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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 ... REP.

RANGEL PROPOSES LIFO REPEAL AS A KEY "REVENUE RAISING" COMPONENT.

Over a year ago, we reported that in June 2006, the Senate Finance Committee held a hearing on the viability (i.e., possible repeal) of the use of the LIFO inventory method.

Since then, things had been pretty quiet until late October 2007 when House Committee Ways and Means Chair Charles Rangel (D-NY) introduced H.R. 3970. Officially, this proposed legislation has the short title: *Tax Reduction and Reform Act of 2007*. Unofficially, it has been dubbed the "Mother-of-All-Tax-Reform-Bills" or the "Trillion Dollar Tax Bill."

Rep. Rangel's comprehensive bill contains general tax reductions to provide relief for individuals, including the full repeal of the Alternative Minimum Tax, a number of other individual income tax reforms and the extension of many favorable tax credits.

H.R. 3970 also includes several corporate tax reforms, one of which would be the reduction of the top corporate marginal tax rate from 35% to 30.5%.

How would all of these wonderful things be paid for? Rep. Rangel's bill proposes to finance many of these basically by (1) repealing the use of the LIFO inventory method and the use of the lower-of-cost-or-market inventory method (projected to result in \$114 billion in increased revenues) and by (2) repealing the Section 199 domestic production deduction (projected to result in \$115 billion in increased revenues).

In H.R. 3970, the section containing the repeal of LIFO would allow taxpayers a spread period of 8 years for taking their LIFO reserves into income.

You've probably already seen details on the proposed rate reductions, etc., and we won't go into all of that here. It is unlikely that any significant action will be taken on this bill before year-end, or even in 2008.

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What is important is that the repeal of LIFO has finally made it to the top of the list of revenue-raisers that Congress will consider when it decides, probably in 2009, to make major tax reforms and needs to find a way to pay for them.

#2. WHAT'S GOING TO HAPPEN TO DEALERS' LIFO RESERVES AT YEAR-END?

A glance at our "One-of-Each" summary of inflation indexes for 2007 on page 21 shows that we can pretty much expect modest inflation across the board for nearly all new automobiles and new light-duty truck pools.

Accordingly, if a dealership's LIFO pools are about the same in dollar size as last year's, then there should be modest increases in the LIFO reserves for both pools this year.

#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 (or deflation).

see LIFO UPDATE, page 2

tion) information for each model. The summaries are on pages 20-23 and the detail lists are on pages 24-31.

#4. 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 of these requirements has numerous 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.

#5. FINAL REGULATIONS ON CORPORATE ESTIMATED TAX PAYMENTS ALLOW USE OF REASONABLE LIFO-RELATED ESTIMATES.

In August 2007, in Treasury Decision (T.D.) 9347, the IRS issued the final Regulations on corporate estimated income tax payments. Some of these provisions affect taxpayers who are using an annualization safe harbor method to compute their estimated income tax installment payments.

As finalized, the Regulations now list six items for which taxpayers may use "reasonable estimates" in order to reflect certain items that "cannot be determined accurately by the installment due date."

Two items on this list of permissible estimates are of significant interest to taxpayers using LIFO ... (1) the inflation index for taxpayers using the dollar-value LIFO inventory method and (2) the liquidation of a LIFO layer at the installment date that the taxpayer reasonably believes will be replaced at the end of the year.

Interestingly, another item on this list of permissible estimates is "adjustments required under Section 263A to capitalize inventory costs."

These Regulations under Section 6655 are effective for tax years starting after September 6, 2007.

#6. THE IRS REJECTS TAXPAYERS' LIFO METHODS USING BROAD DEFINITIONS OF INVENTORY ITEMS AND PRODUCT GROUPS.

Earlier this year, in TAM 200735020, the IRS analyzed how a rather complicated consolidated group of corporations was using LIFO. In the process, it found that none of the members had been using a proper definition of the term "item" in its LIFO computations.

The issue of the proper definition of an "item" for LIFO purposes continues to be high on the IRS' list of points to check in auditing LIFO taxpayers. This is further evidenced by one of the changes in the last revision to Form 970 which now requires taxpayers to disclose how they are defining inventory "items" right on the face of the election/application form. We will analyze this TAM in detail in next issue of the *LIFO Lookout*.

#7. IRS RULING INVOLVING SEC. 263A COST CAPITALIZATION FOR AUTO DEALERSHIPS CONTAINS BAD NEWS FOR ALL DEALERSHIPS ... INCLUDING THOSE USING LIFO.

In September 2007, the IRS published guidance on how the Section 263A inventory cost capitalization rules should be applied to an automobile dealership.

Technical Advice Memorandum (TAM) 200736026 lists 12 basic issues or questions for which it provides conclusions or answers. In reality, the TAM addresses more than a dozen issues and questions. And, for some of these, the IRS' answers are not final or definitive. Rather, they are expressed as depending on the outcome of further findings of fact after the examining agent goes back to the dealership and extracts more information.

This TAM is discussed in considerable detail in the September 2007 issue of the *Dealer Tax Watch*. What readers of the *LIFO Lookout* should be aware of is that ***all automobile dealerships, including those using LIFO to value their inventories, could be hit very hard if they are not computing these additional (Section 263A) costs the way the IRS thinks that they should.***

The reason that the IRS' new "interpretations" of the application of Section 263A in this TAM could be so painful for ***all*** dealerships is because the (initial) adjustment to correctly capitalize all of the additional Section 263A costs is considered to be a change in accounting method. And whenever there is a change in accounting method like this one, it is necessary to make a corresponding adjustment under Section 481(a) to the opening (beginning) inventory in the year of change. The IRS will not allow the so-called "cut-off" method (which does not require a Section 481(a) adjustment) to be used in this case.

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Although there are special provisions in the Regulations addressed to the complexities that arise when taxpayers are using the LIFO method, TAM 200736026 does not discuss them even though the dealership under audit was using LIFO to value its new vehicle inventories.

The summary below describes the interaction of Section 263A adjustments (to capitalize additional inventory costs) with LIFO inventory valuation computations. Where the LIFO method is used, additional Section 263A costs are to be capitalized **only** with respect to the amount of the LIFO increment for that year ... and not with respect to the overall dollar amount of the actual cost of that inventory. And, in a year where there is a decrement, no additional Sec. 263A costs are required to be capitalized. In fact, Sec. 263A costs capitalized in prior years are re-

quired to be recovered (i.e., deducted) in the year of the decrement.

Therefore, in any given year, the use of LIFO could result in significantly smaller costs being capitalized, regardless of which method under Section 263A the taxpayer is using.

However, as indicated above, the fact that the dealership in the TAM was using LIFO to value its new vehicles will not help it to avoid the harsh impact of this TAM on its opening inventories. In the TAM, the IRS applied the absorption ratio against the dealership's total inventory amount, regardless of whether or not the inventories were valued using LIFO. As reflected below, this is considered to be a "permissible variation" in the application of the simplified resale method under the Regulations...even though no taxpayer would ever want to use it voluntarily.

see LIFO UPDATE, page 4

LIFO Taxpayers Electing Simplified Resale Method ... Reg. Sec. 1.263A-3(d)(3)(ii)

(A) In General	<ul style="list-style-type: none"> Under the simplified resale method, a taxpayer using a LIFO method must calculate a particular year's index (e.g., under Reg. Sec. 1.472-8(e)) without regard its additional Section 263A costs. Similarly, a taxpayer that adjusts current-year costs by applicable indexes to determine whether there has been an inventory increment or decrement in the current year for a particular LIFO pool must disregard the additional Section 263A costs in making that determination.
(B) LIFO Increment	<ul style="list-style-type: none"> If the taxpayer determines there has been an inventory increment, the taxpayer must state the amount of the increment in current-year dollars (stated in terms of Section 471 costs). <ul style="list-style-type: none"> The taxpayer then multiplies this amount by the combined absorption ratio. The resulting product is the additional Section 263A costs that must be added to the taxpayer's increment for the year stated in terms of Section 471 costs.
(C) LIFO Decrement	<ul style="list-style-type: none"> If the taxpayer determines there has been an inventory decrement, the taxpayer must state the amount of the decrement in dollars applicable to the particular year for which the LIFO layer has been invaded. The additional Section 263A costs incurred in prior years that are applicable to the decrement are charged to cost of goods sold. The additional Section 263A costs that are applicable to the decrement are determined by multiplying the additional Section 263A costs allocated to the layer of the pool in which the decrement occurred by the ratio of the decrement (excluding additional Section 263A costs) to the Section 471 costs in the layer of that pool.

Permissible Variations of the Simplified Resale Method ... Reg. Sec. 1.263A-3(d)(3)(iii)

(A) & (B) Permitted Variations of the Simplified Resale Method	<ul style="list-style-type: none"> The exclusion of beginning inventories from the denominator in the storage and handling costs absorption ratio formula [...], or Multiplication of the storage and handling costs absorption ratio [...] by the total of Section 471 costs included in a LIFO taxpayer's ending inventory (rather than just the increment, if any, experienced by the LIFO taxpayer during the taxable year) for purposes of determining capitalizable storage and handling costs. <ul style="list-style-type: none"> Note: This language does not include the purchasing costs absorption ratio ... i.e., only the storage and handling costs absorption ratio would be multiplied by the total Section 471 costs. Generally, taxpayers would not choose to use this "permitted variation" for the obvious reason that it results in considerably more costs being capitalized instead of being expensed. However, this is exactly what the National Office did (to the taxpayer) in TAM 200736026.
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Accordingly, even for dealers using the LIFO method, there is no way to avoid this Section 481(a) adjustment to increase the opening inventory. So, be forewarned, the use of LIFO will not prevent, or significantly soften, this result.

There are other technicalities in computing the Section 481(a) adjustment when changes in Section 263A methods of accounting involve LIFO inventories. We will save these inventory revaluation discussions for later.

#8. OUR CONCERN CONTINUES OVER THE IRS' UNOFFICIAL ANSWER TO HOW DEALERSHIPS USING LIFO SHOULD BE HANDLING TRADE DISCOUNTS.

We've reported previously that the IRS has informally stated that a dealership would *not* be considered as being in violation of the LIFO eligibility cost requirement if that dealership is not eliminating trade discounts and floorplan assistance payments from its year-end inventory costs. We are still unable to understand the IRS' rationale for its conclusion.

Apparently, an automobile dealership that is using LIFO to value its new vehicle inventories would not be risking the termination of its LIFO election (because of a violation of the cost requirement). The IRS National Office still has not "gone on record" or taken responsibility for this answer which seems (in our opinion) to ignore the plain language of Reg. Sec. 1.471-3(b), Revenue Ruling 84-481 and Revenue Ruling 79-23.

Until the IRS is willing to provide an "official" answer, we continue to caution any taxpayer on LIFO against relying on this informal, undocumented answer.

#9. SOME LIFO METHOD CHANGES MAY BECOME EVEN EASIER TO IMPLEMENT. In Notice 2007-88 (2007-46 I.R.B. 993), the IRS recently announced that it is considering revising the procedures for taxpayers making changes in accounting methods (including LIFO methods) to make the process even simpler.

These changes, if implemented, should make it easier for LIFO taxpayers to make some changes that previously required more time, effort and advance approval. For example, we would hope that these changes would make it easier for a taxpayer to change from the dollar-value, double-extension LIFO method to the link-chain method. This change presently requires "nonautomatic" processing under Revenue Procedure 97-27.

Before discussing what the IRS is proposing, let's review the current process for changing (LIFO) accounting methods which requires a taxpayer to use

either an "automatic consent process" or a "nonautomatic consent process."

Automatic consent process. Under the existing "automatic consent process," the Commissioner grants eligible taxpayers automatic consent to change to certain methods of accounting, most of which are described in the Appendix to Rev. Proc. 2002-9.

A taxpayer that seeks to change to one of these methods must complete and attach Form 3115 to its timely filed (including extensions) original income tax return for the requested year of change. The taxpayer must also send a copy of the Form 3115 to the IRS National Office no later than the date that the original Form 3115 is filed with the Federal income tax return for the year of change. The taxpayer is not charged a user fee if its method change can be made under the automatic consent process.

In general, a taxpayer, not under audit, complying with all the applicable provisions of Rev. Proc. 2002-9 has obtained the consent of the Commissioner to change its method of accounting and ordinarily receives both "audit protection" and "ruling protection."

Nonautomatic consent process. Some changes in accounting methods do not qualify for the automatic consent process described above. Accordingly, these changes must be requested under a more deliberate nonautomatic consent process described in Rev. Proc. 97-27.

A taxpayer that seeks the Commissioner's consent to change a method of accounting through the nonautomatic consent process must file Form 3115 with the IRS National Office during the taxable year (i.e., before the last day of the year) in which the taxpayer desires to make the proposed change.

The taxpayer must also pay a user fee for a nonautomatic consent request. In general, the current user fee is \$2,500 per request.

Reasons for proposing changes. In Notice 2007-88, the IRS said that it is concerned that certain aspects of the existing processes are unduly complex and inefficient. The result is often significant delays in the processing of such change requests. The IRS said it believes that an efficient process that provides taxpayers with a means of obtaining timely consent to change to a proper method of accounting is crucial to ensuring that taxpayers comply with the consent requirement of Section 446(e).

The IRS said that it will balance taxpayers' need for timely consent with the Commissioner's responsibility to ensure that the process comports with the purpose underlying Section 446(e).



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

**YEAR
END
ALERT**

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

There are many year-end LIFO conformity requirements, and there are many kinds of businesses using LIFO. All taxpayers using LIFO must comply

with all of the year-end financial statement conformity reporting requirements in order to remain eligible to use the method.

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 6

SPECIAL YEAR-END CHALLENGES FOR LIFO USERS

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Conformity Reporting Requirements

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

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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.

Conformity Reporting Requirements

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 manu-

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facturer and/or any other credit source must reflect an estimate of the year-end change in the LIFO reserve if the actual change cannot be computed before the statement has to be released.

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

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

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 8

Conformity Reporting Requirements

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

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period. See Reg. Sec. 1.472-2(e)(6). If one can combine or "aggregate" a series of interim or partial-year statements to disclose the results of operations for a full year, then the last Income Statement must reflect income computed using LIFO to value the inventory.

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

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

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

IRS TESTS

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

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

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

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

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

WARNING

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

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

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

Placement in the Income Statement. LIFO adjustments must appear in the twelfth month Income Statement. However, they do ***not*** have to be reflected in the Cost of Goods Sold section through the

(Continued)

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 September

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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.

(Continued from page 9)

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.

(Continued)

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

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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-subsidary 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	<p style="text-align: center;"><u>Foreign Corporations & Foreign Operations</u></p> <p style="text-align: center;"><u>Financial Statement Conformity Requirements & the 30% Test or Threshold</u></p>
Background	<ul style="list-style-type: none"> 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?	<ul style="list-style-type: none"> 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. <ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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.
<p style="text-align: center;"><i>LTR 200540005 ... Dated June 20, 2005</i></p>	
LTR Summary	<ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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. <ul style="list-style-type: none"> 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	<ul style="list-style-type: none"> 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. <ul style="list-style-type: none"> 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!

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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

(Continued)

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 pay-back 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*.

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Practice Guide	WHY LIFO RESERVES CHANGE THE WAY THEY DO
Background	<ul style="list-style-type: none"> • Taxpayers using LIFO are often surprised when they find out that even though their year-end inventory levels are (<i>projected to be</i>) lower than they were at the beginning-of-the-year, their LIFO reserves (<i>are expected to</i>) increase. ♦ Often these (<i>projected</i>) increases in LIFO reserves are very large.
Change Factors	<ul style="list-style-type: none"> • The <i>net amount of change</i> in the LIFO reserve for any year is the result of two complementing and/or offsetting factors. • This <i>variation analysis</i> simply involves ... <ul style="list-style-type: none"> ♦ <i>Price changes</i>, i.e., inflation or deflation ... prices either increased or decreased, and ♦ <i>Quantity changes</i>, 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	<ul style="list-style-type: none"> • <i>Price increases</i> ... inflation. • <i>Quantity increases</i>, if a dual index LIFO methodology/approach is used for valuing increments. • <i>Certain decreases in inventory investment levels</i> - 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 <i>increase</i> the current year's LIFO reserve if ... <ul style="list-style-type: none"> ♦ 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. ♦ <i>Stated another way</i> ... 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	<ul style="list-style-type: none"> • <i>Price decreases</i> ... deflation. • <i>Decreases in inventory investment levels</i> - 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. • <i>Decreases in inventory investment levels ... But not always ... Sometimes no payback.</i> <ul style="list-style-type: none"> ♦ 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	<ul style="list-style-type: none"> • 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. ♦ <i>Alternative LIFO Methods for New and/or Used Vehicles</i>
Articles Analyzing Changes in LIFO Reserves	<ul style="list-style-type: none"> • "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. <ul style="list-style-type: none"> ♦ 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.



Conformity Reporting Requirements

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

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

ALTERNATIVES

1. Manage inventory levels. Attempt to increase or "manage" the inventory level through transactions that might not otherwise have been considered, but which still have some degree of business justification (other than solely attempting to minimize the impact of LIFO layer liquidations).

2. Year-end change. If eligible, change to a fiscal year-end that is prior to the year-end expected to be adversely affected by the significant inventory reduction.

3. Switch to the IPIC/BLS method. Consider changing to the IPIC/BLS method under the recent changes...and expeditious consent procedure ... available in Section 10.04 of the Appendix to Revenue Procedure 2002-9.

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

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

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

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

(Continued from page 15)

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

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

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

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

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

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

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

see CONFORMITY REPORTING REQUIREMENTS, page 18

Conformity Reporting Requirements

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).

(Continued from page 17)

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

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Conformity Reporting Requirements

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

(Continued)

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 OF LIFO RESERVE CHANGES FOR AUTOMOBILE DEALERSHIPS 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, in general, there is a bit more inflation (than last year) in these new vehicle indexes, based on our one-of-each item category compilations.

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 14, 2007 ... with intro-2008 model prices, unless the 2008 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2006 is the reference date for the equivalent of the calendar year 2007 beginning of the year date; i.e., December 31, 2006/January 1, 2007.

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. Unfortunately, for many dealerships, this approach is simply not practical because of the many competing demands for time and personnel before year-end.

We will use the information on pages 21-31 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 prepare year-end projections of LIFO reserve changes. This included **Practice Guides** and sample formats showing ...

1. A LIFO projection for a new (i.e., first year) LIFO election, without using any special LIFO software.
2. Worksheet approach for determining a blended inflation rate to apply to an auto dealer's pool which contains multiple makes.
3. Schedule formats and correspondence that we use to summarize LIFO projection information for our clients.



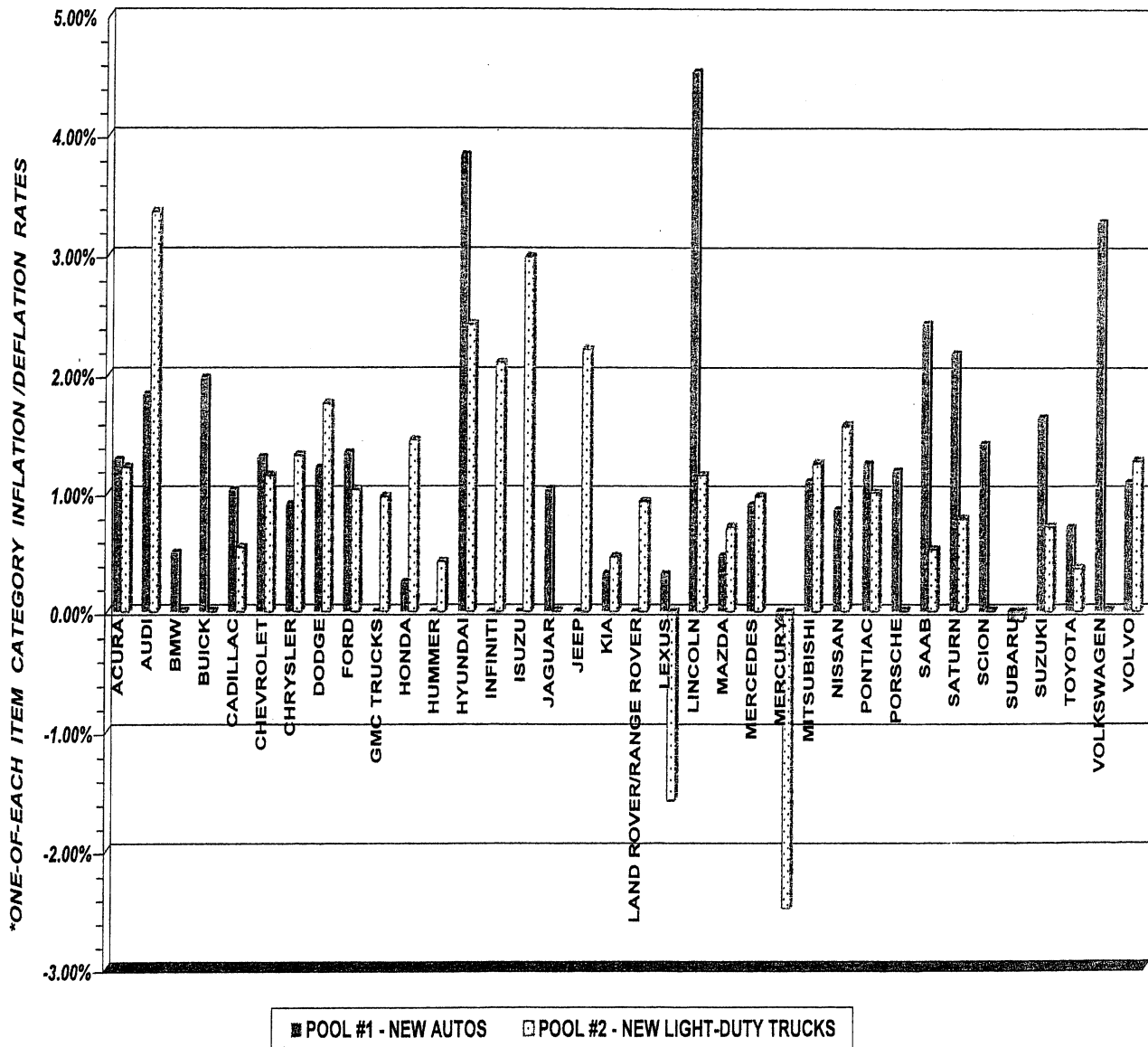
**MODEL/ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
DEALER COST FOR THE YEAR ENDED 12/31/07**

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

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS
ACURA	1.29%	1.22%
AUDI	1.84%	3.36%
BMW	0.50%	0.00%
BUICK	1.98%	0.00%
CADILLAC	1.03%	0.54%
CHEVROLET	1.31%	1.15%
CHRYSLER	0.91%	1.32%
DODGE	1.22%	1.76%
FORD	1.35%	1.01%
GMC TRUCKS	0.00%	0.97%
HONDA	0.25%	1.45%
HUMMER	0.00%	0.42%
HYUNDAI	3.84%	2.42%
INFINITI	0.00%	2.10%
ISUZU	0.00%	2.98%
JAGUAR	1.04%	0.00%
JEEP	0.00%	2.21%
KIA	0.32%	0.46%
LAND ROVER/RANGE ROVER	0.00%	0.93%
LEXUS	0.32%	(1.58)%
LINCOLN	4.53%	1.15%
MAZDA	0.47%	0.71%
MERCEDES	0.90%	0.97%
MERCURY	(0.08)%	(2.49)%
MITSUBISHI	1.10%	1.25%
NISSAN	0.86%	1.57%
PONTIAC	1.25%	1.00%
PORSCHE	1.19%	0.00%
SAAB	2.43%	0.52%
SATURN	2.18%	0.78%
SCION	1.42%	0.00%
SUBARU	(0.08)%	(0.08)%
SUZUKI	1.64%	0.71%
TOYOTA	0.71%	0.36%
VOLKSWAGEN	3.28%	0.00%
VOLVO	1.09%	1.27%



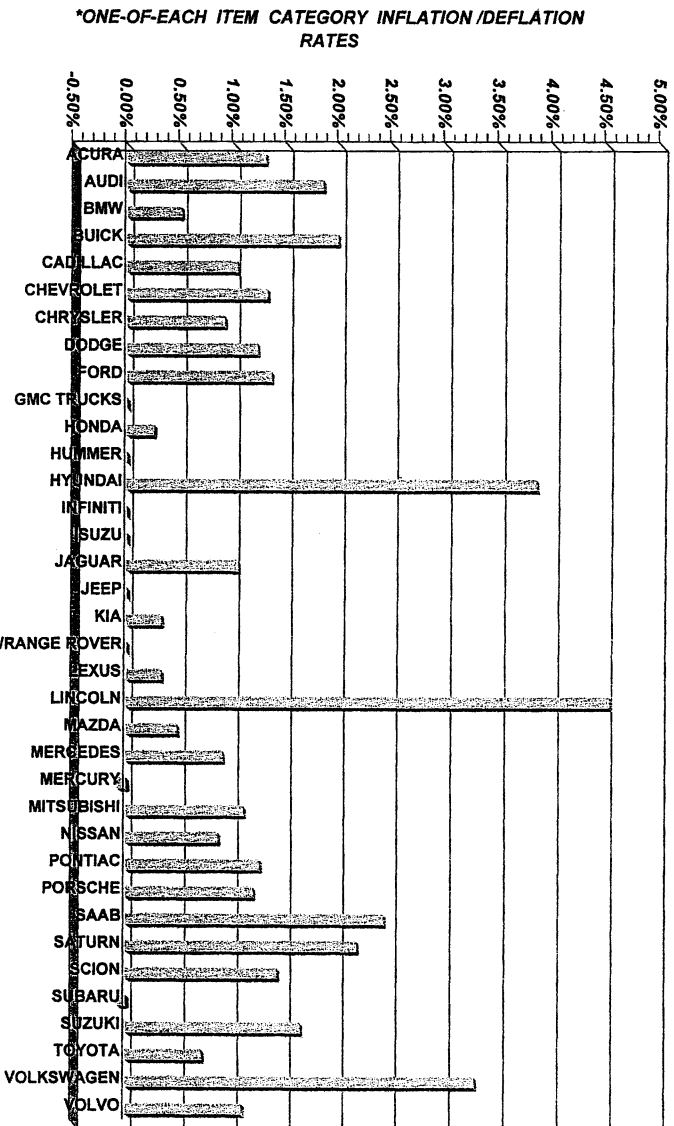
WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/07



Source: De Filippis' SuperLIFO™

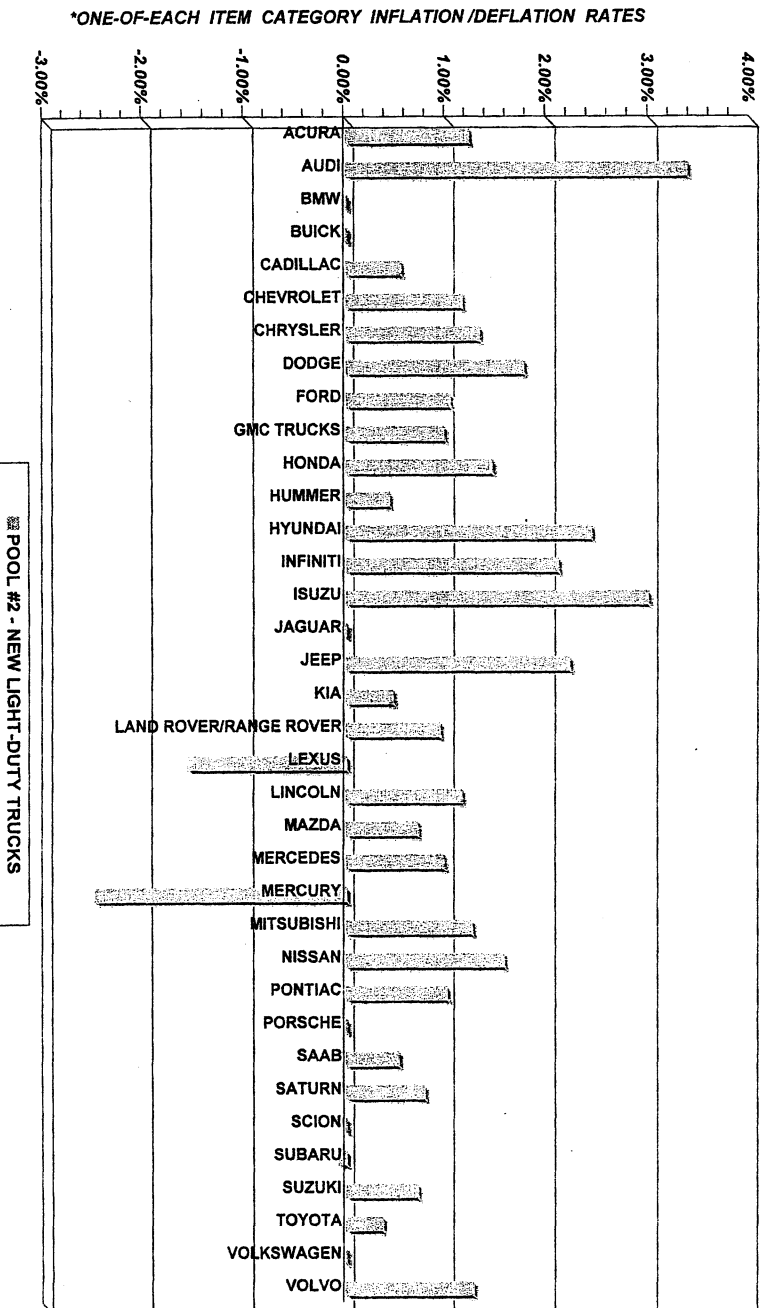


WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/07



POOL #1 - NEW AUTOS

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/07



POOL #2 - NEW LIGHT-DUTY TRUCKS





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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
RL	3	0	3	132,208		134,577	2,369	1.79%
TL	6	0	6	203,090		205,110	2,020	0.99%
TSX	4	0	4	106,194		107,512	1,318	1.24%
TOTAL NEW AUTOS	13	0	13	441,492		447,199	5,707	1.29%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	5	0	5	200,655		203,064	2,409	1.20%
RDX	2	0	2	63,394		64,219	825	1.30%
TOTAL NEW L-D TRUCKS	7	0	7	264,049		267,283	3,234	1.22%
TOTAL ACURA	20	0	20	705,541		714,482	8,941	1.27%
AUDI								
NEW AUTOS - POOL #1								
A3	2	1	3	56,417	24,115	82,077	1,545	1.92%
A4	14	0	14	459,156		471,335	12,179	2.65%
A5	0	2	2		75,423	75,423	0	0.00%
A6	4	0	4	175,528		180,747	5,219	2.97%
A8	3	0	3	241,518		246,895	5,377	2.23%
R8	0	2	2		211,110	211,110	0	0.00%
RS4	1	1	2	60,594	76,168	138,395	1,633	1.19%
S4	6	0	6	282,814		291,456	8,642	3.06%
S5	0	1	1		46,966	46,966	0	0.00%
S6	1	0	1	66,148		67,285	1,137	1.72%
S8	1	0	1	84,065		86,771	2,706	3.22%
TT	0	6	6		229,158	229,158	0	0.00%
TOTAL NEW AUTOS	32	13	45	1,426,240	662,940	2,127,618	38,438	1.84%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q7	3	0	3	134,471		138,988	4,517	3.36%
TOTAL NEW L-D TRUCKS	3	0	3	134,471		138,988	4,517	3.36%
TOTAL AUDI	35	13	48	1,560,711	662,940	2,266,606	42,955	1.93%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
BMW								
NEW AUTOS - POOL #1								
3 SERIES	13	4	17	423,380	161,370	585,120	370	0.06%
5 SERIES	1	5	6	53,820	226,135	279,955	0	0.00%
6 SERIES	2	0	2	142,420		145,635	3,215	2.26%
7 SERIES	3	0	3	252,540		255,115	2,575	1.02%
M5	1	0	1	75,900		76,270	370	0.49%
M6	2	0	2	186,485		188,045	1,560	0.84%
Z4	3	0	3	109,670		109,670	0	0.00%
TOTAL NEW AUTOS	25	9	34	1,244,215	387,505	1,639,810	8,090	0.50%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	1	0	1	34,960		34,960	0	0.00%
X5	2	0	2	92,370		92,370	0	0.00%
TOTAL NEW L-D TRUCKS	3	0	3	127,330		127,330	0	0.00%
TOTAL BMW	28	9	37	1,371,545	387,505	1,767,140	8,090	0.46%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	3	1	4	70,020	29,687	101,738	2,031	2.04%
LUCERNE	4	0	4	113,126		115,314	2,188	1.93%
TOTAL NEW AUTOS	7	1	8	183,146	29,687	217,052	4,219	1.98%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENCLAVE	0	4	4		128,486	128,486	0	0.00%
TOTAL NEW L-D TRUCKS	0	4	4		128,486	128,486	0	0.00%
TOTAL BUICK	7	5	12	183,146	158,173	345,538	4,219	1.24%
CADILLAC								
NEW AUTOS - POOL #1								
CTS	0	2	2		62,449	62,449	0	0.00%
DTS	4	1	5	189,470	39,242	213,905	5,193	2.49%
STS	3	0	3	156,321		158,431	2,110	1.35%
XLR	3	2	5	236,263	163,066	400,501	1,172	0.29%
TOTAL NEW AUTOS	10	5	15	562,054	264,757	835,286	8,475	1.03%



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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	4	1	5	208,126	55,384	264,928	1,418	0.54%
SRX	2	0	2	75,198		75,618	420	0.56%
TOTAL NEW L-D TRUCKS	6	1	7	283,324	55,384	340,546	1,838	0.54%
TOTAL CADILLAC	16	6	22	845,378	320,141	1,175,832	10,313	0.88%
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	4	0	4	44,235		45,369	1,134	2.56%
COBALT	6	0	6	86,194		88,886	2,692	3.12%
CORVETTE	1	2	3	61,912	88,524	151,331	895	0.59%
IMPALA	6	0	6	136,817		138,843	2,026	1.48%
MALIBU	0	6	6		122,420	122,420	0	0.00%
MALIBU CLASSIC	2	0	2	35,267		36,066	799	2.27%
TOTAL NEW AUTOS	19	8	27	364,425	210,944	582,915	7,546	1.31%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	4	0	4	125,127		127,138	2,011	1.61%
COLORADO	11	3	14	184,360	52,598	248,567	11,609	4.90%
COLORADO CHASSIS CAB	1	1	2	15,682	19,065	34,917	170	0.49%
EQUINOX	4	4	8	86,956	104,496	192,514	1,062	0.55%
EXPRESS CARGO VAN	10	0	10	234,656		239,822	5,166	2.20%
EXPRESS CUTAWAY VAN	3	0	3	66,607		68,415	1,808	2.71%
EXPRESS PASSENGER VAN	5	0	5	127,362		130,050	2,688	2.11%
HHR	2	2	4	31,109	32,159	63,750	482	0.76%
SILVERADO 1500	40	2	42	1,036,344	53,473	1,092,686	2,849	0.26%
SILVERADO 2500HD	36	0	36	1,068,306		1,078,704	10,398	0.97%
SILVERADO 3500	38	0	38	1,144,715		1,159,635	14,920	1.30%
SILVERADO 3500HD CHASSIS CAB	0	14	14		385,882	385,882	0	0.00%
SUBURBAN	12	0	12	429,409		436,768	7,359	1.71%
TAHOE	6	2	8	198,614	94,336	294,790	1,840	0.63%
TRAILBLAZER	8	6	14	231,239	163,727	396,701	1,735	0.44%
UPLANDER	6	0	6	127,592		132,711	5,119	4.01%
TOTAL NEW L-D TRUCKS	186	34	220	5,108,078	905,736	6,083,030	69,216	1.15%
TOTAL CHEVROLET	205	42	247	5,472,503	1,116,680	6,665,945	76,762	1.16%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHRYSLER								
NEW AUTOS - POOL #1								
300	18	6	24	545,043	183,146	740,372	12,183	1.67%
CROSSFIRE	0	12	12		385,657	385,657	0	0.00%
SEBRING	9	12	21	171,717	318,398	492,575	2,460	0.50%
TOTAL NEW AUTOS	27	30	57	716,760	887,201	1,618,604	14,643	0.91%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASPEN	8	0	8	236,864		246,778	9,914	4.19%
PACIFICA	18	0	18	493,494		501,905	8,411	1.70%
PT CRUISER	5	3	8	87,680	63,833	148,011	(3,502)	(2.31)%
TOWN & COUNTRY	0	9	9		238,104	238,104	0	0.00%
TOTAL NEW L-D TRUCKS	31	12	43	818,038	301,937	1,134,798	14,823	1.32%
TOTAL CHRYSLER	58	42	100	1,534,798	1,189,138	2,753,402	29,466	1.08%
DODGE								
NEW AUTOS - POOL #1								
AVENGER	0	16	16		323,440	323,440	0	0.00%
CALIBER	16	4	20	250,620	84,149	347,101	12,332	3.68%
CHARGER	20	8	28	543,650	201,346	753,537	8,541	1.15%
MAGNUM	16	8	24	465,084	213,652	688,890	10,154	1.50%
VIPER	0	6	6		459,768	459,768	0	0.00%
TOTAL NEW AUTOS	52	42	94	1,259,354	1,282,355	2,572,736	31,027	1.22%
NEW LIGHT-DUTY TRUCKS - POOL #2								
DAKOTA	34	68	102	744,908	1,695,488	2,474,183	33,787	1.38%
DURANGO	29	9	38	825,089	271,917	1,122,526	25,520	2.33%
GRAND CARAVAN	0	10	10		225,375	225,375	0	0.00%
NITRO	24	0	24	506,026		516,517	10,491	2.07%
RAM CHASSIS CAB	0	0	0				0	N/A%
RAM PICKUP	170	110	280	5,525,906	3,044,459	8,731,496	161,131	1.88%
SPRINTER	0	8	8		263,151	263,151	0	0.00%
TOTAL NEW L-D TRUCKS	257	205	462	7,601,929	5,500,390	13,333,248	230,929	1.76%
TOTAL DODGE	309	247	556	8,861,283	6,782,745	15,905,984	261,956	1.67%



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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	5	0	5	122,085		125,194	3,109	2.55%
FOCUS	0	6	6		85,452	85,452	0	0.00%
FUSION	7	0	7	133,059		136,448	3,389	2.55%
MUSTANG	10	0	10	265,760		268,762	3,002	1.13%
TAURUS	0	4	4		96,385	96,385	0	0.00%
TOTAL NEW AUTOS	22	10	32	520,904	181,837	712,241	9,500	1.35%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY VAN	9	0	9	197,154		205,976	8,822	4.47%
E-SERIES	16	1	17	389,509	22,091	429,911	18,311	4.45%
EDGE	4	2	6	102,384	58,659	161,284	241	0.15%
ESCAPE	0	11	11		238,857	238,857	0	0.00%
EXPEDITION	8	2	10	246,781	75,289	330,068	7,998	2.48%
EXPEDITION EL	8	2	10	270,942	80,105	355,856	4,809	1.37%
EXPLORER	12	3	15	340,376	91,666	437,812	5,770	1.34%
EXPLORER SPORT TRAC	8	2	10	203,904	56,267	264,553	4,382	1.68%
F150 PICKUP	60	10	70	1,605,689	284,815	1,893,682	3,178	0.17%
F250 SUPER DUTY PICKUP	0	0	0				0	N/A%
F350 SUPER DUTY CHASSIS CAB	0	32	32		915,653	915,653	0	0.00%
F350 SUPER DUTY PICKUP	0	2	2		70,283	70,283	0	0.00%
RANGER	22	0	22	385,099		390,195	5,096	1.32%
TAURUS X	0	6	6		163,777	163,777	0	0.00%
TOTAL NEW L-D TRUCKS	147	73	220	3,741,838	2,057,462	5,857,907	58,607	1.01%
TOTAL FORD	169	83	252	4,262,742	2,239,299	6,570,148	68,107	1.05%
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACADIA	6	0	6	188,588		190,066	1,478	0.78%
CANYON	14	0	14	236,532		244,801	7,969	3.37%
CANYON CHASSIS CAB	1	1	2	15,829	19,065	34,917	23	0.07%
ENVY	4	0	4	111,677		112,528	851	0.76%
ENVY DENALI	2	0	2	67,489		65,534	(1,955)	(2.90)%
SAVANA CARGO VAN	10	0	10	234,542		239,922	5,380	2.29%
SAVANA CUTAWAY VAN	3	0	3	66,607		68,415	1,808	2.71%
SAVANA PASSENGER VAN	5	0	5	127,362		130,049	2,687	2.11%
SIERRA 1500 SERIES PICKUP	40	2	42	1,042,654	53,839	1,099,339	2,846	0.26%
SIERRA 2500HD SERIES PICKUP	36	0	36	1,074,495		1,084,889	10,394	0.97%
SIERRA 3500 SERIES PICKUP	38	0	38	1,152,585		1,167,503	14,918	1.29%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SIERRA 3500HD CHASSIS CAB	0	14	14		389,578	389,578	0	0.00%
SIERRA DENALI	0	2	2		72,926	72,926	0	0.00%
YUKON	14	4	18	518,635	180,919	706,955	7,401	1.06%
TOTAL NEW L-D TRUCKS	173	23	196	4,837,095	716,327	5,607,222	53,800	0.97%
TOTAL GMC TRUCKS	173	23	196	4,837,095	716,327	5,607,222	53,800	0.97%
HONDA								
NEW AUTOS - POOL #1								
ACCORD	0	39	39		908,991	908,991	0	0.00%
CIVIC	26	9	35	470,094	179,100	652,645	3,451	0.53%
FIT	4	0	4	57,198		57,882	684	1.20%
S2000	1	2	3	30,838	66,628	97,683	217	0.22%
TOTAL NEW AUTOS	31	50	81	558,130	1,154,719	1,717,201	4,352	0.25%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CR-V	8	0	8	180,255		183,642	3,387	1.88%
ELEMENT	10	0	10	198,206		200,017	1,811	0.91%
ODYSSEY	6	1	7	173,005	36,214	214,825	5,806	2.68%
PILOT	8	2	10	237,504	51,257	291,165	2,404	0.83%
RIDGELINE	5	0	5	138,918		140,459	1,541	1.11%
TOTAL NEW L-D TRUCKS	37	3	40	927,888	87,471	1,030,108	14,749	1.45%
TOTAL HONDA	68	53	121	1,486,018	1,242,190	2,747,309	19,101	0.70%
HUMMER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
H2	0	2	2		102,447	102,447	0	0.00%
H3	1	1	2	27,053	35,627	63,374	694	1.11%
TOTAL NEW L-D TRUCKS	1	3	4	27,053	138,074	165,821	694	0.42%
TOTAL HUMMER	1	3	4	27,053	138,074	165,821	694	0.42%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	6	0	6	72,875		77,278	4,403	6.04%
AZERA	2	1	3	47,264	23,030	72,424	2,130	3.03%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ELANTRA	6	0	6	88,357		92,425	4,068	4.60%
SONATA	4	3	7	74,581	59,791	138,457	4,085	3.04%
TIBURON	7	0	7	129,871		134,232	4,361	3.36%
TOTAL NEW AUTOS	25	4	29	412,948	82,821	514,816	19,047	3.84%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENTOURAGE	3	0	3	73,315		75,973	2,658	3.63%
SANTA FE	8	0	8	180,938		187,862	6,924	3.83%
TUCSON	7	0	7	134,223		138,089	3,866	2.87%
VERACRUZ	0	6	6		167,223	167,223	0	0.00%
TOTAL NEW L-D TRUCKS	18	6	24	388,476	167,223	569,127	13,428	2.42%
TOTAL HYUNDAI	43	10	53	801,424	250,044	1,083,943	32,475	3.09%
INFINITI								
NEW AUTOS - POOL #1								
G35	0	0	0				0	N/A%
M35	0	0	0				0	N/A%
M45	0	0	0				0	N/A%
Q45	0	0	0				0	N/A%
TOTAL NEW AUTOS	0	0	0				0	N/A%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FX35	2	0	2	70,876		71,151	275	0.39%
FX45	1	0	1	45,796		45,934	138	0.30%
QX56	2	0	2	94,618		98,652	4,034	4.26%
TOTAL NEW L-D TRUCKS	5	0	5	211,290		215,737	4,447	2.10%
TOTAL INFINITI	5	0	5	211,290		215,737	4,447	2.10%
ISUZU								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASCENDER	0	0	0				0	N/A%
I-280/I290	1	0	1	15,290		15,746	456	2.98%
I-350/I370	0	0	0				0	N/A%
I-370	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	1	0	1	15,290			456	2.98%
TOTAL ISUZU	1	0	1	15,290		15,746	456	2.98%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
JAGUAR								
NEW AUTOS - POOL #1								
S-TYPE	3	0	3	151,975		153,340	1,365	0.90%
X-TYPE	2	0	2	67,032		67,696	664	0.99%
XJ SERIES	5	0	5	343,686		350,284	6,598	1.92%
XK SERIES	2	0	2	141,660		141,660	0	0.00%
XKR SERIES	2	0	2	161,680		162,044	364	0.23%
TOTAL NEW AUTOS	14	0	14	866,033		875,024	8,991	1.04%
TOTAL JAGUAR	14	0	14	866,033		875,024	8,991	1.04%
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMMANDER	14	0	14	444,039		442,641	(1,398)	(0.31)%
COMPASS	12	0	12	210,686		219,587	8,901	4.22%
GRAND CHEROKEE	21	0	21	694,128		711,980	17,852	2.57%
LIBERTY	0	12	12		263,254	263,254	0	0.00%
PATRIOT	0	12	12		212,092	212,092	0	0.00%
WRANGLER	32	4	36	696,621	78,917	807,624	32,086	4.14%
TOTAL NEW L-D TRUCKS	79	28	107	2,045,474	554,263	2,657,178	57,441	2.21%
TOTAL JEEP	79	28	107	2,045,474	554,263	2,657,178	57,441	2.21%
KIA								
NEW AUTOS - POOL #1								
AMANTI	0	1	1		23,250	23,250	0	0.00%
OPTIMA	0	0	0				0	N/A%
RIO	7	2	9	88,560	25,610	114,975	805	0.71%
SPECTRA	7	1	8	102,820	13,300	116,120	0	0.00%
TOTAL NEW AUTOS	14	4	18	191,380	62,160	254,345	805	0.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
RONDO	0	0	0				0	N/A%
SEDONA	0	0	0				0	N/A%
SORENTO	0	0	0				0	N/A%
SPORTAGE	7	0	7	131,820		132,420	600	0.46%
TOTAL NEW L-D TRUCKS	7	0	7	131,820		132,420	600	0.46%
TOTAL KIA	21	4	25	323,200	62,160	386,765	1,405	0.36%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER LR2	0	0	0				0	N/A%
LAND ROVER LR3	2	0	2	92,338		93,321	983	1.06%
RANGE ROVER	2	0	2	153,399		154,700	1,301	0.85%
TOTAL NEW L-D TRUCKS	4	0	4	245,737		248,021	2,284	0.93%
TOTAL LAND ROVER/RANGE ROVER	4	0	4	245,737		248,021	2,284	0.93%
LEXUS								
NEW AUTOS - POOL #1								
ES 350	1	0	1	29,410		29,899	489	1.66%
GS 350	2	0	2	79,419		79,419	0	0.00%
GS 430	0	0	0				0	N/A%
GS 450H	1	0	1	48,312		48,312	0	0.00%
IS 250	3	0	3	84,444		84,620	176	0.21%
IS 350	1	0	1	31,420		31,596	176	0.56%
LS 460	2	0	2	114,840		115,710	870	0.76%
LS 600H	0	1	1		90,480	90,480	0	0.00%
SC 430	1	0	1	56,945		56,945	0	0.00%
TOTAL NEW AUTOS	11	1	12	444,790	90,480	536,981	1,711	0.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 470	1	0	1	40,571		40,729	158	0.39%
LX 470	0	0	0				0	N/A%
RX 350	2	0	2	67,437		67,437	0	0.00%
RX 400H	2	0	2	77,640		74,542	(3,098)	(3.99)%
TOTAL NEW L-D TRUCKS	5	0	5	185,648		182,708	(2,940)	(1.58)%
TOTAL LEXUS	16	1	17	630,438	90,480	719,689	(1,229)	(0.17)%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LINCOLN								
NEW AUTOS - POOL #1								
MKZ	2	0	2	55,563		58,082	2,519	4.53%
TOWN CAR	0	0	0				0	N/A%
TOTAL NEW AUTOS	2	0	2	55,563			2,519	4.53%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARK LT	4	0	4	142,963		143,901	938	0.66%
MX	2	0	2	64,531		67,001	2,470	3.83%
NAVIGATOR	2	0	2	90,788		90,798	10	0.01%
TOTAL NEW L-D TRUCKS	8	0	8	298,282		301,700	3,418	1.15%
TOTAL LINCOLN	10	0	10	353,845		359,782	5,937	1.68%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA3	18	0	18	313,934		316,531	2,597	0.83%
MAZDA6	17	0	17	364,458		364,177	(281)	(0.08)%
MIATA MX-5	12	2	14	270,257	49,798	323,426	3,371	1.05%
RX-8	6	2	8	162,406	58,669	221,075	0	0.00%
TOTAL NEW AUTOS	53	4	57	1,111,055	108,467	1,225,209	5,687	0.47%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-7	6	0	6	146,126		146,126	0	0.00%
CX-9	6	0	6	175,042		178,141	3,099	1.77%
MAZDA5	4	0	4	72,560		74,793	2,233	3.08%
TRIBUTE	0	13	13		276,653	276,653	0	0.00%
TRUCK	4	0	4	79,417		79,417	0	0.00%
TOTAL NEW L-D TRUCKS	20	13	33	473,145	276,653	755,130	5,332	0.71%
TOTAL MAZDA	73	17	90	1,584,200	385,120	1,980,339	11,019	0.56%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	0	5	5		159,197	159,197	0	0.00%
CL CLASS	2	2	4	227,013	310,620	543,120	5,487	1.02%
CLK CLASS	5	1	6	285,882	125,550	411,432	0	0.00%
CLS CLASS	2	0	2	147,963		149,544	1,581	1.07%
E CLASS	8	0	8	466,257		466,860	603	0.13%
S CLASS	4	1	5	461,188	118,110	596,688	17,390	3.00%
SL CLASS	4	0	4	503,688		506,850	3,162	0.63%
SLK CLASS	3	0	3	142,523		145,127	2,604	1.83%
SLR MC CLAREN	0	1	1		460,350	460,350	0	0.00%
TOTAL NEW AUTOS	28	10	38	2,234,514	1,173,827	3,439,168	30,827	0.90%
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	0	2	2		182,373	182,373	0	0.00%
GL CLASS	2	1	3	99,789	71,587	172,492	1,116	0.65%
ML CLASS	3	1	4	159,829	48,732	211,434	2,873	1.38%
R CLASS	2	1	3	80,910	38,967	122,481	2,604	2.17%
TOTAL NEW L-D TRUCKS	7	5	12	340,528	341,659	688,780	6,593	0.97%
TOTAL MERCEDES	35	15	50	2,575,042	1,515,486	4,127,948	37,420	0.91%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	2	0	2	51,204		49,848	(1,356)	(2.65)%
MILAN	6	0	6	122,857		123,996	1,139	0.93%
SABLE	0	4	4		97,196	97,196	0	0.00%
TOTAL NEW AUTOS	8	4	12	174,061	97,196	271,040	(217)	(0.08)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	0	8	8		181,252	181,252	0	0.00%
MOUNTAINEER	6	0	6	174,843		165,972	(8,871)	(5.07)%
TOTAL NEW L-D TRUCKS	6	8	14	174,843	181,252	347,224	(8,871)	(2.49)%
TOTAL MERCURY	14	12	26	348,904	278,448	618,264	(9,088)	(1.45)%
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	10	2	12	230,271	55,036	289,831	4,524	1.59%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
GALANT								
GALANT	3	0	3	64,266		64,597	331	0.52%
LANCER	0	6	6		93,498	93,498	0	0.00%
TOTAL NEW AUTOS	13	6	21	294,537	148,534	447,926	4,855	1.10%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	4	0	4	105,558		106,876	1,318	1.25%
OUTLANDER	0	0	0				0	N/A%
RAIDER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	4	0	4	105,558			1,318	1.25%
TOTAL MITSUBISHI	17	6	25	400,095	148,534	554,802	6,173	1.13%
NISSAN								
NEW AUTOS - POOL #1								
350Z	13	1	14	419,263	35,332	459,780	5,186	1.14%
ALTIMA	9	7	16	181,207	148,335	330,623	1,081	0.33%
MAXIMA	2	0	2	53,354		53,600	246	0.46%
SENTRA	4	3	7	61,837	55,522	118,622	1,263	1.08%
VERSA	4	0	4	53,838		54,732	894	1.66%
TOTAL NEW AUTOS	32	11	43	769,499	239,189	1,017,357	8,669	0.86%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	8	0	8	283,660		289,258	5,598	1.97%
FRONTIER PICKUP	25	2	27	540,751	35,612	583,761	7,398	1.28%
MURANO	5	0	5	137,159		137,409	250	0.18%
PATHFINDER	0	11	11		332,779	332,779	0	0.00%
QUEST	4	0	4	102,386		104,523	2,137	2.09%
ROGUE	0	4	4		77,518	77,518	0	0.00%
TITAN	24	30	54	642,514	860,014	1,530,290	27,762	1.85%
XTERRA	12	0	12	271,296		279,642	8,346	3.08%
TOTAL NEW L-D TRUCKS	78	47	125	1,977,766	1,305,923	3,335,180	51,491	1.57%
TOTAL NISSAN	110	58	168	2,747,265	1,545,112	4,352,537	60,160	1.40%
PONTIAC								
NEW AUTOS - POOL #1								
G5	2	0	2	30,830		32,130	1,300	4.22%
G6	7	2	9	149,249	49,319	201,061	2,493	1.26%
G8	0	2	2		53,128	53,128	0	0.00%



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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
GRAND PRIX	3	0	3	71,021		71,324	303	0.43%
SOLSTICE	2	0	2	45,389		46,372	983	2.17%
VIBE	1	0	1	15,791		15,885	94	0.60%
TOTAL NEW AUTOS	15	4	19	312,280	102,447	419,900	5,173	1.25%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TORRENT	2	2	4	43,133	52,527	96,620	960	1.00%
TOTAL NEW L-D TRUCKS	2	2	4	43,133	52,527	96,620	960	1.00%
TOTAL PONTIAC	17	6	23	355,413	154,974	516,520	6,133	1.20%
PORSCHE								
NEW AUTOS - POOL #1								
911	13	1	14	1,063,819	119,331	1,199,950	16,800	1.42%
BOXSTER	2	2	4	88,163	96,779	184,292	350	0.19%
CAYMAN	2	0	2	94,467		94,642	175	0.19%
TOTAL NEW AUTOS	17	3	20	1,246,449	215,110	1,478,884	17,325	1.19%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	0	3	3		170,197	170,197	0	0.00%
TOTAL NEW L-D TRUCKS	0	3	3		170,197	170,197	0	0.00%
TOTAL PORSCHE	17	6	23	1,246,449	385,307	1,649,081	17,325	1.06%
SAAB								
NEW AUTOS - POOL #1								
9-3	0	8	8		256,653	256,653	0	0.00%
9-5	4	0	4	132,384		141,836	9,452	7.14%
TOTAL NEW AUTOS	4	8	12	132,384	256,653	398,489	9,452	2.43%
NEW LIGHT-DUTY TRUCKS - POOL #2								
9-7X	2	1	3	73,950	41,630	116,185	605	0.52%
TOTAL NEW L-D TRUCKS	2	1	3	73,950	41,630	116,185	605	0.52%
TOTAL SAAB	6	9	15	206,334	298,283	514,674	10,057	1.99%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SATURN								
NEW AUTOS - POOL #1								
AURA	2	2	4	41,038	39,163	81,977	1,776	2.21%
SKY	2	0	2	49,695		50,751	1,056	2.12%
TOTAL NEW AUTOS	4	2	6	90,733	39,163	132,728	2,832	2.18%
NEW LIGHT-DUTY TRUCKS - POOL #2								
OUTLOOK	4	0	4	111,150		113,286	2,136	1.92%
RELAY	0	0	0				0	N/A%
VUE	0	7	7		163,849	163,849	0	0.00%
TOTAL NEW L-D TRUCKS	4	7	11	111,150	163,849	277,135	2,136	0.78%
TOTAL SATURN	8	9	17	201,883	203,012	409,863	4,968	1.23%
SCION								
NEW AUTOS - POOL #1								
TC	4	0	4	61,180		62,890	1,710	2.80%
XB	0	2	2		30,637	30,637	0	0.00%
XD	0	2	2		28,404	28,404	0	0.00%
TOTAL NEW AUTOS	4	4	8	61,180	59,041	121,931	1,710	1.42%
TOTAL SCION	4	4	8	61,180	59,041	121,931	1,710	1.42%
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	0	27	27		639,471	639,471	0	0.00%
LEGACY	9	2	11	219,515	52,263	271,047	(731)	(0.27)%
TOTAL NEW AUTOS	9	29	38	219,515	691,734	910,518	(731)	(0.08)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FORESTER	10	1	11	234,677	22,291	256,918	(50)	(0.02)%
OUTBACK	8	5	13	207,121	137,493	343,993	(621)	(0.18)%
TRIBECA	0	7	7		221,431	221,431	0	0.00%
TOTAL NEW L-D TRUCKS	18	13	31	441,798	381,215	822,342	(671)	(0.08)%
TOTAL SUBARU	27	42	69	661,313	1,072,949	1,732,860	(1,402)	(0.08)%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SUZUKI								
NEW AUTOS - POOL #1								
AERIO	0	0	0				0	N/A%
FORENZA	9	2	11	130,695	31,870	167,077	4,512	2.78%
RENO	3	3	6	41,229	42,333	83,994	432	0.52%
SK4	6	8	14	92,538	123,608	218,762	2,616	1.21%
TOTAL NEW AUTOS	18	13	31	264,462	197,811	469,833	7,560	1.64%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GRAND VITARA	10	1	11	206,544	22,703	232,241	2,994	1.31%
XL7	7	7	14	170,201	183,113	354,483	1,169	0.33%
TOTAL NEW L-D TRUCKS	17	8	25	376,745	205,816	586,724	4,163	0.71%
TOTAL SUZUKI	35	21	56	641,207	403,627	1,056,557	11,723	1.12%

TOYOTA

NEW AUTOS - POOL #1								
AVALON	4	0	4	107,574		108,284	710	0.66%
CAMRY	11	0	11	221,797		223,583	1,786	0.81%
COROLLA	6	0	6	83,968		85,060	1,094	1.30%
MATRIX	4	0	4	60,015		60,931	916	1.53%
PRIUS	2	1	3	41,590	19,692	61,560	278	0.45%
SOLARA	11	0	11	243,553		243,553	0	0.00%
YARIS	6	2	8	70,636	25,236	97,284	1,412	1.47%
TOTAL NEW AUTOS	44	3	47	829,131	44,928	880,255	6,196	0.71%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	12	0	12	349,434		353,300	3,866	1.11%
FJ CRUISER	3	0	3	62,332		64,064	1,732	2.78%
HIGHLANDER	0	6	6		163,981	163,981	0	0.00%
LAND CRUISER	0	1	1		55,300	55,300	0	0.00%
RAV4	12	0	12	262,007		264,754	2,747	1.05%
SEQUOIA	0	8	8		308,778	308,778	0	0.00%
SIENNA	9	0	9	237,887		236,851	(1,036)	(0.44)%
TACOMA PICKUP	18	0	18	338,274		341,571	3,297	0.97%
TUNDRA	0	44	44		1,183,324	1,183,324	0	0.00%
TOTAL NEW L-D TRUCKS	54	59	113	1,249,934	1,711,383	2,971,923	10,606	0.36%
TOTAL TOYOTA	98	62	160	2,079,065	1,756,311	3,852,178	16,802	0.44%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/07
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

DECEMBER 17, 2007

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/06 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
VOLKSWAGEN								
NEW AUTOS - POOL #1								
EOS	3	3	6	89,965	90,628	180,980	367	0.20%
GTI	4	4	8	84,422	87,844	175,688	3,422	1.99%
JETTA	16	4	20	295,958	81,571	386,045	8,516	2.26%
NEW BEETLE	8	6	14	151,504	127,544	284,648	5,600	2.01%
PASSAT	10	3	13	251,969	80,524	360,778	28,285	8.51%
R32	0	1	1		31,283	31,283	0	0.00%
RABBIT	8	0	8	126,912		129,916	3,004	2.37%
TOTAL NEW AUTOS	49	21	70	1,000,750	499,394	1,549,338	49,194	3.28%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Touareg 2	0	3	3		143,375	143,375	0	0.00%
TOTAL NEW L-D TRUCKS	0	3	3		143,375	143,375	0	0.00%
TOTAL VOLKSWAGEN	49	24	73	1,000,750	642,769	1,692,713	49,194	2.99%

VOLVO

NEW AUTOS - POOL #1								
30 SERIES	0	2	2		45,566	45,566	0	0.00%
40 SERIES	3	0	3	76,829		78,358	1,529	1.99%
50 SERIES	3	0	3	81,388		82,935	1,547	1.90%
60 SERIES	3	0	3	90,679		91,854	1,175	1.30%
70 SERIES	1	2	3	36,780	65,157	102,078	141	0.14%
S80	2	1	3	80,962	39,558	121,783	1,263	1.05%
TOTAL NEW AUTOS	12	5	17	366,538	150,281	522,574	5,655	1.09%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	3	0	3	124,053		125,634	1,581	1.27%
TOTAL NEW L-D TRUCKS	3	0	3	124,053		125,634	1,581	1.27%
TOTAL VOLVO	15	5	20	490,691	150,281	648,208	7,236	1.13%

Possible new three-tier system. The IRS is considering replacing the existing dual "automatic consent" and "nonautomatic consent" processes with a system under which a taxpayer would request either (1) "standard consent," (2) "specific consent" or (3) "letter ruling consent." Under this proposal, the majority of accounting method change requests would be made through the standard consent process.

#1 ... Standard consent process. This proposed process is expected to operate in a manner similar to the existing automatic consent process. In other words, a taxpayer that timely files Form 3115 with its tax return and complies with the procedures governing the process is granted the Commissioner's consent to change its method of accounting. A change made under the standard consent process must be made under the published terms and conditions applicable to the standard consent process. No letter ruling would be issued by the IRS, and no user fee would be charged.

#2 ... Specific consent process. This proposed process would be available for only two categories of accounting method changes. **First category** ... changes specifically identified in published guidance as required to be made under the specific consent process. **Second category** ... changes that otherwise qualify under the standard consent process, but for which the taxpayer seeks different terms and conditions or a waiver of certain scope limitations that apply to the standard consent process. The IRS expects that under this proposal a user fee would apply to a change requiring specific consent.

Under the proposal, the IRS would publish guidance in the Internal Revenue Bulletin that lists specific accounting method changes that must be made using the specific consent process. The specific accounting method changes listed in this published guidance would include the types of changes that the IRS wants

to review in more depth and prior to the taxpayer implementing the accounting method on its tax return. The IRS would update the proposed published list as necessary to add or remove specific accounting method changes that are required to be made under the specific consent process.

The IRS expects that, in general, the process for requesting specific consent would be similar to the existing advance consent process that is described in Rev. Proc. 97-27 ... a taxpayer files a Form 3115 that is substantially complete and awaits a ruling from the IRS granting consent to the change.

The specific consent process would also apply to any change that otherwise qualifies for the standard consent process (including a change specifically identified in Rev. Proc. 2002-9, or any successor, or other automatic consent guidance), but for the fact that the taxpayer either (1) seeks a term and/or condition different from those that apply to standard consent requests, or (2) seeks a waiver of certain scope limitations that apply to standard consent requests.

#3 ... Letter ruling consent. Finally, the IRS recognizes that some taxpayers who want to change an accounting method may also want to have the certainty of a Letter Ruling issued by the IRS National Office concerning the propriety of a requested method of accounting. Under the proposal, a taxpayer that seeks a change in accounting method other than a change that is specifically identified in Rev. Proc. 2002-9 (or any successor), or other automatic consent guidance, may request a Letter Ruling under Rev. Proc. 2007-1 or its successor.

What's next? ... The IRS has requested that any comments on these proposals be submitted in writing no later than January 15, 2008. After evaluating written comments, the Service will determine appropriate further action.



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