,974	2,364	1.22%
TRAILBLAZER	8	0	8	226,521		218,055	(8,466)	(3.74)%
UPLANDER	4	5	9	96,830	113,612	210,762	320	0.15%
TOTAL NEW L-D TRUCKS	162	56	218	4,301,132	1,592,667	5,951,438	57,639	0.98%
TOTAL CHEVROLET	182	75	257	4,660,049	2,029,052	6,749,559	60,458	0.90%
CHRYSLER								
NEW AUTOS - POOL #1								
300	18	3	21	496,683	112,289	615,167	6,195	1.02%
CROSSFIRE	18	0	18	642,228		641,198	(1,030)	(0.16)%
SEBRING	13	3	16	294,039	66,908	363,819	2,872	0.80%
TOTAL NEW AUTOS	49	6	55	1,432,950	179,197	1,620,184	8,037	0.50%
NEW LIGHT-DUTY TRUCKS - POOL #2								
PACIFICA	15	0	15	408,699		414,149	5,450	1.33%
PT CRUISER	13	0	13	265,811		272,539	6,728	2.53%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
TOWN & COUNTRY	8	0	8	190,239		192,057	1,818	0.96%
TOTAL NEW L-D TRUCKS	36	0	36	864,749		878,745	13,996	1.62%
TOTAL CHRYSLER	85	6	91	2,297,699	179,197	2,498,929	22,033	0.89%
DODGE								
NEW AUTOS - POOL #1								
CHARGER	0	12	12		315,141	315,141	0	0.00%
MAGNUM	15	6	21	385,206	170,073	560,736	5,457	0.98%
STRATUS	2	0	2	38,862		40,590	1,728	4.45%
VIPER	1	1	2	74,236	75,704	150,296	356	0.24%
TOTAL NEW AUTOS	18	19	37	498,304	560,918	1,066,763	7,541	0.71%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CARAVAN	10	0	10	210,822		214,053	3,231	1.53%
DAKOTA	48	0	48	1,057,222		1,082,032	24,810	2.35%
DURANGO	16	8	24	482,188	219,082	718,538	17,268	2.46%
RAM PICKUP	48	209	257	1,351,948	6,439,107	7,826,204	35,149	0.45%
SPRINTER	13	0	13	365,547		372,595	7,048	1.93%
TOTAL NEW L-D TRUCKS	135	217	352	3,467,727	6,658,189	10,213,422	87,506	0.86%
TOTAL DODGE	153	236	389	3,966,031	7,219,107	11,280,185	95,047	0.85%
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	6	0	6	148,473		152,237	3,764	2.54%
FIVE HUNDRED	6	0	6	137,230		139,107	1,877	1.37%
FOCUS	12	0	12	177,772		173,795	(3,977)	(2.24)%
FUSION	0	5	5		88,976	88,976	0	0.00%
GT	0	0	0				0	N/A%
MUSTANG	4	6	10	80,915	140,807	224,495	2,773	1.25%
TAURUS	2	0	2	39,908		40,527	619	1.55%
THUNDERBIRD	3	0	3	109,731		110,926	1,195	1.09%
TOTAL NEW AUTOS	33	11	44	694,029	229,783	930,063	6,251	0.68%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY VAN	2	0	2	42,954		43,641	687	1.60%
E-SERIES	18	0	18	426,446		442,110	15,664	3.67%
ESCAPE	14	0	14	308,186		311,724	3,538	1.15%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
EXPEDITION	14	0	14	467,088		473,507	6,419	1.37%
EXPLORER	9	5	14	270,059	140,422	400,202	(10,279)	(2.50)%
F150 PICKUP	48	2	50	1,200,411	64,808	1,307,852	42,633	3.37%
F250 SUPER DUTY PICKUP	28	4	32	740,942	143,796	912,255	27,517	3.11%
F350 SUPER DUTY PICKUP	56	0	56	1,608,348		1,662,913	54,565	3.39%
FREESTAR	4	0	4	99,518		91,727	(7,791)	(7.83)%
FREESTYLE	6	0	6	150,835		152,817	1,982	1.31%
RANGER	15	8	23	261,589	158,918	425,893	5,386	1.28%
SUPER DUTY CAB/CHASSIS	36	0	36	949,180		976,235	27,055	2.85%
TOTAL NEW L-D TRUCKS	250	19	269	6,525,556	507,944	7,200,876	167,376	2.38%
TOTAL FORD	283	30	313	7,219,585	737,727	8,130,939	173,627	2.18%
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
CANYON	8	6	14	140,127	110,890	255,509	4,492	1.79%
CANYON CHASSIS CAB	0	1	1		16,507	16,507	0	0.00%
ENVOY	4	0	4	119,994		115,227	(4,767)	(3.97)%
ENVOY DENALI	4	0	4	145,914		140,086	(5,828)	(3.99)%
ENVOY XL	4	0	4	126,004		120,040	(5,964)	(4.73)%
SAVANA CARGO VAN	12	0	12	282,057		289,870	7,813	2.77%
SAVANA CUTAWAY VAN	3	0	3	65,095		67,335	2,240	3.44%
SAVANA PASSENGER VAN	5	0	5	126,398		127,736	1,338	1.06%
SIERRA 3500 CHASSIS-CABS	18	2	20	456,650	61,817	523,428	4,961	0.96%
SIERRA HEAVY-DUTY PICKUP	42	10	52	1,221,731	317,228	1,549,922	10,963	0.71%
SIERRA PICKUP	63	19	82	1,756,263	579,661	2,350,858	14,934	0.64%
YUKON	8	8	16	298,226	269,988	574,338	6,124	1.08%
TOTAL NEW L-D TRUCKS	171	46	217	4,738,459	1,356,091	6,130,856	36,306	0.60%
TOTAL GMC TRUCKS	171	46	217	4,738,459	1,356,091	6,130,856	36,306	0.60%
HONDA								
NEW AUTOS - POOL #1								
ACCORD	42	15	57	947,369	309,259	1,277,547	20,919	1.66%
CIVIC	0	18	18		299,523	299,523	0	0.00%
INSIGHT	3	0	3	56,922		57,357	435	0.76%
S2000	1	0	1	29,640		30,633	993	3.35%
TOTAL NEW AUTOS	46	33	79	1,033,931	608,782	1,665,060	22,347	1.36%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
CR-V	5	0	5	103,495		105,365	1,870	1.81%
ELEMENT	8	4	12	142,104	78,452	224,748	4,192	1.90%
ODYSSEY	7	0	7	198,224		204,159	5,935	2.99%
PILOT	5	5	10	141,352	140,250	285,891	4,289	1.52%
RIDGELINE	0	5	5		140,851	140,851	0	0.00%
TOTAL NEW L-D TRUCKS	25	14	39	585,175	359,553	961,014	16,286	1.72%
TOTAL HONDA	71	47	118	1,619,106	968,335	2,626,074	38,633	1.49%
HUMMER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
H2	1	0	1	47,063		48,477	1,414	3.00%
H3	0	1	1		26,476	26,476	0	0.00%
TOTAL NEW L-D TRUCKS	1	1	2	47,063	26,476	74,953	1,414	1.92%
TOTAL HUMMER	1	1	2	47,063	26,476	74,953	1,414	1.92%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	5	0	5	51,419		52,312	893	1.74%
AZERA	0	2	2		46,052	46,052	0	0.00%
ELANTRA	11	0	11	149,206		151,217	2,011	1.35%
SONATA	0	5	5		91,956	91,956	0	0.00%
TIBURON	5	2	7	84,443	38,352	122,717	(78)	(0.06)%
XG350	2	0	2	45,358		46,258	900	1.98%
TOTAL NEW AUTOS	23	9	32	330,426	176,360	510,512	3,726	0.74%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SANTA FE	6	0	6	131,921		132,650	729	0.55%
TUCSON	7	0	7	131,660		133,277	1,617	1.23%
TOTAL NEW L-D TRUCKS	13	0	13	263,581		265,927	2,346	0.89%
TOTAL HYUNDAI	36	9	45	594,007	176,360	776,439	6,072	0.79%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
INFINITI								
NEW AUTOS - POOL #1								
G35	5	0	5	146,300		147,627	1,327	0.91%
M35	0	3	3		115,435	115,435	0	0.00%
M45	0	2	2		88,843	88,843	0	0.00%
Q45	1	0	1	51,343		51,801	458	0.89%
TOTAL NEW AUTOS	6	5	11	197,643	204,278	403,706	1,785	0.44%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FX35	2	0	2	65,284		65,926	642	0.98%
FX45	1	0	1	41,580		41,900	320	0.77%
QX56	2	0	2	90,952		91,592	640	0.70%
TOTAL NEW L-D TRUCKS	5	0	5	197,816		199,418	1,602	0.81%
TOTAL INFINITI	11	5	16	395,459	204,278	603,124	3,387	0.56%
ISUZU								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASCENDER	0	0	0				0	N/A%
I-280	0	3	3		49,110	49,110	0	0.00%
I-350	0	1	1		25,717	25,717	0	0.00%
TOTAL NEW L-D TRUCKS	0	4	4		74,827	74,827	0	0.00%
TOTAL ISUZU	0	4	4		74,827	74,827	0	0.00%
JAGUAR								
NEW AUTOS - POOL #1								
S-TYPE	3	0	3	140,042		146,048	6,006	4.29%
X-TYPE	2	0	2	64,300		62,482	(1,818)	(2.83)%
XJ SERIES	5	1	6	326,375	104,950	442,695	11,370	2.64%
XK SERIES	4	4	8	284,214	300,484	586,515	1,817	0.31%
TOTAL NEW AUTOS	14	5	19	814,931	405,434	1,237,740	17,375	1.42%
TOTAL JAGUAR	14	5	19	814,931	405,434	1,237,740	17,375	1.42%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMMANDER	0	12	12		361,297	361,297	0	0.00%
GRAND CHEROKEE	12	1	13	332,858	38,400	386,190	14,932	4.02%
LIBERTY	6	0	6	126,436		131,860	5,424	4.29%
WRANGLER	11	0	11	244,918		245,903	985	0.40%
TOTAL NEW L-D TRUCKS	29	13	42	704,212	399,697	1,125,250	21,341	1.93%
TOTAL JEEP	29	13	42	704,212	399,697	1,125,250	21,341	1.93%
KIA								
NEW AUTOS - POOL #1								
AMANTI	1	0	1	22,860		23,130	270	1.18%
OPTIMA	5	0	5	83,050		85,435	2,385	2.87%
RIO	0	5	5		61,015	61,015	0	0.00%
SPECTRA	8	0	8	109,760		113,210	3,450	3.14%
TOTAL NEW AUTOS	14	5	19	215,670	61,015	282,790	6,105	2.21%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SEDONA	2	0	2	40,130		41,460	1,330	3.31%
SORENTO	6	0	6	126,085		128,825	2,740	2.17%
SPORTAGE	0	7	7		127,625	127,625	0	0.00%
TOTAL NEW L-D TRUCKS	8	7	15	166,215	127,625	297,910	4,070	1.39%
TOTAL KIA	22	12	34	381,885	188,640	580,700	10,175	1.78%
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER FREELANDER	0	0	0				0	N/A%
LAND ROVER LR3	3	0	3	120,069		123,627	3,558	2.96%
RANGE ROVER	1	3	4	66,507	195,153	262,752	1,092	0.42%
TOTAL NEW L-D TRUCKS	4	3	7	186,576	195,153	386,379	4,650	1.22%
TOTAL LAND ROVER/RANGE ROVER	4	3	7	186,576	195,153	386,379	4,650	1.22%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LEXUS								
NEW AUTOS - POOL #1								
ES 330	1	0	1	28,350		28,640	290	1.02%
GS 300	0	2	2		77,659	77,659	0	0.00%
GS 430	0	1	1		44,694	44,694	0	0.00%
IS 250	0	3	3		83,976	83,976	0	0.00%
IS 350	0	1	1		31,186	31,186	0	0.00%
LS 430	1	0	1	48,435		49,176	741	1.53%
SC 430	1	0	1	54,960		56,858	1,898	3.45%
TOTAL NEW AUTOS	3	7	10	131,745	237,515	372,189	2,929	0.79%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 470	1	0	1	39,822		40,484	662	1.66%
LX 470	1	0	1	56,352		58,544	2,192	3.89%
RX 330	2	0	2	64,557		65,611	1,054	1.63%
RX 400H	0	2	2		80,738	80,738	0	0.00%
TOTAL NEW L-D TRUCKS	4	2	6	160,731	80,738	245,377	3,908	1.62%
TOTAL LEXUS	7	9	16	292,476	318,253	617,566	6,837	1.12%
LINCOLN								
NEW AUTOS - POOL #1								
LS	5	1	6	173,103	36,182	210,450	1,165	0.56%
TOWN CAR	6	1	7	244,405	42,662	289,496	2,429	0.85%
ZEPHYR	0	1	1		26,711	26,711	0	0.00%
TOTAL NEW AUTOS	11	3	14	417,508	105,555	526,657	3,594	0.69%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARK LT	0	2	2		71,178	71,178	0	0.00%
NAVIGATOR	4	0	4	186,178		188,495	2,317	1.24%
TOTAL NEW L-D TRUCKS	4	2	6	186,178	71,178	259,673	2,317	0.90%
TOTAL LINCOLN	15	5	20	603,686	176,733	786,330	5,911	0.76%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA 3	6	12	18	88,664	202,582	292,414	1,168	0.40%
MAZDA 6	17	6	23	360,254	142,117	510,223	7,852	1.56%
MAZDASPEED 6	0	2	2		53,441	53,441	0	0.00%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MIATA MX-5	0	6	6		127,822	127,822	0	0.00%
MX-5 MIATA	0	0	0				0	N/A%
RX-8	0	0	0				0	N/A%
TOTAL NEW AUTOS	23	26	49	448,918	525,962		9,020	0.93%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MAZDA 5	0	2	2		34,065	34,065	0	0.00%
MPV	2	1	3	47,550	20,475	68,099	74	0.11%
TRIBUTE	6	0	6	121,703		124,623	2,920	2.40%
TRUCK	10	0	10	187,530		187,608	78	0.04%
TOTAL NEW L-D TRUCKS	18	3	21	356,783	54,540	414,395	3,072	0.75%
TOTAL MAZDA	41	29	70	805,701	580,502	1,398,295	12,092	0.87%
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	2	3	5	77,330	103,278	181,072	464	0.26%
CL CLASS	4	0	4	481,926		488,343	6,417	1.33%
CLK CLASS	3	2	5	182,095	92,489	277,699	3,115	1.13%
CLS CLASS	0	2	2		140,895	140,895	0	0.00%
E CLASS	5	5	10	283,999	271,840	563,999	8,160	1.47%
S CLASS	6	2	8	516,197	217,527	746,421	12,697	1.73%
SL CLASS	4	0	4	481,647		496,434	14,787	3.07%
SLK CLASS	2	1	3	98,580	39,897	140,756	2,279	1.65%
TOTAL NEW AUTOS	26	15	41	2,121,774	865,926	3,035,619	47,919	1.60%
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	2	0	2	165,168		167,679	2,511	1.52%
M CLASS	0	2	2		82,073	82,073	0	0.00%
R CLASS	0	2	2		96,255	96,255	0	0.00%
TOTAL NEW L-D TRUCKS	2	4	6	165,168	178,328	346,007	2,511	0.73%
TOTAL MERCEDES	28	19	47	2,286,942	1,044,254	3,381,626	50,430	1.51%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	4	0	4	101,954		104,013	2,059	2.02%
MILAN	0	4	4		76,236	76,236	0	0.00%
MONTEGO	4	0	4	96,340		97,868	1,528	1.59%
TOTAL NEW AUTOS	8	4	12	198,294	76,236	278,117	3,587	1.31%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	6	1	7	132,572	27,140	161,832	2,120	1.33%
MONTEREY	1	0	1	29,528		26,332	(3,196)	(10.82)%
MOUNTAINEER	0	8	8		237,466	237,466	0	0.00%
TOTAL NEW L-D TRUCKS	7	9	16	162,100	264,606	425,630	(1,076)	(0.25)%
TOTAL MERCURY	15	13	28	360,394	340,842	703,747	2,511	0.36%
MINI								
NEW AUTOS - POOL #1								
COOPER	4	0	4	73,530		75,182	1,652	2.25%
TOTAL NEW AUTOS	4	0	4	73,530		75,182	1,652	2.25%
TOTAL MINI	4	0	4	73,530		75,182	1,652	2.25%
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	0	4	4		83,214	83,214	0	0.00%
GALANT	4	0	4	83,038		84,829	1,791	2.16%
LANCER	8	1	9	155,775	29,593	188,577	3,209	1.73%
TOTAL NEW AUTOS	12	5	17	238,813	112,807	356,620	5,000	1.42%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	4	0	4	112,344		110,933	(1,411)	(1.26)%
MONTERO	1	0	1	33,723		34,061	338	1.00%
OUTLANDER	6	2	8	119,746	42,798	166,335	3,791	2.33%
RAIDER	0	13	13		325,188	325,188	0	0.00%
TOTAL NEW L-D TRUCKS	11	15	26	265,813	367,986	636,517	2,718	0.43%
TOTAL MITSUBISHI	23	20	43	504,626	480,793	993,137	7,718	0.78%
NISSAN								
NEW AUTOS - POOL #1								
350Z	10	4	14	302,637	140,651	448,268	4,980	1.12%
ALTIMA	12	0	12	245,311		249,513	4,202	1.71%
MAXIMA	3	0	3	76,670		78,178	1,508	1.97%
SENTRA	6	0	6	85,501		88,319	2,818	3.30%
TOTAL NEW AUTOS	31	4	35	710,119	140,651	864,278	13,508	1.59%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	5	0	5	172,511		177,284	4,773	2.77%
FRONTIER PICKUP	0	0	0				0	N/A%
MURANO	5	0	5	132,882		136,679	3,797	2.86%
PATHFINDER	7	0	7	188,044		192,639	4,595	2.44%
QUEST	4	0	4	97,792		100,824	3,032	3.10%
TITAN	12	12	24	309,145	316,376	632,752	7,231	1.16%
XTERRA	0	14	14		308,129	308,129	0	0.00%
TOTAL NEW L-D TRUCKS	33	26	59	900,374	624,505	1,548,307	23,428	1.54%
TOTAL NISSAN	64	30	94	1,610,493	765,156	2,412,585	36,936	1.55%
PONTIAC								
NEW AUTOS - POOL #1								
BONNEVILLE	0	0	0				0	N/A%
G6	2	5	7	40,238	99,095	138,485	(848)	(0.61)%
GRAND AM	0	0	0				0	N/A%
GRAND PRIX	3	0	3	72,400		71,461	(939)	(1.30)%
GTO	1	0	1	29,873		29,550	(323)	(1.08)%
SOLSTICE	0	1	1		18,158	18,158	0	0.00%
VIBE	3	0	3	53,940		53,285	(655)	(1.21)%
TOTAL NEW AUTOS	9	6	15	196,451	117,253	310,939	(2,765)	(0.88)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MONTANA	3	0	3	72,500		73,974	1,474	2.03%
TORRENT	0	2	2		43,525	43,525	0	0.00%
TOTAL NEW L-D TRUCKS	3	2	5	72,500	43,525	117,499	1,474	1.27%
TOTAL PONTIAC	12	8	20	268,951	160,778	428,438	(1,291)	(0.30)%
PORSCHE								
NEW AUTOS - POOL #1								
911	1	0	1	60,497		62,248	1,751	2.89%
BOXSTER	0	2	2		86,937	86,937	0	0.00%
TOTAL NEW AUTOS	1	2	3	60,497	86,937	149,185	1,751	1.19%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	2	0	2	87,550		86,675	(875)	(1.00)%
TOTAL NEW L-D TRUCKS	2	0	2	87,550		86,675	(875)	(1.00)%
TOTAL PORSCHE	3	2	5	148,047	86,937	235,860	876	0.37%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SAAB								
NEW AUTOS - POOL #1								
9-2X	2	0	2	47,444		47,444	0	0.00%
9-3 SERIES	2	4	6	71,094	125,270	194,864	(1,500)	(0.76)%
9-5 SERIES	2	2	4	68,561	64,623	131,296	(1,888)	(1.42)%
TOTAL NEW AUTOS	6	6	12	187,099	189,893	373,604	(3,388)	(0.90)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
9-7X	0	2	2		72,716	72,716	0	0.00%
TOTAL NEW L-D TRUCKS	0	2	2		72,716	72,716	0	0.00%
TOTAL SAAB	6	8	14	187,099	262,609	446,320	(3,388)	(0.75)%
SATURN								
NEW AUTOS - POOL #1								
ION 2	4	0	4	56,406		47,596	(8,810)	(15.62)%
ION 3	4	0	4	62,498		56,980	(5,518)	(8.83)%
ION RED LINE	1	0	1	19,477		17,925	(1,552)	(7.97)%
TOTAL NEW AUTOS	9	0	9	138,381		122,501	(15,880)	(11.48)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
RELAY	3	0	3	75,017		74,515	(502)	(0.67)%
VUE	4	0	4	78,931		74,345	(4,586)	(5.81)%
TOTAL NEW L-D TRUCKS	7	0	7	153,948		148,860	(5,088)	(3.31)%
TOTAL SATURN	16	0	16	292,329		271,361	(20,968)	(7.17)%
SCION								
NEW AUTOS - POOL #1								
TC	2	0	2	31,064		31,540	476	1.53%
XA	2	0	2	24,470		24,946	476	1.95%
XB	2	0	2	26,750		27,130	380	1.42%
TOTAL NEW AUTOS	6	0	6	82,284		83,616	1,332	1.62%
TOTAL SCION	6	0	6	82,284		83,616	1,332	1.62%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	10	11	21	202,246	274,072	479,236	2,918	0.61%
LEGACY	11	10	21	269,711	259,308	532,180	3,161	0.60%
TOTAL NEW AUTOS	21	21	42	471,957	533,380	1,011,416	6,079	0.60%
NEW LIGHT-DUTY TRUCKS - POOL #2								
B9 TRIBECA	0	16	16		504,308	504,308	0	0.00%
BAJA	5	0	5	111,723		113,522	1,799	1.61%
FORESTER	0	6	6		138,586	138,586	0	0.00%
OUTBACK	8	8	16	212,610	237,764	452,440	2,066	0.46%
TOTAL NEW L-D TRUCKS	13	30	43	324,333	880,658	1,208,856	3,865	0.32%
TOTAL SUBARU	34	51	85	796,290	1,414,038	2,220,272	9,944	0.45%
SUZUKI								
NEW AUTOS - POOL #1								
AERIO	8	3	11	123,344	43,101	164,053	(2,392)	(1.44)%
FORENZA	8	8	16	114,368	120,568	236,912	1,976	0.84%
RENO	4	2	6	56,234	28,030	84,474	210	0.25%
VERONA	3	0	3	55,321		57,021	1,700	3.07%
TOTAL NEW AUTOS	23	13	36	349,267	191,699	542,460	1,494	0.28%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GRAND VITARA	0	12	12		245,172	245,172	0	0.00%
XL-7	4	2	6	96,896	43,870	140,154	(612)	(0.43)%
TOTAL NEW L-D TRUCKS	4	14	18	96,896	289,042	385,326	(612)	(0.16)%
TOTAL SUZUKI	27	27	54	446,163	480,741	927,786	882	0.10%
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	0	4	4		106,686	106,686	0	0.00%
CAMRY	10	0	10	188,558		192,142	3,584	1.90%
CAMRY SOLARA	10	0	10	208,196		211,440	3,244	1.56%
COROLLA	7	0	7	96,884		98,961	2,077	2.14%
ECHO	4	0	4	41,430		41,806	376	0.91%
MATRIX	7	0	7	108,013		110,252	2,239	2.07%
PRIUS	1	0	1	19,222		20,006	784	4.08%
TOTAL NEW AUTOS	39	4	43	662,303	106,686	781,293	12,304	1.60%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/05
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/04 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	12	0	12	341,256		349,434	8,178	2.40%
HIGHLANDER	8	4	12	190,774	129,517	323,552	3,261	1.02%
LAND CRUISER	1	0	1	48,146		49,100	954	1.98%
RAV4	0	12	12		255,520	255,520	0	0.00%
SEQUOIA	4	0	4	137,623		138,869	1,246	0.91%
SIENNA	9	0	9	231,393		234,941	3,548	1.53%
TACOMA PICKUP	18	0	18	327,235		333,322	6,087	1.86%
TUNDRA	18	0	18	414,724		418,881	4,157	1.00%
TOTAL NEW L-D TRUCKS	70	16	86	1,691,151	385,037	2,103,619	27,431	1.32%
TOTAL TOYOTA	109	20	129	2,353,454	491,723	2,884,912	39,735	1.40%
VOLKSWAGEN								
NEW AUTOS - POOL #1								
GOLF	5	0	5	85,718		85,465	(253)	(0.30)%
GTI	2	0	2	36,727		38,125	1,398	3.81%
JETTA	0	14	14		277,275	277,275	0	0.00%
NEW BEETLE	2	7	9	38,443	132,770	168,307	(2,906)	(1.70)%
PASSAT	0	6	6		145,278	145,278	0	0.00%
PHAETON	4	0	4	298,948		310,686	11,738	3.93%
TOTAL NEW AUTOS	13	27	40	459,836	555,323	1,025,136	9,977	0.96%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TOUAREG	2	0	2	73,899		74,423	524	0.71%
TOTAL NEW L-D TRUCKS	2	0	2	73,899		74,423	524	0.71%
TOTAL VOLKSWAGEN	15	27	42	533,735	555,323	1,099,559	10,501	0.96%
VOLVO								
NEW AUTOS - POOL #1								
40 SERIES	3	0	3	72,515		74,140	1,625	2.24%
50 SERIES	3	0	3	77,027		78,746	1,719	2.23%
60 SERIES	4	0	4	123,896		124,484	588	0.47%
70 SERIES	3	0	3	96,286		98,513	2,227	2.31%
80 SERIES	2	0	2	69,112		72,398	3,286	4.75%
TOTAL NEW AUTOS	15	0	15	438,836		448,281	9,445	2.15%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	2	0	2	75,491		76,662	1,171	1.55%
TOTAL NEW L-D TRUCKS	2	0	2	75,491		76,662	1,171	1.55%
TOTAL VOLVO	17	0	17	514,327		524,943	10,616	2.06%

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Willard J. De Filipps, C.P.A., P.C.
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