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A Quarterly Update of LIFO - News, Views and Ideas

LIFO LOOKOUT

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LIFO UPDATE

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

#1. POSSIBLE REPEAL OF LIFO ... NOTHING NEW, FOR THE TIME BEING. In June, we reported that the Senate Finance Committee held a hearing on the possible repeal of the use of the LIFO inventory method. To date, there have been no real developments on this.

The October 16, 2006 issue of *Tax Notes* included an article written by Dr. Plesko and two others, entitled *"Time to Pull the Plug on LIFO?"* This expanded on his anti-LIFO comments at the Senate hearing.

A rejoinder of sorts entitled *"Arguing Against LIFO Repeal"* appeared shortly after that, in the Nov. 6 issue of *Tax Notes*.

That's all we have seen or heard.

We expect to comment on all of this, at length, next year. Oh, yes ... we plan to continue the *LIFO Lookout* in 2007. In fact, we are "looking forward" to it.

#2. WHAT'S GOING TO HAPPEN TO DEALERS' LIFO RESERVES AT YEAR-END? Many CPAs have been concerned about the so-called "big price reductions" that many manufacturers have introduced to try to stimulate sales. A glance at our "One-of-Each" summary of inflation indexes for 2006 on page 21 shows the very modest inflation indexes projected for nearly all new automobiles, and the somewhat greater amount of deflation projected for almost half of the new light-duty truck pools.

Accordingly, if the pools are about the same as last year's in dollar size, the slight increases in the LIFO reserves for the new auto pools this year probably will be completely offset, and then some, by the greater decreases in the reserves for the new truck pools where deflation is projected.

Saturn dealers, who truly "took a hit" last year if they stayed on LIFO, are likely to have inflation in both pools (almost 2%) this year. This will make up in some (small) measure for last year's disappointingly large decreases in their LIFO reserves.

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#3. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX ASSUMPTION. As we do every year at this time, we've included detailed information to help you estimate changes in your dealers' LIFO reserves before you do the final calculations after year-end.

To assist in making year-end projections, each year we provide a listing for *new* vehicle LIFO inventories showing weighted average inflation (deflation) information for each model. The summaries are on pages 20-23 and the detail lists appear on pages 24-31.

#4. AUTO DEALERS ... ALTERNATIVE LIFO vs. THE IPIC/BLS METHOD. Some CPAs have inquired about the possible advantages of an auto dealer switching LIFO methods for new vehicles from the Alternative LIFO Method to the IPIC Method. The latter (IPIC) allows dealers to use published external indexes from BLS for their LIFO calculations, instead of computing their own internal indexes.

For many reasons, we've never been a fan of the IPIC Method for use by auto dealers on LIFO ... for a lot of reasons. We won't go into them here; but, those of you who have attended our seminars in the past are well aware of them.

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At the recent AICPA National Auto Dealership Conference, one speaker on the Tax Panel suggested taking a careful look at the IPIC Method.

We've always believed that dealers were better off computing their own inflation indexes. We've run some numbers to show in a general way just how significantly disadvantaged dealers would be if they were using the IPIC Method. By "disadvantaged" we mean how much lower their LIFO reserves would have been as a result of applying the IPIC inflation factors instead of those (properly) calculated under the Alternative LIFO Method.

The results show clearly that ***the Alternative LIFO Method would result in higher cumulative inflation indexes ... and, therefore, greater LIFO reserves*** than if the IPIC Method indexes, in whatever variation, had been used. How big the differences are depends on what "time slice," or period of years, is selected for review.

By the way, our discussions with many practitioners who say they're using the IPIC Method lead us to conclude that there are no answers to a number of technical questions, both pooling and calculation-wise. For example, if you were using the IPIC Method, would you use the CPI Table 3 or the PPI Table 6? There seem to be a number of possible variations and approaches. We've discussed some of them on page 3. It would be nice if the IRS were to provide some guidance on this.

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

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

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

One can't overdo reminders about year-end projections, estimates and the importance of placing proper LIFO disclosures in the year-end financial statements. Our year-end coverage of these topics begins on page 5.

#6. LIFO AND THE DAYS OF WINE & ROSES. Earlier this year, the IRS sniffed a winery's LIFO calculations and said ... "These stink." In FAA 20064301F, the IRS found that a producer of bottled wines did not properly establish item definitions for "goods" in its various LIFO pools.

Part of the taxpayer's difficulties were due to the fact that it did not maintain books and records that were sufficient to provide answers to many of the questions that the IRS raised about the LIFO calculations. There's some really relevant information in this for wineries (in particular) and for all other LIFO taxpayers (except auto dealers) in general.

The bottom line: The Service concluded that the winery's inflation indexes did not "clearly reflect income." (You might say, they were intoxicated ... the indexes, not the IRS.) And, you know what that means. To quote the IRS National Office on this ... "The next step will be to consider whether the Service should seek to terminate (the taxpayer's) LIFO method." That's bad news.

This "case" will be more fully sniffed in next quarter's issue of the *LIFO Lookout.*

#7. CONCERN OVER UNOFFICIAL ANSWER FROM IRS ON HOW DEALERS ON LIFO SHOULD BE HANDLING TRADE DISCOUNTS. During the Question & Answer portion of Ms. Harris' presentation at the 2006 AICPA National Auto Dealership Conference in Phoenix, she was again asked...

Is an automobile dealership that is using the LIFO method to value its new vehicle inventories risking the termination of its LIFO election (because of a violation of the cost requirement) if that dealership is not eliminating trade discounts and floorplan assistance payments from its year-end inventory costs?

Ms. Harris's answer this year was exactly the same as it was last year. She said that "someone" in the National Office "informally" told her that ... *The taxpayer would **not** be considered as being in violation of the LIFO eligibility cost requirement.*

Ms. Harris did not identify the individual who gave her this answer, nor did she provide any rationale for this position. No one in the IRS National Office has "gone on record" or taken responsibility for this answer.

We are unable to understand the IRS' rationale on this. Where is there precedent for ignoring the plain language of Reg. Sec. 1.471-3(b), the plain language of Revenue Ruling 84-481 and the plain language of Revenue Ruling 79-23?

Our advice. Until the IRS provides an "official" answer, we caution any taxpayer on LIFO against relying on this informal, undocumented answer.

Automobile Dealership Considerations in Evaluating the Alternative LIFO Method vs. the IPIC Method

Background & Comments

- The Inventory Price Index Computation (IPIC) Method allows taxpayers to use published external indexes from the U.S. Bureau of Labor Statistics (BLS) for their LIFO calculations, instead of computing their own internal indexes.
    - A sample "slice" of 7 years' data from BLS Tables appears on Page 2 of 2.
- The IPIC Method is described in Reg. Sec. 1.472-8(e)(3). In addition, taxpayers must follow Reg. Sec. 1.472-8(c)(1) in electing to establish their dollar-value pools for the items accounted for under the IPIC Method.
- There are many unanswered questions and variations in approach related to how dealers can/should/must use the IPIC Method.
- Currently, there are no official pronouncements or other guidance from the IRS concerning how the IPIC Method should be tailored to auto dealerships.
    - Undoubtedly, over the years, many dealerships have filed Form 3115s to change to the IPIC Method, but, this information (i.e., the IPIC methodologies accepted by the IRS) is not available under the FOIA.
    - Comments and any other information from readers is encouraged. (We'll do a follow-up article.)
- If any CPAs claim that they know exactly how to apply IPIC to a dealership, there are five basic questions to ask them. (See below.) We have yet to find any consensus in their answers.
- Unlike the Alternative LIFO Method (which has prescribed rules and methodologies), there seems to be no uniformity in how CPAs are applying the IPIC Method to dealership clients.

Quick Quiz for Dealers Using IPIC Method ... 5 Questions

- ***#1 ... What's on IPIC LIFO? What's not on IPIC LIFO?*** How much of the dealer's inventories are on IPIC LIFO? (New, used, parts, two out of three, all three, plus something else?)
- ***#2 ... Pooling?*** What LIFO pools have been set up in connection with the IPIC Method? Are the dealership's LIFO pools consistent with the IRS holding in TAM 200603027?
- ***#3 ... Index selection?*** Which BLS index ... or indexes ... are being used? Also, specifically, which line items from the data are being used?
    - PPI Table 6?
    - CPI Table 3?
    - PPI Table 5?
    - Other?
- ***#4 ... Why?*** For the line item (or items) of the BLS data being used for IPIC purposes, why was that specific line item selected? Are any adjustments being made to reflect the difference between the mix of goods in the IPIC pools and the mix of goods reflected in the specific line item(s) selected?
- ***#5 ... Rates?*** For the IPIC LIFO pools, what inflation/deflation rates were reflected for the years...

  Pool ______________ ***2006*** ____***%, 2005*** ____***%, 2004*** ____***%, 2003*** ____***%, 2002*** ____***%***

  Pool ______________ ***2006*** ____***%, 2005*** ____***%, 2004*** ____***%, 2003*** ____***%, 2002*** ____***%***

Alt. LIFO vs. IPIC ... Here's What We Found

- Our computations of the cumulative inflation indexes for ***dealerships using the Alternative LIFO Method*** show that they have, in general, ***experienced significantly more inflation by computing their indexes internally over the period from 2000 through 2006.***
    - Our calculations are based on comparing the "One-of-Each Item Category Inflation Indexes" that have been published in prior issues of the *LIFO Lookout* with various inflation rates provided by the BLS for either the PPI or the CPI.
- For a Dodge dealership, the cumulative inflation index over the 7-year period (2000-2006) was ...
    - ***Positive*** 9.9% under Alternative LIFO Method for Pool #1 (new autos).
    - ***Negative*** 7.4% under IPIC LIFO, using the PPI Table 6 index data for cars.
        - The difference between the two is 17.3% (positive 9.9% + negative 7.4%) ... an average of almost 2½% more inflation using the Alternative LIFO Method.

Our Conclusions (In Our Opinion ...)

- We've done enough of these calculations to make the following generalizations.
    - There are overall significant differences in the cumulative index results of Alternative LIFO versus IPIC results computed under either the PPI Table 6 or CPI Table 3.
    - If a dealer had elected to use either IPIC approach - rather than the Alternative LIFO Method - its cumulative indexes, and its corresponding LIFO reserves, would have been (significantly) lower.
    - Part of the reason is because the BLS relies (significantly) on information made available to the public by manufacturers which consistently understate the amount of inflation actually buried in the beginning-of-the-year to the end-of-the-year price/cost comparisons.

Automobile Dealership Considerations in Evaluating the Alternative LIFO Method vs. the IPIC Method

Pooling	• In using the IPIC Method, some practitioners have adopted the pooling method permitted by the Alternative LIFO Method for New Vehicles (under Rev. Procs. 92-79 and 97-36) ... In their IPIC calculations, they use one pool for new automobiles (including demos?) and a separate pool for new (light-duty) trucks (including demos?). And, used vehicles are not included on LIFO. • Is this two-pool approach under the IPIC Method by auto dealers acceptable to the IRS? ◆ In TAM 200603027, the IRS expressed a position which could be interpreted to prohibit selective LIFO elections, and this could prohibit the two pool approach for dealerships mentioned above. (See *LIFO Lookout*, Sept. 2006, page 12).
PPI vs. CPI	• ***Dealers have a choice/election.*** Dealers (as retailers) must elect to use either Table 3 of the *CPI Detailed Report* or Table 6 of the *PPI Detailed Report* ... unless they can demonstrate that another PPI table is more appropriate. (Some CPAs believe that Table 5 of the PPI may be used.) • ***PPI ...*** There are 15 PPI General Categories, each with a two-digit commodity code. ◆ The applicable Category for auto dealers would be ... ***14 Transportation Equipment.*** ◆ Each 2-digit General Category is comprised of successively more detailed 3-digit, 4-digit, 6-digit and 8-digit categories. ◆ Some CPAs simply work off of the primary inflation factors reported for Category 14. • ***CPI ...*** Taxpayers using the CPI indexes should use the CPI Major Expenditure Categories ◆ These Major Categories/Major Groups are not defined in the Regulations ... but they appear to include ... ***#4 Transportation***, which seems to be applicable to auto dealers. ◆ The BLS restructured the entire CPI series beginning in Jan. 1998, and may do so again in the future.
Differences in PPI & CPI Tables	• ***PPI Indexes ... Composition & mix*** ◆ The index for *cars* includes/combines both new and used cars. ◆ There are two separate indexes for *trucks* ... ▪ Both truck indexes include/combine new and used vehicles, and ▪ There is one index for trucks that weigh less than 14,000 pounds GVW, and a separate index for trucks that weigh more than 14,000 pounds GVW. • ***CPI Indexes ... Composition & mix*** ◆ There are separate indexes for new cars and for new trucks. ◆ There is a single (i.e., combined) index for used cars and used trucks (regardless of truck weight). • ***Both PPI & CPI ... Similar treatment for parts.*** For parts inventories, car parts and truck parts are combined (i.e., both PPI &CPI Tables combine them) as one line item listing. • ***Observation.*** If the ***PPI Indexes*** are used, the combination of new and used vehicles in determining the appropriate line item index will result in the index for each mixing/weighting generally deflationary indexes for used vehicles with generally inflationary indexes for new vehicles.

PPI & CPI INFLATION - DEFLATION RATES
SELECTED FROM PRODUCER PRICE INDEX & CONSUMER PRICE INDEX INFORMATION FOR USE WITH IPIC/BLS LIFO METHOD BY AUTOMOBILE DEALERS FOR THE CALENDAR YEARS INDICATED BELOW (EXCEPT 2006 - 11 MONTHS)

	Description		2000	2001	2002	2003	2004	2005	2006*
	PPI Indexes (Table 6)								
14	TRANSPORTATION EQUIPMENT								
141	Motor vehicles & equipment								
1411	Motor vehicles								
141101	Cars (new & used) ... (Passenger cars)		-3.1%	-2.4%	-4.0%	4.0%	1.9%	-3.4%	-0.4%
141105	Trucks (new & used) under 14,000 lbs. GVW		-2.5%	-3.9%	-3.5%	3.3%	0.7%	-5.6%	2.2%
141106	Trucks (new & used) over 14,000 lbs. GVW		1.2%	0.7%	4.6%	-1.0%	0.5%	6.4%	3.2%
1412	Car & truck parts ... (Motor vehicle parts)		-1.0%	-0.5%	-0.1%	-0.9%	1.2%	1.1%	2.8%
	CPI Indexes (Table 3)								
12110402	New cars	(SS45011)	0.3%	0.0%	-2.0%	-2.1%	0.5%	0.8%	0.0%
12110403	New trucks	(SS45021)	-0.6%	-0.1%	-2.2%	-1.5%	0.5%	-1.9%	-2.3%
121105	Used cars & trucks	(SETA02)	3.4%	-1.9%	-5.5%	-11.8%	4.8%	1.4%	-1.4%
1214021	Car & truck parts	(SS48021)	1.4%	1.1%	2.3%	1.4%	0.4%	3.4%	4.7%

Notes:
- * Rates for 2006 reflect 11-month period (Jan. 1 to Nov. 30, 2006).
- All data is from preliminary indexes for the year released by BLS ... These are updated to final status after year-end.

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

YEAR END ALERT

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

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

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

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SPECIAL YEAR-END CHALLENGES FOR LIFO USERS

CONFORMITY REPORTING REQUIREMENTS

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

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

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

TERMINATION SITUATIONS

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

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

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

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

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

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

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

FORM 970 QUESTIONS REGARDING CONFORMITY

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

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

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

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CONFORMITY REQUIREMENTS... THERE ARE MANY

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

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

TWO SETS OF REQUIREMENTS

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

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

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

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

EVERY YEAR, ALL OF THE CONFORMITY REQUIREMENTS MUST BE MET

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

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

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

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IRS TESTS

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

HOW SOME BUSINESSES GET AROUND THE LIFO CONFORMITY LIMITATIONS

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

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

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

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

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

INTERIM REPORTS

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

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

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

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

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

"CONFORMITY" ... WHERE FOREIGN CORPORATIONS ARE INVOLVED

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

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

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

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

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

In this Ruling, the Service held that ...

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

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Rev. Rul. 78-246	***Foreign Corporations & Foreign Operations*** ***Financial Statement Conformity Requirements & the 30% Test or Threshold***
Background	• The LIFO financial statement reporting requirements were enacted to ensure that the LIFO method "conforms as nearly as may be to the best accounting practice in the trade or business. ..." (H. Rep. No. 2330, 75th Cong., 3d Sess. 34 (1938)). • The legislative history of Section 472 indicates that the conformance "to the best accounting practice" is to be made on the basis of United States standards of accounting practice. • Congress was concerned solely with domestic accounting practice. Therefore, the conformity requirements of Section 472 should not be extended to determine what is the "best accounting practice" in foreign countries.
Are Operating Assets of "Substantial Value" Used in the Foreign Operations?	• If a foreign parent owns ***operating assets of substantial value which are used in foreign operations,*** the LIFO financial statement conformity requirements ***do not apply*** to the consolidated financial statements. ◆ This applies to ownership by the parent either directly or indirectly through members of its group. • Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that ... (1) are members of the consolidated group, (2) are ***foreign*** corporations, (3) ***do not use the LIFO method*** of accounting for Federal income tax purposes, and (4) ***engage in a business outside the United States.*** • For purposes of this test, operating assets are all the assets necessary for the conduct of an active operating company.
30% or More Threshold	• The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes ***30% or more*** of the total operating assets of the consolidated group. • This determination will be made annually. • This determination ***will normally be made on the basis of the asset valuation*** reflected in the consolidated financial statements of the group for the year.
Facts & Circumstances	• ***If the consolidated group does not satisfy the 30% test,*** the IRS may waive the 30% test and make a determination on the basis of all of the ***facts and circumstances*** presented.
	LTR 200540005 ... Dated June 20, 2005
LTR Summary	• In LTR 200540004, the IRS was dealing with a foreign parent corporation that had to issue consolidated financial statements to its shareholders and creditors in which it was reporting its own operations and the operations of subsidiaries acquired by its own wholly-owned U.S. subsidiary. • The taxpayer persuaded the IRS that, although it failed to have operating assets in excess of the 30% threshold, it should be considered to have satisfied the alternative "facts and circumstances" test. • As a result, the parent was permitted to issue consolidated financial statements on a non-LIFO basis without violating the LIFO financial statement conformity requirements ... ***but only for the one year in question.***
LTR Facts	• The parent (a foreign corporation, not reporting under U.S. GAAP) made an agreement whereby the taxpayer (its wholly-owned U.S. subsidiary) would acquire all of the outstanding stock of a group of new subsidiaries. ◆ Prior to the acquisition, the taxpayer also had other wholly-owned U.S. subsidiaries ("old subs"). ◆ Following the acquisition, the activities of the parent, the taxpayer, and the taxpayer's subsidiaries (old subs and new subs) would be reported in the consolidated financial statements of the Parent. • Prior to the acquisition, the new subs used LIFO for valuing their inventories. The parent and the taxpayer used a non-LIFO method for valuing inventory for U.S. and for the parent's foreign country tax purposes.
LTR Discussion	• The taxpayer conceded that it did not meet the more than 30% test for establishing substantial foreign operations under Rev. Rul. 78-246. However, it said that it should be allowed to make certain distinctions in order to qualify under the alternative "facts and circumstances" test. • The taxpayer argued that as a result of the stepped-up basis in the assets involved in the acquisition, financial statement comparisons did not fairly represent its situation. The assets of the new subsidiaries reflected current value because the acquisition was recorded as a purchase pursuant to U.S. GAAP. • Accordingly, the taxpayer argued that it should be allowed to compare the higher ***market values*** (i.e., instead of the lower asset book values) of the foreign operations to its total operations. ◆ In determining the market value of new subsidiaries, the taxpayer proposed to use the purchase price of the new subsidiaries. ◆ For the market value of the remainder of the Group, the taxpayer proposed to use EBITDA (earnings before interest, taxes, depreciation and amortization) as a basis for allocating the Group's market value, prior to the acquisition, between its foreign and domestic operations. • As a result of this alternative analysis, the computed percentage of assets used in foreign operations (to total operations) would only be slightly less than the 30% minimum threshold set forth in Rev. Rul. 78-246.

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

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

CONCLUDING CONFORMITY WARNINGS

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

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

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

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

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

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

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

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

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

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

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

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

PROJECTION MECHANICS, STEP-BY-STEP

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

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

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

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

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

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

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

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

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

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

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

PROJECTIONS STEP-BY-STEP

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 17

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

(Continued from page 15)

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

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

ALTERNATIVES

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

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

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

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

As discussed in the next section, the IRS has been successful in challenging transactions that appeared to be motivated by the desire to avoid LIFO recapture impact. In these cases, the IRS ignored the last-ditch efforts that resulted in inventory on hand at year-end which was not "intended to be sold or placed in the normal inventory channels."

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 18

(Continued from page 17)

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

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

In TAM 199911044, the IRS gave some indication of its interpretation of the "for each separate trade or business" language. In this TAM, the National Office allowed an auto dealer to keep all new autos in one pool and all new light-duty trucks in a separate pool, even though that dealer was involved with two manufacturers, five franchises and three locations, all of which were in the same city. For more on this TAM, see "Automobile Dealer with Multiple Franchises & Locations Can Use One Pool for all New Cars," *LIFO Lookout*, June 1999.

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

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

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

SOMETIMES THE IRS REVERSES YEAR-END LIQUIDATION AVOIDANCE MEASURES

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

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

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

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

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

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

PLANNING CHECKLIST

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

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

→

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

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

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

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

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

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

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

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

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

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

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

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

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

This low inflation is due to competitive pressures among the manufacturers and some foreign currency pressures.

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

Our "one-of-each item category" report compares everything in our *SUPERLIFO* database as of December 19, 2006 ... with intro-2007 model prices, unless the 2007 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2005 is the reference date for the equivalent of the calendar year 2006 beginning of the year date; i.e., December 31, 2005/January 1, 2006.

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

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

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

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

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

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

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

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

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

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

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

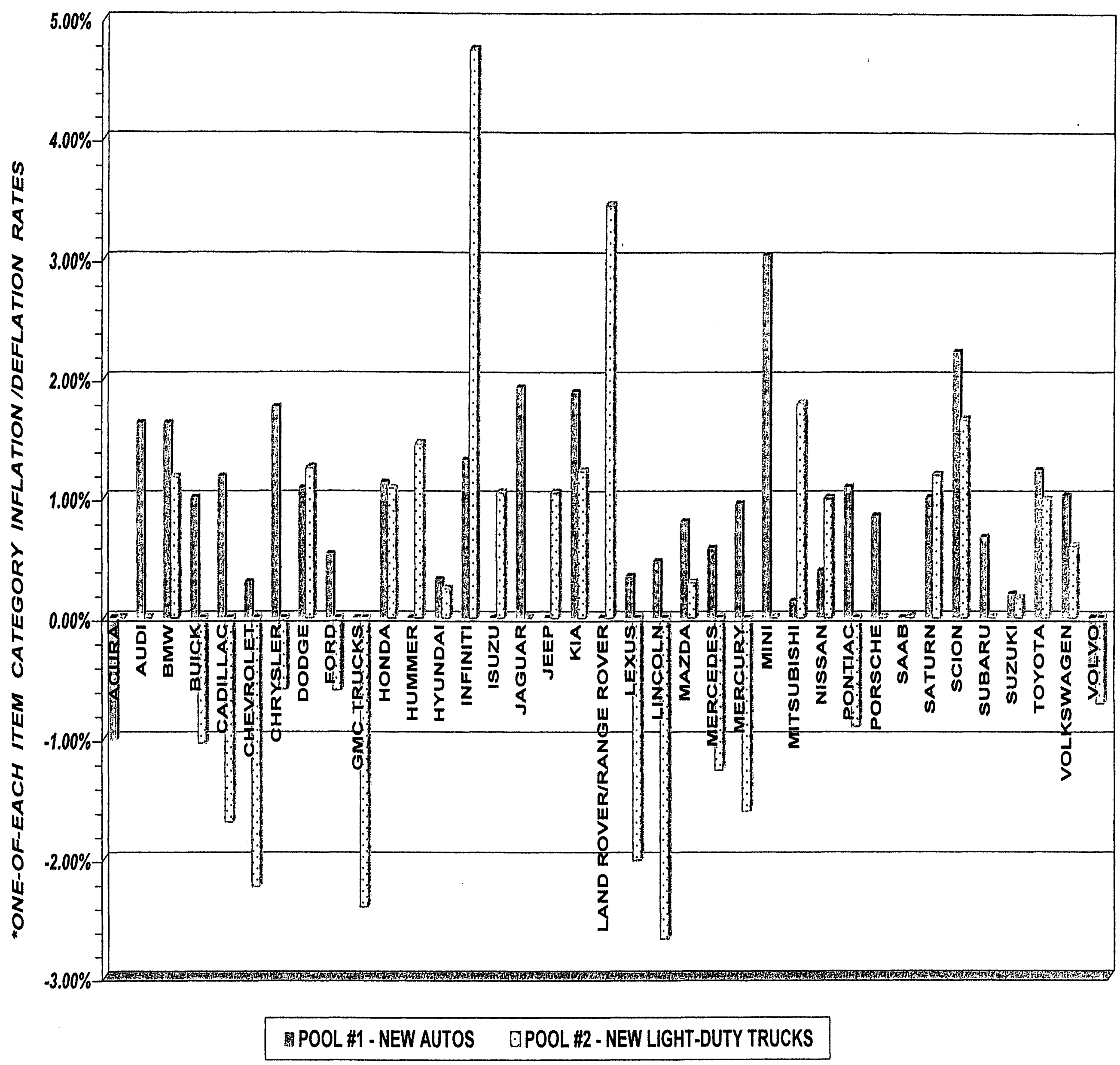
DECEMBER 19, 2006

**MODEL/ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
DEALER COST FOR THE YEAR ENDED 12/31/06**

**INFLATION ESTIMATE REPORT BY MAKE
BASED ON INFORMATION AVAILABLE**

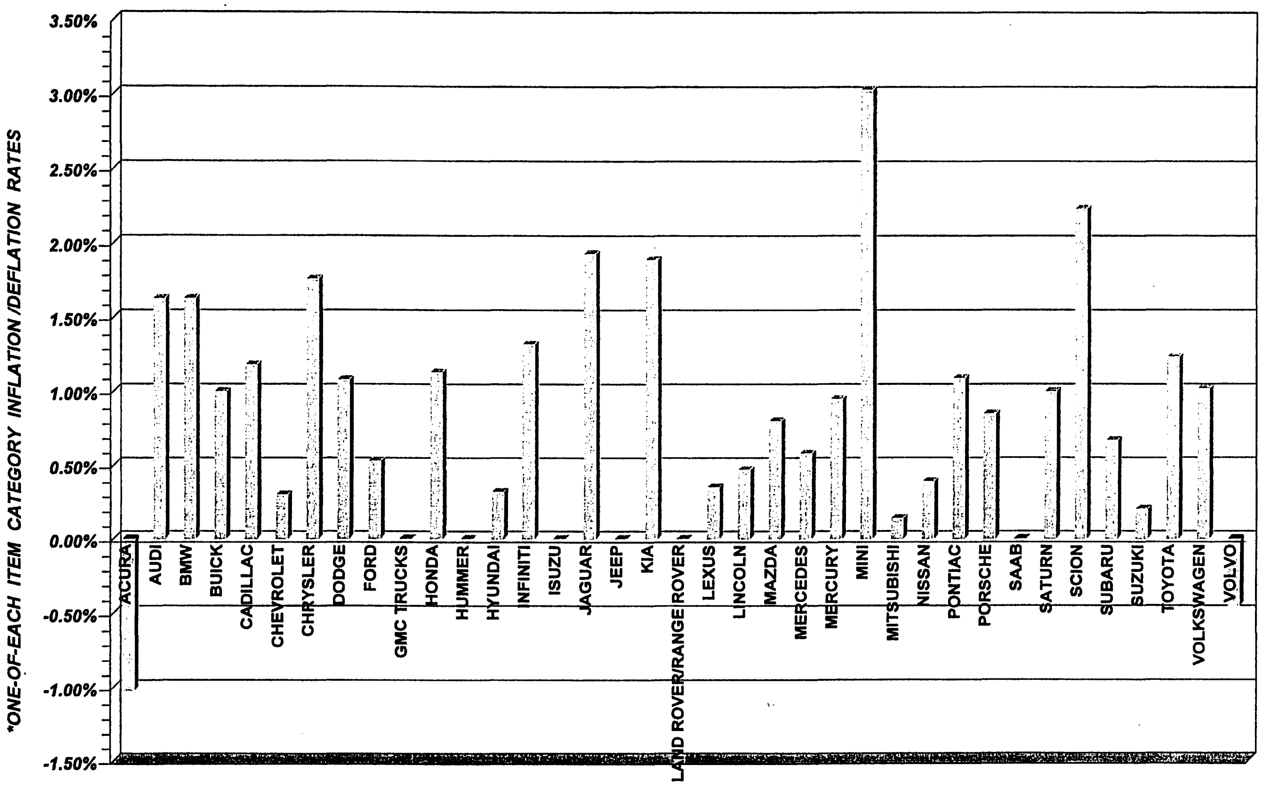
	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS
ACURA	(1.02)%	0.00%
AUDI	1.63%	0.00%
BMW	1.63%	1.17%
BUICK	1.00%	(1.04)%
CADILLAC	1.18%	(1.69)%
CHEVROLET	0.30%	(2.23)%
CHRYSLER	1.76%	(0.59)%
DODGE	1.08%	1.25%
FORD	0.53%	(0.60)%
GMC TRUCKS	0.00%	(2.40)%
HONDA	1.13%	1.08%
HUMMER	0.00%	1.45%
HYUNDAI	0.32%	0.24%
INFINITI	1.32%	4.75%
ISUZU	0.00%	1.04%
JAGUAR	1.93%	0.00%
JEEP	0.00%	1.04%
KIA	1.89%	1.22%
LAND ROVER/RANGE ROVER	0.00%	3.45%
LEXUS	0.35%	(2.01)%
LINCOLN	0.47%	(2.67)%
MAZDA	0.80%	0.29%
MERCEDES	0.58%	(1.26)%
MERCURY	0.95%	(1.60)%
MINI	3.03%	0.00%
MITSUBISHI	0.14%	1.79%
NISSAN	0.39%	0.99%
PONTIAC	1.09%	(0.90)%
PORSCHE	0.85%	0.00%
ROLLS ROYCE	0.00%	0.00%
SAAB	1.00%	1.19%
SATURN	2.23%	1.65%
SCION	0.67%	0.00%
SUBARU	0.20%	0.16%
SUZUKI	1.23%	0.98%
TOYOTA	1.02%	0.59%
VOLKSWAGEN	(0.45)%	(0.71)%
VOLVO	2.46%	0.44%

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/06

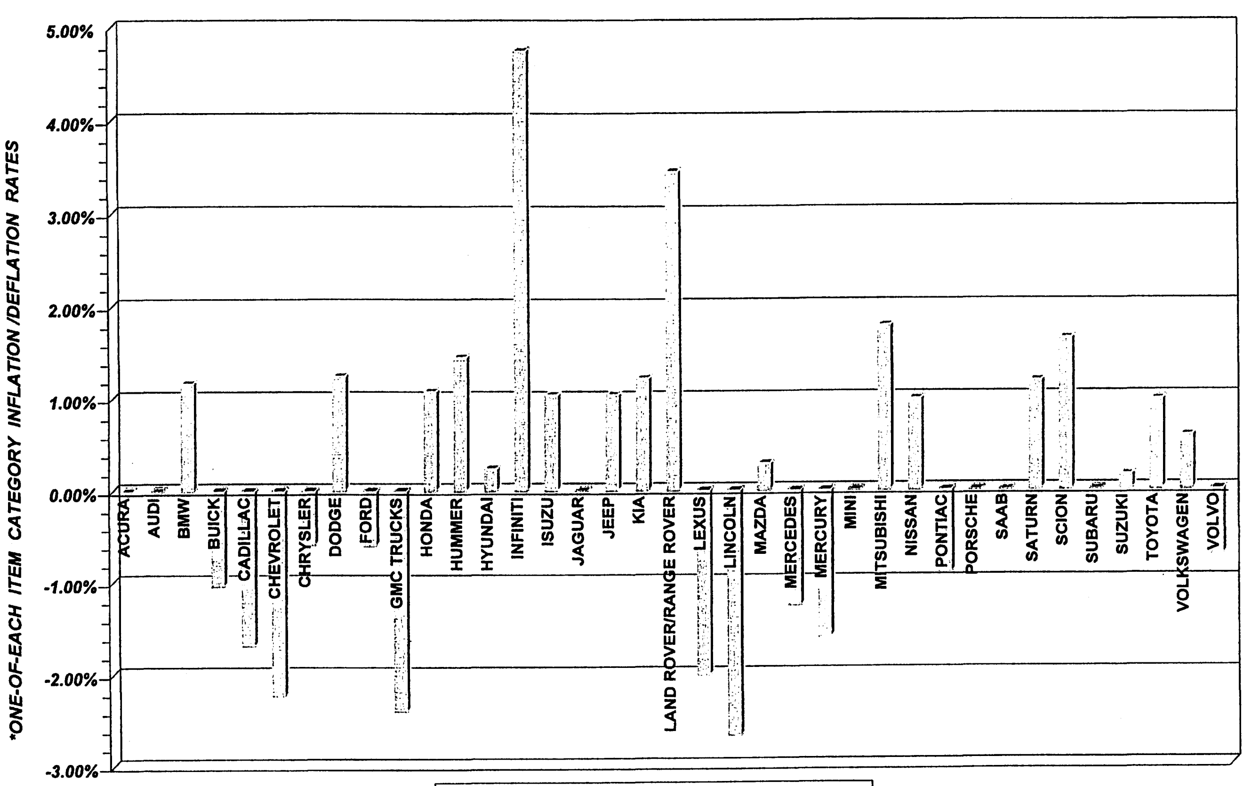


Source: De Filipps' *SuperLIFO*™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/06



WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/06



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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
RL	2	1	3	91,195	47,397	132,208	(6,384)	(4.61)%
TL	2	4	6	62,589	139,460	203,090	1,041	0.52%
TSX	4	0	4	105,386		106,194	808	0.77%
TOTAL NEW AUTOS	8	5	13	259,170	186,857	441,492	(4,535)	(1.02)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	0	5	5		200,655	200,655	0	0.00%
RDX	0	2	2		63,394	63,394	0	0.00%
TOTAL NEW L-D TRUCKS	0	7	7		264,049	264,049	0	0.00%
TOTAL ACURA	8	12	20	259,170	450,906	705,541	(4,535)	(0.64)%
AUDI								
NEW AUTOS - POOL #1								
A3	3	0	3	79,009		79,821	812	1.03%
A4	11	3	14	330,874	117,451	459,151	10,826	2.41%
A6	3	1	4	121,493	50,951	175,528	3,084	1.79%
A8	3	0	3	238,993		241,518	2,525	1.06%
RS4	0	1	1		60,594	60,594	0	0.00%
S4	4	0	4	175,196		179,200	4,004	2.29%
S4 SERIES	2	0	2	101,684		103,614	1,930	1.90%
S6	0	1	1		66,148	66,148	0	0.00%
S8	0	1	1		84,065	84,065	0	0.00%
TOTAL NEW AUTOS	26	7	33	1,047,249	379,209	1,449,639	23,181	1.63%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q7	0	4	4		180,508	180,508	0	0.00%
TOTAL NEW L-D TRUCKS	0	4	4		180,508	180,508	0	0.00%
TOTAL AUDI	26	11	37	1,047,249	559,717	1,630,147	23,181	1.44%
BMW								
NEW AUTOS - POOL #1								
3 SERIES	0	8	8		265,690	265,690	0	0.00%
5 SERIES	6	0	6	265,540		273,240	7,700	2.90%
6 SERIES	2	0	2	137,050		142,060	5,010	3.66%
7 SERIES	3	0	3	242,520		252,180	9,660	3.98%
M SERIES	0	0	0				0	N/A%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
M5	0	1	1		75,720	75,720	0	0.00%
M6	0	2	2		186,030	186,030	0	0.00%
Z4	0	5	5		203,690	203,690	0	0.00%
TOTAL NEW AUTOS	11	16	27	645,110	731,130	1,398,610	22,370	1.63%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	1	0	1	33,490		34,960	1,470	4.39%
X5	0	2	2		92,370	92,370	0	0.00%
TOTAL NEW L-D TRUCKS	1	2	3	33,490	92,370	127,330	1,470	1.17%
TOTAL BMW	12	18	30	678,600	823,500	1,525,940	23,840	1.59%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	3	0	3	70,277		70,020	(257)	(0.37)%
LUCERNE	4	0	4	111,055		113,126	2,071	1.86%
TOTAL NEW AUTOS	7	0	7	181,332		183,146	1,814	1.00%
NEW LIGHT-DUTY TRUCKS - POOL #2								
RAINIER	2	0	2	62,358		60,886	(1,472)	(2.36)%
RENDEZVOUS	1	1	2	24,334	26,895	50,448	(781)	(1.52)%
TERRAZA	1	2	3	28,539	51,107	79,886	240	0.30%
TOTAL NEW L-D TRUCKS	4	3	7	115,231	78,002	191,220	(2,013)	(1.04)%
TOTAL BUICK	11	3	14	296,563	78,002	374,366	(199)	(0.05)%
CADILLAC								
NEW AUTOS - POOL #1								
CTS	4	0	4	139,785		139,334	(451)	(0.32)%
DTS	4	0	4	168,609		169,264	655	0.39%
STS	3	0	3	150,600		156,321	5,721	3.80%
XLR	2	1	3	157,018	75,412	234,669	2,239	0.96%
TOTAL NEW AUTOS	13	1	14	616,012	75,412	699,588	8,164	1.18%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	0	4	4		208,126	208,126	0	0.00%
SRX	2	0	2	80,058		75,198	(4,860)	(6.07)%
TOTAL NEW L-D TRUCKS	2	4	6	80,058	208,126	283,324	(4,860)	(1.69)%
TOTAL CADILLAC	15	5	20	696,070	283,538	982,912	3,304	0.34%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	0	4	4		44,235	44,235	0	0.00%
COBALT	8	3	11	127,535	53,647	175,174	(6,008)	(3.32)%
CORVETTE	3	0	3	142,556		148,440	5,884	4.13%
IMPALA	6	0	6	135,036		136,817	1,781	1.32%
MALIBU	6	1	7	116,690	16,287	131,670	(1,307)	(0.98)%
MALIBU MAXX	4	0	4	83,300		83,098	(202)	(0.24)%
MONTE CARLO	3	0	3	65,046		67,255	2,209	3.40%
TOTAL NEW AUTOS	30	8	38	670,163	114,169	786,689	2,357	0.30%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	0	4	4		124,396	124,396	0	0.00%
COLORADO	11	0	11	200,787		184,360	(16,427)	(8.18)%
COLORADO CHASSIS CAB	1	0	1	16,359		15,682	(677)	(4.14)%
EQUINOX	4	0	4	87,408		86,956	(452)	(0.52)%
EXPRESS CARGO VAN	12	0	12	289,870		286,258	(3,612)	(1.25)%
EXPRESS CUTAWAY VAN	3	0	3	67,335		66,607	(728)	(1.08)%
EXPRESS PASSENGER VAN	5	0	5	128,140		127,362	(778)	(0.61)%
HHR	2	0	2	29,779		31,109	1,330	4.47%
SILVERADO 1500	0	40	40		1,036,344	1,036,344	0	0.00%
SILVERADO 2500HD	0	36	36		1,068,306	1,068,306	0	0.00%
SILVERADO 3500	0	38	38		1,144,715	1,144,715	0	0.00%
SILVERADO CLASSIC 1500	53	2	55	1,428,145	51,643	1,409,659	(70,129)	(4.74)%
SILVERADO CLASSIC 2500HD	46	0	46	1,323,182		1,269,463	(53,719)	(4.06)%
SILVERADO CLASSIC 3500	49	0	49	1,452,980		1,396,270	(56,710)	(3.90)%
SILVERADO CLASSIC 3500 CHASSIS CABS	20	0	20	519,065		495,185	(23,880)	(4.60)%
SUBURBAN	0	12	12		427,214	427,214	0	0.00%
TAHOE	0	6	6		197,533	197,533	0	0.00%
TRAILBLAZER	4	4	8	106,259	127,300	229,930	(3,629)	(1.55)%
UPLANDER	8	0	8	179,840		185,796	5,956	3.31%
TOTAL NEW L-D TRUCKS	218	142	360	5,829,149	4,177,451	9,783,145	(223,455)	(2.23)%
TOTAL CHEVROLET	248	150	398	6,499,312	4,291,620	10,569,834	(221,098)	(2.05)%
CHRYSLER								
NEW AUTOS - POOL #1								
300	18	0	18	531,010		545,033	14,023	2.64%
SEBRING	6	9	15	158,400	171,717	331,242	1,125	0.34%
TOTAL NEW AUTOS	24	9	33	689,410	171,717	876,275	15,148	1.76%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASPEN	0	6	6		178,018	178,018	0	0.00%
PACIFICA	15	3	18	414,149	92,434	493,204	(13,379)	(2.64)%
PT CRUISER	13	0	13	272,539		276,559	4,020	1.48%
TOWN & COUNTRY	8	0	8	192,057		194,627	2,570	1.34%
TOTAL NEW L-D TRUCKS	36	9	45	878,745	270,452	1,142,408	(6,789)	(0.59)%
TOTAL CHRYSLER	60	18	78	1,568,155	442,169	2,018,683	8,359	0.42%
DODGE								
NEW AUTOS - POOL #1								
CALIBER	0	16	16		250,620	250,620	0	0.00%
CHARGER	16	16	32	409,048	391,528	805,636	5,060	0.63%
MAGNUM	27	0	27	713,209		727,273	14,064	1.97%
STRATUS	2	0	2	40,788		41,193	405	0.99%
VIPER	0	0	0				0	N/A%
TOTAL NEW AUTOS	45	32	77	1,163,045	642,148		19,529	1.08%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CARAVAN	12	0	12	259,322		263,296	3,974	1.53%
DAKOTA	48	0	48	1,085,464		1,095,408	9,944	0.92%
DURANGO	28	0	28	833,255		793,890	(39,365)	(4.72)%
NITRO	0	24	24		506,026	506,026	0	0.00%
RAM PICKUP	168	0	168	5,318,663		5,444,920	126,257	2.37%
SPRINTER	13	0	13	377,104		381,246	4,142	1.10%
TOTAL NEW L-D TRUCKS	269	24	293	7,873,808	506,026	8,484,786	104,952	1.25%
TOTAL DODGE	314	56	370	9,036,853	1,148,174	10,309,508	124,481	1.22%
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	5	0	5	121,273		122,085	812	0.67%
FIVE HUNDRED	4	0	4	96,428		94,693	(1,735)	(1.80)%
FOCUS	12	0	12	173,795		174,647	852	0.49%
FUSION	5	2	7	88,976	42,810	133,059	1,273	0.97%
GT	0	0	0				0	N/A%
MUSTANG	8	2	10	184,746	78,330	265,760	2,684	1.02%
TAURUS	2	0	2	40,527		41,014	487	1.20%
TOTAL NEW AUTOS	36	4	40	705,745	121,140	831,258	4,373	0.53%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY VAN	9	0	9	196,111		197,154	1,043	0.53%
E-SERIES	17	0	17	413,385		416,458	3,073	0.74%
EDGE	0	6	6		158,641	158,641	0	0.00%
ESCAPE	14	0	14	311,724		311,203	(521)	(0.17)%
EXPEDITION	8	0	8	269,482		246,781	(22,701)	(8.42)%
EXPEDITION EL	0	8	8		270,942	270,942	0	0.00%
EXPLORER	12	0	12	349,718		340,376	(9,342)	(2.67)%
EXPLORER SPORT TRAC	0	8	8		203,904	203,904	0	0.00%
F150 PICKUP	50	6	56	1,310,466	176,639	1,474,101	(13,004)	(0.87)%
F250 SUPER DUTY PICKUP	34	0	34	963,951		967,611	3,660	0.38%
F350 SUPER DUTY PICKUP	58	0	58	1,708,557		1,714,805	6,248	0.37%
FREESTAR	4	0	4	91,727		92,006	279	0.30%
FREESTYLE	4	0	4	104,833		104,838	5	0.00%
RANGER	26	0	26	474,947		454,307	(20,640)	(4.35)%
SUPER DUTY CAB/CHASSIS	36	0	36	985,450		989,332	3,882	0.39%
TOTAL NEW L-D TRUCKS	272	28	300	7,180,351	810,126	7,942,459	(48,018)	(0.60)%
TOTAL FORD	308	32	340	7,886,096	931,266	8,773,717	(43,645)	(0.49)%
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARCADIA	0	6	6		188,588	188,588	0	0.00%
CANYON	14	0	14	255,479		236,631	(18,848)	(7.38)%
CANYON CHASSIS CAB	1	0	1	16,507		15,829	(678)	(4.11)%
ENVOY	4	0	4	115,227		110,929	(4,298)	(3.73)%
ENVOY DENALI	2	0	2	68,735		67,115	(1,620)	(2.36)%
ENVOY XL	4	0	4	120,040		113,210	(6,830)	(5.69)%
SAVANA CARGO VAN	12	0	12	289,870		286,574	(3,296)	(1.14)%
SAVANA CUTAWAY VAN	3	0	3	67,335		66,607	(728)	(1.08)%
SAVANA PASSENGER VAN	5	0	5	127,736		127,362	(374)	(0.29)%
SIERRA 1500 SERIES PICKUP	0	39	39		1,008,122	1,008,122	0	0.00%
SIERRA 2500HD SERIES PICKUP	0	36	36		1,074,495	1,074,495	0	0.00%
SIERRA 3500 SERIES PICKUP	0	38	38		1,152,585	1,152,585	0	0.00%
SIERRA CLASSIC 3500 CHASSIS-CABS	20	0	20	523,428		499,484	(23,944)	(4.57)%
SIERRA CLASSIC HEAVY-DUTY PICKUP	52	0	52	1,549,922		1,490,408	(59,514)	(3.84)%
SIERRA CLASSIC PICKUP	96	2	98	2,741,956	52,302	2,677,714	(116,544)	(4.17)%
YUKON	0	14	14		516,439	516,439	0	0.00%
TOTAL NEW L-D TRUCKS	213	135	348	5,876,235	3,992,531	9,632,092	(236,674)	(2.40)%
TOTAL GMC TRUCKS	213	135	348	5,876,235	3,992,531	9,632,092	(236,674)	(2.40)%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
HONDA								
NEW AUTOS - POOL #1								
ACCORD	51	2	53	1,161,247	42,086	1,211,459	8,126	0.68%
CIVIC	22	0	22	377,902		388,370	10,468	2.77%
FIT	0	4	4		57,198	57,198	0	0.00%
S2000	1	0	1	30,633		30,838	205	0.67%
TOTAL NEW AUTOS	74	6	80	1,569,782	99,284	1,687,865	18,799	1.13%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CR-V	0	8	8		180,255	180,255	0	0.00%
ELEMENT	12	2	14	224,748	42,726	274,852	7,378	2.76%
ODYSSEY	7	0	7	204,159		206,220	2,061	1.01%
PILOT	10	0	10	285,891		287,489	1,598	0.56%
RIDGELINE	5	1	6	140,851	25,491	167,261	919	0.55%
TOTAL NEW L-D TRUCKS	34	11	45	855,649	248,472	1,116,077	11,956	1.08%
TOTAL HONDA	108	17	125	2,425,431	347,756	2,803,942	30,755	1.11%
HUMMER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
H2	2	0	2	96,501		98,215	1,714	1.78%
H3	1	1	2	26,476	34,541	61,594	577	0.95%
TOTAL NEW L-D TRUCKS	3	1	4	122,977	34,541	159,809	2,291	1.45%
TOTAL HUMMER	3	1	4	122,977	34,541	159,809	2,291	1.45%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	0	4	4		47,806	47,806	0	0.00%
AZERA	2	0	2	46,052		47,264	1,212	2.63%
ELANTRA	0	6	6		88,357	88,357	0	0.00%
SONATA	4	0	4	74,060		73,658	(402)	(0.54)%
TIBURON	0	0	0				0	N/A%
TOTAL NEW AUTOS	6	10	16	120,112	136,163		810	0.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENTOURAGE	0	3	3		73,315	73,315	0	0.00%
SANTA FE	0	8	8		180,192	180,192	0	0.00%
TUCSON	7	0	7	133,277		134,223	946	0.71%
TOTAL NEW L-D TRUCKS	7	11	18	133,277	253,507	387,730	946	0.24%
TOTAL HYUNDAI	13	21	34	253,389	389,670	644,815	1,756	0.27%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
INFINITI								
NEW AUTOS - POOL #1								
G35	2	5	7	61,343	149,920	211,996	733	0.35%
M35	3	0	3	116,922		119,698	2,776	2.37%
M45	2	0	2	88,843		91,547	2,704	3.04%
Q45	0	1	1		53,359	53,359	0	0.00%
TOTAL NEW AUTOS	7	6	13	267,108	203,279	476,600	6,213	1.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FX35	2	0	2	65,926		70,876	4,950	7.51%
FX45	1	0	1	41,900		45,705	3,805	9.08%
QX56	2	0	2	93,792		94,618	826	0.88%
TOTAL NEW L-D TRUCKS	5	0	5	201,618		211,199	9,581	4.75%
TOTAL INFINITI	12	6	18	468,726	203,279	687,799	15,794	2.35%
ISUZU								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASCENDER	2	0	2	48,526		50,682	2,156	4.44%
I-280/I290	4	0	4	64,760		64,760	0	0.00%
I-350/370	2	0	2	52,067		52,067	0	0.00%
I-370	0	2	2		41,957	41,957	0	0.00%
TOTAL NEW L-D TRUCKS	8	2	10	165,353	41,957	209,466	2,156	1.04%
TOTAL ISUZU	8	2	10	165,353	41,957	209,466	2,156	1.04%
JAGUAR								
NEW AUTOS - POOL #1								
S-TYPE	3	0	3	146,048		151,975	5,927	4.06%
X-TYPE	2	0	2	62,482		67,032	4,550	7.28%
XJ SERIES	5	0	5	337,745		343,686	5,941	1.76%
XK	0	1	1		78,110	78,110	0	0.00%
XK SERIES	0	3	3		225,230	225,230	0	0.00%
TOTAL NEW AUTOS	10	4	14	546,275	303,340	866,033	16,418	1.93%
TOTAL JAGUAR	10	4	14	546,275	303,340	866,033	16,418	1.93%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMMANDER	12	2	14	361,653	76,897	444,039	5,489	1.25%
COMPASS	0	12	12		210,686	210,686	0	0.00%
GRAND CHEROKEE	21	0	21	681,462		694,128	12,666	1.86%
LIBERTY	8	0	8	170,589		173,388	2,799	1.64%
WRANGLER	0	24	24		520,308	520,308	0	0.00%
TOTAL NEW L-D TRUCKS	41	38	79	1,213,704	807,891	2,042,549	20,954	1.04%
TOTAL JEEP	41	38	79	1,213,704	807,891	2,042,549	20,954	1.04%
KIA								
NEW AUTOS - POOL #1								
AMANTI	1	0	1	23,130		25,510	2,380	10.29%
OPTIMA	0	5	5		86,865	86,865	0	0.00%
RIO	5	2	7	61,015	26,415	88,560	1,130	1.29%
SPECTRA	7	0	7	100,700		102,820	2,120	2.11%
TOTAL NEW AUTOS	13	7	20	184,845	113,280	303,755	5,630	1.89%
NEW LIGHT-DUTY TRUCKS - POOL #2								
RONDO	0	5	5		87,205	87,205	0	0.00%
SEDONA	0	1	1		19,895	19,895	0	0.00%
SORENTO	0	5	5		110,730	110,730	0	0.00%
SPORTAGE	7	0	7	127,605		131,820	4,215	3.30%
TOTAL NEW L-D TRUCKS	7	11	18	127,605	217,830	349,650	4,215	1.22%
TOTAL KIA	20	18	38	312,450	331,110	653,405	9,845	1.53%
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER LR3	3	0	3	123,627		130,044	6,417	5.19%
RANGE ROVER	4	0	4	262,752		269,670	6,918	2.63%
TOTAL NEW L-D TRUCKS	7	0	7	386,379		399,714	13,335	3.45%
TOTAL LAND ROVER/RANGE ROVER	7	0	7	386,379		399,714	13,335	3.45%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LEXUS								
NEW AUTOS - POOL #1								
ES 350	0	1	1		29,410	29,410	0	0.00%
GS 350	0	2	2		79,419	79,419	0	0.00%
GS 430	1	0	1	44,694		45,564	870	1.95%
GS 450H	0	1	1		48,312	48,312	0	0.00%
IS 250	3	0	3	83,976		84,444	468	0.56%
IS 350	1	0	1	31,186		31,420	234	0.75%
LS 460	0	2	2		106,140	106,140	0	0.00%
SC 430	1	0	1	56,858		56,945	87	0.15%
TOTAL NEW AUTOS	6	6	12	216,714	263,281	481,654	1,659	0.35%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 470	1	0	1	40,484		40,571	87	0.21%
LX 470	1	0	1	58,544		58,631	87	0.15%
RX 350	0	2	2		67,437	67,437	0	0.00%
RX 400H	2	0	2	82,831		77,640	(5,191)	(6.27)%
TOTAL NEW L-D TRUCKS	4	2	6	181,859	67,437	244,279	(5,017)	(2.01)%
TOTAL LEXUS	10	8	18	398,573	330,718	725,933	(3,358)	(0.46)%
LINCOLN								
NEW AUTOS - POOL #1								
MKZ	0	2	2		55,563	55,563	0	0.00%
TOWN CAR	7	0	7	289,496		291,108	1,612	0.56%
TOTAL NEW AUTOS	7	2	9	289,496	55,563	346,671	1,612	0.47%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARK LT	2	2	4	71,268	71,744	142,963	(49)	(0.03)%
MKX	0	2	2		64,531	64,531	0	0.00%
NAVIGATOR	4	0	4	188,495		177,976	(10,519)	(5.58)%
TOTAL NEW L-D TRUCKS	6	4	10	259,763	136,275	385,470	(10,568)	(2.67)%
TOTAL LINCOLN	13	6	19	549,259	191,838	732,141	(8,956)	(1.21)%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA3	16	2	18	257,476	43,208	313,934	13,250	4.41%
MAZDA6	7	23	30	166,765	502,234	664,584	(4,415)	(0.66)%
MIATA MX-5	4	3	7	81,981	67,911	150,695	803	0.54%
RX-8	2	4	6	48,304	113,940	162,856	612	0.38%
TOTAL NEW AUTOS	29	32	61	554,526	727,293	1,292,069	10,250	0.80%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-7	0	6	6		146,126	146,126	0	0.00%
CX-9	0	6	6		175,042	175,042	0	0.00%
MAZDA5	2	3	5	34,065	56,047	90,486	374	0.42%
TRUCK	10	0	10	187,796		189,169	1,373	0.73%
TOTAL NEW L-D TRUCKS	12	15	27	221,861	377,215	600,823	1,747	0.29%
TOTAL MAZDA	41	47	88	776,387	1,104,508	1,892,892	11,997	0.64%
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	5	0	5	162,752		164,842	2,090	1.28%
CL CLASS	0	0	0				0	N/A%
CLK CLASS	2	3	5	92,489	192,510	285,882	883	0.31%
CLS CLASS	0	2	2		147,963	147,963	0	0.00%
E CLASS	3	5	8	146,383	318,107	466,256	1,766	0.38%
S CLASS	0	4	4		461,188	461,188	0	0.00%
SL CLASS	3	0	3	410,037		415,524	5,487	1.34%
SLK CLASS	3	0	3	140,756		142,523	1,767	1.26%
SLR MC CLAREN	0	0	0				0	N/A%
TOTAL NEW AUTOS	16	14	30	952,417	1,119,768		11,993	0.58%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GL CLASS	0	1	1		51,057	51,057	0	0.00%
ML CLASS	2	2	4	82,073	120,137	205,585	3,375	1.67%
R CLASS	2	2	4	96,255	122,202	209,157	(9,300)	(4.26)%
TOTAL NEW L-D TRUCKS	4	5	9	178,328	293,396	465,799	(5,925)	(1.26)%
TOTAL MERCEDES	20	19	39	1,130,745	1,413,164	2,549,977	6,068	0.24%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	2	0	2	50,996		51,204	208	0.41%
MILAN	4	2	6	76,236	44,853	122,857	1,768	1.46%
MONTEGO	3	0	3	73,671		74,031	360	0.49%
TOTAL NEW AUTOS	9	2	11	200,903	44,853	248,092	2,336	0.95%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	7	0	7	161,882		161,877	(5)	(0.00)%
MONTEREY	1	0	1	26,332		26,372	40	0.15%
MOUNTAINEER	4	2	6	121,358	59,425	174,843	(5,940)	(3.29)%
TOTAL NEW L-D TRUCKS	12	2	14	309,572	59,425	363,092	(5,905)	(1.60)%
TOTAL MERCURY	21	4	25	510,475	104,278	611,184	(3,569)	(0.58)%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MINI								
NEW AUTOS - POOL #1								
COOPER	4	0	4	75,182		77,458	2,276	3.03%
TOTAL NEW AUTOS	4	0	4	75,182		77,458	2,276	3.03%
TOTAL MINI	4	0	4	75,182		77,458	2,276	3.03%
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	4	6	10	83,214	146,489	230,271	568	0.25%
GALANT	4	1	5	83,885	25,474	109,270	(89)	(0.08)%
TOTAL NEW AUTOS	8	7	15	167,099	171,963	339,541	479	0.14%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	2	2	4	51,474	55,841	108,620	1,305	1.22%
OUTLANDER	0	5	5		110,091	110,091	0	0.00%
RAIDER	5	0	5	109,625		114,176	4,551	4.15%
TOTAL NEW L-D TRUCKS	7	7	14	161,099	165,932	332,887	5,856	1.79%
TOTAL MITSUBISHI	15	14	29	328,198	337,895	672,428	6,335	0.95%
NISSAN								
NEW AUTOS - POOL #1								
350Z	14	0	14	448,268		450,854	2,586	0.58%
ALTIMA	0	9	9		181,207	181,207	0	0.00%
MAXIMA	2	0	2	52,805		53,354	549	1.04%
SENTRA	0	5	5		75,940	75,940	0	0.00%
VERSA	0	4	4		53,838	53,838	0	0.00%
TOTAL NEW AUTOS	16	18	34	501,073	310,985	815,193	3,135	0.39%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	4	4	8	140,191	141,830	283,660	1,639	0.58%
FRONTIER PICKUP	19	6	25	400,994	137,192	540,751	2,565	0.48%
MURANO	5	0	5	135,779		137,159	1,380	1.02%
PATHFINDER	7	0	7	192,639		195,092	2,453	1.27%
QUEST	4	0	4	100,824		102,386	1,562	1.55%
TITAN	24	0	24	632,752		642,514	9,762	1.54%
XTERRA	12	0	12	269,369		271,296	1,927	0.72%
TOTAL NEW L-D TRUCKS	75	10	85	1,872,548	279,022	2,172,858	21,288	0.99%
TOTAL NISSAN	91	28	119	2,373,621	590,007	2,988,051	24,423	0.82%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
PONTIAC								
NEW AUTOS - POOL #1								
G5	0	2	2		30,830	30,830	0	0.00%
G6	6	1	7	121,036	27,103	149,249	1,110	0.75%
GRAND PRIX	3	0	3	71,364		71,021	(343)	(0.48)%
SOLSTICE	1	1	2	18,158	25,057	45,389	2,174	5.03%
VIBE	1	0	1	15,362		15,791	429	2.79%
TOTAL NEW AUTOS	11	4	15	225,920	82,990	312,280	3,370	1.09%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TORRENT	2	0	2	43,525		43,133	(392)	(0.90)%
TOTAL NEW L-D TRUCKS	2	0	2	43,525		43,133	(392)	(0.90)%
TOTAL PONTIAC	13	4	17	269,445	82,990	355,413	2,978	0.84%
PORSCHE								
NEW AUTOS - POOL #1								
911	8	5	13	588,600	466,379	1,063,819	8,840	0.84%
BOXSTER	2	0	2	86,937		88,163	1,226	1.41%
CAYMAN	0	1	1		43,075	43,075	0	0.00%
TOTAL NEW AUTOS	10	6	16	675,537	509,454	1,195,057	10,066	0.85%
TOTAL PORSCHE	10	6	16	675,537	509,454	1,195,057	10,066	0.85%
ROLLS ROYCE								
NEW AUTOS - POOL #1								
BENTLEY	0	0	0				0	N/A%
ROLLS ROYCE	0	0	0				0	N/A%
TOTAL NEW AUTOS	0	0	0				0	N/A%
TOTAL ROLLS ROYCE	0	0	0				0	0.00%
SAAB								
NEW AUTOS - POOL #1								
9-2X	0	0	0				0	N/A%
9-3 SERIES	6	0	6	184,864		187,030	2,166	1.17%
9-5 SERIES	4	0	4	131,376		132,384	1,008	0.77%
TOTAL NEW AUTOS	10	0	10	316,240		319,414	3,174	1.00%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
9-7X	2	0	2	72,716		73,582	866	1.19%
TOTAL NEW L-D TRUCKS	2	0	2	72,716		73,582	866	1.19%
TOTAL SAAB	12	0	12	388,956		392,996	4,040	1.04%
SATURN								
NEW AUTOS - POOL #1								
AURA	0	2	2		41,038	41,038	0	0.00%
ION 2	4	0	4	47,596		49,556	1,960	4.12%
ION 3	4	0	4	56,980		59,093	2,113	3.71%
ION RED LINE	1	0	1	17,925		18,607	682	3.80%
SKY	0	2	2		49,695	49,695	0	0.00%
TOTAL NEW AUTOS	9	4	13	122,501	90,733	217,989	4,755	2.23%
NEW LIGHT-DUTY TRUCKS - POOL #2								
OUTLOOK	0	4	4		111,150	111,150	0	0.00%
RELAY	2	1	3	46,789	20,384	69,179	2,006	2.99%
VUE	4	1	5	74,345	20,916	97,759	2,498	2.62%
TOTAL NEW L-D TRUCKS	6	6	12	121,134	152,450	278,088	4,504	1.65%
TOTAL SATURN	15	10	25	243,635	243,183	496,077	9,259	1.90%
SCION								
NEW AUTOS - POOL #1								
TC	2	2	4	31,540	29,260	61,180	380	0.63%
XA	2	0	2	24,946		25,040	94	0.38%
XB	2	0	2	27,130		27,416	286	1.05%
TOTAL NEW AUTOS	6	2	8	83,616	29,260	113,636	760	0.67%
TOTAL SCION	6	2	8	83,616	29,260	113,636	760	0.67%
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	21	1	22	479,236	31,618	518,791	7,937	1.55%
LEGACY	15	0	15	378,735		372,534	(6,201)	(1.64)%
TOTAL NEW AUTOS	36	1	37	857,971	31,618	891,325	1,736	0.20%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
B9 TRIBECA	10	2	12	309,447	69,734	383,285	4,104	1.08%
FORESTER	6	5	11	136,854	118,188	255,260	218	0.09%
OUTBACK	8	0	8	224,771		221,826	(2,945)	(1.31)%
TOTAL NEW L-D TRUCKS	24	7	31	671,072	187,922	860,371	1,377	0.16%
TOTAL SUBARU	60	8	68	1,529,043	219,540	1,751,696	3,113	0.18%
SUZUKI								
NEW AUTOS - POOL #1								
AERIO	5	0	5	74,587		76,123	1,536	2.06%
FORENZA	11	9	20	160,021	134,583	298,534	3,930	1.33%
RENO	6	1	7	84,474	14,351	99,497	672	0.68%
SX4	0	2	2		29,758	29,758	0	0.00%
TOTAL NEW AUTOS	22	12	34	319,082	178,692	503,912	6,138	1.23%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GRAND VITARA	12	0	12	245,172		249,550	4,378	1.79%
XL7	0	8	8		200,422	200,422	0	0.00%
TOTAL NEW L-D TRUCKS	12	8	20	245,172	200,422	449,972	4,378	0.98%
TOTAL SUZUKI	34	20	54	564,254	379,114	953,884	10,516	1.11%
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	4	0	4	106,686		107,574	888	0.83%
CAMRY	0	11	11		221,797	221,797	0	0.00%
COROLLA	7	0	7	98,961		100,145	1,184	1.20%
MATRIX	7	0	7	110,252		111,209	957	0.87%
PRIUS	1	1	2	20,006	21,171	41,590	413	1.00%
SOLARA	10	1	11	211,440	26,512	243,553	5,601	2.35%
YARIS	0	6	6		70,636	70,636	0	0.00%
TOTAL NEW AUTOS	29	19	48	547,345	340,116	896,504	9,043	1.02%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	12	0	12	349,434		349,434	0	0.00%
FJ CRUISER	0	3	3		62,332	62,332	0	0.00%
HIGHLANDER	12	9	21	323,552	251,217	572,354	(2,415)	(0.42)%
LAND CRUISER	1	0	1	49,100		49,188	88	0.18%
RAV4	12	0	12	255,520		262,007	6,487	2.54%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/06
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/05 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SEQUOIA	4	0	4	138,869		140,093	1,224	0.88%
SIENNA	4	0	4	94,448		95,121	673	0.71%
TACOMA PICKUP	18	0	18	333,322		338,274	4,952	1.49%
TUNDRA	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	63	12	75	1,544,245	313,549		11,009	0.59%
TOTAL TOYOTA	92	31	123	2,091,590	653,665	2,765,307	20,052	0.73%
VOLKSWAGEN								
NEW AUTOS - POOL #1								
EOS	0	4	4		115,706	115,706	0	0.00%
GTI	2	2	4	41,553	42,667	84,422	202	0.24%
JETTA	6	4	10	124,071	72,484	192,089	(4,466)	(2.27)%
NEW BEETLE	6	0	6	108,667		109,039	372	0.34%
PASSAT	6	4	10	145,278	106,490	251,969	201	0.08%
PHAETON	0	0	0				0	N/A%
RABBIT	0	4	4		63,456	63,456	0	0.00%
TOTAL NEW AUTOS	20	18	38	419,569	400,803	816,681	(3,691)	(0.45)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TOUAREG	2	1	3	74,423	53,499	127,018	(904)	(0.71)%
TOTAL NEW L-D TRUCKS	2	1	3	74,423	53,499	127,018	(904)	(0.71)%
TOTAL VOLKSWAGEN	22	19	41	493,992	454,302	943,699	(4,595)	(0.48)%
VOLVO								
NEW AUTOS - POOL #1								
40 SERIES	3	0	3	74,140		76,829	2,689	3.63%
50 SERIES	3	0	3	78,746		81,388	2,642	3.36%
60 SERIES	4	0	4	124,484		127,359	2,875	2.31%
70 SERIES	5	1	6	165,777	38,326	207,721	3,618	1.77%
80 SERIES	0	0	0				0	N/A%
TOTAL NEW AUTOS	15	1	16	443,147	38,326		11,824	2.46%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	1	2	3	43,125	80,379	124,053	549	0.44%
TOTAL NEW L-D TRUCKS	1	2	3	43,125	80,379	124,053	549	0.44%
TOTAL VOLVO	16	3	19	486,272	118,705	617,350	12,373	2.05%

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