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A Quarterly Update of LIFO - News, Views and Ideas

LIFO LOOKOUT

Volume 16, Number 1

Publisher: Willard J. De Filippis, C.P.A.

March 2006

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. INDEX OF LIFO LOOKOUT ARTICLES

THROUGH DEC. 31, 2005. We have expanded and updated our *Index* of all articles appearing in the *LIFO Lookout* from our first issue, March, 1991, through December, 2005.

This *Index of Articles* is available for your review on our web site, www.defilippis.com. You can print the *Index* out on your own or, if you prefer, contact us for a printed copy.

This *Index of Articles* is divided into seventeen sections which list all articles by key topic or subject. It also includes *Finding Lists* for all tax cases, Revenue Rulings and Procedures, Letter Rulings (including TAMs), IRS Coordinated Issue Papers, Field Service Advice Memoranda, Motor Vehicle Technical Advisor *Automotive Alerts*, and *Practice Guides*.

Typo correction. In the course of updating our compilation, I noticed that in Update #6 on page 2 of the September 2005 *LIFO Lookout*, the reference to the IRS Ruling on financial statement conformity should have been to LTR 200540005.

#2. DID YOUR DEALERS' LIFO RESERVES GET WHACKED? In our last issue, (Update #2) we asked whether you thought your dealers' LIFO reserves were going to get "whacked" ... by which we meant: were they going to be severely reduced at Dec. 31, 2005?

Reviewing our own recent experience on this, and reflecting on conversations with several other CPAs, here's the way things turned out.

For new vehicles ... overall inventory levels were considerably lower at year-end 2005 than they were at the end of 2004.

As a result, decrements of various sizes were carried back against prior years' increments. The extent to which any dealer's LIFO reserve was reduced by this process depended on which years' layers were being invaded. As we've generalized

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about this before, whether a dealer has a large repayment, a small repayment, or no repayment at all of the LIFO reserve depends on the specific LIFO layer structure and valuations for those layers.

All Saturn dealers using the Alternative LIFO Method ... were burned severely by major **deflation** in new vehicle prices.

This result had nothing to do with the levels of their year-end inventories. As discussed more fully in Update #3, many Saturn dealers felt they had virtually no choice but to go off LIFO, rather than face the consequences of staying on.

For used vehicles on LIFO ... the results for 2005 were more favorable than in prior years. In looking at the used vehicle LIFO calculations for 20 dealerships (selected at random from all over the country, rather than concentrated in one area), here's what we found.

Pool #1 - Used automobiles ... in 19 out of 20 calculations for this pool, there was inflation rather than deflation. The inflation rates ranged from just slightly over ½% to as high as 9%. The used vehicle inventories showing the inflation percentages at the high end of the range were located in the Southwest.

Pool #2 - Used light-duty trucks ... only 5 out of 20 used truck pools showed inflation, meaning that 15 see **LIFO UPDATE**, page 2

showed deflation ranging from just over zero to almost 6% deflation.

Some of these dealers who are still on LIFO for used vehicles experienced a second windfall. If their inventory levels dropped at the end of 2005, the decrements they experienced were carried back to preceding years where the layers for those years had contributed negative amounts (because of deflation in those years) to the LIFO reserves. This caused further increases in their LIFO reserves for 2005.

Triple benefit ... finally, in a few instances, by reclassifying vehicles that did not properly belong in the used vehicle inventory account, the dealer experienced an even greater increase in the LIFO reserve because an even larger decrement for the current year was carried back to prior years' layers which were contributing negatively to the LIFO reserve.

#3. SATURN PRICE DEFLATION CAUSES

MAJOR DILEMMAS. As highlighted above, for 2005, Saturn LIFO indexes hit a real pothole. LIFO indexes for new autos reflected deflation of 14-15% and light-duty truck indexes were in the neighborhood of 6-7-8% deflation. Result: Huge reductions in LIFO reserves for 2005 ... Some reductions were large enough to cause negative LIFO reserve dollar amounts.

After rechecking the math (and finding it was still correct), many dealers had to make a difficult decision. Unfortunately, they had only three alternatives—each one unpleasant—to consider. Should the Saturn dealer ...

3 CHOICES

- Terminate the LIFO election
- Stay on LIFO, but change to the IPIC method, or
- Just bite the bullet and remain on LIFO, taking a big hit in the LIFO Reserve for 2005

Termination. Technically, the termination of the LIFO election should be made under Revenue Procedure 97-27. This requires the filing of the Form 3115 before (Yes, *before!*) the end of the year of change. Recently, the IRS National Office has rejected some LIFO termination requests that were attempted by filing Form 3115 *after* the end of the year under the "automatic" change provisions of Rev. Proc. 2002-9.

As a consequence of terminating the LIFO election for 2005, the amount of the LIFO reserve associated with that inventory as of Dec. 31, 2004 would have to be paid back (i.e., included in taxable income) in four equal installments over four years. An exception to this 4-year spread is allowed if the amount of this Section 481(a) adjustment is less than \$25,000.

Changing to the IPIC LIFO method. Some Saturn dealers thought that, under these circumstances, terminating their LIFO elections was too drastic a step to take.

They wanted to stay on LIFO, but they wanted to avoid the impact of deflation at the same time. This is possible, and it can be done by changing to the IPIC (LIFO) method for 2005 ... and this change can be made after year-end. This change is an automatic change made by filing Form 3115 under Rev. Proc. 2002-9 when the tax return is filed after year-end.

One of the conditions that the IRS attaches to changing to the IPIC method is that any other inventories on LIFO at the time of the change also must be changed over to the IPIC method. This condition was not a major deterrent because in the situations we encountered, the Saturn dealers had only their new vehicles on LIFO.

If this change to use the Bureau of Labor Statistics indexes were made, the dealers, as retailers, could elect to use either Table 3 of the CPI or Table 6 of the PPI. For 2005, Table 3 of the CPI would be the preferable choice.

One drawback or downside of changing to the IPIC method is that LIFO indexes in subsequent years are likely to be (considerably) smaller than they would be under the Alternative LIFO calculations ... if past experience is any guide for future expectations.

Bite the bullet and stay on LIFO. Some Saturn dealers decided they would remain on LIFO despite the hard hit their LIFO reserves took. In a few instances, the Saturn store (showing the large reduction in LIFO reserves due to deflation) was one of several stores in a dealership group. Thus, the decision to stay on LIFO for one of the entities—despite the negative consequences—was made because it was preferable to maintain a consistency of accounting methods/principles for all of the new vehicle inventories of all of the dealerships.

In other instances, however, the dealers concluded that consistency of inventory valuation methods was not a significant enough reason to stay on LIFO and the Saturn stores terminated their LIFO elections.

Consensus: 3 equally unattractive choices ... take your pick. There was no clear consensus on how dealers handled this dilemma ... no overall pattern seemed to emerge.

It appears that the "conventional wisdom" was that if the dealer had a fairly tight cash flow situation and had somewhere else the money was critically or urgently needed, the more logical choice was to terminate the LIFO election.

→



#4. NEW LIFO ELECTION FORM 970 GETS MORE THAN A FACE-LIFT.

You were warned in the last issue of the *Lookout* that Form 970 was being revised by the IRS. The last time that the IRS revised Form 970, in December of 2001, the changes were purely cosmetic and insignificant. These changes were reported in the December 2001 issue of the *Lookout* on page 4.

The current revision of Form 970 has been completed, and (we sadly report that) the new Form 970 promises to be far more troublesome for you to complete for your LIFO elections starting in 2006.

What do we mean by "troublesome?" Let's qualify that a little bit more. If you're filling out the new Form 970 for an automobile dealership (see Update #5 below), most of the attachments to the Form 970 will not change very much. However, what you must now watch out for are the revised questions concerning financial statement conformity for the year of the LIFO election. This area of inquiry has been expanded considerably. And as we all know, the LIFO conformity requirement for auto dealerships has been a very troublesome area ever since ... Day #1.

If you are filling out the Form 970 for other types of businesses, some of the questions are new and/or technically more challenging. For example, one question now asks you to explain how the dollar-value LIFO method you are using will define the term "item." This could be your invitation for a visit by the IRS Specialist.

In another question, the IRS requires you tell if you are going to "attempt to apply" a dual index approach for valuing increments. The IRS has also introduced a new question that should prevent taxpayers who have benefited from bargain purchase acquisitions of inventory from slipping under the IRS radar undetected.

We have analyzed the new Form 970 in some detail on pages 4-13. To provide you with a better understanding of some of the changes the IRS has made, we've included some (hopefully helpful) background information.

#5. SAMPLE FILLED-IN FORM 970 FOR AN AUTO DEALERSHIP ELECTING THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES. We've also included on pages 14-21 a "proforma filing package" that is tailored to the portion of our readership serving automobile dealerships.

This shows you our version of how the Form 970 would be filled out, including additional responses as supplementary information attachments. From this, you can see how important it is to tailor the responses to each of the questions on Form 970 to the specific business for which the Form is being filed.

#6. SAMPLE FILLED-IN PROFORMA FORM 3115 FILING PACKAGES.

Over the past several months, we've been fairly busy with accounting method changes for 2005.

Terminating LIFO Elections. One situation encountered frequently involves the termination by an automobile dealer of its LIFO election for new vehicles. Generally, for this, the Form 3115 should be filed **before** the end of the year of change. The position of the National Office seems to be that if the dealer is not using the same inventory method for all of its non-LIFO inventory, including the inventory for which the change is being requested, then Revenue Procedure 97-27 requires the taxpayer to apply for advance approval from the IRS for the LIFO election termination.

To be on the safe side and to avoid considerable after-the-fact repercussions, LIFO termination elections under these circumstances **should/must be filed before the end of the year change ... and the earlier in the year, the better.** In this regard, we strongly advise you to reread our discussion of certain problems in the September 2005 *LIFO Lookout* (pages 16-19) entitled "Dealer LIFO Election Termination Problems ... 'Permitted Methods' for Valuing Inventories Formerly on LIFO."

Some dealerships have filed for the change to terminate their LIFO elections **after year-end**, considering this change to be covered under the automatic change procedures. In most, if not all, cases the dealership assumed that it had successfully terminated its LIFO election, and the year-end financial statements for 2005 that the dealership submitted to the manufacturer and to shareholders did not include any LIFO estimates or adjustments.

This poses some interesting questions. What will be the effect of this "conformity" requirement violation if the IRS denies the termination of the LIFO election for the year intended by the dealership? Will the dealership be required to stay on LIFO until such year as it timely files (before year-end) its Form 3115? If so, there's the matter of amended Federal and state—corporate and individual—returns to be filed for the intervening year(s). What a nightmare.

Will the IRS "bend" its own rigid position that the conformity violation in the earlier year was sufficiently egregious to warrant termination of LIFO in that earlier year? Would the Service accept a request for an extension of time to file Form 3115 for that earlier-intended year? It will be interesting to see how all of this plays out in the future.

We have included on pages 22-27 a "proforma Form 3115 filing package" that may be helpful for dealing with LIFO termination situations.

see **LIFO UPDATE**, page 44



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

Application To Use LIFO Inventory Method

OMB No. 1545-0042

Attachment
Sequence No. **122**

► **Attach to your tax return.**

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)

Overview

**New Form
Face-Lift
Presents
Complications**

- If a taxpayer wants to use the Last-In, First-Out (LIFO) method for valuing inventory, it must notify the IRS of this election.
 - ♦ This is done by filing Form 970.
 - ♦ If this Form, or a narrative equivalent providing all of the information required, has not been filed, the taxpayer will not have made a proper election.
- Taxpayers making LIFO elections for calendar year 2005 should use the new Form 970.
- In this new revision (2 pages), the IRS split the old Form onto 2 pages, expanded it from 2 parts to 5 parts and added a few new questions.

Lookout Capsule ... Background Basics

- Section 472 permits taxpayers to value their inventories under the LIFO method.
- In contrast to the FIFO method, which treats the first goods acquired as the first goods sold, the LIFO method of inventory valuation treats the last goods acquired as the first goods sold.
- In other words, under the LIFO method, the earliest goods acquired are treated as the goods remaining in ending inventory.
- During a period of rising costs, the use of the LIFO method generally results in lower taxes because ending inventory will be lower, and therefore Cost of Goods Sold will be higher.
- The theory behind LIFO is that income may be more accurately determined by matching current costs against current revenues, thereby eliminating from earnings any artificial profits resulting from inflationary increases in inventory costs.
- In computing LIFO inventory values, two basic approaches are used: The specific-goods method and the dollar-value method.

**Still Waters
Run Deep**

- Despite these innocent-looking changes in format, the new Form nevertheless reflects some very significant changes.
 - ♦ Expansion of questions relating to issuance of financial statements for the year of election.
 - ♦ Specific question about below-market (bargain purchase) inventory acquisitions.
 - ♦ Taxpayers are required to describe how they will determine "items" for dollar-value LIFO purposes.
 - ♦ It is now more difficult for taxpayers to elect to use a dual-index LIFO methodology.
 - ♦ Taxpayers electing IPIC Method are required to indicate right Form 970 which BLS Table they will use.

6 Sections

- The new Form is divided into 6 parts or sections.
 1. *Statement of Election under Section 472 ...* Questions/items 1-5
 2. *LIFO Inventory Requirements ...* Questions/items 6-10
 3. *Specific Goods (Unit) Method ...* Questions/items 11-12
 4. *Dollar-Value Method ...* Questions/items 13-17
 5. *Inventory Price Index Computation (IPIC) Method ...* Questions/items 18-21
 6. *Other Information ...* Questions/items 22-23
- Both pages of the revised Form 970 are reproduced in connection with the auto dealership proforma. Also, the item-by-item instructions for completing Form 970 for an auto dealer contain other unique insights.



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.		

**Statement
of Election**

(#1 - 5)

- The five items in this section are pretty straight-forward.
- The analysis of inventories (required by the instructions) should reflect three years' data.
 - ♦ Between the inventory described on Line 1 (inventory going onto LIFO) and on Line 5 (inventory not going onto LIFO), all of the taxpayer's inventory should be accounted for.
- Question 2 is new. It asks for a description of the inventory method that was previously used to value the goods for which the LIFO election is being made.
 - ♦ This question is to be contrasted with Question 6, which asks whether any writedowns from cost were made under the prior method.
 - ♦ In response to this question, it may be desirable to disclose whether or not inventory cost is reduced by the elimination of trade discounts (a mandatory treatment) or by cash discounts (an elective treatment).
- Question 3 relates to a situation where the taxpayer is making a "subsequent" LIFO election (i.e., technically, extending its previous LIFO election to another, or to additional, classes of goods).
 - ♦ The Instructions also indicate that taxpayers should show or somewhere include on the inventory schedule "the ending inventory reported on your tax return for the preceding year."
 - This has been added, presumably to make it easier for the IRS to "eyeball" or spot-check continuity between inventory numbers and to tie them back to the tax return filed for the previous year.
 - See the attachment to the auto dealer proforma for one type of presentation.
- The rearrangement/re-sequencing of Question 4 is interesting.
 - ♦ Does it imply that a higher level of attention will be paid to situations where the taxpayer previously used the LIFO method, then terminated its LIFO election (which requires a 5-year waiting period before the taxpayer can re-elect LIFO without IRS approval) and now, in a later year, intends to re-elect LIFO for the same goods?
 - ♦ On the previous Form 970, this was Question 13 at the end, and it was more broadly worded, "Did you ever use the LIFO inventory method before?"
 - ♦ On the current Form 970, Question 4a refers only to "the goods covered by this election."
- Question 5, as indicated above, is where all inventory goods not on LIFO are to be identified. Often, the IRS scrutinizes the accounting methods for these non-LIFO goods as part of its overall review of the taxpayer's LIFO election.



Part II ... LIFO Inventory (Eligibility) 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?	<input type="checkbox"/>	<input type="checkbox"/>
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)?	<input type="checkbox"/>	<input type="checkbox"/>
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?	<input type="checkbox"/>	<input type="checkbox"/>
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?	<input type="checkbox"/>	<input type="checkbox"/>
b If "No" to line 7a, attach an explanation.	<input type="checkbox"/>	<input type="checkbox"/>
9a Will the applicant determine beginning and ending inventories at cost regardless of market value?	<input type="checkbox"/>	<input type="checkbox"/>
b If "No" to line 9a, attach an explanation.	<input type="checkbox"/>	<input type="checkbox"/>

**Part II
(#6 - 10)**

- Part II addresses three of the LIFO eligibility requirements ...
 - ♦ Cost ... Questions 6, 7 and 9
 - ♦ Conformity (year-end financial statements reporting on the LIFO basis) ... Question 8
 - ♦ Consent (to an unlimited statute of limitations) ... Question 10
- The Instructions for Form 970 do not provide any guidance or clarification for Questions 6-10.

**LIFO
Eligibility
Cost
Requirements
(#6, 7 & 9)**

- Writedowns are not permitted for any goods on LIFO.
 - ♦ Although writedowns to lower-of-cost-or-market are more commonly associated with this requirement, there are numerous other situations in which inventories may not have been (properly) carried at cost.
- Generally, answer to Question 6a will be "Yes."
 - ♦ However, improper treatment for trade discounts may need to be disclosed because of the requirements of Reg. Sec. 1.471-3(b) and Revenue Ruling 84-41.
 - ♦ Reg. Sec. 1.471-3(b) provides that *cost* means, ... *"in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed."*
- Questions 6b and 6c address the 3-year period over which any writedowns to the beginning inventory of the goods going onto LIFO must be spread. This is based on Section 472(d).
 - ♦ The instructions for completing the auto dealer proforma indicate one situation (involving writedowns to demonstrator vehicles) where the opening inventory for the first year on LIFO may have been written-down, but the taxpayer may not be reporting that writedown in income over 3 years (because the writedown has already been taken into income 100% in the current year as a result of the sale of all of the vehicles in the current year).
- Unless the taxpayer uses the "average cost" method, the answer to Question 7 would be, "No," and some explanation would need to be provided.
 - ♦ A "Yes" answer to Question 7 means that the taxpayer is using an "average cost" method.
 - ♦ Where specific identification is used, the answer to Question 7 would be "No," and explanation should be provided.
- Question 9 reinforces the statutory requirement that LIFO inventories must be valued at cost, regardless of market value, and no writedowns are permitted.



Part II ... LIFO Inventory (Eligibility) Requirements (...continued)

Part II LIFO Inventory Requirements		Yes	No
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?	<input type="checkbox"/>	<input type="checkbox"/>
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.	<input type="checkbox"/>	<input type="checkbox"/>
LIFO Eligibility Year-End Financial Statement Conformity Requirements (#8a & 8b)	<ul style="list-style-type: none"> • Generally, the answer to Question 8a will be "Yes," in simple, single entity situations. • This question on the current revision of Form 970 has been significantly expanded. <ul style="list-style-type: none"> ♦ Question 8a has been expanded to include not only the individual taxpayer/entity, but it now also includes "any member of the same group of financially-related corporations as defined in Section 472(g)." ♦ Essentially, Sec. 472(g) references controlled groups with 50% [not 80%] ownership relationships. ♦ Sec. 472(g) also includes "any other group of corporations which consolidate or combine for purposes of financial statements." <ul style="list-style-type: none"> ▪ In addition to the more traditional consolidation/combination situations, special consideration must be given to FASB Interpretation 46 (Revised Dec. 2003) <i>Consolidation of Variable Interest Entities</i> (an interpretation of ARB No. 51). ▪ This FASB has increased the number of situations where consolidation may be required, particularly if variable interest entities are involved ... Commonly encountered in related-party lease situations. • Advisors should be thoroughly familiar with these requirements. <ul style="list-style-type: none"> ♦ See <i>Year-End Alert: Special LIFO Challenges ... Conformity Reporting Requirements & Projections for Year-End Planning</i>, December 2005, <i>LIFO Lookout</i>, pages 5-19. 		
Part II LIFO Inventory Requirements		Yes	No
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?	<input type="checkbox"/>	<input type="checkbox"/>
b	If "No" to line 10a, the applicant is not eligible to use the LIFO inventory method and does not need to file Form 970.	<input type="checkbox"/>	<input type="checkbox"/>
LIFO Eligibility Consent Requirements (#10)	<ul style="list-style-type: none"> • Essentially, the taxpayer electing to use LIFO must agree to make any adjustments that the IRS may require should it audit the taxpayer. • The prior Form 970 simply included a general, passive, declarative statement (in Part I, Item B) that "the taxpayer agrees ... to make any adjustments ...". • The current Form 970, Question 10a, requires an affirmative answer ... which undoubtedly would be "Yes" ... in response to the question that follows the slightly re-worded declarative statement • Adjustments incident to "the change to" the LIFO method ... means that the IRS may require adjustments to correct the inventory valuations in any or all of the years before the LIFO election. <ul style="list-style-type: none"> ♦ In many instances, the IRS has made audit adjustments to the methods used for valuing inventories other than those inventories for which the taxpayer was electing LIFO. ♦ In other words, in some instances, the taxpayer might have been using inappropriate valuation methods (for non-LIFO goods) and did not want to restore write-downs or to correct other cost accounting deficiencies, so the taxpayer chose not to elect LIFO for those "troublesome" goods. In the course of examining the taxpayer's LIFO election, the IRS agent proposed adjustments to these other inventory valuation methods. • Adjustments incident to "the use of" the LIFO method ... means that the IRS may require adjustments during the years while the LIFO inventory election is in effect if the taxpayer is not properly making its LIFO computations. • Adjustments incident to "the change from" the LIFO method ... means that the taxpayer agrees (prospectively) to accept whatever conditions the IRS imposes (or may impose) if the taxpayer wishes to terminate its LIFO election in a later year prior. • Adjustments necessary to "clearly reflect income" ... This is an imprecise standard at best ... some believe it is whatever the IRS wants it to be. 		



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.
- 12** Check the box corresponding to the method that the applicant will use to determine the cost of the goods in the closing inventories in excess of 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)

**Unit
Method
(#11-12)**

- Ordinarily, taxpayers electing the LIFO method will not want to use the specific goods (unit) method.
- Part III, Questions 11 and 12 should not be completed by taxpayers electing to use the dollar-value method.

Lookout Capsule ... Background Basics

- Under the specific-goods or unit method, the physical quantity of homogeneous items of inventory at the end of the taxable year is compared with the quantity of like items in the beginning inventory to determine whether there has been an increase or decrease during the year.
- Because the specific-goods method requires the matching of physical units, it is generally used for valuing inventories only in those industries with inventories which contain a limited number of items with quantities that are more easily measured in units.

Part IV ... Dollar-Value Method ... DVM

**DVM
Basics**

Lookout Capsule ... Background Basics

- The dollar-value method (DVM) measures increases or decreases in inventory quantities in terms of total dollars, rather than in terms of physical units.
- Under the DVM, to determine whether there has been an increase or decrease in the inventory during the year, the ending inventory is valued in terms of total dollars that are equivalent in value to the dollars used to value the beginning inventory.
- Because it is not predicated upon the matching of specific items, the DVM permits the application of the LIFO principle in those industries that rely upon complex inventories containing a vast number of items.
- Inventory is grouped into "pools," and these pools are composed of "items."
- At the end of the year, to determine the amount of change (i.e., either an increase or a decrease) in a LIFO inventory pool's value from the prior year, the current year aggregate cost of the "items" in ending inventory for each pool is valued at "base-year cost."
 - ♦ **Base-year cost** is the aggregate cost of all items in the pool expressed in terms of what they cost (or would have cost) as of the beginning of the taxable year for which the LIFO method was first adopted.
 - ♦ After converting the current year ending inventory from current-year cost to base-year cost, the value of the beginning inventory and of the ending inventory - both expressed in terms of base-year cost - is compared to determine whether an increase or a decrease in inventory quantity has occurred. For this purpose, it is necessary to compare the value of the beginning and of the ending inventories of a particular year in dollar amounts expressed in terms of the same dollar equivalent (i.e., their equivalent base-year costs).



Part IV ... Dollar-Value Method ... DVM (continued ...)

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.

**New
Question re:**

**Definition
of an
"Item"**

(#13)

- Question 13 has been newly added to Form 970. There are no "Yes" or "No" response boxes.
- Neither the Code nor the Regulations define the term "item." The Instructions for Form 970 do not amplify this question. You are on your own in responding to this question.

Lookout Capsule ... Background Basics

- The Tax Court has held that the proper definition of an "*item*" for dollar value LIFO purposes depends on the specific facts and circumstances of the case. These must be examined in light of the objectives of the dollar-value LIFO method, i.e.,
 - ♦ To eliminate from earnings any artificial profit resulting from inflationary increases in inventory cost.
 - ♦ To insure that any increase in cost of property passing through the inventory during the year is reflected in the cost of goods sold.
- The dollar-value LIFO method does not require the matching of specific goods in opening and closing inventories. It focuses on the total dollars invested in an inventory. Accordingly, minor modifications to an item should not cause the item to be treated as new or separate. "This freedom from having to take into account minor technological changes in a product represents a major objective of the dollar-value approach."
- To properly reflect increases attributable to inflation, goods contained in a taxpayer's item category must have *similar characteristics*, because a "system which groups like items together and separates dissimilar items permits cost increases attributable to inflation to be isolated and accurately measured."
- A "narrower definition of an *item* within a pool will generally lead to a more accurate measure of inflation and thereby lead to a clearer reflection of income."
- "The definition of an item of inventory must not be so narrow as to impose unreasonable administrative burdens on a taxpayer, thus rendering impractical the taxpayer's use of ... LIFO" (*Amity Leather Products Co.*)

**New
Question re:**

**Bargain
Purchase
Inventory**

(#14)

- Question 14a has been newly added to Form 970.
- A "yes" response to this question requires additional disclosures relating to how these goods are going to be treated for pooling and other purposes.

Lookout Capsule ... Background Basics

- LIFO cannot be used to postpone the realization of gains associated with the acquisition of bargain-priced inventory.
- Bargain purchase inventory items cannot be placed in the same pool with similar inventory items subsequently manufactured or purchased because of the substantial price difference between bargain-priced inventory and the similar goods which were subsequently manufactured or purchased. Because they have *different cost characteristics*, bargain purchase inventory items belong in a *separate* pool.
- Inventory is deemed acquired in a bargain purchase if the actual (or allocated) cost of the inventory was *less than or equal to 50%* of the replacement cost of physically identical inventory.
- Inventory is not considered acquired in a bargain purchase if the actual (or allocated) cost of the inventory was *greater than or equal to 75%* of the replacement cost of physically identical inventory.
- Query: What happens if the cost amounts are *more than 50%, but less than 75%*?
- See Reg. Sec. 1.472-8(h)(3) and Rev. Proc. 2003-51.



Part IV ... Dollar-Value Method ... DVM (... continued)

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).

Pooling

(#15)

- Question 15 is not a question ... It requires the attachment of a statement describing the method of pooling that will be used.
- The prior Form 970 (Question 9) provided seven pooling choices, with respect to which boxes were simply checked. (These choices are not printed on the current Form 970.)
 - ♦ By line, type, or class of goods authorized by Reg. Sec. 1.472-8(c) ... for retailers, wholesalers, jobbers or distributors
 - ♦ Pooling method authorized by Reg. Sec. 1.472-8(e)(3)(iv) ... for retailers, wholesalers, jobbers or distributors
 - ♦ Natural business unit authorized by Reg. Sec. 1.472-8(b)(1) ... for manufacturers or processors
 - ♦ Multiple pools authorized by Reg. Sec. 1.472-8(b)(3)(i) ... for manufacturers or processors
 - ♦ Raw material-content authorized by Reg. Sec. 1.472-8(b)(3)(ii) ... for manufacturers or processors
 - ♦ Simplified dollar-value method under Section 474
 - ♦ Other ... to be described and/or explained and justified.

**Methods for
Valuing Pools**

(#16)

- Question 16 asks for identification and/or description of the method that will be used to compute the LIFO value of each dollar-value pool.
 - ♦ Three examples are suggested on the Form ... double-extension, link-chain, or index.
 - ♦ Taxpayers using any type of sampling in connection with their LIFO methodology should recognize that the "link-chain" method technically requires the repricing of every item, and the "index" method - although it permits repricing of less than every item - requires that repricing to be made back to the base date (i.e., the first day of the first year of the LIFO election).
 - Accordingly, taxpayers must be extremely careful in both (1) describing their methodologies and (2) referring to them using the proper technical terminology.
- The prior Form 970 (Question 10) provided seven choices that might be applicable...
 - ♦ Double-extension (describe)
 - ♦ Link-chain (describe and justify)
 - ♦ Published price index (describe) ... the IPIC method
 - ♦ New Vehicle Alternative LIFO for Automobile Dealers ... Rev. Proc. 97-36
 - ♦ Used Vehicle Alternative LIFO for Automobile Dealers ... Rev. Proc. 2001-23
 - ♦ Index (describe and justify)
 - ♦ Other method (describe and justify)
- The language below Question 16 requires an attachment or statement "(1) describing the method in detail and (2) justifying the applicant's use of the selected method" in all situations except where the taxpayer will be using either (1) the double-extension or (2) the IPIC method for its LIFO calculations.
 - ♦ For taxpayers using the "link-chain, index" method, this information must be provided.
 - The Instructions for Question/Item 16 include an additional requirement in connection with this ... "if you use a link-chain method, your statement should explain why the nature of the pool makes the double-extension or index method impractical or unsuitable."
- **Warning** ... The Instructions to Form 970 (still) do not alert taxpayers to the requirement (in Reg. Sec. 1.472-8(e)(1)) that a statement concerning the use of a method other than double-extension method must also be filed with the IRS National Office in Washington, D.C.
- The special dollar-value methods for automobile dealers are mentioned in the Instructions to Form 970, but they are not given any special prominence on Form 970.



Part IV ... Dollar-Value Method ... DVM (... continued)

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)

**Determining
Current Cost**

**Is the IRS
Trying to
Outlaw
Dual-Index
Methods?**

(#17)

- Question 17 requires the identification of the method that will be used "to determine the current-year cost of goods in the closing inventories and to value the LIFO increments in the dollar-value pools."
 - ♦ The four choices provided on the current Form are the same as those on 7a of the previous version...
 - Actual cost of goods mostly 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 ... This would be "earliest acquisitions during the year."
 - Other (attach explanation)
 - ♦ The words "*or produced*" have been added to the current Form.
- **Significant point ...** Note the use of the conjunction "*and*" above.
 - ♦ In essence, the IRS is joining together both (1) the method to determine current-year costs in the closing inventories and (2) the method to determine the valuation of increments in the LIFO pool.
 - ♦ In other words, the same index must be used for both purposes ... i.e., a single-index method ... not a dual-index method.
 - ♦ This is a requirement of the IPIC method ... taxpayer cannot use dual-indexes.
 - ♦ This is also a requirement of both Alternative LIFO Methods for New and for Used Vehicles under Revenue Procedures 97-36 and 2001-23, respectively.
 - ♦ The Service's position adamantly opposed to the use of the dual-index approach is a matter of significant dispute in many current audit examinations.
- These two aspects were dealt with separately on the prior version of Form 970.
 - ♦ It provided (on Part II, Line 7a) one line for a selection or choice among four alternatives, and
 - ♦ It provided (on Part II, Line 10) for the description of the valuation of an increment in the dollar-value pool as part of the description of the method used in computing the LIFO value of the dollar-value pools.
- There has been long-standing recognition by the Internal Revenue Service that link-chain LIFO elections may include the use of a dual-index methodology.
 - ♦ A 1995 Coordinated Issue Paper (discussed in the June 1996 *LIFO Lookout*) states that taxpayers may use a dual-index approach in connection with link-chain LIFO elections.
 - The CIP states that a taxpayer may use a dual-index method if it can demonstrate that the inflation rate computed for the "earliest acquisitions period" is appropriate.
 - In other words, subject to certain limitations, the use of the dual index method is not expressly prohibited under the existing LIFO Regulations.
 - ♦ Also in Appeals Industry Specialization Program Settlement Guidelines related to the Dollar-Value LIFO Earliest Acquisition Method (dated February 8, 2002), it is stated that ...

"If properly applied, the use of a two index method or dual indexes may result in an inventory valuation method that is substantially the same as if the ending inventory was double-extended on an item-by-item basis in the order of acquisitions (proper regulatory method)."



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.

**IPIC/BLS
Method
(#18-21)**

- If the IPIC method is not being elected, Part V, Questions 18-21 should be ignored.
- If the IPIC method is elected, taxpayers are required to answer 3 questions and select a representative month for selecting BLS price indexes.
- Question 18 asks the taxpayer electing the IPIC method to indicate which of the two methods of accounting (in Reg. Sec. 1.472-8(e)(3)(iii)(E)) it will use to value its pools ...
 - ♦ Double-extension IPIC method
 - ♦ Link-chain IPIC method
- Question 19 asks the taxpayer to indicate (check the box) which Table will be used to provide the Bureau of Labor Statistics (BLS) Price Indexes.
 - ♦ The choices are
 - Table 3 of the *Consumer Price Index (CPI) Detailed Report*, or
 - Table 6 of the *Producer Price Index (PPI) Detailed Report*, or
 - (Some) Other table of the *PPI Detailed Report*.
 - ♦ Manufacturers, processors, wholesalers, jobbers and distributors must select BLS Price Indexes from Table 6 of the *PPI Detailed Report*,
 - An *exception* is made if the taxpayer can demonstrate that selecting BLS Price Indexes from another table of the *PPI Detailed Report* is more appropriate.
 - ♦ Retailers can select BLS Price Indexes from *either*
 - Table 3 of the *CPI Detailed Report*, or
 - From Table 6 (or another more appropriate table) of the *PPI Detailed Report*.
 - Automobile dealerships, as retailers, may select either one.
 - ♦ If a taxpayer selects the third option (other table of the *PPI Detailed Report*), it must attach a statement explaining why the table selected is more appropriate than Table 6.
- Question 20 asks whether the IPIC user will [attempt to] simplify its calculations by using "the 10% method" for assigning items to BLS categories.
 - ♦ "The 10% method" involves a 3-step procedure, described in Reg. Sec. 1.472-8(e)(3)(iii)(C)(2).
 - ♦ This question requires a simple "Yes" or "No" answer.
- Question 21 requires the IPIC user to identify the month it has selected to use as a "representative month for selecting BLS price indexes" in accordance with the rules of ... 1.472-8(e)(3)(iii)(B)(3).
 - ♦ It is common for IPIC users to select a month that is one or two months before the end of their taxable year. This selection is made because often the BLS indexes are not released until several months after the end of the month to which they relate. In order not to delay the issuance of their financial statements on account of delays in getting BLS indexes, IPIC taxpayers often find it better not to select the last month of their year as their "representative" month.



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

**Other
Information
(#22-23)**

- Question 22 is not a question. It asks for a statement to be attached that describes the method or methods of determining the cost of inventory items.
- The attachment to the automobile dealer proforma shows our response to this request in that context.
- Question 23 simply asks whether the taxpayer received IRS consent to change the method for valuing inventories for the current year in which the LIFO election becomes effective.

Form 970 ... Instructions ... 2 Pages

**When to
File**

- Form 970 is to be filed with the income tax return for the first year in which the taxpayer elects to use the Last-In, First-Out (LIFO) inventory valuation method.

**Use the
Form ...
or Create
Your Own**

- The Instructions state that a taxpayer may, if it prefers, "... file an election statement that gives the same information requested on Form 970." [I can recall only once in 40 years of working with LIFO, ever having done that. ...And, that was because the taxpayer was pathologically afraid that including "the Form 970" in the tax return would be a red flag inviting the IRS in for an audit.]

**What If
Someone
Forgot ...
to Include
Form 970
with the
Tax Return?**

- The Instructions provide that taxpayers will be granted some leeway if they have forgotten to include Form 970 in the tax return filed for the first year when LIFO was elected.
- The Instructions state, "...[taxpayer] can make the election by filing an amended return within 12 months of the date [taxpayer] filed your original return. Attach Form 970 (or similar statement) to the amended return and write 'Filed pursuant to section 301.9100-2' at the top of Form 970. File the amended return at the same address the original return was filed."
- Note: This only applies if you discover the omission of Form 970 within 12 months. If discovered at a later date, more drastic/stringent procedures must be followed.
- It seems clear from the foregoing that this relief is available only if the taxpayer has already filed a tax return in which it used LIFO to value ending inventory.
 - ♦ A taxpayer cannot amend a previously filed return that did not reflect LIFO by replacing it with an amended return that uses LIFO to value the ending inventory.
 - ♦ Note: Failure to satisfy the financial statement conformity requirement would most likely be a factor to consider here, also.

**Change from
the LIFO
Method ...
Terminating
the Election**

- Once a taxpayer elects to use the LIFO method, that election is irrevocable unless the IRS allows the taxpayer to change to another method.
- To request approval to change from the LIFO inventory method, the taxpayer can use the automatic change request procedures or the advance consent request procedures.
 - ♦ See pages 22-27 for further discussion of these alternatives.

**Limited Other
Information**

- The Instructions contain a few other discussions, but they are fairly general and of limited use.
 - ♦ LIFO recapture amounts
 - ♦ Simplified dollar-value LIFO method
 - ♦ Alternative LIFO Methods for New Vehicles and for Used Vehicles



AUTO DEALER ELECTION
TO USE THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES

This section contains a sample, filled-in Form 970 with attachments for an auto dealership that is electing to use the safe harbor LIFO calculation for new vehicles provided in Revenue Procedure 97-36.

Page

- 15-16 **Instructions for Completing Form 970**, tailored to the Alternative LIFO Method election
- 17 **Summary Calculation and Statement of LIFO Layers** (beginning/base layer and either (a) increment, or (b) current year's reduction-liquidation netted against that beginning/base layer)
- **Recommended ... But Not Required.** Although submission of this schedule is not required, this schedule is helpful to disclose the computational format/pattern that will be followed in subsequent years' LIFO calculations.
- 18-19 **Form 970 Application to Use LIFO Method**
- It is preferable (i.e., it is our recommendation) that you complete IRS Form 970.
 - However, if you prefer, you may instead construct your own equivalent of a LIFO election statement, provided that your statement contains all of the same information that is requested by the official Form 970.
- 20 **Statement of Inventory Valuation Methods for Different Inventories & Three Year Inventory Analysis**
- 21 **Dollar-Value LIFO Method Information & Statement Required by Reg. Sec. 1.472-8(e)(1)**
- Statement required by Part IV describing dollar-value LIFO method computations and calculation of the index and justification for using the link-chain, index method.
 - A copy of the Statement Required by Reg. Sec. 1.472-8(e)(1) must be filed with the National Office of the Internal Revenue Service in Washington, D.C.
 - ♦ This copy of this statement must be filed/mailed at the same time as the corporation files its income tax return for the year electing the LIFO method for new vehicles.
 - ♦ See sample transmittal letter below.
- **Sample Transmittal Letter to IRS National Office, Washington, D.C. ... see below.**

Sample Transmittal Letter to IRS National Office, Washington, D.C.

(DEALERSHIP LETTERHEAD)

Date _____

Commissioner of Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20025
Attention: T:R

Re: Dealership Name
EI # _____

Form 1120: Year Ending December 31, 200

Adoption of LIFO Inventory Method
Statement Required by Regulations Section 1.472-8(e)(1)
Use of Link-Chain, Index Method

Gentlemen:

Pursuant to the requirements of Regulations Section 1.472-8(e)(1), attached is a statement concerning the above-identified taxpayer's use of a link-chain, index method in connection with its election to use the LIFO (Last-In, First-Out) inventory method. Taxpayer has elected to use the Alternative LIFO Method for Automobile Dealers for its new vehicle inventories in accordance with Revenue Procedure 97-36.

A copy of the attached statement was also included as part of the Form 970 attachments filed by the taxpayer with the corporate income tax return for the year of election.

If you have any questions, please call or write the undersigned.

Sincerely,

/s/ _____



INSTRUCTIONS FOR COMPLETING FORM 970
ELECTING THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES ... REV. PROC. 97-36

Page 1 of 2

Form 970, *Application to Use LIFO Inventory Method* (Rev. Dec. 2005), consists of 2 pages.

The initial election to use the LIFO (Last-In, First-Out) Inventory Valuation Method for New Vehicle Inventories **does not require permission** in advance from the Internal Revenue Service. It is only necessary to include Form 970 (with attachments) in the Federal Income Tax Return for the year of change. In addition, because of the LIFO methodology employed, there is an **additional special filing requirement** with the IRS National Office in Washington, D.C. which is also covered in this Form 970 filing package.

Part I, No. 1 ... Enter the last day of first year for the LIFO election (i.e., Dec. 31, 2005, etc.)

Identify the "goods" going on LIFO as ... ***"All new vehicles, including demonstrators."***

Part I, No. 2 ... Required statement is included on separate attachment.

Part I, No. 3 ... Generally, answer will be, "No." If otherwise, provide necessary information.

Part I, No. 4 ... Generally, answer will be, "No." If otherwise, provide necessary information.

Part I, No. 5 ... Identify the "goods" not subject to the LIFO election as ... ***"Used vehicles, parts & accessories and all other inventories."***

Part II, No. 6 ... Generally, answer will be "Yes."

- However, improper treatment for trade discounts may need to be disclosed because of the requirements of Reg. Sec. 1.471-3(b) and Revenue Ruling 84-41. Reg. Sec. 1.471-3(b) provides that *cost* means, ... ***"in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts,*** except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed."
- If there were writedowns to demonstrator vehicles at the end of the preceding year, the answer to No. 6a would be, "No," and No. 6b and No. 6c should be answered based on the specific facts and circumstances, taking into consideration the fact that all demonstrator writedowns at end of preceding year may have been taken into income 100% in the current year.

Part II, No. 7 ... Generally, answer will be "No," because the method used was/is "specific identification by vehicle."

Part II, No. 8a ... ***Financial statement conformity requirement. The responses to Nos. 8a & 8b are crucial to a proper LIFO election. Extreme care must be exercised in providing responses.***

- Generally, the answer to No. 8a will be "Yes," in simple situations where only a single dealership is involved.
- However, care must be exercised in answering this question, because No. 8a references not only the individual taxpayer/entity, but also includes ***"any member of the same group of financially-related corporations as defined in Section 472(g)."***
 - ♦ Essentially, Sec. 472(g) references controlled groups with 50% [not 80%] ownership relationships.
 - ♦ Sec. 472(g) also includes "any other group of corporations which consolidate or combine for purposes of financial statements."

(Continued)



INSTRUCTIONS FOR COMPLETING FORM 970

ELECTING THE ALTERNATIVE LIFO METHOD FOR NEW VEHICLES ... REV. PROC. 97-36

Page 2 of 2

Part II, No. 8b ... Attach a statement identifying all recipients of financial statements, the dates of issuance and the inventory method(s) used to determine income, profit or loss.

- Generally, response would identify (1) recipients such as "Manufacturer, credit corp., bank," (2) dates financial statements were issued, and (3) "LIFO for goods in No. 1 above" as the description for the method used.
- If the required response cannot be squeezed into the space allowed beneath No. 8b, an additional attachment/schedule in the following form should be included as part of the Form 970 filing package.

Form 970 ... Part II, Line 8b Distribution of Year-End Financial Statements		
Name of Recipient	Date of Issuance	Method Used for Valuing Inventories in Statements
(Manufacturer)		LIFO for goods subject to LIFO election ... for all other inventories, see attachment describing other valuation methods.
(Credit Corp.)		
(Bank)		
(Others)		
(Dealer)		
(Other Shareholders)		

Part II, No. 9 ... Generally, answer will be, "Yes."

- However, the answer to this question must be evaluated carefully if the dealership has not removed trade discounts from inventory cost. See comments re: No. 6 above.

Part II, No. 10 ... Generally, the answer to this question must be, "Yes."

Part III, Nos. 11 & 12 ... Do not complete this Part. It is applicable only to LIFO elections involving the specific goods (unit) method ... which is not applicable here.

Part IV, Nos. 13-17 ... The separate one page attachment entitled *Dollar-Value LIFO Method Information* provides all the information for this part.

- No. 14a generally will be answered, "No."
- For No. 17, the "Other" box should be checked.

Part V, Nos. 18-21 ... Do not complete this Part. It is applicable only to LIFO elections involving the inventory price index computation (IPIC) method ... which is not applicable here.

Part VI, No. 22 ... The separate one page attachment entitled *Statement of Inventory Valuation Methods* provides all the information for this response.

Part VI, No. 23 ... Generally, answer will be "No."

Attachments to Form 970

1. *Statement of Inventory Valuation Methods & Three-Year Inventory Analysis*
 2. *Dollar-Value LIFO Method Information & Statement Required by Reg. Sec. 1.472-8*
Re: Use of Link-Chain, Index Method for New Vehicle LIFO Inventory
 3. *Calculation of Annual LIFO Inventory and Reserve Changes for Pools #1 & 2*
- *Note: If the space on Form 970 is insufficient, a fourth/separate attachment may be required to identify all of the recipients of year-end financial statements, dates of issuance, etc.*



XYZ DEALERSHIP

LIFO INVENTORY RESERVE REPORT
ALTERNATIVE LIFO METHOD PER REVENUE PROCEDURE 97-36
FOR THE YEAR ENDED DECEMBER 31, 200__

REPORTS #1 & 2- CALCULATION OF ANNUAL LIFO INVENTORY AND RESERVE CHANGES

	NEW AUTOS POOL #1 200__	NEW TRUCKS POOL #2 200__
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	1,500,000	2,500,000
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	2,047,225	4,394,858
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED
D. <u>CURRENT YEAR PRICE INDEX</u> END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) RATIO OF: <u>END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES</u>	1.01500	1.03500
E. <u>CUMULATIVE LINK-CHAIN INDEX</u> CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.01500	1.03500
F. <u>END OF YEAR INVENTORY AT BASE DATE COST</u> (LINE B DIVIDED BY LINE E)	2,016,970	4,246,240
G. <u>CURRENT YEAR INVENTORY INCREASE</u> (DECREASE) - EXPRESSED IN BASE DOLLARS		
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	2,016,970	4,246,240
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(1,500,000)	(2,500,000)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	516,970	1,746,240
	X 1.01500	X 1.03500
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	<u>524,725</u>	<u>1,807,358</u>
H. ANALYSIS OF YEAR-END INVENTORY LIFO "LAYERS" - AS REBASED		
	BASE VALUATION DOLLARS FACTOR	
#1 JANUARY 1, 200__ BASE	1,500,000 X 1.00000	1,500,000
CALENDAR YEAR 200__ INCREMENT	516,970 X 1.01500	<u>524,725</u>
	<u>2,016,970</u>	
#2 JANUARY 1, 200__ BASE	2,500,000 X 1.00000	2,500,000
CALENDAR YEAR 200__ INCREMENT	1,746,240 X 1.03500	<u>1,807,358</u>
	<u>4,246,240</u>	
ENDING INVENTORY AT LIFO VALUATION, TOTAL PER ABOVE	2,024,725	4,307,358
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	<u>2,047,225</u>	<u>4,394,858</u>
LIFO RESERVE AT END OF CURRENT YEAR	22,500	87,500
LESS: LIFO RESERVE AT END OF PREVIOUS YEAR	0	0
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	<u>22,500</u>	<u>87,500</u>



Application To Use LIFO Inventory Method

OMB No. 1545-0042

Attachment
Sequence No. **122**

▶ Attach to your tax return.

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) ▶ <u>December 31, 2005</u> for the following goods (enter here): <u>all new vehicles, including demonstrators</u> . 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): ▶ <u>Used vehicles, parts and accessories, and all other miscellaneous inventories.</u> 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. <u>7b - Specific identification by vehicle</u>		
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 and does not need to file Form 970.		

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.	
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For Paperwork Reduction Act Notice, see the instructions.

Cat. No. 17057T

Form **970** (Rev. 12-2005)

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A Quarterly Update of LIFO - News, Views and Ideas

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 in excess of 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).
Revenue Procedure 97-36 - Automobile dealership - Alternative LIFO Method for New Vehicles
 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) - **Specific identification increment method**

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. 12-2005)

Form 970, Part I, Line 2 & Part IV, Line 22**Statement of Inventory Valuation Methods & Three-Year Inventory Analysis****New Vehicles**

New vehicle inventories are valued at actual cost based on specific identification by invoice.

Invoices are received from the manufacturer(s) or from other dealers in dealer trades. Each vehicle invoice consists of the aggregate of differing combinations of capitalizable costs including the vehicle base price which is the principal component, and other lesser sub-components such as destination charges, factory-installed options (both individual as well as in package combinations), options and accessories installed by the dealer, and other capitalizable charges.

Trade discounts. For the purpose of determining cost, inventory cost *has [has not]* been reduced by eliminating trade discounts (floorplan assistance payments) in accordance with Reg. Sec. 1.471-3(b) and Revenue Ruling 84-41.

Ad fees. For the purpose of determining cost, inventory cost *has [has not]* been reduced by eliminating certain advertising fees and expenses.

Used Vehicles

Some used vehicles are acquired by purchase (at auctions or from other dealers) and some used vehicles are acquired by trade from retail customers. Used vehicles are valued at the lower of cost or market, with market considered to be lower of wholesale, "as is" value, less estimated reconditioning cost, or estimated current wholesale market value.

If applicable, include the following statement ... For used vehicle inventories on LIFO, the determination of current cost is made in accordance with Revenue Procedure 2001-23.

Parts & Accessories

Pursuant to accepted industry-wide practice, cost of parts and accessories inventories is determined at year-end by reference to manufacturer current price lists in effect at year-end. As a result, the ending parts and accessories inventory is valued at higher replacement costs instead of at actual cost. This practice results in an overall valuation for parts and accessories inventories that closely approximates, but usually is slightly in excess of, cost.

This method for valuing parts inventories is permitted by Revenue Procedure 2002-17 which allows automobile dealers to approximate the actual cost of parts and accessories inventory items by reference to end-of-the-year prices taken from manufacturers' price lists.

Miscellaneous Other Inventories

Gas, oil, grease, work in process, body shop supplies, sublet and other inventories are valued at cost.

Three-Year Inventory Analysis - By Class of Goods

	<u>Year Ended</u>			
	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2005 at LIFO</u>
<i>New & Demonstrator Automobiles</i>	\$ _____	\$ _____	\$ _____	\$ _____
<i>New & Demonstrator Light-Duty Trucks</i>	\$ _____	_____	_____	_____
<i>Used Vehicles - Automobiles</i>	\$ _____	_____	_____	_____
<i>Used Vehicles - Light-Duty Trucks</i>	\$ _____	_____	_____	_____
<i>Parts and Accessories</i>	\$ _____	_____	_____	_____
<i>Gas, Oil, Grease, WIP, Other</i>	\$ _____	_____	_____	_____
<i>Total *</i>	\$ _____	\$ _____	\$ _____	\$ _____

* Amounts before Section 263A Inventory Cost Capitalization Adjustments

Ending Inventory Amount Reported on Income Tax Return for Preceding Year

\$ _____



Form 970, Part IV, Lines 13-17 ... Dollar-Value LIFO Method Information
& Statement Required by Regulation Section 1.472-8

Re: Use of Link-Chain, Index Method For New Vehicle LIFO Inventory
Automobile Dealership Electing Alternative LIFO Method under Revenue Procedure 97-36

Part IV, Line 13 ... Method of Defining "Items." "Item categories" will be determined by using the entire manufacturer's base model code number that represents the most detailed description of the base vehicle's characteristics, such as model line, body style, trim level, etc.

Part IV, Line 14a ... Taxpayer did not acquire any of the goods covered by the LIFO election at below-market prices.

Part IV, Line 15 ... Pooling - Taxpayer will use two pools. Taxpayer has elected LIFO treatment for its new vehicles in accordance with the pooling criteria set forth in Section 4.02(1) of Revenue Procedure 97-36.

Pool #1: Consists of all new automobiles (regardless of manufacturer), including demonstrators.

Pool #2: Consists of all new light-duty trucks (regardless of manufacturer), including demonstrators.

Part IV, Line 16 ... Method to Compute the LIFO Value of Each Dollar-Value Pool. Taxpayer elects not to use the so-called "double extension" method for computing the LIFO value of its dollar value inventory pools. Instead, taxpayer elects and will use a dollar value, link-chain, index method for each pool as required by, and in accordance with, Revenue Procedure 97-36. This approach has been selected because of anticipated future technological changes in the stock of inventory, the extensive variety of items, and the changes in the items which are combined into and make up the vehicles sold by the taxpayer at retail. It has also been selected because of its availability and acceptability under Section 4.01 of Revenue Procedure 97-36.

The index to be applied to each LIFO pool of inventory investment is determined in accordance with the fourteen (14) step methodology of Section 4.03 of Revenue Procedure 97-36. Taxpayer is a franchised automobile dealer and the indexes it will develop will reflect its own ending inventory invoices and specific price data and inventory quantities and mix. Accordingly, its procedures are consistent with the intent of Reg. Sec. 1.472-8 and will demonstrate the accuracy, reliability, and suitability of its index computations.

Under the link-chain, index method as provided in Revenue Procedure 97-36, the change in cost levels will be measured first on an annual basis, and then the cumulative change (forward from the base date) will be determined by multiplying the current annual index by the last previously determined cumulative index (i.e., by the cumulative index at the beginning of the year).

Part IV, Line 17 ... "Other" Method (to Determine the Current-Year Cost in the Closing Inventories and to Value the LIFO Increments of the Dollar-Value Pools). Taxpayer has also elected to value any future annual inventory increments (as determined under the link-chain, index method described above) by applying an index developed with reference to the specific identification of items (new vehicles, including demonstrators) in inventory at year-end. This is described as the "specific identification increment method" in Section 4.02(2) of Revenue Procedure 97-36. This method is expected to approximate (although it will not be exactly the same as) the "most recent purchases" method. This approach for valuing increments will simplify the computations because the same index that is used in converting (deflating) the ending inventory from actual cost to a base dollar equivalent will also be used for valuing any increments that are computed at year-end.



This section contains information relating to the filing of Form 3115 for a dealership terminating its LIFO election for new vehicles, where the dealership previously elected to use the Alternative LIFO Method provided in Rev. Proc. 97-36.

Page

- 23 **Comparison of Procedures for Terminating LIFO Elections**
- 24 **Instructions for Completing Form 3115**, tailored to terminating the Alternative LIFO Method election
- Because of the length of Form 3115 (8 pages), a filled-in sample is not included.
- 25 **Permitted Method(s) for Inventory Valuation After Termination of LIFO Election**
- Reg. Sec. 1.472-6 applies where LIFO termination is under the advance consent request procedures.
 - Section 10.01 of Appendix to Rev. Proc. 2002-9 applies if change is under the automatic change procedures.
- 26-27 **Form 3115: Narrative Statements & Other Information ... 2 pages to be attached to Form 3115**
- Computation of the positive Section 481(a) adjustment is a part of this attachment.
 - This includes a disclosure that not all non-LIFO inventories are valued using the same method
 - ♦ Used vehicles are valued at cost or market, whichever is lower, and
 - ♦ Parts and accessories inventories are valued using the replacement cost method.
 - **Reminders ...**
 - ♦ Taxpayer name and employer ID number need to be inserted at the top of each page.
 - ♦ Appropriateness of statement (on page 2 of 2) regarding use of a *simplified resale method* in connection with Section 263A Inventory Cost Capitalization Rules should be confirmed. Usually, Question 3 in Part II on Page 6 of Form 3115 will be answered ... "Yes."
 - ♦ Copies of Forms 970 filed and any subsequent Forms 3115 should be attached.
 - ♦ Include Form 2848 *Power of Attorney* ... and Request a *Conference of Right* on Page 3.

Form 3115, Page 6, Schedule D, Part II, Change in Valuing Inventories ... Line 4a

4a Check the appropriate boxes below.

Identification methods:

Specific identification

FIFO

LIFO

Other (attach explanation)

Valuation methods:

Cost

Cost or market, whichever is lower

Retail cost

Retail, lower of cost or market

Other (attach explanation)

b Enter the value at the end of the tax year preceding the year of change . . .

Inventory Being Changed		Inventory Not Being Changed
Present method	Proposed method	Present method
	X	X - Used
X		
X		
	X	X-Used
Parts/Access		RP 2002-17
2,700,000	3,500,000	

Requirements for Form 3115 Filings Common to Both Procedures

Recapture of LIFO Reserve	<ul style="list-style-type: none"> • Upon termination of the LIFO election, the LIFO reserve must be repaid by including the amount of the LIFO reserve in income 25% per year over a 4-year period beginning with the year of termination. The cut-off method may not be used. • This is the Section 481(a) adjustment. See Page 3, Part IV, Questions 24-27.
Audit Protection	<ul style="list-style-type: none"> • Generally, audit protection applies if the taxpayer is not under IRS audit at the time of filing Form 3115. • Applicants must indicate whether or not audit protection for their change applies, regardless of whether filing is under the advance consent request procedures or the automatic change procedures. • The revenue procedures indicate circumstances under which audit protection may not be applicable.
Other Information to Provide	<ul style="list-style-type: none"> • The amount of gross receipts for the three tax years preceding the year of change should be entered on Page 3, Part II, Line 17. • Schedule D, Part II, should be completed. <ul style="list-style-type: none"> ♦ Items 1 and 2 require the attachment of descriptions of <ul style="list-style-type: none"> ▪ The inventory goods which are being changed from LIFO to another method, and ▪ The inventory goods which are <i>not</i> being changed (i.e., all other inventory goods). ♦ Section 263A information is required. Also, if the applicant is subject to, but not in compliance with, Section 263A, generally on the same Form 3115 the applicant must first comply with Section 263A <i>before</i> changing an inventory valuation method.



Termination <i>Comparison of Procedures for Terminating LIFO Elections</i>		
Two Different Procedures	<ul style="list-style-type: none"> Advance permission to make the change is required from the IRS. Rev. Proc. 97-27 	<ul style="list-style-type: none"> Advance permission to make the change is not required. Change is automatic. Rev. Proc. 2002-9 ... Appendix Section 10.01
Which Should be Used? Which One Applies?	<ul style="list-style-type: none"> Taxpayers must file under Rev. Proc. 97-27 if they do not meet the conditions set forth for filing under the automatic change procedures. 	<ul style="list-style-type: none"> Taxpayers must file under the automatic change request procedures if both <ul style="list-style-type: none"> The accounting method change is included in those (automatic change) procedures for the requested year of change, and The taxpayer is within the scope of the (automatic change) procedures for the requested year of change.
Caution	<ul style="list-style-type: none"> Six general scope limitations are set forth in Section 4.02 of Rev. Proc. 2002-9. Additional requirements concerning the permitted accounting method that the taxpayer will use in connection with all of its inventories after the termination of its LIFO election may prevent an automobile dealer from being eligible to file under the automatic change provisions. <ul style="list-style-type: none"> These are found in Section 10.01(1)(a) and (b) of the Appendix to Rev. Proc. 2002-9. See discussion below. 	<ul style="list-style-type: none"> Special scope limitations apply with respect to LIFO inventory method changes and these limitations may prevent automobile dealers from being able to use the automatic change provisions. The current position of the IRS appears to be that if an automobile dealership uses multiple inventory valuation methods for its non-LIFO inventory (and all dealerships do), then the automatic consent procedures do not apply.
Permitted Method	<ul style="list-style-type: none"> Page 6, Schedule D, Part II, Line 5(b). Reference for permitted method is to Reg. Sec. 1.472-6(a) or (b) ... or to a different method, if applicant is proposing a different method. Note Reg. Sec. 472-6 includes two additional sub-sections (c) and (d). Reg. Sec. 472-6(d) does allow the use of ... "any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner." 	<ul style="list-style-type: none"> Page 6, Schedule D, Part II, Line 5(c). Reference for permitted method is to the Appendix for Revenue Procedure 2002-9 and to the statement(s) required by Appendix Section 10.01(4) <ul style="list-style-type: none"> Sec. 10.01(4) actually requires 3 statements. The third statement, in turn, is referenced to Appendix Sec. 10.01(1)(b)(i) and to its four component sub-parts...(A), (B), (C) and (D). For a typical automobile dealership, it is not possible to literally meet either (A), (B), (C) or (D). In part, this is because the dealership's parts and accessories inventories are valued by using the replacement cost method...(usually pursuant to the safe-harbor method provided in Rev. Proc. 2002-17). As a result, the dealership is not eligible to use the automatic change request procedures because not all of its non-LIFO inventories are valued using the same method.
Time for Filing Original Form 3115	<ul style="list-style-type: none"> Before the end of the year of change. <ul style="list-style-type: none"> Original of Form 3115 must be signed by taxpayer. Form 3115 should be filed as early as possible during the year of change. In general, a taxpayer that fails to timely file a Form 3115 will not be granted an extension of time to file except in unusual and compelling circumstances. <ul style="list-style-type: none"> Reg. Sec. 301.9100-3 lists standards that must be met. (A separate user fee is required for these extension requests.) 	<ul style="list-style-type: none"> After the end of the year of change. Form 3115 is filed in duplicate. <ul style="list-style-type: none"> Original Form 3115 is to be attached to timely filed income tax return for the year of change. Copy of Form 3115 is filed with IRS National Tax Office no later than when the original is filed with the Federal income tax return for the year of change. (This copy must be signed by taxpayer.)
Mailing Address For NTO	Attn: CC:PA:LPD P.O. Box 7604 Ben Franklin Station Washington, DC 20044	Attn: CC:IT&A (Automatic Rulings Branch) P.O. Box 7604 Ben Franklin Station Washington, DC 20044
User Fee Required?	<u>Yes</u>	<u>No</u>



INSTRUCTIONS FOR COMPLETING FORM 3115 FOR ADVANCE IRS CONSENT FILING

TERMINATION OF LIFO INVENTORY METHOD BY AUTO DEALERSHIP

The current revision of Form 3115, *Application for Change in Accounting Method*, is dated Dec. 2003 and consists of 8 pages. This request for permission to terminate the LIFO election is made pursuant to Revenue Procedure 97-27 and it must be filed before the end of the taxable year for which the change is to be effective.

Page 1 ... Under "check the appropriate box ...,"

- Check the ☐ **Other** box and specify as ... "termination of LIFO election" or as "LIFO to specific identification cost."
- Do not complete Part I, Lines 1, 2 or 3.

Complete Part II questions 4a and 4b on page 1.

Applicant/Filer/Taxpayer and Form 3115 Preparer must sign and date at bottom of Page 1.

Page 2 ... Enter all information, answer all questions.

Part II, Line 9 ... This question concerning whether there have been changes in accounting method within the past 5 years may be tricky because of its broad language, including its reference to taxpayers other than the Applicant.

Note that many dealerships have filed Forms 3115 within the past five years in order to change their method of accounting to remove trade discounts (floor plan assistance payments) and/or certain advertising fees from inventory costs.

Page 3 ... **Part II, Lines 13-17 ...** Enter all information, answer all questions. On line 17, include gross receipts information for all three years.

Part II, Lines 18-23 ... These are required to be completed.

Part IV, Line 24 ... Answer should be, "No." The cut-off method is not applicable where LIFO elections are being terminated ... the taxpayer must repay the entire amount of its LIFO reserves when it goes off of LIFO.

Part IV, Line 25 ... Sec. 481(a) adjustment is the amount of the LIFO reserve as of the end of the last LIFO year.

Page 4 ... **Schedules A & B ...** Include this page, but leave it blank or else in white space portion at bottom of page 4, enter the following: "This page is not applicable."

Page 5 ... **Schedule C ...** Either leave blank or in white space portion at bottom of page 5, enter the following: "Taxpayer is applying for permission to terminate its LIFO method for valuing its new vehicle inventory. This page is not applicable."

Page 6 ... **Schedule D, Part I ...** Is not applicable.

Schedule D, Part II ... This part should be completed for LIFO terminations...

For inventory being changed, Present Method: Check the boxes for "LIFO" and for "Cost."

For inventory being changed, Proposed Method: Check the boxes for "specific identification" and for "cost or market, whichever is lower."

For inventory not being changed, Present Method:

- **For used vehicles**, check the boxes for "specific identification" and for "cost or market, whichever is lower."
- **For parts and accessories inventories**, on the bottom line for "Other," enter "Rev. Proc. 2002-17" or you may want to indicate "replacement cost method/RP 2002-17."

Schedule D, Part II, Line 5(b) ... Requires statement with respect to compliance with Reg. Sec. 1.472-6.

Page 7 ... **Schedule D, Part III ...** Include this page, but leave it blank or else in white space portion at bottom of page 7, enter the following: "This page is not applicable."

The portion of the narrative statement which addresses Section 263A in general is intended to substitute for more detailed completion of Schedule D, Part III, Sections A, B and C.

Page 8 ... **Schedule E ...** Include this page, but leave it blank or else in white space portion at bottom of page 8, enter the following: "This page is not applicable."

"Narrative Statements & Other Information" ... Consists of 2 pages to be attached to Form 3115, following page 8.



Permitted Method(s) for Inventory Valuation after Termination of LIFO Election

Under Advance Consent Request Procedures ... Reg. Sec. 1.472-6

If the taxpayer is granted permission by the Commissioner to discontinue the use of LIFO method of taking inventories, and thereafter to use some other method, [... text omitted ...] the inventory of the specified goods for the first taxable year affected by the change and for each taxable year thereafter shall be taken ...

- (a) In conformity with the method used by the taxpayer under Section 471 in inventorying goods not included in his LIFO inventory computations; or
- (b) If the LIFO inventory method was used by the taxpayer with respect to all of his goods subject to inventory, then in conformity with the inventory method used by the taxpayer prior to his adoption of the LIFO inventory method; or
- (c) If the taxpayer had not used inventories prior to his adoption of the LIFO inventory method and had no goods currently subject to inventory by a method other than the LIFO inventory method, then in conformity with such inventory method as may be selected by the taxpayer and approved by the Commissioner as resulting in a clear reflection of income; or
- (d) In any event, in conformity with any inventory method to which the taxpayer may change pursuant to application approved by the Commissioner.

Under Automatic Change Request Procedures ... Rev. Proc. 2002-9 - Appendix - Sec. 10.01 & 10.04

.01 Change from the LIFO inventory method.

(1) Description of change and scope.

(a) In general. This change applies to any taxpayer that wants to:

- (i) change from the LIFO inventory method for all its LIFO inventory or for a pool or pools within its LIFO inventory; and
- (ii) change to the permitted method as determined in section 10.01(1)(b) of this APPENDIX.

(b) Method to be used.

(i) Determining method to be used. The inventory method to be used by a taxpayer is determined as follows:

- (A) If the taxpayer has inventoriable goods not included in its LIFO inventory computations (non-LIFO inventory) and, for all the taxpayer's non-LIFO inventory, the taxpayer uses an inventory method that is a permitted method, then the taxpayer must use that same inventory method for its entire inventory.
- (B) If the LIFO inventory method is used by the taxpayer with respect to all its inventoriable goods, then the taxpayer must use the same inventory method it used prior to the adoption of the LIFO inventory method, if that prior method is a permitted method.
- (C) If the taxpayer has only LIFO inventory and the method used by the taxpayer prior to the adoption of the LIFO inventory method is not a permitted method, then the taxpayer must use a permitted method.
- (D) If the taxpayer did not use an inventory method prior to the adoption of the LIFO inventory method and has no inventoriable goods other than its LIFO inventory, then the taxpayer must use a permitted method.

(ii) Permitted method defined. For purposes of section 10.01 of this APPENDIX, a permitted method is a method under which:

- (A) the identification method is either the first-in, first-out (FIFO) inventory method or the specific identification inventory method; and
- (B) the valuation method is cost; cost or market, whichever is lower [... text omitted ...].

(iii) Method not to be used. The average cost method (sometimes also referred to as "the rolling average method") described in Rev. Rul. 71-234, 1971-1 C.B. 148, is not a permitted method.

(iv) Determining permitted method.

Whether an inventory method is a permitted method is determined by the taxpayer's method of inventory identification and valuation, and not by which types and amounts of costs are capitalized under the taxpayer's method of computing inventory cost. [... text omitted ...].

(2) Limitation on LIFO election. ... Text of Sec. 10.01(2) omitted.

(3) Effect of subchapter S election by corporation.

(a) S election effective for year of LIFO discontinuance. ... Text of Sec. 10.01(3)(a) omitted.

(b) S election effective for a year after LIFO discontinuance. ... Text of Sec. 10.01(3)(b) omitted.

(4) Additional requirements. The taxpayer must complete the following statements and attach them to the application:

- (a) "The new method of identifying inventory goods is the [insert method; that is, specific identification; FIFO; retail; etc.] method."
- (b) "The new method of valuing inventory goods is [insert method; that is, cost; cost or market, whichever is lower; etc.]."
- (c) "The new method conforms to the requirements of section 10.01(1)(b)(i) [insert either (A), (B), (C), or (D)] of the Appendix of Rev. Proc. 2002-9 because [explain in detail how the new method conforms to the specific subdivision]."



FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD**W/R/T TAXABLE YEAR ENDING****NARRATIVE STATEMENTS & OTHER INFORMATION**

Page 1 of 2

In accordance with the advance consent request procedures of Revenue Procedure 97-27, Taxpayer is applying for permission to terminate the LIFO election that it previously made in taxable year _____ for valuing its new vehicle inventories. This change is to be effective for the taxable year beginning on _____ and ending on _____.

Taxpayer is not under IRS audit examination at the time of filing this Form 3115. Accordingly, Taxpayer should be entitled to audit protection in connection with this request for change in accounting method.

Taxpayer is a franchised automobile dealer engaged in the purchase and retail sale of new automobiles and light-duty trucks. Taxpayer also buys and sells used vehicles, and it provides parts, repair and maintenance services on the vehicles it sells, as well as on vehicles customers have purchased from other dealers. Taxpayer reports on the basis of a calendar year-end and it employs the accrual method of accounting for maintaining its records and for filing its Federal and State income tax returns. Taxpayer's business code for principal business activity is 441110. Taxpayer has four general classes of inventory.

New Vehicles. New vehicle inventories are presently valued using LIFO in accordance with the methodology in Revenue Procedure 97-36. Invoices are received from the manufacturer(s) or from other dealers in dealer trades. Each vehicle invoice consists of the aggregate of differing combinations of capitalizable costs including the vehicle base price which is the principal component, and other lesser sub-components such as destination charges, factory-installed options (both individual as well as in package combinations), options and accessories installed by the dealer, and other capitalizable charges. Trade discounts (floorplan assistance payments) *[have] [have not]* been eliminated from inventory cost. Also, certain advertising fees and expenses *[have] [have not]* been eliminated from inventory cost.

Used Vehicles. Taxpayer acquires some used vehicles by purchase at auctions or directly from other dealers; Taxpayer acquires other used vehicles as trade-ins from (retail) customers. Used vehicles are valued at the lower of cost or market, with market considered to be lower of wholesale, "as is" value, less estimated reconditioning cost, or estimated current wholesale market value. *[If LIFO is or has been elected for used vehicles, insert statements concerning (1) prior election of LIFO, (2) method for determining the current cost under Rev. Proc. 2001-23, and/or (3) termination of LIFO election for used vehicles.]*

Parts & Accessories. Pursuant to accepted industry-wide practice, cost of parts and accessories inventories is determined at year-end by reference to manufacturer current price lists in effect at year-end. As a result, the ending parts and accessories inventory is valued at higher replacement costs instead of at actual cost. This practice results in an overall valuation for parts and accessories inventories that closely approximates, but usually is slightly in excess of, cost. This method for valuing parts inventories is permitted by Revenue Procedure 2002-17 which allows automobile dealers to approximate the actual cost of parts and accessories inventory items by reference to end-of-the-year prices taken from manufacturers' price lists.

Misc. Other Inventories. Gas, oil, grease, work in process, body shop supplies, sublet and other inventories are valued at cost.

Page 3, Part IV - Net Positive Section 481(a) Adjustment - Taxpayer's computation is below.

	<i>Pool #1</i> <i>New</i> <i>Automobiles</i>	<i>Pool #2</i> <i>New Light-Duty</i> <i>Trucks</i>	<i>Total</i> <i>All New</i> <i>Vehicles</i>
<u>New Vehicle Inventory at December 31, 2004</u>			
* Inventory at Cost (Specific Identification)	2,000,000	1,500,000	3,500,000
** LIFO Valuation of Above Inventory at Dec. 31, 2004	1,500,000	1,200,000	2,700,000
Net Positive Section 481(a) Adjustment (LIFO Reserve)	500,000	300,000	800,000

* Beginning inventory for the year of change under the proposed method.

** Beginning inventory for the year of change under the present (LIFO) method.



FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD**W/R/T TAXABLE YEAR ENDING****NARRATIVE STATEMENTS & OTHER INFORMATION**

Page 2 of 2

Page 6, Schedule D, Part II, Line 5(b)

After the termination of its LIFO election for new vehicles, Taxpayer proposes to value its new vehicle inventories using the same method that it currently employs for valuing its used vehicle inventories (i.e., identifying goods by the specific identification method and valuing those goods in ending inventory at cost or market, whichever is lower. *[If applicable, add the following: This is the same method that the Taxpayer used for valuing its new vehicle inventories prior to making its election to use the LIFO inventory method for these goods.]*

Taxpayer believes that this proposed method for valuing its new vehicle inventories (after the termination of its LIFO election) would be permissible under Regulation Section 1.472-6(d). The method that Taxpayer proposes (1) is in substantial compliance with the requirements of Section 10.01(4) of the Appendix to Revenue Procedure 2002-9, and (2) it will clearly reflect income.

The method Taxpayer is proposing to use is different from the other "permitted" methods because the Taxpayer is an automobile dealership, and a portion of its non-LIFO inventories consists of parts and accessories which are valued using the replacement cost method in compliance with the Revenue Procedure 2002-17. Taxpayer's method for valuing its parts and accessories (at replacement cost) is specifically permitted by Rev. Proc. 2002-17 *only for* parts and accessories. Accordingly, this method cannot be used - and it would be improper to use (because it would not clearly reflect income) - for valuing the new vehicle inventories after the Taxpayer's LIFO election is terminated.

After the termination of its LIFO election, Taxpayer requests permission to value its new vehicle inventories using the same method that it is currently using for valuing its used vehicle inventories because this method conforms to Generally Accepted Accounting Principles (GAAP) and to the best accounting practice in its trade or business, and this method will more clearly reflect income (than would any other alternative). The method Taxpayer proposes to use also (1) conforms to the accounting principles followed by other automobile dealerships in Taxpayer's industry and (2) is consistent with the accounting policies that the dealership is required to follow in maintaining its accounts and records and in submitting monthly reports and financial statements to its manufacturer/franchisor. Taxpayer would also use its proposed method in reporting for all other financial statement purposes.

Accordingly, Taxpayer submits (as modified) the statements required by Rev. Proc. 2002-9, Appendix Sec. 10.01(4):

- (a) The new method of identifying inventory goods *proposed by the Taxpayer* is the specific identification method.
- (b) The new method for valuing inventory goods *proposed by the Taxpayer* is cost or market, whichever is lower.
- (c) The new method conforms *as nearly as is possible (after taking into careful consideration the unique circumstances [discussed more fully in Section 2.08 of Rev. Proc. 2002-17] surrounding the use of the replacement cost method by automobile dealers)* to the requirements of Section 10.01(1)(b)(i)(A). ("If the taxpayer has inventoriable goods not included in its LIFO inventory computations (non-LIFO inventory) and, for *all* the taxpayer's non-LIFO inventory, the taxpayer uses an inventory method that is a permitted method, then the taxpayer must use that same method for its *entire* inventory.")

Section 263A Inventory Cost Capitalization Matters

- ☐ Taxpayer is subject to the Section 263A Inventory Cost Capitalization Rules, and no changes are contemplated in connection with its Section 263A method of accounting. Taxpayer has elected to determine the capitalization and inclusion in inventory costs of certain expenses in accordance with:
 - ☐ The *Simplified Resale Method Without Historic Absorption Ratio Election* ... Reg. Sec. 1.263A-3(d)(3)
 - ☐ The *Simplified Resale Method With Historic Absorption Ratio Election* ... Reg. Sec. 1.263A-3(d)(4)
 - ☐ A method other than either of the Simplified Resale Methods indicated above ... Reg. Sec. 1.263A-3(d)(5)
- ☐ Sec. 263A is *not applicable* because the Taxpayer has gross receipts of less than \$10 million over the past three years.

Form 970 Original LIFO Election

- ☐ A copy of the original Form 970 LIFO election for new vehicle inventories is attached.
- ☐ A copy of the original Form 970 LIFO election for new vehicle inventories is not attached.

"I certify that to the best of my knowledge and belief (_____ Dealership) properly elected the LIFO inventory method by filing Form 970 with its return for the tax year(s) ended (_____) and otherwise complied with the provisions of Section 472(d) and Reg. Sec. 1.472-3."

/S/ _____



**SAMPLE FORM 3115 PACKAGE FOR AUTO DEALERSHIP
CHANGING TO THE ALTERNATIVE LIFO METHOD (REV. PROC. 97-36)
FROM THE LIFO METHOD IT ORIGINALLY ELECTED TO USE**

This section contains the filing package that we have provided to other CPAs for an auto dealership that has already elected to use the LIFO method, but that now wants to change to the Alternative LIFO Method for New Vehicles provided in Revenue Procedure 97-36. This is automatic Change #58. Because of the length of Form 3115 (8 pages), a filled-in sample is not included.

Page

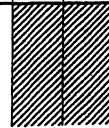
29	Instructions for Completing Form 3115 , tailored to changing to the Alternative LIFO Method
30-31	Transmittal Letter to the CPA / Client
32-34	Form 3115: Narrative Statements & Other Information ... 3 pages to be attached to Form 3115
35	Transmittal Letter to IRS National Office, Washington, D.C.

Part I Information For Automatic Change Request

Yes No

- 1 Enter the requested designated accounting method change number from the **List of Automatic Accounting Method Changes** (see instructions). Enter only one method change number, except as provided for in the instructions. If the requested change is not included in that list, check "Other," and provide a description.

▶ (a) Change No. 58 (b) Other ☐ Description ▶ _____



58. Alternative LIFO inventory method (section 472)—for a qualifying applicant that sells new automobiles or new light-duty trucks, to the "Alternative LIFO Method" described in Rev. Proc. 97-36, 1997-33 I.R.B. 450. Complete Schedule C of Form 3115, as applicable. Attach the statement required by section 10.03(2)(c)(ii) in the Appendix of Rev. Proc. 2002-9 and the Form 970 required by reference in section 10.03(2)(c)(i) in the Appendix of Rev. Proc. 2002-9. This change is made on a cut-off basis. See section 10.03 in the Appendix of Rev. Proc. 2002-9.

Should a Copy of the Original LIFO Election - Form 970 - Be Attached to the Form 3115?

The answer to this question is, "Yes." The Instructions concerning **automatic change #58** (page 11 of 12) state that taxpayers should ... "Complete **Schedule C** of Form 3115 as applicable." Schedule C (page 5 of the Form 3115) is for "changes within the LIFO inventory method." Schedule C is used to request a change from one LIFO inventory method or submethod to another LIFO inventory method or submethod, and Part I (**General LIFO Information**) must be completed by all filers and Part II (**Change in Pooling Inventories**) should be completed only if it is applicable in connection with the change.

At the very top of Part I, the following appears ... "Attach a copy of all Forms 970 ... filed to adopt or expand the use of the LIFO method."

In some instances, taxpayers may be unable to locate a copy of the original Form 970 that was filed (even though one might expect that a copy of Form 970 was included in the copy of the tax return filed for that year that was retained by the dealership. In such a case, what should one do?

Under these circumstances, we have followed the instructions for Line 5a of **Schedule D**. Schedule D (**Change in the Treatment of Long-Term Contracts under Sec. 460, Inventories or Other Section 263A Assets**) comprises pages 6-7-8 of Form 3115, and Part II (**Change in Valuing Inventories** ...) includes the requirement that copies of Form(s) 970 filed to adopt or expand the use of the LIFO method must be attached to the Form 3115. The Instructions for Form 3115 (page 7 of 12), for Schedule D, Part II, Line 5a state that if the applicant is unable to furnish a copy of the Form(s) 970, a statement should be attached in lieu thereof.

The proforma 3115 reflects this alternative language for situations where a copy of the original Form 970 cannot be attached.



Auto Dealership Changing Within the LIFO Method for New Vehicles
To Use the Alternative LIFO Methodology in Rev. Proc. 97-36

This change is Automatic Change No. 58 on the *List of Automatic Accounting Method Changes* (included on Page 11 in the 12 pages of Instructions to Form 3115).

This change in LIFO methodology for new vehicles does *not* require permission in advance from the IRS.

The current Form 3115, *Application for Change in Accounting Method*, is dated December 2003 and consists of 8 pages. Basically, only Pages 1, 2, 3 and 5 need to be completed.

Page 1 ... Part I, Line 1(a) ... Identify as **Change #58** on Line (a). Do not make any other entries on (b). It is not necessary to include any information in the top right hand section where *appropriate box* is asked to be checked. For automatic change requests, this informational change requirement is satisfied by properly completing Part I, Line 1.

Applicant/Filer/Taxpayer and Form 3115 Preparer must sign and date at bottom of Page 1.

Page 2 ... Enter all information, answer all questions.

Part II, Line 9 ... This question concerning whether there have been changes in accounting method within the past 5 years may be tricky because of its broad language, including its reference to taxpayers other than the Applicant.

Page 3 ... Part II, Lines 13-17 ... Enter all information, answer all questions.

Part III ... Not required to be completed.

Part IV, Line 24 ... The answer should be ... "Yes" ... because the cut-off method is applicable.

Page 4 ... Schedules A & B ... Include this page, but leave it blank or else in white space portion at bottom of page 4, enter the following: "This page not applicable."

Page 5 ... Schedule C ... Either leave blank or in the white space portion at bottom of page 5, enter the following: "Change is to the Alternative LIFO Method for New Automobiles in accordance with Revenue Procedure 97-36 ... Automatic Change No. 58. See statement attached."

Page 6 ... Schedule D, Parts I & II ... Include this page, but leave it blank or else in the white space portion at bottom of page 6, enter the following: "This page not applicable."

Page 7 ... Schedule D, Part III ... Include this page, but leave it blank or else in the white space portion at bottom of page 7, enter the following: "This page not applicable."

Page 8 ... Schedule E ... Include this page, but leave it blank or else in the white space portion at bottom of page 8, enter the following: "This page not applicable."

"Narrative Statements & Other Information" ... Consists of 3 pages to be attached to Form 3115, following page 8.

- Reminders ...**
1. Taxpayer name and employer ID number need to be inserted at the top of each page.
 2. Be sure to confirm correctness of statements on page 2 of 3 (regarding non-filing of Form 970) and on page 3 of 3 (regarding the use of a *simplified resale method* in connection with Section 263A Inventory Cost Capitalization Rules).
 3. Copies of original Forms 970 and any subsequent 3115s should be attached.



TRANSMITTAL LETTER TO THE CPA/CLIENT

Page 1 of 2

Date: _____

Contact Name / Firm
Address - Street, City, State, Zip

**Re: Dealership Name
Change in LIFO Accounting Method under Automatic Change Procedure
to the Alternative LIFO Method for New Vehicles
Under Rev. Proc. 97-36 and Rev. Proc. 2002-9
For The Calendar Year Ending December 31, 2005**

Dear _____:

In accordance with our prior discussions, enclosed is the Form 3115 filing package that needs to be completed and processed in accordance with the instructions below.

A blank Form 3115 (all 8 pages) is attached. You will need to complete the current Form 3115 (Rev. Dec. 2003) in accordance with our enclosed page entitled "*Instructions for Completing Form 3115.*"

Since we do not have any of the client-specific information in our files, we have included only ***Narrative Statements & Other Information*** (3 pages of text). This is to be attached after the last page of Form 3115 once you have completed all of the appropriate general (i.e., non-LIFO) information from your records.

You should not have to make any substantive alterations to the technical/LIFO-related language on these 3 pages. However there are a few places where you will need to indicate the correct response from a series of choices, or where you may need to modify the language somewhat to reflect your specific circumstances.

In addition, please note the following:

1. The taxpayer's name and employer ID number need to be inserted at the top of each page.
2. The appropriateness of statement (on page 2 of 3) regarding the non-filing of Form 970 in connection with this change should be confirmed.
3. The appropriateness of statement (on page 3 of 3) regarding use of a *simplified resale method* in connection with Section 263A Inventory Cost Capitalization Rules should be confirmed.
4. A copy of original Form 970 should be attached to this Form 3115. If subsequent to the LIFO election, any other Forms 3115 were filed (other than this one), a copy of each 3115 should also be attached.

File the Original Form 3115 with the Year-of-Change Federal Income Tax Return

The original Form 3115 must be attached to the dealership's timely filed (including extensions) original Federal Income Tax Return for the year of change. An officer of the corporation should sign and date the Form 3115 and also print his/her name below his/her signature on the left-hand side.

In addition, you or your Firm should sign the Form 3115 as "Preparer" at the bottom of Page 1.

(Continued)



A Copy of Form 3115 Should Also Be Mailed to the IRS National Office

A copy of the Form 3115 must be filed with the IRS National Office in Washington, D.C. no later than when the original is filed with the Federal Income Tax Return for the year of change. A sample transmittal letter to the National Office is included herewith.

This sample transmittal letter text can be copied beneath the dealership's corporate letterhead and signed and dated. The filing with the National Office should be mailed to the address below:

Internal Revenue Service
Attn: CC:IT&A (Automatic Rulings Branch)
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

No user fee is required in connection with this filing since it is being made under an automatic change procedure. You will not receive any acknowledgement from the IRS regarding its receipt of your Form 3115.

Rebasing LIFO Indexes to 1.000 as of the Beginning of the Year-of-Change

To make the changeover to the Alternative LIFO Method for New Vehicles, one of the technical requirements is that the LIFO indexes at the beginning of the year-of-change (i.e., as of December 31, 2004 ... the last day of the year before the year of change) must be rebased to 1.000.

Section 5.03(8) of Revenue Procedure 97-36 requires a recomputation of the prior years' LIFO indexes so that the first year under the Alternative LIFO Method for New Vehicles (calendar year ending December 31, 2005) reflects its opening inventory indexes rebased to 1.000 *for LIFO computation purposes only*.

The LIFO reserves for the dealership as of December 31, 2004 (i.e., the last of the year immediately preceding the year of change to the Alternative LIFO Method) have remained unchanged. Since the use of the cut-off method is allowed in connection with this change, there has been no Section 481(a) adjustment for any years prior to the first year under the Alternative LIFO Method for New Vehicles.

It is *not* necessary to include the rebasing computations with either (1) the original Form 3115 included in the Federal Income Tax Return when it is filed or (2) the filing of the copy of the Form 3115 with the IRS National Office in Washington, D.C. This rebasing has been done as part of the routine processing of the new vehicle LIFO computations for the year of change, and it is reflected in the year-end LIFO layer valuations and history.

If you have any questions on any of this, please call.

Thank you for the opportunity to be of assistance in this matter.

Sincerely,



FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHODW/R/T TAXABLE YEAR ENDING DECEMBER 31, 2005NARRATIVE STATEMENTS & OTHER INFORMATIONPage 1 of 3General Information

This request is for **Change No. 58** ... Change from Taxpayer's existing LIFO inventory valuation method to the Alternative LIFO Method for New Vehicles, as described in Revenue Procedure 97-36. This change is being made for the calendar year ending December 31, 2005.

Taxpayer is not under IRS audit examination at the time of filing this Form 3115.

No user fee is required ... Per Form 3115 instructions, applicants filing under an automatic change procedure are not required to pay a user fee.

Taxpayer's business code for principal business activity is 441110. Taxpayer is a franchised automobile dealer engaged in the purchase and retail sale of new automobiles and light-duty trucks. Taxpayer also buys and sells used vehicles, and it provides parts, repair and maintenance services on the vehicles it sells, as well as on vehicles customers have purchased from other dealers. Taxpayer reports on the basis of a calendar year-end and it employs the accrual method of accounting for maintaining its records and for filing its Federal and State income tax returns.

Taxpayer's change is not a change within the LIFO method from a previous IPIC LIFO election method. Therefore, the additional provisions of Section 10.03(2)(b) of the Appendix to Revenue Procedure 2002-9 (related to the dollar-value, link-chain methods to be applied to goods on the IPIC method which are not new vehicles [i.e., to used vehicles and to parts and accessories inventories.]) do not apply to this Form 3115 filing.

Page 2, Part II, Line 12 and Page 5, Schedule C, Part I:Description of Changes within the LIFO Inventory Method

One of the reasons that the Internal Revenue Service established the Alternative LIFO Method for New Vehicles was to significantly reduce expensive and time-consuming disagreements that might otherwise arise between automobile dealerships and the IRS over the acceptability of various LIFO computation methodologies that dealerships might apply. By making this change beginning with its taxable year 2005, Taxpayer wishes to conform its LIFO calculations and methodology to the "safe-harbor" methodology in Rev. Proc. 97-36.

Revenue Procedure 97-36 establishes a "safe harbor" approach for retail automobile dealers. Under this approach, for taxpayers utilizing the Alternative LIFO Method, the Commissioner will waive strict adherence to the comparability requirement found in Reg. Sec. 1.472-8. Taxpayers must use the compensating submethods described in Revenue Procedure 97-36 in order to ensure that the results obtained by applying the Alternative LIFO Method for New Vehicles will clearly reflect income.

The Alternative LIFO Method is a dollar-value, link-chain (index) method employing a specific identification increment method and sub-methods, definitions and special rules provided in Section 4.02 and a computational methodology set forth in 14 steps in Section 4.03 of Revenue Procedure 97-36.

The attached copy of the Form 970 originally filed by Taxpayer describes the previous LIFO methodology from which Taxpayer is now changing to the Alternative LIFO Method.

(Continued)



FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

W/R/T TAXABLE YEAR ENDING DECEMBER 31, 2005

NARRATIVE STATEMENTS & OTHER INFORMATION

Page 2 of 3

Consent Statements ... Required by Section 10.03(2)(c)(ii) in the Appendix of Rev. Proc. 2002-9

Under penalties of perjury, taxpayer agrees to all of the conditions of consent contained in Section 5.03 of Revenue Procedure 97-36, to change to the Alternative LIFO Method and to all of the terms and conditions in Revenue Procedure 2002-9.

In this regard, Taxpayer will ...

- (1) Maintain and retain complete records of the computations of the LIFO inventory under the Alternative LIFO Method for New Vehicles. In addition, Taxpayer will retain copies of the actual purchase invoices for all vehicles used in the computation.
- (2) Retain (in effecting the change in its LIFO methodology) any layers of inventory increments previously determined and the LIFO value of such increments.

Instead of using the earliest taxable year for which Taxpayer adopted the LIFO method for any items in the inventory pool or pools, the year of change (2005) will be used as the base year in determining the LIFO value of the inventory pool or pools for the year of change and later taxable years. The cumulative index at the beginning of the year of change (i.e., as for January 1, 2005) will be adjusted to be 1.0000.

Accordingly, the base year costs of layers of increments in the pool or pools at the beginning of the year of change will be restated so that they are expressed in terms of the new base year costs, using the year of change (2005) as the new base year.

- (3) Effect the change to the Alternative LIFO Method for New Vehicles using the cut-off method. No Section 481(a) is required because the values (i.e., the LIFO valuations) of the respective new vehicle pools at the beginning of the year of change must be kept the same as their respective values (i.e., LIFO valuations) at the end of the preceding taxable year.

No market value restorations are required as of the end of the year preceding the year of change because no inventory writedowns were made. See also statement on following page re: *Part IV, Page 3 - Section 481(a) Adjustment*.

- (4) Not be required to include a new *Form 970* as part of its Federal Income Tax Return filed for the year of change (2005).

Section 5.03(5) requires taxpayers (automobile dealers) changing to the Alternative LIFO Method for New Vehicles to file *Form 970, Application to Use LIFO Inventory Method*, under certain circumstances. In its previous LIFO election, Taxpayer included demonstrator vehicles in the appropriate new automobile and/or new light-duty truck pools. Therefore, Taxpayer does not have to "extend its LIFO election to include any vehicles to which the LIFO election did not previously apply." Accordingly, there is no need for Taxpayer to include a new *Form 970* as part of its income tax return filed for the year of change (2005).

(Continued)



FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD**W/RT TAXABLE YEAR ENDING DECEMBER 31, 2005****NARRATIVE STATEMENTS & OTHER INFORMATION****Page 3 of 3****Page 3, Part IV - Section 481(a) Adjustment ... This change requires use of the cut-off method.**

Cut-off method. Under Section 5.03(6) of Revenue Procedure 97-36, an automobile dealer must effect the change to the Alternative LIFO Method for New Vehicles using the cut-off method. Under the cut-off method, the value of the new automobile and new light-duty truck inventory ... at the beginning of the year of change shall be the same as the value of such inventory at the end of the preceding taxable year, plus market value restorations, if any are required. No market value restorations are required as of the end of the year preceding the year of change because no inventory writedowns were made.

Accordingly, taxpayer proposes to make no Section 481(a) adjustment for the change in LIFO methodology herein requested. In effecting the changes in LIFO methodology requested, Taxpayer proposes to retain without change any layers of inventory increments previously determined and the corresponding LIFO values of such increments. The base-year costs of the layers of increments in the pools at the beginning of the year of change will be restated in terms of the new base-year costs, using the year of change as the new base-year.

Taxpayer will retain (for subsequent review by the Internal Revenue Service) copies of all computations incident to the rebasing of its LIFO inventory indexes to 1.000 as of December 31, 2004.

Section 263A Inventory Cost Capitalization Matters

- ☐ Taxpayer is subject to the Section 263A Inventory Cost Capitalization Rules, and no changes are contemplated in connection with its Section 263A method of accounting. Taxpayer has elected to determine the capitalization and inclusion in inventory costs of certain expenses in accordance with:
 - ☐ The *Simplified Resale Method Without Historic Absorption Ratio Election* (Reg. Sec. 1.263A-3(d)(3))
 - ☐ The *Simplified Resale Method With Historic Absorption Ratio Election* (Reg. Sec. 1.263A-3(d)(4))
 - ☐ A method other than either of the Simplified Resale Methods indicated above (Reg. Sec. 1.263A-3(d)(5))
- ☐ Taxpayer is not subject to the Section 263A Inventory Cost Capitalization Rules because it has gross receipts of less than \$10 million over the past three years.

Form 970 Original LIFO Election

- ☐ A copy of the original Form 970 LIFO election for new vehicle inventories is attached.
 - ☐ A copy of the original Form 970 LIFO election for new vehicle inventories is not attached.
- "I certify that to the best of my knowledge and belief (_____ Dealership) properly elected the LIFO inventory method by filing Form 970 with its return for the tax year(s) ended (_____) and otherwise complied with the provisions of Section 472(d) and Reg. Sec. 1.472-3."

/S/ _____

Form 3115 Filings

The original of Form 3115 has been attached to Taxpayer's Federal Income Tax Return for the year of change. A duplicate copy of this Form 3115 has been sent to the IRS National Office in Washington, D.C.



**TRANSMITTAL LETTER FOR FORM 3115
TO BE PREPARED ON DEALERSHIP LETTERHEAD
& MAILED IMMEDIATELY TO IRS NATIONAL OFFICE**

Date_____, 200_

Internal Revenue Service
Attn: CC:IT&A (Automatic Rulings Branch)
P. O. Box 7604
Ben Franklin Station
Washington, DC 20044

Re: Dealership Name

EI No. _____

**Form 3115: Change in LIFO Accounting Method under Automatic Change Procedure
to the Alternative LIFO Method for New Vehicles
Under Rev. Proc. 97-36 and Rev. Proc. 2002-9
For The Calendar Year Ending December 31, 2005**

Dear Sir or Madam:

Enclosed is a copy of the Form 3115 for the dealership identified above reflecting that dealership's request for permission to change to the Alternative LIFO Method for New Vehicles provided by Revenue Procedure 97-36 in connection with its use of the Last-In, First-Out (LIFO) inventory valuation method for new automobile and new light-duty truck inventories.

This change is to be effective for the calendar year ending December 31, 2005. The Alternative LIFO Method for Automobile Dealers is set forth in Revenue Procedure 97-36 and this change is being made under Section 10.03 of the Appendix of Revenue Procedure 2002-9.

The original Form 3115 will be attached to Taxpayer's timely filed (including extensions) original Federal income tax return for 2005, the year of change. This copy of Form 3115 is also being filed at this time with the IRS National Office in Washington, D.C.

As of the dates of these filings, Taxpayer is *not* under audit examination and Taxpayer does not have any Federal income tax return(s) under consideration by any IRS Appeals Officer or by any Federal Court.

Taxpayer agrees to all of the conditions of Revenue Procedures 97-36 and 2002-9 and taxpayer proposes to make no Section 481(a) adjustment because of the availability of the cut-off method for making this change in its LIFO inventory valuation procedures.

No user fee is required in connection with this filing since it is being made under one of the published automatic change procedures.

Respectfully submitted,

(Authorized Officer), President



FORM 3115 & INSTRUCTIONS ... Rev. Dec. 2003
COMMENTS ON CHANGES & REVISIONS

Background

- Form 3115 must be filed to request a change in either an overall accounting method or the accounting treatment of any item. Currently, two procedures exist under which a taxpayer may request a change in accounting method.
 - ♦ One procedure involves so-called **automatic change** requests, wherein advance permission or consent from the IRS to make the change in method is not required.
 - ♦ The second procedure involves **advance consent** requests, and this involves all changes in method other than those specifically treated as automatic change requests.
- Current revision of Form 3115 is dated December, 2003. The previous revision was dated May, 1999.
- Form 3115 and Instructions cover 20 pages ... 8 pages - Form 3115 ... 12 pages - Instructions
 - ♦ Layout of Form 3115 pages is below; see facing page for copy of Page 1
 - ♦ Instructions for current Form 3115 have been significantly expanded from 12 to 24 full-page columns.

**Form 3115
8 Pages**

- **PAGE 1**
 - ♦ Taxpayer Identification, CAM Identification & Signature Blocks
 - ♦ Part I ... Information for Automatic Change Request (Questions 1-3)
 - ♦ Part II ... Information for All Requests (Questions 4a & b)
- **PAGE 2**
 - ♦ Part II ... Information for All Requests ... Continued (Questions 4c-12)
- **PAGE 3**
 - ♦ Part II ... Information for All Requests ... Continued (Questions 13-17)
 - ♦ Part III ... Information for Advance Consent Request (Questions 18-23)
 - ♦ Part IV ... Section 481(a) Adjustment (Questions 24-27)
- **PAGE 4**
 - ♦ Schedule A - Parts I & II ... Change in Overall Method of Accounting
 - ♦ Schedule B ... Change in Reporting Advance Payments
- **PAGE 5**
 - ♦ **Schedule C ... Changes within the LIFO Inventory Method ... Note: This section is to be completed by a dealership already on LIFO that is changing to the Alternative LIFO Method (R.P. 97-36).**
 - Part I ... General LIFO Information
 - Part II ... Change in Pooling Inventories
- **PAGE 6**
 - ♦ **Schedule D ... Changes in Long-Term Contracts, Inventories or Other Section 263A Assets ... Note: This section is to be completed by a dealership that is terminating its LIFO election.**
 - Part I ... Change in Reporting Income from Long-Term Contracts ... Section 460
 - Part II ... Change in Valuing Inventories including Cost Allocation Changes
- **PAGE 7**
 - ♦ Part III ... Method of Cost Allocation
 - Section A ... Allocation & Capitalization Methods
 - Section B ... Direct and Indirect Costs Required to Be Allocated
- **PAGE 8**
 - ♦ Part III ... Method of Cost Allocation ... Continued
 - Section C ... Other Costs Not Required to be Allocated
 - ♦ Schedule E ... Change in Depreciation or Amortization

**Instructions
12 Pages**

- **PAGE 1** ... General instructions are readable and straightforward. (Portions appear on pages 39 & 40.)
 - ♦ Purpose of Form 3115 and discussions of **Automatic Change** Request vs. **Advance Consent** Request
 - ♦ Who Must File
 - ♦ When and Where to File ... Automatic Change Requests ... Advance Consent Requests
- **PAGE 2** ... Provides specific instructions for who should sign and for different entity filing situations
- **PAGES 3 - 5** ... Provide specific instructions for completing change requests involving **automatic** CAMs and for **advance consent** CAMs
- **PAGES 4 - 8** ... Contain specific instructions for many, but not all, questions and line items on Form 3115
- **PAGES 8 - 12** ... Current IRS List of **Automatic** Accounting Method Changes
 - ♦ For comments in the instructions on the Automatic CAM list, see page 40.
 - ♦ For our condensed List of Automatic Accounting Method Changes, see pages 41-42.



Application for Change in Accounting Method

OMB No. 1545-0152

Name of filer (name of parent corporation if a consolidated group) (see instructions)		Identification number (see instructions)	
Number, street, and room or suite no. If a P.O. box, see the instructions.		Principal business activity code number (see instructions)	
City or town, state, and ZIP code		Tax year of change begins (MM/DD/YYYY)	
Name of applicant(s) (if different than filer) and identification number(s) (see instructions)		Tax year of change ends (MM/DD/YYYY)	
		Name of contact person (see instructions)	
		Contact person's telephone number ()	

If the applicant is a member of a consolidated group, check this box ☐
If Form 2848, Power of Attorney and Declaration of Representative, is attached, check this box ☐

Check the box to indicate the applicant.

- | | |
|--|--|
| <input type="checkbox"/> Individual | <input type="checkbox"/> Cooperative (Sec. 1381) |
| <input type="checkbox"/> Corporation | <input type="checkbox"/> Partnership |
| <input type="checkbox"/> Controlled foreign corporation (Sec. 957) | <input type="checkbox"/> S corporation |
| <input type="checkbox"/> 10/50 corporation (Sec. 904(d)(2)(E)) | <input type="checkbox"/> Insurance co. (Sec. 816(a)) |
| <input type="checkbox"/> Qualified personal service corporation (Sec. 448(d)(2)) | <input type="checkbox"/> Insurance co. (Sec. 831) |
| <input type="checkbox"/> Exempt organization. Enter Code section ▶ | <input type="checkbox"/> Other (specify) ▶ |

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

- | |
|---|
| <input type="checkbox"/> Depreciation or Amortization |
| <input type="checkbox"/> Financial Products and/or Financial Activities of Financial Institutions |
| <input type="checkbox"/> Other (specify) ▶ |

Caution: The applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.

Part I Information For Automatic Change Request		Yes	No
1	Enter the requested designated accounting method change number from the List of Automatic Accounting Method Changes (see instructions). Enter only one method change number, except as provided for in the instructions. If the requested change is not included in that list, check "Other," and provide a description. ▶ (a) Change No. _____ (b) Other <input type="checkbox"/> Description ▶ _____		
2	Is the accounting method change being requested one for which the scope limitations of section 4.02 of Rev. Proc. 2002-9 (or its successor) do not apply? If "Yes," go to Part II.		
3	Is the tax year of change the final tax year of a trade or business for which the taxpayer would be required to take the entire amount of the section 481(a) adjustment into account in computing taxable income? If "Yes," the applicant is not eligible to make the change under automatic change request procedures.		
Note: Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).			
Part II Information For All Requests		Yes	No
4a	Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)? If you answered "No," go to line 5.		
b	Is the method of accounting the applicant is requesting to change an issue (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)?		

Signature (see instructions)

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

Filer

Preparer (other than filer/applicant)

Signature and date	Signature of individual preparing the application and date
Name and title (print or type)	Name of individual preparing the application (print or type)
	Name of firm preparing the application

For Privacy Act and Paperwork Reduction Act Notice, see the instructions.

Cat. No. 19280E

Form **3115** (Rev. 12-2003)

Termination of LIFO Election ... Identification of Type of Change Requested

Rev. Proc. 97-27 ... Advance Permission Required

- Complete the right-hand section entitled "Check the appropriate box to indicate type of change being requested."
- Check "Other" box.
- Specify the change as "Termination of LIFO election" or "LIFO to specific identification cost."
- Do not complete Part I, Line 1(a) for this change.

Automatic Method Change Provisions Apply

- Complete only Part I, Line 1(a).
- Identify this change as **Change No. 56**.
- No further description of change needs to be provided.

**Caution ...
You Must
Be Thorough
In Preparing
Form 3115**

- Note the warning that the IRS has placed in the middle of Form 3115, Page 1...
- "Caution: The applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. *The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.*" (Emphasis added.)
- This warning did not appear on previous Form 3115. ... Could this warning possibly result from IRS involvement with Letter Ruling 200328001 last year? (See discussion below.)
- Similarly, Question 10 on the previous version of Form 3115 asked the taxpayer to attach an explanation of the legal basis supporting the proposed CAM. It said that the applicant was "*encouraged*" to include a discussion of any authorities that may be contrary to the proposed method.
 - ♦ On the new Form 3115, the corresponding question is #19 in Part III (Information for Advance Consent Requests). Form 3115 now directs the taxpayer to "attach a *full* explanation of the legal basis ...".
 - ♦ Instead of "encouraging" a discussion of authorities that may be contrary to the proposed CAM, Form 3115 reads, "The application *should* include a discussion of any authorities that may be contrary."

**In CAM Requests,
the Burden for
Full Disclosure
Is on
the Taxpayer**

- In **Letter Ruling 200328001**, the IRS dealt with some CAM issues involving a taxpayer using the LIFO IPIC method. More germane to Form 3115 preparation, this LTR involved a situation where the taxpayer did not include as much information with the Form 3115 as the IRS thought it should have.
 - ♦ When there is less than (what the IRS considers to be) "full disclosure" on or accompanying a Form 3115, what can or should the taxpayer be entitled *presume* that the National Office will know or assume about what is going on?
 - ♦ In other words, should you "dare" to fully disclose or should you take your chances on submitting less than full disclosure to the IRS?
 - ♦ Just how much can a taxpayer rely on Form 3115 and the instructions? This applies to either making a change in accounting method where permission to make the change is *automatically* granted or in requesting permission to change in situations that are not *automatic*.
- The National Office held that when a taxpayer files a Form 3115 requesting the Commissioner's consent to a change in method of accounting, the taxpayer has "a duty to reveal all material factors pertinent to its request for an accounting method change."
- It is not the responsibility of the National Tax Office to try to ferret out all of the pertinent information. And, the taxpayer cannot shift this burden to the National Office.
- One interpretation of this Letter Ruling is simply that *the taxpayer will lose whenever it tries to rely on its own vague or sketchy attempts at disclosure in filling out a Form 3115.*

**Another
Example**

- In **Cochran Hatchery, Inc. v. Commissioner**, (T.C. Memo 1979-390), the taxpayer was granted permission to change from an accrual method of accounting to the cash receipts and disbursements method of accounting (cash method). In requesting the change, the taxpayer fully and honestly provided all of the information requested on the Form 3115. *However, the taxpayer had failed to disclose in the Form 3115 that most of its sales were made to a related party.*
 - ♦ In part, the Service granted the requested change based on the taxpayer's representation that there was a long delay between the time of the sale and the receipt of payments on accounts receivable.
 - ♦ Subsequently, the Service discovered that most of the taxpayer's sales were to a related party, and it retroactively revoked the Letter Ruling.
 - ♦ The Tax Court held that the revocation by the IRS was justified, and it was not an abuse of discretion. The Court said, "It would be exceedingly difficult, if not impossible, for [the Commissioner] to design specific questions covering every conceivable circumstance relating to an accounting method change."

**When in Doubt,
Err on
the Side of
Full Disclosure**

- LTR 200328001 reinforces a position about which we have always felt very strongly.
- In connection with Form 3115 filings (and Form 970 filings), it has always been our practice, without exception, to include a schedule showing the computation format that will be followed in the LIFO methodology to which the taxpayer is requesting permission to change (or that is being elected).
- Some practitioners have said that they felt it was unnecessary to include this extra disclosure which might simply draw more IRS attention to what was being done.
 - ♦ Our opinion has consistently been that adding a schedule showing the computation format should avoid any possible controversy in the future over how the IRS might interpret the changes we were electing or making.
 - ♦ This disclosure practice is especially crucial where a dual index LIFO method is being used.



Instructions for Form 3115

(Rev. December 2003)

Application for Change in Accounting Method



Department of the Treasury
Internal Revenue Service

General Instructions

Purpose of Form

File Form 3115 to request a change in either an overall accounting method or the accounting treatment of any item. File a separate Form 3115 for each unrelated item or submethod, unless the IRS specifically permits (in published guidance) a change for more than one unrelated item or submethod to be requested on a single Form 3115.

Two procedures exist under which an applicant may request a change in accounting method:

Automatic Change Request. You must file under the automatic change request procedures if (a) the accounting method change is included in those procedures for the requested year of change and (b) you are within the scope of those procedures for the requested year of change (see **Automatic Change Request Scope Limitations** on page 3). A Form 3115 filed under these procedures may be reviewed by the IRS and you will be notified if information in addition to that requested on Form 3115 is required or if your request is denied. No user fee is required. An applicant that timely files and complies with an automatic change request procedure is granted consent to change its accounting method, subject to review by the IRS National Office and operating division director. See the instructions for Part I on page 3 for more information and the **List of Automatic Accounting Method Changes** beginning on page 8.

Advance Consent Request. If you are not within the scope of the automatic change request procedures for the requested year of change or the accounting method change you are requesting is not included in those procedures for the requested year of change, you may be able to file under the advance consent request procedures (see **Advance Consent Request Scope Limitations** on page 5). If the requested change is approved, the applicant will receive a letter ruling on the requested change. A user fee is required. See the instructions for Part III on page 5 for more information.

For general rules on changing an accounting method under:

Automatic change request procedures . . .	See Rev. Proc. 2002-9, as modified by Announcement 2002-17, Rev. Proc. 2002-19, and Rev. Proc. 2002-54.
Advance consent request procedures . . .	See Rev. Proc. 97-27, as modified by Rev. Proc. 2002-19 and Rev. Proc. 2002-54.

For more information, see Rev. Proc. 2004-1, particularly section 9.

When filing Form 3115, applicants must determine if the IRS has published an accounting method revenue procedure, revenue ruling, notice, regulation, or other published guidance relating to the specific method the applicant is requesting to change. This guidance is published in the Internal Revenue Bulletin and, for years after 1995, is available at www.irs.gov.

For more information, see Pub. 538, Accounting Periods and Methods.

Late Application

In general, a taxpayer that fails to timely file a Form 3115 will not be granted an extension of time to file except in unusual and compelling circumstances. See Regulations section 301.9100-3 for the standards that must be met. For information on the period of limitations, see section 5.02(2) of Rev. Proc. 2004-1.

In certain circumstances, an automatic extension of time to file is available for automatic change requests. For details, see section 6.02(3)(b) of Rev. Proc. 2002-9.

A taxpayer submitting a ruling request for an extension of time to file Form 3115 must pay a user fee for its accounting method change request and a separate user fee for its extension request. For the schedule of user fees, see (A)(3)(b) in Appendix A of Rev. Proc. 2004-1.

Who Must File

Generally, a Form 3115 must be filed by or on behalf of each applicant seeking consent to change an accounting method. An "applicant" is a taxpayer whose accounting method is being changed.

For a consolidated group of corporations, the parent corporation must file the Form 3115 for a change in accounting method for itself or any member of the consolidated group. For a controlled foreign corporation or 10/50 corporation without a U.S. trade or business, the Form 3115 must be filed, respectively, by the controlling U.S. shareholder(s) or majority domestic corporate shareholder(s). If the U.S. shareholder(s) is a member of a consolidated group, the parent corporation must file Form 3115 for the U.S. shareholder on behalf of the foreign corporation.

Generally, a separate Form 3115 must be filed for each applicant that is part of a related group of corporations. However, a single Form 3115 may be filed by a parent corporation requesting the identical accounting method change on behalf of more than one member of a consolidated group.

When and Where To File

Automatic change requests. A Form 3115 that is filed under the automatic change request procedures is filed in duplicate. The original must be attached to the filer's timely filed (including extensions) Federal income tax return for the year of change. A copy of the Form 3115 must be filed with the IRS National Office (see page 2) no earlier than the first day of the year of change and no later than when the original is filed with the Federal income tax return for the year of change. See also **Late Application** on page 2 and instructions for lines 4d and 4e on page 4.

Advance consent requests. A Form 3115 that is filed under the advance consent request procedures must be filed during the tax year for which the change is requested. If the tax year is a short period, file Form 3115 by the last day of the short tax year. File the Form 3115 with the IRS National Office (see page 2). Form 3115 should be filed as early as possible during the year of change to provide adequate time for the IRS to respond prior to the due date of the applicant's return for the year of change. See also **Late Application** on page 2 and instructions for lines 4d and 4e on page 4.

File Form 3115 at the applicable IRS address listed below.

	For applicants (other than exempt organizations) filing under . . .	
	Advance consent request procedures	Automatic change request procedures
Delivery by mail	Internal Revenue Service Attn: CC:PA:LPD P.O. Box 7804 Ben Franklin Station Washington, DC 20044	Internal Revenue Service Attn: CC:IT&A (Automatic Rulings Branch) P.O. Box 7804 Ben Franklin Station Washington, DC 20044
Delivery by private delivery service	Internal Revenue Service Attn: CC:PA:LPD Room 5336 1111 Constitution Ave., NW Washington, DC 20224	Internal Revenue Service Attn: CC:IT&A (Automatic Rulings Branch), Room 4516 1111 Constitution Ave., NW Washington, DC 20224

For exempt organizations filing under the advance consent or automatic change request procedures . . .

By mail	By designated private delivery service . . .
Internal Revenue Service Tax Exempt & Government Entities Attn: TEGE:EO P.O. Box 27720 McPherson Station Washington, DC 20038	Internal Revenue Service Tax Exempt & Government Entities Attn: TEGE:EO 1750 Pennsylvania Ave., NW Washington, DC 20038

The IRS normally acknowledges receipt of a filed Form 3115 for an advance consent request within 60 days after receipt. If an acknowledgement has not been received within 60 days of filing Form 3115, the filer of an advance consent request can inquire to: Internal Revenue Service, Control Clerk, CC:IT&A, Room 4516, 1111 Constitution Ave., NW, Washington, DC 20224.

Note: The filer of an automatic change request will not receive an acknowledgment.



AUTOMATIC ACCOUNTING METHOD CHANGES

Form 3115 Instructions Concerning List of 76 Automatic CAMs

The IRS has assigned a “change number” to each of the Automatic Accounting Method Changes. This *Change #* is to be used to identify an *automatic* change in method on Page 1, Part I, Line 1 of Form 3115. Pages 8-12 of the Instructions list 76 automatic changes, along with additional information (see below) concerning each one.

Our condensed list of the IRS list appears on pages 41 and 42. The identification of the CAMs in the right-hand columns is for general purposes only and is not intended to be all inclusive. Some of the CAMs identified as “Other Applications” on our list may apply to very small or very large dealerships, or in cases where special activities (such as buy-here, pay-here operations) are conducted.

Note the IRS’ warning (below) that you may not rely on the list or on the descriptions of the accounting method changes in the list as authority for making an accounting method change. If any information on the IRS’ *List of Automatic Method Changes* in the Instructions conflicts with other guidance published elsewhere by the IRS, then that other published guidance applies. Since the instructions were printed, additional automatic method changes have been added to the IRS list by various revenue procedures and other announcements.

Terminating a LIFO election (i.e., change from LIFO inventory method) is Change #56.

Changing to the Alternative LIFO Method within an existing LIFO method is Change #58.

List of Automatic Accounting Method Changes

Listed below are automatic accounting method changes providing for the filing of Form 3115. The **List of Automatic Accounting Method Changes** includes regulatory automatic changes, changes provided for in the Appendix of Rev. Proc. 2002-9, and automatic changes provided for in other guidance. These automatic changes may be modified or supplemented with additional automatic changes by subsequently published guidance.

Note: *The list provides a brief description of each automatic accounting method change that is included in the list. A filer/applicant may not rely on the list or the descriptions of accounting method changes in the list as authority for making an accounting method change. A filer/applicant that is within the scope of, and complies with, all the applicable provisions of the published guidance that authorizes each listed change may rely on the applicable published guidance as authority for its automatic accounting method change. If any information in the List of Automatic Accounting Method Changes conflicts with published guidance, the published guidance applies.*

56. Change from LIFO inventory method (section 472)—for an applicant changing from the LIFO inventory method for its entire LIFO inventory, or for a pool or pools within its LIFO inventory, to the permitted method as determined in section 10.01(1)(b) in the Appendix of Rev. Proc. 2002-9. Complete Schedule D, Parts II and III, of Form 3115, as applicable. Attach the statements required by section 10.01(4) in the Appendix of Rev. Proc. 2002-9. See section 10.01 in the Appendix of Rev. Proc. 2002-9.

- Each item in the list below:
- Designates an automatic accounting method change number for each change for entry on line 1a of Form 3115.
 - Briefly describes the accounting method change.
 - Indicates if scope limitation rules may not apply.
 - Indicates if audit protection may not apply.
 - Indicates in some cases which schedules of Form 3115 to complete.
 - Indicates in some cases any additional reporting requirements.
 - Indicates in some cases if the change is made on a cut-off basis.
 - Provides a reference to the basic published guidance (e.g., revenue procedure) that provides for the automatic change which filers should review prior to completing Part I, Information For Automatic Change Request, on page 1 of Form 3115.

58. Alternative LIFO inventory method (section 472)—for a qualifying applicant that sells new automobiles or new light-duty trucks, to the “Alternative LIFO Method” described in Rev. Proc. 97-36, 1997-33 I.R.B. 450. Complete Schedule C of Form 3115, as applicable. Attach the statement required by section 10.03(2)(c)(ii) in the Appendix of Rev. Proc. 2002-9 and the Form 970 required by reference in section 10.03(2)(c)(i) in the Appendix of Rev. Proc. 2002-9. This change is made on a cut-off basis. See section 10.03 in the Appendix of Rev. Proc. 2002-9.



**76 "Automatic"
CAMs**

AUTOMATIC ACCOUNTING METHOD CHANGES
PER FORM 3115 INSTRUCTIONS (Rev. Dec. 2003)

(Page 1 of 2)

Code Section	Assigned Reference # for CAM		Auto Dealer- and/or LIFO-Related	Other Applications
77	1	Commodity Credit Corporation loans		✓
	2	Lawyers handling cases on a contingent fee basis		✓
162	3	ISO 9000 costs		✓
	4	Restaurant smallwares costs		✓
166	5	Bad debts		✓
	6	Bad debt conformity for banks		✓
Various	7	Depreciation or amortization (impermissible)	✓	
56 & 167	8	Depreciation (permissible)	✓	
Various	9	Post-disposition depreciation or amortization	✓	
Various	10	Sale or lease transactions	✓	
Various	11	Modern golf course greens		✓
168	12	Original and replacement tire costs		✓
Various	13	Depreciation of gas pump canopies		✓
Various	14	Depreciation of utility assets		✓
168	15	Depreciation of cable TV fiber optics		✓
171	16	Amortizable bond premium		✓
174	17	Research and experimental expenditures		✓
162 & 167	18	Computer software expenditures		✓
	19	Package design costs		✓
263	20	Line pack gas or cushion gas costs		✓
	21	Removal costs		✓
	22	Certain uniform capitalization methods used by small resellers, formerly small resellers, and reseller-producers	✓	
263A	23	Certain uniform capitalization methods used by producers and reseller-producers	✓	
	24	Research and experimental expenditures under uniform capitalization methods		✓
	25	Impact fees		✓
267	26	Related party transactions	✓	
	27	Deferred compensation determination		✓
404	28	Bonus or vacation pay deferred compensation		✓
	29	Grace period contributions		✓
	30	Overall accrual method		✓
446	31	Multi-year insurance policies for multi-year service warranty contracts (SWIM - Service Warranty Income Method)	✓	
	32	Overall cash method (\$1 million)		✓
	33	Overall cash method (\$10 million)		✓
448	34	Overall accrual method		✓
	35	Nonaccrual-experience method		✓
	36	Interest accrual on non-performing loans		✓
451	37	Advance rentals		✓
	38	State tax refunds		✓
	39	Capital cost reduction (CCR) payments		✓

See Page 42 for Changes #40 - 76 and for Explanatory Note



**76 "Automatic"
CAMs**

AUTOMATIC ACCOUNTING METHOD CHANGES
PER FORM 3115 INSTRUCTIONS (Rev. Dec. 2003)

(Page 2 of 2)

Code Section	Assigned Reference # for CAM		Auto Dealer- and/or LIFO-Related	Other Applications
458	40	Exclusion for certain returned magazines, paperbacks, or records		✓
460	41	Percentage-of-completion		✓
	42	Timing of incurring employee medical benefit liabilities		✓
	43	Timing of incurring real property, personal property and state income tax liabilities	✓	
461	44	Timing of incurring workers' compensation act, tort, breach of contract, or violation of law liabilities		✓
	45	Timing of incurring payroll tax liabilities	✓	
	46	Cooperative advertising		✓
	47	Distributor commissions	✓	
	48	Cash discounts	✓	
	49	Estimating inventory shrinkage		✓
471	50	Small taxpayer (\$1 million) inventory exception	✓	
	51	Small taxpayer (\$10 million) inventory exception	✓	
	52	"Floor stocks"	✓	
	53	Qualifying volume-related trade discounts	✓	
	54	Impermissible methods of inventory valuation	✓	
	55	Valuation of remanufactured cores	✓	
	56	Change from LIFO inventory method	✓	
	57	Determining current-year cost	✓	
	58	Alternative LIFO Inventory Method (for <i>New Vehicles</i>)	✓	
	59	<i>Used Vehicle</i> Alternative LIFO Method	✓	
472	60	Determining the cost of used vehicles purchased or taken as a trade-in	✓	
	61	Change to IPIC inventory method	✓	
	62	Changes within IPIC inventory method	✓	
	63	Replacement cost method for automobile dealers' parts inventory	✓	
475	64	Mark-to-market		✓
	65	Dealer status changes		✓
585	66	Bank reserves for bad debts		✓
832	67	Insurance company premium acquisition expenses		✓
846	68	Discounted unpaid losses		✓
861	69	Income from sources within the United States		✓
985	70	Functional currency		✓
1272	71	Rule of 78s		✓
1272 & -73	72	Original issue discount		✓
1278	73	Market discount bonds		✓
1281	74	Interest income on short-term obligations		✓
	75	Stated interest on short-term loans		✓
1286	76	Sales of mortgage loans		✓

Note: The identification of the CAMs in the right-hand columns is for general purposes only. It is not intended to be all inclusive. Some of the CAMs identified as "Other Applications" may be relevant or pertinent to very small or very large dealerships or in cases where special activities (such as buy-here, pay-here operations) are conducted.



IRS PERMITS HEAVY EQUIPMENT DEALERS TO USE REPLACEMENT COST ... WITH LIFO ... FOR VALUING PARTS INVENTORIES

REV.
PROC.
2006-14

We have followed the IRS attack on the use of the replacement cost method for valuing parts inventories by automobile dealers for a long time. The Index of Articles for our publication shows that we have been following this closely since the first TAM on this issue in June of 1994.

Background. In the Tax Court case involving Mountain State Ford Truck Sales, Inc., the IRS took the position that actual cost, not "replacement cost," must be used for valuing parts inventories by the dealership. After the Tax Court ruled in favor of the IRS, the IRS finally came to realize that no dealer could ever do what the IRS wanted (i.e., to use actual cost instead of replacement cost) ... even though in 1999 the Tax Court had agreed with the IRS and said that's what dealers were supposed to be doing.

So, a few years later, in Rev. Proc. 2002-17, the IRS finally gave up on its unrealistic expectation and it permitted auto dealers to use replacement cost for valuing their parts inventories. The IRS provided a safe harbor change in accounting method procedure for auto dealerships to use for this purpose. All of this, naturally, was subject to certain reasonable limitations and conditions.

At that time, nothing was said about whether this treatment could be used by the universe of other taxpayers who also were using replacement cost for valuing their parts inventories. Ironically, Rev. Proc. 2002-17 was issued only for automobile dealerships, even though the taxpayer whom the IRS took to court over this issue was a heavy-duty truck dealer.

Revenue Procedure 2006-14. In this Revenue Procedure, the IRS recently extended similar "permission" and safe harbor protection to heavy equipment dealers to value their parts inventories by using the replacement cost method. This Revenue Procedure allows heavy equipment dealers to refer to prices from "standard price lists" to determine replacement costs that they can use in connection with valuing their inventories under either LIFO or FIFO.

The dealer must satisfy a "book conformity requirement" in connection with the use of replacement cost for its parts inventory. This means that the dealer must also use the replacement cost method for determining income, profit or loss in its year-end financial statements to its shareholders, partners, other proprietors and creditors. And, the term "creditors" would include manufacturers (i.e., Freightliner, Ford, etc.) if

the dealership is regularly sending them (monthly) reports.

If dealerships are already using replacement cost (and, aren't they all?), Rev. Proc. 2006-14 gives them permission to continue to use the replacement cost method without filing a new Form 3115. Heavy equipment dealers that are using hybrid versions of other methods to value their parts inventories are given permission to change to the new method by filing a new Form 3115 and following the automatic change in accounting method provisions of Rev. Proc. 2002-9. This change is designated automatic change #96 if it is promptly made.

Definitions & restrictions. "Heavy equipment" is defined as those items that fall within two BLS Producer Price Index categories ... WPU111 and WPU112. The full list of goods in both of these categories is available from the BLS web site; partial listings are below.

WPU112 includes construction machinery and equipment; tractors; tractor attachments; shovel loaders; power cranes, excavators and equipment; mixers, pavers, spreaders; off-highway equipment; off-highway trucks; and forklifts, graders, rollers and compactors.

WPU111 includes agricultural machinery and equipment; commercial turf and grounds care equipment; plows, listers, harrows, pulverizers, wheel tractors and attachments; farm dairy machines; and planting, seeding, fertilizing and harvesting machinery, equipment and attachments.

A "**heavy equipment dealer**" is defined as a dealer who meets two conditions ... (1) sells **new** heavy equipment under an agreement with one or more heavy equipment manufacturers or distributors **and** (2) earns a majority of its revenue for the sale, or sale and lease, of **new** heavy equipment.

Observations. Rev. Proc. 2006-14 does not apply to wholesalers or to dealers in **used** equipment. Even so, many of these taxpayers may be using a replacement cost method to value their parts inventories also.

This new revenue procedure could be very beneficial for a heavy equipment dealership to correct a previously deficient method of accounting for valuing its parts inventories since no Section 481(a) adjustment is required in connection with making the change. ✱



Changing within the LIFO Method to the Alternative LIFO Method. Another change that we are still running into involves auto dealerships already on LIFO for new vehicles, where the prior CPA was not making the LIFO computations using the Alternative LIFO Method. For a variety of reasons (sometimes "messed up LIFO calculations" is putting it generously), the recommendation to the dealer is to change to the safe-harbor LIFO methodology in Revenue Procedure 97-36.

Under these circumstances, it is possible to do some year-end planning *after* the year is over by changing LIFO sub-methods within the overall LIFO election retroactively under the automatic method change provisions.

We have included a "proforma Form 3115 filing package" on pages 28-35 that may be helpful for this situation.

Caveat. It is our intention that these sample proformas will help you avoid having to "reinvent the wheel," by giving you a head-start in dealing with these situations. However, they have to be modified to fit your exact situation. So, please, please, be sure to read the forms, instructions and our proforma supplementary responses carefully. Be sure to tailor your responses on the Forms 3115 that you are preparing to the specific facts and circumstances of the situation and the type of business you are dealing with.

#7. OVERVIEW & GENERAL COMMENTS ON THE PREPARATION OF FORM 3115. Given the need to be thoroughly familiar with Form 3115 in connection with the above proforma filing packages,

you'll find on pages 36-42 an overview and some general comments on the preparation of Form 3115. This material, which originally appeared in the March 2004 issue of the *Dealer Tax Watch*, has been updated on page 37 to reflect the alternative presentations depending on whether or not the LIFO termination change request is under the automatic procedures.

Practitioners should be aware that when a taxpayer files a Form 3115 requesting the Commissioner's consent to a change in method of accounting, the taxpayer has "a duty to reveal all material factors pertinent to its request for an accounting method change." It is not the responsibility of the National Tax Office to try to pry all of the pertinent information out of the taxpayer who wants to make the change.

In thinking about how thorough or careful you should be in filling out Form 3115, take note of the IRS' own disclaimer about its authorship of forms and instructions. In Letter Ruling 200328001, the IRS said: "Generally, forms and instructions do not bind the Service and are not intended to replace the law or change its meaning. The sources of authoritative law in the tax field are the statutes and regulations and not the informal publications and tax forms that are published by the Service **Therefore, taxpayers who rely solely on IRS forms and instructions are at risk.**"

Lots of help here: Thank you very much.

#8. IRS PERMITS HEAVY EQUIPMENT DEALERS TO USE REPLACEMENT COST ... WITH LIFO ... FOR VALUING PARTS INVENTORIES... For more on this recent development, see page 43. ❄

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De Filippis' LIFO LOOKOUT

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317 West Prospect Avenue
Mt. Prospect, IL 60056

First-class postage paid at Mt. Prospect, IL

