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A Periodic 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. WILL LIFO BE AROUND NEXT YEAR? Let's skip all the baloney. No one really knows. Right now, our focus is on the belief that it is in the taxpayer's best interest to maximize its LIFO reserves until such time as political and legislative forces ... all well beyond our control ... dictate what is really going to happen.

#2. WHAT'S GOING TO HAPPEN TO DEALERS' LIFO RESERVES AT THE END OF THIS YEAR? We are expecting more inflation in our LIFO indexes this year. A glance at our "One-of-Each" summary table on page 49 shows how much.

So, if a dealership's LIFO pools are about the same in dollar size as last year's, you can expect sizeable increases in their LIFO reserves, especially if they are Ford, GM or Chrysler dealers. (Ironic, isn't it?)

Many dealerships didn't change to the single pool method for 2007, and this could complicate their projections if they make the change for 2008.

We've included a sample letter that discusses year-end LIFO projections for dealers who didn't make the change last year. This emphasizes the variability of results and the dealer's option to combine the pools for new vehicles into a single pool.

#3. IT'S NOW EASIER TO CHANGE SOME LIFO METHODS. In August, the IRS issued Revenue Procedure 2008-52 to update the procedures for taxpayers who are making voluntary changes in (LIFO and other) accounting methods that the IRS favors under its "automatic consent process."

Our analysis of the LIFO-related aspects of these new procedures begins on page 20.

LIFO Election Terminations. In our last issue, we discussed the problem all dealers have faced in "terminating" their LIFO elections. Mercifully, this problem has now been eliminated on a prospective basis. For more on this, see pages 22-23.

Unfortunately, there are still many dealers who used the wrong procedure in previously filing to "request permission" to terminate their LIFO elections. Does the IRS regard them as still being on LIFO? For them, this limbo state is a mess.

#4. COMBINING LIFO POOLS FOR ALL NEW VEHICLES. Recently, the IRS issued informal guidance on how dealerships implementing the change to the *Vehicle-Pool Method* should combine their pools. IRS Chief Counsel Office Memo (CCM) No. 200825044 provides two examples ... and some interesting results.

Some dealerships may wish they had ***not*** made the change ... If the IRS is "right" (and unwavering) in its non-precedential guidance/opinion on procedures for combining pools.

see **LIFO UPDATE**, page 37

LOOKOUT LOOKS INTO

LIFO Update

(Continued from page 1)

The mid-year (Spring 2008) issue of the *LIFO Lookout*, the longest in our history, was devoted almost entirely to the opportunity the IRS gave dealers to combine their LIFO pools. The IRS allowed dealerships to make this change retroactively for their 2007 calculations. However, the majority of the dealers we discussed this change with opted not to use the *Vehicle-Pool Method* for 2007.

Why look a gift horse in the mouth? Possibly for 3 reasons.

Some dealers didn't change because their LIFO calculations were already completed for the year and they didn't want to bother. Others didn't change because there was no tax benefit in 2007 from making the change, so they decided to "wait and see" how 2008 played out. Still others didn't change for 2007 because they had operating losses and net operating loss carryforwards so gigantic, the opportunity to increase their LIFO reserve by a comparatively small amount was not attractive in this overall negative context.

Our mid-year issue discussed many of the computation issues associated with making the change to a single LIFO pool under Rev. Proc. 2008-23. One issue relates to the procedure for combining the two new vehicle LIFO pools. This combination becomes further complicated in situations where the two pools being combined did not originate or start in the same year.

Our analysis and observations on the CCM informal guidance on this subject begins on page 33. We have also added a sample 3115 narrative for making changes to the single pool method to update it to reflect changes made under Revenue Procedure 2008-52.

#5. ROLLING-AVERAGE METHODS TO <u>DETERMINE COST</u>. The IRS will now permit use of rolling-average methods to determine cost for LIFO and for non-LIFO inventories. Revenue Procedure 2008-43 will make life easier for many businesses which were unable to determine actual cost, but were previously prevented from using a rolling-average cost method to approximate cost.

Rev. Proc. 2008-43, discussed in the article on page 3, now provides that such methods can be used if they meet certain conditions.

#6. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX <u>ASSUMPTION</u>. 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.

You'll note this year we've added information for those dealerships that have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method.

To assist in making year-end projections, each year we provide a listing for *new* vehicle LIFO inventories showing weighted average inflation (or deflation) information for each model. The summaries are on pages 48-52 and the detail lists are on pages 54-61.

#7. LIFO CONFORMITY: WATCH THOSE YEAR-END FINANCIAL STATEMENTS ... AGAIN, <u>OUR USUAL LIFO CONFORMITY REMINDER</u>. 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.

THE IRS NOW PERMITS USE OF THE ROLLING AVERAGE METHOD TO DETERMINE COST FOR LIFO CALCULATIONS

For businesses using the dollar-value LIFO method, Question 17 on page 2 of the LIFO election Form 970 requires them to choose one of four alternatives to describe the method that will be used to determine the current year cost of goods in the closing inventories.

These four choices are (1) actual cost of goods most recently purchased or produced, (2) average cost of goods purchased or produced during the year, (3) actual cost of goods purchased or produced in order of acquisition, or (4) other, for which an explanation of the "other" method must be provided. In some instances, specific identification may be the response for the fourth choice.

Recently, the IRS added a fifth alternative ... the rolling average method ... to this list of choices.

In Revenue Procedure 2008-43, the IRS reversed its long-standing opposition to the use of a rolling-average inventory valuation method and said that it will now permit its use, subject to certain conditions.

This should make life easier for many businesses that were previously unable to determine actual cost but did not qualify for "relief" under the revenue procedures which allowed certain businesses to use safe harbor replacement cost methods to approximate the actual cost for their parts inventories.

BACKGROUND

For decades, the IRS would not permit most taxpayers to use an average cost method (also known as a "rolling-average method"). Revenue Rulings 71-234 and 77-480 reflected this prohibition in what many would argue were very limited fact patterns. However, the holdings in these Revenue Rulings over time were generalized and calcified into overall prohibitions against the use of a rolling cost method in almost all circumstances.

Revenue Ruling 71-234. This Ruling involved a product that required aging over a period of from one to three years. This product might have been wine or tobacco or some other product which over time actively or passively transferred from one "grade" to another. The facts in this Revenue Ruling were that the materials purchased were not currently consumed in the manufacturing operations, but were held for aging purposes. The Ruling does not state whether the taxpayer used the LIFO method or not.

In addition, the prices of the product were subject to substantial fluctuation. "In computing its inventories, materials purchased during a month are added, both as to quantity and cost, to the quantity and cost balance brought forward from the previous month and an average cost to the close of the month is computed by dividing the total quantity into the total money figure. This average is then applied to the quantity of materials used for manufacture during the month and the amount so computed is credited to the material account."

The IRS said that the taxpayer in Rev. Rul. 71-234 could not use the average cost inventory method or rolling average method since it did not conform to the requirements of Section 471. The concern of the IRS was that in a business requiring goods to be carried for lengthy periods of time and where an average cost method of inventory valuation was used, an overstatement of profit would occur when the current market is declining, while on an advancing market, the profits on the actual sales of the year would be understated. Only when the market was stable would the average method reflect with approximate accuracy the true profit.

The Revenue Ruling held that "the computation of taxable income upon such a basis results in an assignment of income to a year, not upon the basis of the transactions of the year, but upon the basis of transactions, parts of which spread over more than a year. An annual accounting period is a fundamental requirement of the Federal income tax law, and every computation of taxable income must be made in conformity therewith. This, the average cost inventory method in the instant case failed to do."

Revenue Ruling 77-480. In this later Revenue Ruling, the taxpayer was on LIFO and it computed the current year cost using a moving average cost method. Under this method, the taxpayer added the cost of the units in inventory at the end of the prior year plus the cost of units purchased during the current year and divided that sum by the sum of the total number of units on hand at the end of the prior year plus the number of units purchased during that year. The resulting quotient was used as the average cost in determining the total current year cost of the LIFO inventory.

Rev. Rul. 77-480 states that "the methods of determining the current-year cost of a dollar value pool under Reg. Sec. 1.472-8(e)(2)(ii) contemplate

see **ROLLING AVERAGE METHOD**, page 4

the determination of current-year cost to be made on a year-by-year basis by using costs applicable to the current year. The moving average method in the instant situation uses costs from prior years as well as the current year and as a result, does not present a true current-year cost."

Accordingly, the taxpayer's method was not a proper method, and the taxpayer was required to use the average unit cost method for LIFO purposes.

RECENT RECONSIDERATION OF POSITION BY THE IRS

In January of 2006, the American Institute of Certified Public Accountants (AICPA) urged the Service to reconsider its opposition to the use of rolling average cost methods. The AICPA acknowledged the holdings in the above Revenue Rulings that the determination of cost under Sections 471 and 472 may not consider costs incurred prior to the beginning of the year (i.e., a "rolling average cost").

However, the AICPA argued that the Regulations under Section 471 also define cost to include a reasonable approximation of cost (Reg. Sec. 471-3(d)). At the time when these Rulings were issued in the 70's, taxpayers' inventory cost systems were less sophisticated and it was not uncommon to find that when an inventory system averaged costs, the averaging process took place infrequently, sometimes only once a year. In those circumstances, in periods of rapidly increasing prices, it was possible for the cost of the items in the ending inventory under a rolling average cost method to be lower than any cost incurred in the current year.

The AICPA pointed out that today's cost accounting systems are much more sophisticated. They typically average acquisition costs very frequently - and sometimes this averaging occurs after every acquisition. Some textbooks refer to the method just described (i.e., determining weighted averages after every acquisition) as a true "moving-average method." In contrast, where costs and quantities are carried forward and recomputed at the end of a period (i.e., periodically, such as at the end of each month), as found in the facts in Rev. Rul. 71-234, the method is often described as a "period-average" method.

Due to the arguably more sophisticated inventory cost systems employing various rolling average practices by high powered computers, the AICPA stated that "the (IRS) ban on using a rolling average cost method in Rev. Rul. 71-234 and Rev. Rul. 77-480 poses significant and, in our view, unwarranted exposure for taxpayers with such systems."

More recent evidence of the fact that rolling average cost also can approximate actual cost can be deduced from the IRS' allowing the use of replacement cost methods for certain parts inventories. The AICPA specifically cited Revenue Procedures 2002-17 and 2006-14 which permit automobile dealers and heavy equipment dealers, respectively, to use a replacement cost method to approximate the actual cost of their parts inventories.

REVENUE PROCEDURE 2008-43

The IRS acceded to the AICPA's view that a rolling-average cost method for financial statement purposes can produce an accurate approximation of costs. In August, 2008 the Service issued Revenue Procedure 2008-43 which included procedures by which taxpayers may obtain the IRS' automatic consent to change to a rolling-average method.

The Rev. Proc. indicates that generally the IRS will view a rolling-average method that is used to value inventories for financial accounting purposes as clearly reflecting income for Federal income tax purposes. Note, the key here is that that method is being used for financial statement purposes. If a taxpayer does not use a rolling-average method for financial accounting purposes, then the rolling-average method may not accurately determine costs or clearly reflect income for Federal income tax purposes.

However, if inventory is held for several years or costs fluctuate substantially (as was the case in the previous Revenue Rulings), a rolling-average cost method may or may not clearly reflect income, depending on the particular facts and circumstances.

The basic Regulation that opens the door to the IRS' acceptance of the use of a rolling-average method is Reg. Sec. 1.471-3(d). This Regulation provides that in any industry in which the usual rules for computation of cost of production are inapplicable, cost may be approximated upon a basis that is reasonable and in conformity with established trade practice in that industry.

Rolling-average method safe harbors. Rev. Proc. 2008-43 provides that, in general, a taxpayer's use of the rolling-average method it uses for financial accounting purposes to value inventories for Federal income tax purposes will be deemed to clearly reflect income if that method meets ***two*** requirements.

First requirement. The rolling-average method used by the taxpayer must recompute the rolling average cost of an inventory item ***either*** each time the taxpayer purchases or produces an additional unit or units of that item (i.e., the true "moving-average

see **ROLLING AVERAGE METHOD**, page 37

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

CONFORMITY REPORTING REQUIREMENTS

YEAR-END PROJECTIONS FOR PLANNING PURPOSES

(Continued from page 5)

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

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

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

TERMINATION SITUATIONS

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

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

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

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

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

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

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

FORM 970 QUESTIONS REGARDING CONFORMITY

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

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

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

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CONFORMITY REQUIREMENTS... THERE ARE MANY

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

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

TWO SETS OF REQUIREMENTS

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

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

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

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

EVERY YEAR, ALL OF THE CONFORMITY REQUIREMENTS MUST BE MET

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

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

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

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 8

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

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

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

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

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

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

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

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

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

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

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

IRS TESTS

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 10

(Continued from page 9)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

HOW SOME BUSINESSES GET AROUND THE LIFO CONFORMITY LIMITATIONS

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 12

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

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

INTERIM REPORTS

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

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

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

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

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

"CONFORMITY" ... WHERE FOREIGN CORPORATIONS ARE INVOLVED

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

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

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

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

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

In this Ruling, the Service held that ...

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

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<table>
<tr><th>Rev. Rul. 78-246</th><th><u>Foreign Corporations & Foreign Operations</u>
<u>Financial Statement Conformity Requirements & the 30% Test or Threshold</u></th></tr>
<tr><td>Background</td><td>• 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.</td></tr>
<tr><td>Are Operating Assets of "Substantial Value" Used in the Foreign Operations?</td><td>• If a foreign parent owns operating assets of substantial value which are used in foreign operations, the LIFO financial statement conformity requirements do not apply to the consolidated financial statements.
◆ This applies to ownership by the parent either directly or indirectly through members of its group.
• Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that ... (1) are members of the consolidated group, (2) are foreign corporations, (3) do not use the LIFO method of accounting for Federal income tax purposes, and (4) engage in a business outside the United States.
• For purposes of this test, operating assets are all the assets necessary for the conduct of an active operating company.</td></tr>
<tr><td>30% or More Threshold</td><td>• The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes <u>30% or more</u> of the total operating assets of the consolidated group.
• This determination will be made annually.
• This determination will normally be made on the basis of the asset valuation reflected in the consolidated financial statements of the group for the year.</td></tr>
<tr><td>Facts & Circumstances</td><td>• 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.</td></tr>
<tr><th colspan="2">LTR 200540005 ... Dated June 20, 2005</th></tr>
<tr><td>LTR Summary</td><td>• 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.</td></tr>
<tr><td>LTR Facts</td><td>• The parent (a foreign corporation, not reporting under U.S. GAAP) made an agreement whereby the taxpayer (its wholly-owned U.S. subsidiary) would acquire all of the outstanding stock of a group of new subsidiaries.
◆ Prior to the acquisition, the taxpayer also had other wholly-owned U.S. subsidiaries ("old subs").
◆ Following the acquisition, the activities of the parent, the taxpayer, and the taxpayer's subsidiaries (old subs and new subs) would be reported in the consolidated financial statements of the Parent.
• Prior to the acquisition, the new subs used LIFO for valuing their inventories. The parent and the taxpayer used a non-LIFO method for valuing inventory for U.S. and for the parent's foreign country tax purposes.</td></tr>
<tr><td>LTR Discussion</td><td>• The taxpayer conceded that it did not meet the more than 30% test for establishing substantial foreign operations under Rev. Rul. 78-246. However, it said that it should be allowed to make certain distinctions in order to qualify under the alternative "facts and circumstances" test.
• The taxpayer argued that as a result of the stepped-up basis in the assets involved in the acquisition, financial statement comparisons did not fairly represent its situation. The assets of the new subsidiaries reflected current value because the acquisition was recorded as a purchase pursuant to U.S. GAAP.
• Accordingly, the taxpayer argued that it should be allowed to compare the higher market values (i.e., instead of the lower asset book values) of the foreign operations to its total operations.
◆ In determining the market value of new subsidiaries, the taxpayer proposed to use the purchase price of the new subsidiaries.
◆ For the market value of the remainder of the Group, the taxpayer proposed to use EBITDA (earnings before interest, taxes, depreciation and amortization) as a basis for allocating the Group's market value, prior to the acquisition, between its foreign and domestic operations.
• As a result of this alternative analysis, the computed percentage of assets used in foreign operations (to total operations) would only be slightly less than the 30% minimum threshold set forth in Rev. Rul. 78-246.</td></tr>
</table>

(Continued from page 12)

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

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

CONCLUDING CONFORMITY WARNINGS

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

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

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

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

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

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

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

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

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

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

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

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

PROJECTION MECHANICS, STEP-BY-STEP

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

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

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

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

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Conformity Reporting Requirements

(Continued)

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

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

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

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

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

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

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

PROJECTIONS STEP-BY-STEP

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 17

Practice Guide

WHY LIFO RESERVES CHANGE THE WAY THEY DO

Background

- Taxpayers using LIFO are often surprised when they find out that even though their year-end inventory levels are (*projected to be*) lower than they were at the beginning-of-the-year, their LIFO reserves (*are expected to*) increase.
  - ♦ Often these (*projected*) increases in LIFO reserves are very large.

Change Factors

- The *net amount of change* in the LIFO reserve for any year is the result of two complementing and/or offsetting factors.
- This ***variation analysis*** simply involves ...
  - ♦ ***Price changes***, i.e., inflation or deflation ... prices either increased or decreased, and
  - ♦ ***Quantity changes***, i.e., changes in the dollar amount of the inventory investment levels.

Upward influences ... causing increases (i.e., factors causing the LIFO reserve to go up) ...

Upward ... Increases

- ***Price increases*** ...inflation.
- ***Quantity increases***, if a dual index LIFO methodology/approach is used for valuing increments.
- ***Certain decreases in inventory investment levels*** - To the extent that a current-year quantity decrease (referred to as a "decrement") is carried back against an increment built up in a prior year or years, any pay-back of the previously built-up LIFO increment and its related contribution to the LIFO reserve will ***increase*** the current year's LIFO reserve if ...
  - ♦ There was deflation in the prior year(s)'s layers that are now being invaded, and
  - ♦ The layers being invaded are/were contributing "negatively" or negative amounts to the LIFO reserve at the end of the preceding year.
  - ♦ ***Stated another way ...*** The layers of inventory being invaded by the carryback of a decrement (expressed in base dollars) are contributing negative amounts toward the overall LIFO reserve balance; Accordingly, to the extent that any carryback of the current-year's decrement eliminates these negative effects, that leaves only inventory layers contributing positive amounts toward the overall LIFO reserve balance ... or fewer inventory layers still contributing negatively toward the overall LIFO reserve balance.

Downward influences ... causing decreases (i.e., factors causing the LIFO reserve to go down) ...

Downward ... Decreases

- ***Price decreases*** ...deflation.
- ***Decreases in inventory investment levels*** - i.e., pay-backs of previously built-up LIFO reserves to the extent resulting from the carryback of a current-year inventory quantity decrease (referred to as "decrements") against increases ("increments") built up in prior years.
- ***Decreases in inventory investment levels ... But not always ... Sometimes no payback.***
  - ♦ An inventory decrease/decrement may not necessarily cause, or result in, any pay-back of some or any of the LIFO reserve at the beginning of the year. Whether or not there is a "pay-back" depends the order in which the prior year layers were built up over time and how they were valued for LIFO purposes.

No Effect

- If the decrement in the current year is less than the amount of the increment in the immediately preceding year, there will be no dollar change in the LIFO reserve due to the carryback of that decrement against that prior year's increment.
- This result will occur under any LIFO method that values a current-year increment by using the cumulative inflation index (factor) at the end of the year.
  - ♦ Alternative LIFO Methods for New and/or Used Vehicles

Articles Analyzing Changes in LIFO Reserves

- "*Why Do Some LIFO Reserves Go Up Even Though Inventory Levels Go Down?*" in the March 1992 *LIFO Lookout*
- "*Another Rebasing Example - With Proofs: Why LIFO Reserves Go Up Even Though Inventory Levels Go Down and Despite Rebasing Indexes to 1.000 in Between*" in the June 1993 *LIFO Lookout.*
- "*Strange ... But Explainable ... Results from the Wacky World of Negative LIFO Reserves,*" in the December 1998 *LIFO Lookout.* This article, with supporting schedules, analyzes pay-back mechanics where negative LIFO reserves are involved.
- "*Dealers Who've Remained on LIFO Through a Few Years of Deflation Are Finally Rewarded by Inflation & Big LIFO Reserve Increases*" in the June 2004 *LIFO Lookout.*
  - ♦ This article, with supporting schedules, analyzes LIFO reserve changes where some of the more recent years' LIFO layers reflect general price deflation, but not to the point where overall negative LIFO reserve balances have been created.

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

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

ALTERNATIVES

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

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

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

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

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

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 18

(Continued from page 17)

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

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

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

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

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

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

SOMETIMES THE IRS REVERSES YEAR-END LIQUIDATION AVOIDANCE MEASURES

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

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

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

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

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

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

PLANNING CHECKLIST

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

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

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

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

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

1. X's method of accounting for the Y purchases carried over to the taxpayer created in the merger process,

2. the treatment of the purchases in inventory constituted an unauthorized change in method of accounting, and

3. corrections could be made by changing the new taxpayer's method of accounting and making adjustments pursuant to Section 481(a).

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

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

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

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

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

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

REVISED PROCEDURES FOR SECURING AUTOMATIC CONSENT FROM THE IRS TO MAKE CHANGES IN LIFO & OTHER METHODS OF ACCOUNTING

REV PROC 2008-52

In Revenue Procedure 2008-52, the IRS recently updated the procedures by which taxpayers may obtain automatic consent for certain changes in methods of accounting. The focus of this article is on the sections in the Appendix to Revenue Procedure 2008-52 which deal with LIFO inventories. This new guidance supersedes Rev. Proc. 2002-9 which formerly was the controlling document for automatic changes.

INTRODUCTION

On a somewhat regular basis, CPAs have to consider the advisability of recommending changes in their clients' methods of accounting. This advice may be needed in connection with new developments and pronouncements by the IRS or recently decided tax cases. Or it may be needed in connection with knowing that a taxpayer's method of applying LIFO (i.e., a LIFO method or submethod) is not correct (or as good as it could be) and trying to decide whether to "voluntarily" change the method or just wait for the IRS to come along and initiate a change.

Why change a method of accounting before the IRS forces you to? There are several advantages to making a voluntary change in an IRS-designated automatic change method of accounting. With these kinds of changes, taxpayers have a certain amount of hindsight about whether or not to make the change because they are not required to file the Form 3115 until after the end of the year. No user fee is required to be paid with the filing of Form 3115.

Voluntarily changing an accounting method - before the IRS requires a change - also eliminates what might be significant exposure to potential penalties.

For many voluntary changes involving LIFO submethods, the cut-off method is used. No Section 481(a) adjustment is required, and only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. If a Section 481(a) adjustment is required in order to avoid a distortion of income, that adjustment is usually made starting with the year of change, and not in an earlier year. In general, the spread period for a net positive Sec. 481(a) adjustment is 4 years and a net negative Sec. 481(a) adjustment may be taken into income (as a deduction) in the year of change.

Taxpayers complying with all the applicable provisions obtain the consent of the Commissioner to change the method of accounting under Section 446(e). However, in this regard, taxpayers must fully comply with the detailed filing and timely duplicate notification requirements that are included in Revenue Procedure 2008-52.

Corrections of errors are not the same as changes in accounting methods. The June 2006 issue of the *LIFO Lookout* was devoted to analyzing what was a real disaster for an auto dealership when its accountant did not properly do the LIFO computations. (*Dow A. and Sandra E. Huffman, et al. v. Commissioner* (126 T.C. No. 17))

The CPA/accountant responsible for the LIFO calculations was consistent in applying his method of making the link-chain computations each year. The problem (for these dealerships) was that he was just consistently wrong.

In March of 2008, the U.S. Court of Appeals for the 6th Circuit affirmed the Tax Court holding in this case. The 6th Circuit Court placed emphasis on the fact that "systemic flaws" in a taxpayer's method of accounting cannot be described as mere mathematical or posting errors.

Both the Courts allowed the IRS to make Section 481(a) adjustments to adjust the first open year of each of the dealerships and to properly revalue the dealership's inventory because the adjustments constituted a change in the method of (LIFO) accounting. There was no statute of limitations preventing the adjustments, despite several prior IRS audits which apparently "looked at" and did not question these incorrect LIFO calculations.

Making the move to change the method before it's too late. It's too late to make a voluntary change in method if a taxpayer's method of accounting for an item is an ***issue under consideration*** for a taxable year under IRS audit examination.

Accordingly, if a taxpayer receives written notification from an examining agent specifically citing the treatment of the item as an issue under consideration, then it's too late for the taxpayer to "voluntarily" change that method. Written notification includes the agent's examination plan, Information Document Request (IDR), or notification of proposed adjustments or income tax examination changes.

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A one-paragraph digression is in order here. The recitation in the previous paragraph comes straight from the revenue procedure. In the real world where many tax issues (involving LIFO, at least) are not settled at the examination level, but proceed beyond Exam to the Appeals level, taxpayers are often permitted - as a matter of settlement strategy acceptable to both the IRS and the taxpayer - to effect a change in accounting method even though the method in question was an "item under consideration."

The following may clarify the IRS' interpretation of the term "issue under consideration." In the context of a taxpayer's method of pooling under the dollar-value LIFO inventory method, that method would be an "issue under consideration" if it is mentioned in an IRS audit examination plan that identifies LIFO pooling as a matter to be examined. However, that pooling method would not be an "issue under consideration" as a result of an IRS audit examination plan that merely identifies LIFO inventories as a matter to be examined.

Also in connection with defining changes in method, a change within the LIFO inventory method is a change from one LIFO inventory method or submethod to another LIFO inventory method or submethod. However, a change within the LIFO inventory method ***does not include*** a change in method of accounting that could be made by a taxpayer that does not use the LIFO inventory method (for example, a method governed by Sections 471 or 263A).

REV. PROC. 2008-52 UPDATES PROCEDURES

Form 3115 (*Application for Change in Accounting Method*) is the form which must be filed in connection

see REVENUE PROCEDURE 2008-52, page 22

Form **3115** (Rev. December 2003) Department of the Treasury Internal Revenue Service

Application for Change in Accounting Method

OMB No. 1545-0152

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

If the applicant is a member of a consolidated group, check this box . . . . ▶ ☐

If **Form 2848,** Power of Attorney and Declaration of Representative, is attached, check this box . . . . . ▶ ☐

Check the box to indicate the applicant.

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

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

- ☐ Depreciation or Amortization
- ☐ Financial Products and/or Financial Activities of Financial Institutions
- ☐ Other (specify) ▶

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

Part I Information For Automatic Change Request — Yes | No

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

▶ (a) Change No. ________ (b) Other ☐ Description ▶ ____________

2 Is the accounting method change being requested one for which the scope limitations of section 4.02 of Rev. Proc. 2002-9 (or its successor) **do not** apply? . . . .

If "Yes," go to Part II.

3 Is the tax year of change the final tax year of a trade or business for which the taxpayer would be required to take the entire amount of the section 481(a) adjustment into account in computing taxable income? . . .

If "Yes," the applicant is not eligible to make the change under automatic change request procedures.

Note: *Complete Part II below and then Part IV, and also Schedules A through E of this form (if applicable).*

Part II Information For All Requests — Yes | No

4a Does the applicant (or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) have any Federal income tax return(s) under examination (see instructions)? . . .

If you answered "No," go to line 5.

b Is the method of accounting the applicant is requesting to change an issue (with respect to either the applicant or any present or former consolidated group in which the applicant was a member during the applicable tax year(s)) either (i) under consideration or (ii) placed in suspense (see instructions)? . . . .

(Continued from page 21)

with accounting method changes. The last revision date for Form 3115 is December, 2003. However, the Instructions for Form 3115 have been updated more frequently to reflect the constant high level of attention given to this area by the IRS.

In general, Revenue Procedure 2008-52 is effective for Forms 3115 filed after August 18, 2008 for a year of change ending on or after December 31, 2007.

The only methods of accounting that can be changed using the procedures in Rev. Proc. 2008-52 are those methods which are specifically identified in the Appendix to the revenue procedure. This Appendix lists 33 general areas, many with extensive subdivisions, which are designated automatic changes. Section 22 in the Appendix relates specifically to changes in methods for valuing Last-In, First-Out (LIFO) inventories, including terminating LIFO elections.

The Revenue Procedure itself is divided into fifteen Sections. The most important or key Sections are ... "Scope," "Terms & Conditions of Change," "General Application Procedures" and "Audit Protection for Taxable Years Prior to Year of Change," (Sections 4, 5, 6 and 7, respectively). The procedural requirements for filing Form 3115 to notify the IRS that an "automatic" change in accounting method is being made have remained basically the same as they were under Revenue Procedure 2002-9. (A detailed section-by-section analysis of Rev. Proc. 2008-52 is included in the year-end 2008 issue of the *Dealer Tax Watch.*)

TERMINATION OF LIFO ELECTIONS BY AUTO DEALERSHIPS ... UNCERTAINTIES ELIMINATED

Some background. The termination of a LIFO election is referred to as a "change ***from*** the LIFO inventory method."

Articles in previous issues of the *LIFO Lookout* have noted that several years ago, when the IRS changed its procedures for the termination of LIFO elections in Rev. Proc. 2002-9, the wording there was such that significant problems could emerge in the future ... if the IRS ever looked closely at the specifics of dealerships' inventory methods being employed after the termination of its LIFO election.

We also noted that for several years, there seemed to be no problems, but that it had recently come to our attention that the National Office had been rejecting Forms 3115 filed by dealerships for automatic terminations of their LIFO elections under Rev. Proc. 2002-9. It appeared that the IRS was taking the position that dealerships could not use the automatic change provisions to go off of LIFO because they are using different methods of accounting for their non-LIFO inventories (i.e., if they are not using the same method for all of their non-LIFO inventories).

Needless to say, this position of the IRS can create significant problems for dealerships who thought they had terminated their LIFO elections when they filed Form 3115 (automatic change) and never heard back from the IRS. Some of them were being notified by the IRS, at a date (many) years later that they should have filed Form 3115 ***before*** the end of the year the LIFO election was terminated. This is the requirement under Rev. Proc. 97-27 which applies to non-automatic changes.

Apparently, the IRS' position all along has been that a dealership's automatic change request was invalid and should be denied because all of the dealership's non-LIFO inventory was not being valued using the same method. Ironically, there was nothing really difficult involved here. The devil is in the details ... in the procedures. It was just a matter of the IRS requiring taxpayers to know before the year was over that they were going to terminate their LIFO election for the year so that they could file Form 3115 for permission to change ***before*** the end of the year of change. And, of course, pay the appropriate pound of flesh (user fee).

However, the implications for dealers caught in this *Catch-22* are nothing short of horrendous, for some are finding out (in many cases, several years) after the fact that, according to the IRS, they are still on LIFO! Or worse yet, that they have made an unauthorized change in accounting method ... and that leaves them at the mercy of the IRS to do with them whatever it wants.

In summary, Revenue Procedure 2002-9 required that when a dealership terminated its LIFO election, all of the dealership's non-LIFO inventories must be using the same method for valuation and identification of inventories. If the same method was not being used, then, under Rev. Proc. 2002-9, the dealership could not terminate its LIFO method using the automatic change in method procedures by filing Form 3115 ***after*** the end of the year of change.

Out of practical necessity, every automobile dealership uses the replacement cost method for valuing its parts and accessories inventories. As a result, a dealership going off of LIFO could not satisfy the "permitted method of accounting" requirement of Revenue Procedure 2002-9 and, therefore, the dealership was required to obtain consent to terminate its LIFO election in advance from the IRS (i.e., by filing Form 3115 under Rev. Proc. 97-27 before the end of the year of change and paying a user fee).

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The good news ... Rev. Proc. 2008-52 now eliminates these uncertainties. In a liberalization of the IRS' previous position, Section 22.01 of the Appendix to the Rev. Proc. now provides that a taxpayer may change to one or more non-LIFO inventory methods for the LIFO inventories that are the subject of this accounting method change, but only if the selected non-LIFO method is a permitted method for the inventory goods to which it will be applied.

For example, a heavy equipment dealer may change to the specific identification method for new heavy equipment inventories and to the replacement cost method for heavy equipment parts inventories.

So the question is ... what is a "permitted" method? The answer now is that an inventory method (identification or valuation, or both) is a permitted method if it meets two requirements. ***First,*** it is specifically permitted by the Code, the regulations, a decision by the United States Supreme Court, a Revenue Ruling, a Revenue Procedure, or other guidance published in the Internal Revenue Bulletin for the inventory goods. The ***second*** requirement is that the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods. In general, these requirements should be easily satisfied by the typical dealership.

Fortunately, whether an inventory method is a permitted method is determined without regard to the types and amounts of costs capitalized under the taxpayer's method of computing inventory cost under Section 263A which governs the types and amounts of costs required to be included in inventory cost.

What about those dealers who are caught between and still in the "Catch 22"? After celebrating this good news, let's not forget that it only applies prospectively. There are still many dealers who think that they effectively terminated their LIFO elections years ago, but (according to the IRS) they did not comply with the correct procedural requirements.

What should a dealership do if it previously (thought it) terminated its LIFO election, and since then, it has not been using the LIFO method for valuing its inventories? Should it file amended income tax returns for all of the intervening years? Should it apply for a Ruling and "confess" to a LIFO financial statement conformity violation? (Obviously, under these circumstances, the dealership would not have reflected LIFO on its year-end financial statements if it thought it was not on LIFO.)

In this gray area, is there still a 4-year spread period for the recapture of the dealership's LIFO reserve? ... Or, might the IRS insist on the full LIFO reserve being picked up in income 100% in the intended year of termination? ... Or, is the dealership still on LIFO (if the IRS will waive its inadvertent violations of the financial statement conformity requirements)?

The implications for these dealers could be "horrendous." The IRS could take the position that they are still on LIFO and by not continuing to stay on LIFO, they have made an unauthorized change in accounting method. This could render a dealership vulnerable to the IRS either requiring that dealership to continue using the LIFO method or requiring the dealership to change to another (specific identification) method. Or, things could be worse.

It will be interesting to see how all of this works out.

LACK OF OVERALL AUDIT PROTECTION FOR CHANGES IN LIFO SUBMETHODS

Often, taxpayers are willing to voluntarily change an accounting method because, in return for making the change, the IRS agrees that it will not make audit adjustments to prior years related to the method that was previously used.

If a taxpayer complies with all of the requirements of Revenue Procedure 2008-52, the IRS will not require the taxpayer to change its method of accounting for the same item for a taxable year ***prior*** to the year of change.

Unfortunately, there is one major qualification that is upsetting to LIFO-related changes in method. Section 7.02(2) states that "The Service may change a taxpayer's method of accounting for prior taxable years if the taxpayer is changing a sub-method of accounting within the method." This is followed by ... ***"For example, an examining agent may propose to terminate the taxpayer's use of the LIFO inventory method during a <u>prior</u> taxable year even though the taxpayer changes its method of valuing increments in the <u>current</u> year."*** [Emphasis added]

This is not a new limitation ... it is carried over from Rev. Proc. 2002-9. It seems to indicate that even though a taxpayer may change one of its submethods under its broader LIFO method, the IRS still can go back to prior years and make adjustments (or possibly take the taxpayer off of LIFO) if it finds a financial statement conformity violation, a cost violation or some other critical omission such as the failure to file Form 970 in the tax return for the initial year of election.

The IRS may also change a taxpayer's method of accounting for prior taxable years if the taxpayer fails to implement the change or the taxpayer implements the change but does not comply with all the applicable provisions of the Revenue Procedure.

see **REVENUE PROCEDURE 2008-52**, page 24

(Continued from page 23)

INELIGIBILITY TO USE THE AUTOMATIC CHANGE PROCEDURES

There are several circumstances in which a taxpayer may be ineligible to file Form 3115 for an automatic change in accounting method under Revenue Procedure 2008-52. A taxpayer must fall within the "scope" of Revenue Procedure 2008-52 in order to file under its more relaxed provisions. If a "scope limitation" applies, the taxpayer's Form 3115 for a change in accounting method must be filed before yearend under Revenue Procedure 97-27 (and not under 2008-52).

Revenue Procedure 2008-52 has now refined two scope limitations that might prevent a taxpayer from being able to use the automatic change provisions where that taxpayer has made certain changes in the previous five years. This 5-year period includes the year of change, so it is really the year of change plus the four immediately preceding years that need to be examined to see if the taxpayer is eligible to make automatic changes in accounting methods under this Revenue Procedure.

The ***first*** prior 5-year change scope limitation focuses on a prior change in ***overall method.*** This is found in Section 4.02(6), and it is less likely to be problematic.

The ***second*** prior 5-year change scope limitation focuses on a prior change in an ***item.*** This limitation is found in Section 4.02(7). For taxpayers and dealerships on LIFO that intend to make automatic LIFO changes, this ***item*** scope limitation may be more frequently encountered.

In general, if a taxpayer has changed its method of accounting for a ***specific item*** (or applied for consent to change a method of accounting for a specific item regardless of whether it implemented that change) during any of the five taxable years ending with the year of change, the taxpayer may not obtain automatic consent to change its method of accounting for that same item.

There are exceptions to the above. A taxpayer is not prohibited from changing a Last-In, First-Out (LIFO) inventory ***sub-method*** (for example, the method of determining current-year cost or the method of computing a dollar-value pool index) within five years of adopting or changing to the LIFO inventory method or ***another*** LIFO inventory ***sub-method.*** The Revenue Procedure includes two examples to further convey the meaning.

In discussing the prior 5-year item change scope limitation, the Revenue Procedure adds the following statement for emphasis: ***"However, a taxpayer that changes a LIFO inventory sub-method within five years of adopting or changing to the LIFO inventory method does not receive audit protection under Section 7 of this Revenue Procedure."*** This limitation on audit protection for prior years where other issues are involved has been discussed previously in this article.

CHANGE IN ACCOUNTING METHOD TO ELIMINATE CERTAIN ADVERTISING COSTS FROM INVENTORY COSTS

Prior issues of the *LIFO Lookout* have given extensive coverage to the benefits and procedures to be followed by dealerships that change their methods of accounting to eliminate (1) trade discounts and/or (2) local and regional advertising costs from their inventory costs. These are two separate changes in method, although often they are both made at the same time. Both changes are beneficial regardless of whether or not the dealership is on LIFO.

Previously, a change to eliminate trade discounts was permitted to be made as an automatic change. In contrast, a change in accounting method to eliminate advertising costs and credits was ***not*** permitted to be made as an automatic change. Revenue Procedure 2008-52 now permits the latter change (i.e., the change for advertising costs) to be made as an automatic change.

A summary of this change appears on the facing page.

CONCLUSION

Revenue Procedure 2008-52 needs to be carefully studied when voluntary changes in accounting methods are being contemplated. This material has been adapted from a more complete analysis of Rev. Proc. 2008-52 which appears in the year-end 2008 issue of the *Dealer Tax Watch.*

Invoiced Advertising Association Costs for New Vehicle Retail Dealerships * Automatic Change in Accounting Method Procedures for Certain Ad Costs

Designated automatic accounting method change number ... 139.

This change applies to automobile dealerships that want to discontinue capitalizing certain advertising costs as acquisition costs under Reg. Sec. 1.471-3(b).

The change applies to advertising costs that meet the following criteria:

- the dealership must pay this advertising fee when acquiring vehicles from the manufacturer,
- the advertising costs are separately coded and included in the manufacturer's invoice cost of the new vehicle,
- the advertising cost is a flat fee per vehicle or a fixed percentage of the invoice price, and
- the fees collected by the manufacturer are paid to local advertising associations that promote and advertise the manufacturer's products in the dealership's market area.

It had long been the position of the IRS that advertising costs (credits and fees) paid to ***national*** advertising associations must be distinguished from fees paid to local advertising associations, with the latter (local advertising) eligible for a change in accounting method and the former (national advertising), ineligible for such change.

Rev. Proc. 2008-52 does not change this position. Accordingly, advertising fees paid to national advertising associations do not qualify for this change in accounting method.

Under the new method for handling advertising costs, the dealership will exclude advertising costs that meet the above criteria from the cost of new vehicles. These costs will be deducted under Section 162 as the advertising services are provided to the dealership. More details on the timing aspect of when the advertising services are provided are found in Reg. Sec. 1.461-4(d)(2)(i).

Section 481(a) adjustment is required. In the discussion of this change, there is no mention of making the change using a cut-off basis approach. Therefore, a Section 481(a) adjustment is required.

For further information on this change, selected articles include ...

- *Elimination of Trade Discounts (Floorplan assistance Payments) and Advertising Fees and Expenses from Inventory Cost*
  - *Part I ... LIFO Lookout, September 2003*
  - *Part II ... LIFO Lookout, September 2004*
- *Trade Discounts & Advertising Expense CAMs may be the Answer for Dealers Looking for Big, One-Time Tax Write-offs ... LIFO Lookout, December 2002 & Dealer Tax Watch, December 2002*

* Source: Revenue Procedure 2008-52, Appendix Section 21.13

10 Automatic Changes (Section 472)

Source & Notes

Section 22 of the Appendix to Revenue Procedure 2008-52.
Sections 22.01 through 22.07 were included in Rev. Proc. 2002-9.
Sections 22.08 through 22.10 are added as automatic changes since issuance of Rev. Proc. 2002-9.

Section 22.01 Change from the LIFO Inventory Method (i.e., Termination of LIFO Election)

Designated automatic accounting method change number ... 56.

This change applies to a taxpayer that wants to (1) change ***from*** the LIFO inventory method for all its LIFO inventory or for one or more dollar-value pools and (2) change ***to*** a permitted method or methods as discussed below.

Determining the permitted method to be used. A taxpayer may change to one or more non-LIFO inventory methods for the LIFO inventories that are the subject of this accounting method change, but only if the selected non-LIFO method is a permitted method for the inventory goods to which it will be applied.

For example, a heavy equipment dealer may change to the specific identification method for new heavy equipment inventories and the replacement cost method, as described in Rev. Proc. 2006-14, 2006-1 C.B. 350, for heavy equipment parts inventories.

Permitted method defined. An inventory method (identification or valuation, or both) is a permitted method if it is specifically permitted by the Code, the regulations, a decision by the United States Supreme Court, a revenue ruling, a Revenue Procedure, or other guidance published in the Internal Revenue Bulletin (I.R.B.) for the inventory goods and if the taxpayer is neither prohibited from using that method nor required to use a different inventory method for those inventory goods.

Determining permitted method. Whether an inventory method is a permitted method is determined without regard to the types and amounts of costs capitalized under the taxpayer's method of computing inventory cost. See Section 263A and the regulations thereunder, which govern the types and amounts of costs required to be included in inventory cost for taxpayers subject to those provisions.

Certain scope limitation inapplicable. The scope limitation in Section 4.02(7) of this Revenue Procedure does not apply in the first taxable year that the taxpayer does not or will not comply with the requirements of Section 472(e)(2) because the taxpayer has applied or will apply International Financial Reporting Standards in its financial statements or because the taxpayer has been acquired by an entity that has not or will not use the LIFO method in its financial statements.

Additional requirements to identify new methods. The taxpayer must complete the following statements and attach them to its Form 3115. If the taxpayer will use different methods for different inventory goods to which the change applies, the taxpayer must complete the statements ***for each of those different types of inventory goods.***

- "The new method of ***identifying*** [*Insert description of inventory goods*] is the [*Insert method, as appropriate; that is, specific identification; FIFO; retail; etc.*] method," and
- "The new method of ***valuing*** [*Insert description of inventory goods*] is [*Insert method, as appropriate; that is, cost; LCM; etc.*]."

Other special rules included in the Appendix for this change are on the following page.

For further information on LIFO election terminations, selected articles include ...

- *This automatic change to terminate LIFO is more fully discussed in the accompanying overview article.*
- *Would You Believe? ... Dealerships that Terminated Their LIFO Elections ... May Actually Still be on LIFO ... LIFO Lookout Spring 2008 (pg. 3)*
- *Sample Form 3115 Filing for Dealerships Terminating Alternative LIFO Election ... LIFO Lookout March 2006*
- *Dealer LIFO Election Termination Problems ... "Permitted Methods" for Valuing Inventories Formerly on LIFO ... LIFO Lookout September 2005*

Section 22.01 Change from the LIFO Inventory Method (i.e., Termination of LIFO Election (continued)

Limitation on reelection of LIFO method after prior termination. The taxpayer may not re-elect the LIFO inventory method for a period of at least five taxable years beginning with the year of change unless, based on a showing of unusual and compelling circumstances, consent is specifically granted by the Commissioner to change the method of accounting at an earlier time.

A taxpayer that wants to re-elect the LIFO inventory method within a period of five taxable years (beginning with the year of change) must file a Form 3115 in accordance with Rev. Proc. 97-27 (or any successor).

A taxpayer that wants to re-elect the LIFO inventory method after a period of five taxable years (beginning with the year of change) is not required to file a Form 3115 in accordance with Rev. Proc. 97-27, but must file a Form 970, *Application to Use LIFO Inventory Method*, in accordance with Reg. Sec. 1.472-3.

Special rule ... S Corporation election effective for year of LIFO discontinuance. If a C corporation elects to be treated as an S corporation for the taxable year in which it discontinues use of the LIFO inventory method, Section 1363(d) requires an increase in the taxpayer's gross income for the LIFO recapture amount for the taxable year preceding the year of change (the taxpayer's last taxable year as a C corporation) and a corresponding adjustment to the basis of the taxpayer's inventory as of the end of the taxable year preceding the year of change. Any increase in income tax as a result of the inclusion of the LIFO recapture amount is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation. Any corresponding basis adjustment is taken into account in computing the Section 481(a) adjustment (if any) that results upon the discontinuance of the LIFO inventory method by the corporation.

Special rule ... S Corporation election effective for a year after LIFO discontinuance. If a C corporation elects to be treated as an S corporation for a taxable year after the taxable year in which it discontinued use of the LIFO inventory method, the remaining balance of any positive Section 481(a) adjustment must be included in its gross income in its last taxable year as a C corporation. If this inclusion results in an increase in tax for its last taxable year as a C corporation, this increase in tax is payable in four equal installments, beginning with the taxpayer's last taxable year as a C corporation unless the taxpayer is required to take the remaining balance of the Section 481(a) adjustment into account in the last taxable year as a C corporation under another acceleration provision in Section 5.04(3)(c) of this Revenue Procedure.

Section 22.02 Determining Current-Year Cost Under the LIFO Inventory Method

Designated automatic accounting method change number ... 57.

This change applies to a taxpayer using the LIFO inventory method that wants to change its method of determining current-year cost to:

- The actual cost of the goods most recently purchased or produced (most-recent-acquisitions method),
- The actual cost of the goods purchased or produced during the taxable year in the order of acquisition (earliest-acquisitions method),
- The average unit cost equal to the aggregate actual cost of all the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced. (See Reg. Sec. 1.472-8(e)(2)(ii)),
- The specific identification method; or
- A rolling-average method if the taxpayer uses that rolling-average method in accordance with Rev. Proc. 2008-43.

Inapplicability. This change does not apply to a taxpayer using the lower of cost or market method to determine current-year cost. A taxpayer using the lower of cost or market method that valued inventory below cost may not change to a proper cost valuation under this Section 22.02 of the Appendix.

Manner of making change. This change is made using a cut-off basis and applies only to the computations of current-year cost after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Concurrent change to a rolling-average method. A taxpayer that wants to make both a change to a rolling-average method of determining current-year cost for its LIFO inventory and a change to a rolling-average method of accounting for non-LIFO inventories should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *Why Taxpayers Prefer to Use Dual Indexes for Valuing LIFO Inventories ... LIFO Lookout Sept. 2002*
- *Comparing LIFO Reserve Results ... Dual Link-Chain Indexes for Valuing Increments ... LIFO Lookout Sept. 2002*
- *Dollar Value LIFO Method ... the Technicalities ... LIFO Lookout Sept. 2002*
- *Earliest Acquisitions Method for Valuing Increments ... Final IRS Issues Paper ... LIFO Lookout June 1996*

Section 22.03 Alternative LIFO Inventory Method for Retail Automobile Dealers

Designated automatic accounting method change number ... 58.

This change basically applies to automobile dealers that want to change to the "Alternative LIFO Method" described in Section 4 of Rev. Proc. 97-36 (as modified by Rev. Proc. 2008-23, election to change to a single, combined LIFO pool), for their LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which also are referred to as class 1, 2, or 3 trucks.

Manner of making change. This change is made using a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

IPIC Issues ... This change does not apply to an automobile dealer that uses the inventory price index computation (IPIC) method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks.

IPIC Issues ... Concurrent change from IPIC method. An automobile dealer using the IPIC method that also has parts and accessories, used automobiles, or used light-duty trucks (other goods) inventory may incorporate a change, using a cut-off basis, from IPIC to another acceptable LIFO method for those other goods into this change. When changing from IPIC to a dollar-value LIFO method for its other goods, the automobile dealer must establish separate inventory pools for new automobiles and new light-duty trucks, unless the automobile dealer also concurrently changes to the Vehicle-Pool Method (see Section 22.08 of this Appendix). The automobile dealer also must establish a separate inventory pool for the parts and accessories.

Additional requirements to be complied with. An automobile dealer also must comply with the conditions in Section 5.03 of Rev. Proc. 97-36. One of these conditions is that the automobile dealer must effect the change using the cut-off method. Under the cut-off method, the value of the automobile dealer's new automobile and new light-duty truck inventory (and in the case of an automobile dealer changing from the IPIC method, the parts and accessories, used automobile, and used truck inventory) at the beginning of the year of change must be the same as the value of such inventory at the end of the preceding taxable year plus market value restorations, if any are required,.

In addition, if the auto dealer is changing from the IPIC method, the dealer also must attach to the application Form 3115 a schedule setting forth the classes of goods for which the automobile dealer has elected to use the LIFO method and the accounting method changes being made for each class of goods.

Concurrent change to the Vehicle-Pool Method. A taxpayer that wants to make both a change to the Alternative LIFO Method under this section and a change to the Vehicle-Pool Method under Rev. Proc. 2008-23, (see Section 22.08 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *Revenue Procedure 92-79: Overview, Advantages, Disadvantages, Special Rules & Definitions, Other Requirements and Consent Conditions ... LIFO Lookout Sept. 1992*
- *Alternative LIFO Method for New Vehicles - A Good Summary ... LIFO Lookout March 1995*
- *Alternative LIFO Method for Auto Dealers: Rev. Proc. 97-36 Restates Rev. Proc. 92-79 ... LIFO Lookout Sept. 1997*
- *Dealership Considerations in Evaluating the Alternative LIFO Method vs. the IPIC/BLS Method ... LIFO Lookout Dec. 2006*
- *Sample Proforma Filing Packages for Electing (Form 970), Terminating or Changing to the Alternative LIFO Method (Forms 3115) ... LIFO Lookout March 2006*

Section 22.04 Used Vehicle Alternative LIFO Method

Designated automatic accounting method change number ... 59.

This change basically applies to used vehicle dealers that want to change to the "Used Vehicle Alternative LIFO Method" as described in Rev. Proc. 2001-23, as modified by Announcement 2004-16, and Rev. Proc. 2008-23.

A used vehicle dealer making this change must comply with the additional conditions set forth in Section 5.04 of Rev. Proc. 2001-23.

Manner of making change. This change is made on a cut-off basis, which requires that the value of the taxpayer's used automobile and used light-duty truck inventory at the beginning of the year of change must be the same as the value of that inventory at the end of the preceding taxable year, plus cost restorations, if any, required by Section 5.04(5) of Rev. Proc. 2001-23. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

If there has been a previous bargain purchase. If the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer must, as part of this change, first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991),and compute a Section 481(a) adjustment for that part of the change. See Announcement 91-173,1997-47 I.R.B. 29.

Upon examination, if a taxpayer has properly changed its method under this section except for complying with the above requirement, an examining agent may not deny the taxpayer the change. However, the taxpayer does not receive audit protection under Section 7 of this Revenue Procedure with respect to the improper method of accounting for the bargain purchase. Accordingly, the examining agent may make any necessary adjustments in any open year to effect compliance with *Hamilton Industries, Inc.*

New base year. In effecting a change to the Used Vehicle Alternative LIFO Method under this Revenue Procedure, any LIFO inventory cost increments previously determined and the value of those increments must be retained. Instead of using the earliest taxable year for which the taxpayer adopted LIFO as the base year, the year of change must be used as the new base year in determining the value of all existing LIFO cost increments for the year of change and later taxable years. (The year of change becomes a new base year, with the cumulative index at the beginning of the year of change reset to 1.0000).

The base-year cost of all LIFO cost increments at the beginning of the year of change must be restated in terms of new base-year costs, using the year of change as the new base year, and the indexes for previously determined inventory increments must be recomputed accordingly. The new base-year cost of a pool is equal to the total current-year cost of all the vehicles in the pool.

Taxpayers are reminded to complete all applicable parts of the Form 3115, including Part I of Schedule C.

Concurrent change to the Vehicle-Pool Method. A taxpayer that wants to make both a change to the Used Vehicle Alternative LIFO Method under this section of the Appendix and a change to the Vehicle-Pool Method under Rev. Proc. 2008-23 (see Section 22.08 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

IPIC Issues ... Concurrent change from IPIC method. A used vehicle dealer using the IPIC method that also has parts and accessories, new automobiles, or new light-duty trucks (other goods) inventory may incorporate a change, using a cut-off basis, from IPIC to another acceptable LIFO method for those other goods into this change. When changing from IPIC to a dollar-value LIFO method for its other goods, the used vehicle dealer must establish separate inventory pools for new automobiles and new light-duty trucks, unless the used vehicle dealer also concurrently changes to the Vehicle-Pool Method (see Section 22.08 of this Appendix). The used vehicle dealer must also establish a separate inventory pool for the parts and accessories.

For further information on this change, selected articles include ...

- *Revenue Procedure 2001-23 Highlights & Sample Letter to Dealers ... LIFO Lookout March 2001*
- *Evaluating the "New and Improved" LIFO Method for Used Vehicles ... LIFO Lookout June 2001*
- *Form 3115 Proforma Filing Package for Changing to the Used Vehicle Alternative LIFO Method ... LIFO Lookout June 2001*
- *Confusion Over Use of Different Official Guides ... LIFO Lookout Sept. 2001*
- *Good News for Dealers Who've Stayed With Their Used Vehicle LIFO Elections ... LIFO Lookout June 2004*

Section 22.05 Determining the Cost of Used Vehicles Purchased or Taken as a Trade-In

Designated automatic accounting method change number ... 60.

This change applies to a taxpayer using the LIFO inventory method that wants to determine the cost of used vehicles acquired by trade-in using the average wholesale price listed by an official used vehicle guide on the date of the trade-in. (See Rev. Rul. 67-107.) In this case, the official used vehicle guide selected must be consistently used unless the taxpayer receives permission to use a different guide.

This change also applies to a taxpayer using the LIFO inventory method that wants to (1) use a different official used vehicle guide for determining the cost of used vehicles acquired by trade-in, (2) determine the cost of used vehicles purchased for cash using the actual purchase price of the vehicle or (3) reconstruct the beginning-of-the-year cost of used vehicles purchased for cash using values computed by national auto auction companies based on vehicles purchased for cash. The national auto auction company selected must be consistently used.

This change does not apply to a taxpayer that adopted or changed to the Used Vehicle Alternative LIFO Method (see Section 22.04 of the Appendix).

Manner of making change. This change is made on a cut-off basis and applies only to used vehicles acquired on or after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Section 22.06 Change to the Inventory Price Index Computation (IPIC) Method

Designated automatic accounting method change number ... 61

This change applies to a taxpayer that wants to change from a non-IPIC LIFO inventory method to the IPIC method in accordance with all relevant provisions of Reg. Sec. 1.472-8(e)(3).

This change also applies to a taxpayer that wants to change from the IPIC method as described in T.D. 7814 (the old IPIC method) to the IPIC method as described in T.D. 8976 (the new IPIC method). This change includes the following required changes (if applicable):

- From using 80% of the inventory price index (IPI) to using 100% of the IPI to determine the base-year cost and dollar-value of a LIFO pool(s),
- From using a weighted arithmetic mean to using a weighted harmonic mean to compute an IPI for dollar-value pool(s) and
- From using a components-of-cost method to define inventory items to using a total-product-cost method to define inventory items.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

Previous bargain purchases of inventory. If the taxpayer has previously improperly accounted for a bulk bargain purchase, special rules require the taxpayer to first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991), and to compute a Section 481(a) adjustment for that part of the change.

Concurrent automatic changes. A taxpayer that wants to make this change and to also change its method of determining current-year cost (under Section 22.02 of this Appendix) for the same year of change may file a single Form 3115 for both changes. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

A taxpayer that wants to make this change and to also change its method of pooling to IPIC-method pools described in Reg. Sec. 1.472-8(b)(4) or Reg. Sec. 1.472-8(c)(2) for the same year of change may file a single Form 3115. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

A taxpayer that wants to make this change and to also change its method of pooling (under Section 22.10 of this Appendix) for the same year of change may file a single Form 3115. The taxpayer should enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, selected articles include ...

- *A Look at the IPIC Method ... with Special Emphasis on its Use by Auto Dealers ... LIFO Lookout June 2007*
- *A Summary of the IPIC Method ... What it is and How it Works ... LIFO Lookout June 2007*
- *A Case Study Showing the Disadvantage of the IPIC Method for Auto Dealerships ... LIFO Lookout Sept. 2007*
- *Highlights of the Final IPIC Regulations ... LIFO Lookout December 2002*

Section 22.07 Changes Within the Inventory Price Index Computation (IPIC) Method

Designated automatic accounting method change number ... 62

This change applies to a taxpayer using the new IPIC method (i.e., described in Reg. Sec. 1.472-8(e)(3) as revised by T.D. 8976) that wants to make one or more of the changes below. Citations to specific IPIC dollar-value LIFO regulations are included in the Appendix discussion of these changes.

- Change from the double-extension IPIC method to the link-chain IPIC method, or vice versa,
- Change to or from the 10 percent method,
- Change to IPIC-method pools described in Reg. Sec. 1.472-8(b)(4) or Reg. Sec. 1.472-8(c)(2), including a change to begin or discontinue applying one or both of the 5 percent pooling rules,
- Change to combine or separate pools as a result of the application of a 5 percent pooling rule,
- Change its selection of BLS table from Table 3 (Consumer Price Index for All Urban Consumers ...) of the monthly CPI Detailed Report to Table 6 (Producer price indexes percent changes for commodity groupings and individual items, not seasonally adjusted) of the monthly PPI Detailed Report, or vice versa,
- Change the assignment of one or more inventory items to BLS categories under either Table 3 (Consumer Price Index for All Urban Consumers (CPI-U): U.S. City average, detailed expenditure categories) of the monthly CPI Detailed Report or Table 6 (Producer price indexes and percent changes for commodity groupings and individual items, not seasonally adjusted) of the monthly PPI Detailed Report and
- Change the representative month when necessitated because of a change in taxable year or a change in method of determining current-year cost made pursuant to Section 22.02 of this Appendix.

Manner of making change. These changes are made on a cut-off basis and apply only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required. A taxpayer that makes some of these changes must establish a new base year in the year of change.

For further information on this change, see selected articles listing for Section 22.06

Section 22.08 Changes to the Vehicle-Pool Method

Designated automatic accounting method change number ... 112.

This change applies to a retail dealer or wholesale distributor ("reseller") of cars and light-duty trucks that wants to change to the "Vehicle-Pool Method" as described in Rev. Proc. 2008-23.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

A reseller that changes its method of pooling under Rev. Proc. 2008-23 and this section of the Appendix must comply with Reg. Sec. 1.472-8(g). Instead of using the earliest taxable year for which the reseller adopted the LIFO method for any items in a pool, the reseller must use the year of change as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years (i.e., the cumulative index at the beginning of the year of change will be 1.00). The reseller must restate the base-year cost of all layers of increment in a pool at the beginning of the year of change in terms of new base-year cost. For an example of establishing a new base year, see Reg. Sec. 1.472-8(e)(3)(iv)(B)(*1*)(*ii*).

The scope limitation in Section 4.02(7) of this Revenue Procedure does not apply for the reseller's first taxable year ending on or after December 31, 2007.

Concurrent change to the Alternative LIFO Method or the Used Vehicle Alternative LIFO Method. A reseller that wants to make both a change to the Vehicle-Pool Method under this section of the Appendix and a change to the Alternative LIFO Method under Rev. Proc. 97-36 (see Section 22.03 of this Appendix) or the Used Vehicle Alternative LIFO Method under Rev. Proc. 2001-23 (see Section 22.04 of this Appendix) should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

For further information on this change, see LIFO Lookout Mid-Year (Spring) 2008. This entire issue of the LIFO Lookout (Vol. 18, No. 1) is devoted to an analysis of Rev. Proc. 2008-23: The Vehicle-Pool (Single, Combined) LIFO Method for Auto Dealerships & Alternative Rules for Classifying "Crossover Vehicles."

Section 22.09 Changes Within the Used Vehicle Alternative LIFO Method

Designated automatic accounting method change number ... 140.

This change applies to a taxpayer using the "Used Vehicle Alternative LIFO Method" as described in Rev. Proc. 2001-23 that wants to change the particular "official used vehicle guide" utilized by the taxpayer in connection with the Used Vehicle Alternative LIFO Method.

This change also applies to any change in the precise manner of its utilization (e.g., a change in the specific guide category that a taxpayer uses to represent vehicles of average condition for purposes of Section 4.02(5)(a) of Rev. Proc. 2001-23).

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required. A taxpayer that changes its method pursuant to this section of the Appendix must establish a new base year in the year of change.

For further information on this change, see selected articles listing for Section 22.04

Section 22.10 Changes to Dollar-Value Pools of Manufacturers

Designated automatic accounting method change number ... 141.

This change applies to a manufacturer that:

- Purchases goods for resale (resale goods) and, thus, must reassign resale goods from the pool(s) it maintains for the goods it manufactures to one or more resale pools;
- Wants to change from using multiple pools described in Reg. Sec. 1.472-8(b)(3) to using natural business unit (NBU) pools described in Reg. Sec. 1.472-8(b)(1), or vice versa; and
- Wants to reassign items in NBU pools described in Reg. Sec. 1.472-8(b)(1) into the same number or a greater number of NBU pools.

Manner of making change. This change is made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required.

A taxpayer that changes its method of pooling pursuant to this section of the Appendix must combine or separate pools as required by Reg. Sec. 1.472-8(g).

IRS CHIEF COUNSEL MEMO GUIDANCE ON COMBINING LIFO POOLS

In March of 2008, the IRS announced in Revenue Procedure 2008-23 that it would permit automobile dealerships to use a single, combined pool for their new vehicle LIFO calculations. This simplified method of pooling, referred to as the Vehicle-Pool Method, was available for dealerships' calculations for 2007. Some dealerships made the change for 2007; many others did not.

As year-end 2008 approaches, dealerships considering whether to make the change should keep in mind that one of the requirements is that their existing new vehicle LIFO pools must be combined as of the beginning of the year of change.

For dealerships using the Alternative LIFO Method (under Revenue Procedure 97-36, formerly 92-79), this would mean that in making the change for calendar year 2008 they would have to combine their two separate pools for (1) all new automobiles (including demonstrators) and (2) all new light-duty trucks (including demonstrators) into a single pool as of December 31, 2007/January 1, 2008.

This change may also be made for used vehicle inventories that are on LIFO using two pools under the Alternative LIFO Method for Used Vehicles in Revenue Procedure 2001-23.

In May, 2008, the IRS issued "guidance" on how dealerships implementing the change to the Vehicle-Pool Method (for either new or used vehicles on LIFO) under Rev. Proc. 2008-23 should combine their existing LIFO pools. Chief Counsel Office Memo (CCM) No. 200825044 (dated May 7, 2008; released June 20, 2008) provides this guidance which contains the qualifying disclaimer ... "This advice may not be used or cited as precedent."

CCM 200825044 provides two examples showing how to establish the year of change (which is 2008 in both examples) as the new base year for making the change to the single, combined pool method. These examples follow the format used for examples found in the LIFO Regulations.

The first example shows the combination of the two new vehicle pools in a situation where both pools have the same base year. This example is pretty straight-forward.

The second example shows the combination of the two new vehicle pools in a situation where both pools did not start on LIFO in the same year. In other words, these LIFO pools do not have the same base year. This is a situation which we have described in previous articles as one involving "disappearing base dollars."

see **IRS CHIEF COUNSEL GUIDANCE,** page 34

IRS Guidance on How Dealerships Should Combine LIFO Pools in Changing to the Vehicle-Pool (Single Combined) LIFO Pool Method

IRS Chief Counsel Guidance

This article analyzes CCM 200825044 and the two examples and points out several other aspects related to the combination of pools. We believe there are several problems with the computational approach set forth in the CCM and appreciate the IRS' disclaimer already mentioned above.

In analyzing both IRS examples, for reference purposes, we have added related computations of the LIFO reserve and the contribution to the LIFO reserve made by each year's layer of inventory. This sharpens our discussion of how the procedures followed can shift the LIFO reserve payback potential among the years in the LIFO layer history for a pool.

CCM'S DISCUSSION OF THE REQUIREMENTS

If a taxpayer changes from one dollar-value LIFO method of pooling to another method of pooling, the ending LIFO inventory for the taxable year preceding the year of change is required to be restated under the new method of pooling. As part of the process, the taxpayer must combine the LIFO value of its inventory for the base year and each yearly layer of increment in order to conform to the new pool (Reg. Sec. 1.472-8(g)(2)(i)).

The combination of the LIFO value of the taxpayer's inventory for the base year and each yearly layer of increment is be made in accordance with the appropriate method in Reg. Sec. 1.472-8(g)(2), unless the use of a different method is approved by the Commissioner.

The rules that a taxpayer must apply when combining pools with the ***same*** base year are found in Reg. Sec. 1.472-8(g)(2)(iii). The rules that a taxpayer must apply when combining pools with ***different*** base years are found in Reg. Sec. 1.472-8(g)(2)(iv).

(Continued from page 33)

In addition, examples showing the application of these rules to taxpayers that use the "double-extension" LIFO method are found in these Regulations.

Rev. Proc. 2008-23 (Section 4.01(2)) provides that a taxpayer changing to the Vehicle-Pool Method must make the change on a cut-off basis and must comply with Reg. Sec. 1.472-8(g). Therefore, no Section 481(a) adjustment is required.

Instead of using the earliest taxable year for which the dealership adopted the LIFO method for any items in a pool, the dealership must use the year of change (i.e., 2008 in both examples) as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years. In other words, the cumulative index at the beginning of the year of change will be 1.000. The dealership must also restate the base-year cost of all layers of increment in a pool at the beginning of the year of change in terms of new base-year cost. An example of establishing a new base year is found at Reg. Sec. 1.472-8(e)(3)(iv)(B)(1)(ii).

Combining LIFO Pools with Same Base Year. When combining two or more pools that have the ***same base year***, a taxpayer using the double-extension method sums (i.e., adds) the base-year cost and the corresponding LIFO value of each layer of all pools to obtain the total base-year cost and total LIFO value, respectively, for each of the layers in the newly combined pool.

Combining LIFO Pools with Different Base Years. When combining pools having ***different base years***, the taxpayer treats the base year of the oldest pool as the base year of the newly combined pool and treats all subsequent base years as increments. In →

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Rev. Proc. 2008-23 ... Combining and Rebasing Inventories and Indexes. LIFO Lookout, Mid-Year (Spring) 2008

How to Establish a New Base Year - A Detailed Analysis of the Example at Reg. Sec. 1.472-8(e)(3)(iv)(B)(1). LIFO Lookout, Mid-Year (Spring) 2008

addition, the taxpayer restates the base-year cost of all increments arising from each pool other than that oldest pool ("newer pool") in terms of the base-year cost of the base layer of that oldest pool. To restate a newer pool's base-year cost, the regulations require that a taxpayer using the double-extension LIFO method reconstruct or establish a new base-year cost for each item in the newer pool (Reg. Secs. 1.472-8(e)(2) and (g)(2)(iv)).

In further analysis, the CCM states that although Reg. Sec. 1.472-8(g)(2) does not describe how a taxpayer using a link-chain LIFO method combines pools, Chief Counsel's Office believes that analogous rules generally apply. It says, "Most of the principles, concepts, and operating rules that apply to the double-extension method also apply to the link-chain method. Furthermore, the regulations that sanction the double-extension method are cited frequently to justify various methods and approaches used with the link-chain method.

"However, ***when a taxpayer uses the link-chain LIFO method, the rules*** prescribed in Reg. Sec. 1.472-8(g)(2)(iv) (concerning how pools with different base years are to be combined) ***do not work***. This is because under the link-chain method, the taxpayer determines the base-year cost of a pool using an annually determined cumulative (deflator) index rather than summing the base-year costs of each item in the pool.

"Thus, ***these rules must be adapted to the link-chain method***. To restate a newer pool's base-year cost, a taxpayer using the link-chain method divides that pool's base-year cost by the oldest pool's cumulative index, computed as of the newer pool's base year. For example, if the oldest pool has a base year of 1997 and the newer pool has a base year of 2002, the taxpayer uses the oldest pool's 2002 cumulative index as the divisor. ***This restatement procedure***, like the procedure for the double-extension method, ***generally treats the taxpayer as having included the items in the newer pool in the oldest pool beginning in the newer pool's base year***." [Emphasis added.]

CCM CONCLUSIONS

A dealership must comply with Reg. Sec. 1.472-8(g) when combining its LIFO pools to change to the Vehicle-Pool Method under Rev. Proc. 2008-23.

The two examples in the CCM show how a dealership that uses a link-chain method complies with Reg. Sec. 1.4728(g). The examples also illustrate the establishment of the year of change as the new base year for the newly combined pool.

"Before and After Standard." The CCM emphasizes that in both examples, "***the base-year cost of each LIFO layer is in the same proportion to the total base-year cost both before and after the establishment of the new base year***." In addition, the CCM states, "Though there may be other approaches to implementing the change to the Vehicle-Pool method, we have doubts about any approach that allocates the new base-year cost among LIFO layers in different proportions." [Emphasis added]

Audit Protection. The CCM guidance concludes that if a dealership combines its new vehicle LIFO pools into a single vehicle LIFO pool as shown in *Examples 1* or *2*, the IRS should not challenge the implementation of the change to the Vehicle-Pooling Method during an examination of the dealership's Federal income tax return.

THE IRS COMPUTATIONAL APPROACH IS PROBLEMATIC FOR MANY DEALERSHIPS

The result obtained by following the approach in the Chief Counsel Memo examples shifts the amount of the LIFO reserve allocable to a specific year's LIFO layer to different years' LIFO layers.

As discussed further below, and as illustrated in several accompanying schedules, an approach that allocates the base dollars essentially in the ratio of the contribution of a year's layer to the LIFO reserve associated with that layer can create significant differences which may significantly affect the amount of LIFO recapture if the combined pool experiences a decrement in the year of change or thereafter.

The CCM examples simply present and deal with the computational aspect of the combination of the base dollars of investment in the LIFO pools. These examples do not deal with "the other side of the coin," which is the amount of the LIFO reserve that is associated with each layer.

The following discussion is dependent on one's ability to focus on the amount of the LIFO reserve that is allocable to each LIFO layer (year). This is of paramount importance because when a decrement is experienced in the new pool, the amount of decrement that is carried back to prior year's layers will affect the amount of LIFO reserve to be recaptured and taken into income by the taxpayer.

Before the pools are combined, it is possible to determine/compute the amount of the LIFO reserve for that pool that is allocable to each LIFO layer or year making up the LIFO valuation for the pool.

After the two LIFO pools are combined, the LIFO reserve for the single pool should equal the sum of the LIFO reserves of the two pools being combined. (We

see **IRS CHIEF COUNSEL GUIDANCE**, page 36

(Continued from page 35)

have shown these aspects in our analysis of the examples on the following pages.)

Furthermore, after the two LIFO pools are combined, the amount of the LIFO reserve for that pool that is allocable to each LIFO layer or year making up the LIFO valuation for the pool should be the same as the sum of the contributions to the LIFO reserve for each year before the two pools were combined.

This result is not produced if one follows the sequence of calculations in the format of the examples in the CCA Memo.

Depending on the circumstances, the result produced by the sequence of the computations (i.e., the combination of pools first, followed by rebasing of the resulting single pool to 1.000 thereafter) used in the CCA Memo examples may be to shift more of the contribution to the LIFO reserve from some of the earlier years on LIFO to the more recent years.

As previously stated, the consequence of this shifting of the composition of the contributions to the LIFO reserve to other years (in the combined pool) becomes important when a decrement is experienced in the new single/combined pool and that decrement is carried back against previously built up layers. A greater amount of LIFO reserve ... or a lesser amount of LIFO reserve ... will be recaptured or repaid from the more recent years than would have been repaid if the pools had not been combined.

Here's a simple example. Under the Alternative LIFO Method for New Vehicles (or for Used Vehicles), if an increment is experienced in the current year, there is no increase in the LIFO reserve in that year that is attributable to that increment in the inventory. This result (i.e., no addition to the LIFO reserve in the current year can be attributable the increment) is "guaranteed" by the requirement in the methodology that a dealership using the Alternative LIFO Method must value the increment attributable to the current year by multiplying that increment by the cumulative index as of the end of that year. (This result can be clearly demonstrated by any computation that follows the formats that have been included in the *LIFO Lookout* over the past eighteen years.)

We have analyzed both of the examples in the CCA Memo in terms of the contributions to the LIFO reserve before and after the combination of pools that is attributable to the inventory at the end of the year immediately preceding the new base year (i.e., attributable to inventory at Dec. 31, 2007).

From our analysis, it can readily be seen that some amount of the LIFO reserve (prior to the combination of the pools) has been reallocated to that immediately preceding year (2007) and thus will be subject to recapture to the extent that this newly combined layer for the year preceding the new base year is invaded by the carryback of a decrement in a subsequent year. This result would not happen if the pools were not combined because there would be no LIFO reserve attributable to the increment built up in 2007 under the Alternative LIFO Method.

Note that in CCM Example #1, the procedures followed result in the year 2007 layer resulting in a negative contribution to the LIFO reserve of $295. This means that a decrement carried back against this layer will result in an increase in the LIFO reserve in that amount. This seems like a non-sequitur, as well as a result that does not "clearly reflect income."

This overall shifting of portions of the LIFO reserve among layers can be accounted for by considering the sequence or order of the computational steps in the examples in the CCA Memo. The first step in both examples is to combine the pools. (Note, in Example #2, the combination cannot take place until after appropriate adjustment has been made for the difference in the starting dates/base years, and this is made by computing the amount of disappearing base dollars and adjusting the valuation factors for all layers accordingly.) The second step in the process is to rebase the combined pool to 1.0000 as of the beginning of the year. Simply stated, the sequence of operations in the CCM Memo is to combine the pools first and then to rebase only after the pools have been combined.

Taxpayers may want to take the position that the result of this sequence is to (incorrectly) shift the contribution made by each year's layer to the LIFO reserve (from the amount that it was before the combination of pools to a different amount after the combination of pools). This result, it may be argued, does not comply with the overriding "clear reflection of income" requirement or standard that is set forth in Sections 446, relating to accounting methods and Sections 471 and 472 relating to inventories. This "clear reflection of income" standard has been examined many times by the Tax Court in decisions interpreting the regulations under Section 472.

WHAT'S THE ALTERNATIVE?

This result (i.e., of shifting contributions to the LIFO reserve by certain years' layers) can be eliminated or significantly lessened if the sequence or order of the computational steps is reversed and the two pools being combined are each rebased to 1.0000 ***before*** they are combined.

In other words, the shifting of contributions to the LIFO reserve between layers will not occur if, after adjusting the base dollars for any difference in base →

years (i.e., by computing the amount of disappearing base dollars and adjusting the valuation factors for all layers accordingly), the first step after that is to independently rebase each pool to 1.0000 as of the beginning of the year of change (i.e., as of Dec. 31, 2007 / Jan. 1, 2008) and then the second step after that is to then combine the resulting rebased layers for both of the pools. This is readily shown in the "Alternative Computations" for Examples 1 and 2 on pages 44-46.

How Big of a Deal Is This? Interestingly, if one were to assume (1) inflation of 10% in the year of change (2008) and (2) a significant drop in inventory level to $19,000, the LIFO reserve at the end of 2008 under the CCM approach would be larger by $102 ($5,465 vs. $5,363). If one were to assume the same rate of inflation for 2008, but a more modest drop in inventory level to $23,000, then the LIFO reserve at the end of 2008 under the CCM approach would be greater by $228 ($6,478 vs. $6,250).

Based on the Chief Counsel's hypothetical examples, these differences are small. We've included a schedule on page 47 based on a larger dealership case study to help you appreciate the difference in the real world. Notice the large shift of the contribution to the LIFO reserve for the years immediately before the year of change, as well as in all of the other years. In any given dealership, these shifts can go either way, based on the facts and circumstances which include different base years, rates of inflation and years' layers represented in the pools being combined.

CONCLUSION

Detailed schedules are included on the following pages to clearly demonstrate the impact of the difference between the two approaches discussed.

In many instances, if the "non-precedential" approach suggested by the CCM for combining LIFO pools is followed, a dealership may find itself at a significant disadvantage for having made the decision to change to a single pool.

method") ***or*** on a regular basis but no less frequently than once per month (i.e., the "periodic-average method").

Second requirement. The second requirement is that the rolling-average method must satisfy either one of the two following conditions. The first of these conditions is that the ***entire inventory must turn at least four (4) times per year***.

For this purpose, the number of times that the entire inventory of a taxpayer's trade or business turns during a taxable year is equal to the cost of goods sold divided by average inventory (average of beginning and ending inventory). A taxpayer that uses a LIFO cost-flow assumption for tax purposes must calculate inventory turns using rolling-average cost and a FIFO cost-flow assumption.

If this inventory-turn condition is not (or cannot be) met, the second or alternative condition that can provide "safe harbor" protection is that the ***variance percentage does not exceed one percent***.

For this purpose, the variance percentage is determined by (1) subtracting the cost of the ending inventory [of the trade or business computed using the taxpayer's rolling-average method] from the cost of the ending inventory of the trade or business computed using either the FIFO method or the specific identification method to determine the variance; and then (2) dividing the variance by the aggregate rolling-average cost of the inventory. The Revenue Procedure does not give an example of this calculation.

Effective date & audit protection. This revenue procedure is effective for taxable years ending on or after December 31, 2007. The IRS has also agreed to significant audit protection for taxpayers making the change. In addition to agreeing not to raise the use of a rolling-average method of accounting as an issue in tax returns filed before June 25, 2008, the Service indicated that it will not further pursue the issue if it has already been raised and is under consideration in examination, Appeals or before the Tax Court.

PROCEDURES FOR CHANGING TO ROLLING-AVERAGE METHODS & COORDINATION WITH REVENUE PROCEDURE 2008-52

These rolling-average method changes set forth in Rev. Proc. 2008-43 have been coordinated with Revenue Procedure 2008-52 which was issued shortly thereafter.

Non-LIFO inventories. For a taxpayer not using the LIFO inventory method, the change to a rolling-average method of accounting must be made using a cut-off method ***unless*** the taxpayer's books and records contain sufficient information to compute a Section 481(a) adjustment. If the taxpayer's records contain sufficient information, then the taxpayer may choose to implement the change with a Section 481(a) adjustment. Section 21.14(3) of the Appendix to Revenue Procedure 2008-52 identifies the desig-

see **ROLLING AVERAGE METHOD**, page 64

CCM Example #1	Chief Counsel Memo 200825044 - Example #1 Combination of Pools with Same Base Years
Assumptions	• Reseller is a franchised dealer of new cars, new light-duty trucks, and new crossover vehicles (including SUVs, vans, minivans and other similar vehicles). • Reseller uses a dollar-value, link-chain LIFO method for its inventories of new vehicles. • As of Dec. 31, 2007, the dealership has a New Car pool and a New Light-Duty Truck pool with the inventory data shown in Table 1 and Table 2, respectively. • Both pools have the same base year. • Under Rev. Proc. 2008-23, the dealership will combine these pools into a New Vehicle pool for the taxable year ended December 31, 2008 (year of change). • The dealership's current-year cost for its New Car pool and for its New Light-Duty Truck pool at December 31, 2007, are \$15,600 and \$11,200, respectively. • *Note,* this allows us to compute the LIFO reserves and the composition of the LIFO reserve for each layer as of Dec. 31, 2007. ◆ These amounts are shown in the fourth, fifth and sixth columns on the facing page.
Step 1	• *Set Up Formats* • Step 1 involves setting up the LIFO layer histories for both pools in formats shown in the CCM example as Tables 1 and 2.
Step 2	• *Combine Layer Information* • Step 2 involves combining the base costs of the two pools (year by year) to create base costs for the New Vehicle pool (year by year) and combining the LIFO values of the two pools (year by year) to create the LIFO values for the New Vehicle pool (year by year). • This is simply an addition process once the numbers are organized in Table 1 and 2 format. • This is shown as part of Table 3 in the CCM example and the results appear in the first and third columns in Table 4.
Step 3	• *Compute Revised Indexes* • Step 3 involves computing revised indexes for each year's layer. These revised indexes are determined by dividing the total LIFO value for that year's layer by the total base cost for that year's layer. • The results are shown in the second column of Table 4.
Step 4	• *Determine the Restated Index* • Step 4 involves restating the 2007 cumulative index (i.e., the index as of the end of the year preceding the year of change) for the (combined) New Vehicle pool • This restated cumulative index is determined by dividing the [current-year cost of New Vehicle pool] by the [base cost of New Vehicle pool]. • In the example, the restated index is 1.2762 (\$26,800 ÷ \$21,000). ◆ Carried out to 6 decimal places, the index is 1.276190.
Step 5	• *Restate the Base Dollars in the Pool* • Step 5 involves restating the base year of the New Vehicle Pool to the current year. • As shown in Table 5, the restated base year cost for each year's layer is determined by multiplying base cost for that layer by the restated cumulative index. The LIFO valuations for each respective year's layer do not change. • This is shown in Table 5 of the CCM example.
Step 6	• *Revise the Layer Indexes for Each Layer* • Based on the information computed in Step 5 (which is shown in the first and third columns in Table 6 on the facing page), it is necessary to compute a revised index (or valuation factor) for each layer. • This is determined by dividing the amount in the third column of Table 6 by the amount in the first column of Table 6.
Step 7	• *Restate the Cumulative Index as of the End of the Year Preceding Year of Change to 1.000.* • The CCM example states ... "Finally, Reseller restates the 2007 *cumulative* index of the New Vehicle pool as 1.0000 (\$26,800 [current-year cost of New Vehicle pool] ÷ \$26,800 [base cost of New Vehicle pool])." • Note, if the inflation rate for the year of change is 5%, this means that the cumulative index for the pool at the end of the year of change will be 1.0500 (1.0000 x 1.0500).

Example #1 - Combination of LIFO Pools with Same Base Years
Analysis of LIFO Layers as of End of the Year Immediately Before the Year of Change
Tables 1 - 6 ... CCM 200825044

	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Proof Factor	Composition of LIFO Reserve
				Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
Table 1 - Pool #1 - New Automobiles						
2005 Base Layer	10,000	1.000000	10,000	10,000	0.200000	2,000
2006 Layer	2,000	1.100000	2,200	2,000	0.100000	200
2007 Layer	1,000	1.200000	1,200	1,000	-	-
Cumulative Index as of Dec. 31, 2007		1.200000	-	-	-	-
Totals	13,000		13,400	13,000		2,200
Less: Ending Inventory at Current Cost			15,600			
LIFO Reserve at End of Year (Separate Pool)			2,200			
Table 2 - Pool #2 - New Light-Duty Trucks						
2005 Base Layer	5,000	1.000000	5,000	5,000	0.400000	2,000
2006 Layer	-	-	-	-	-	-
2007 Layer	3,000	1.400000	4,200	3,000	-	-
Cumulative Index as of Dec. 31, 2007		1.400000		-	-	-
Totals	8,000		9,200	8,000		2,000
Less: Ending Inventory at Current Cost			11,200			
LIFO Reserve at End of Year (Separate Pool)			2,000			
Table 4 - New Vehicle Pool - Before Rebasing						
2005 Base Layer	15,000	1.000000	15,000	15,000	0.276190	4,143
2006 Layer	2,000	1.100000	2,200	2,000	0.176190	352
2007 Layer	4,000	1.350000	5,400	4,000	(0.073810)	(295)
* Cumulative Index as of Dec. 31, 2007	-	1.276190		-	-	-
Totals	21,000		22,600	21,000		4,200
Less: Ending Inventory at Current Cost			26,800			
LIFO Reserve at End of Year (Combined Pool)			4,200			
* 1.276190 = 26,800 / 21,000						
Table 6 - New Vehicle Pool - After Rebasing						
2005 Base Layer	19,143	0.783582	15,000	19,143	0.216418	4,143
2006 Layer	2,552	0.861940	2,200	2,552	0.138060	352
2007 Layer	5,105	1.057836	5,400	5,105	(0.057836)	(295)
Cumulative Index as of Dec. 31, 2007	-	1.000000	-	-	-	-
Totals	26,800		22,600	26,800		4,200
Less: Ending Inventory at Current Cost			26,800			
LIFO Reserve at End of Year (Combined Pool)			4,200			

Table 5 - Rebasing Conversion Computation			
2005 Base Layer	15,000	1.276190	19,143
2006 Layer	2,000	1.276190	2,552
2007 Layer	4,000	1.276190	5,105
Cumulative Index as of Dec. 31, 2007	-	1.276190	-
	21,000		26,800
	Old Base Dollars (Before)	Old Base Dollars (Before)	Old Base Dollars (Before)

CCM Example #2

Chief Counsel Memo 200825044 - Example #2
Combination of Pools with Different Base Years

Assumptions

- In this example, the dealership using the link-chain method has LIFO pools with different starting base dates. The dealership will combine these pools into a New Vehicle pool for the taxable year ended December 31, 2008 (the year of change) under Rev. Proc. 2008-23.
- As of Dec. 31, 2007, the dealership has a New Car pool and a New Light-Duty Truck pool with the inventory data shown in Table 1 and Table 2, respectively.
- The dealership's current-year cost for its New Car pool and for its New Truck pool at December 31, 2007, are $12,000 and $5,750, respectively.

Step 1

- *Set Up Formats*
- Step 1 involves setting up the LIFO layer histories for both pools in formats shown in the CCM example as Tables 1 and 2.

Step 2

- *Restate the Base Cost of the Newer Pool (Light-Duty Trucks) in Terms of the Older Pool's Base Year*
- This is done by dividing the base year cost for each layer in the newer pool by the cumulative index for the older pool, computed as of the newer pool's base year (i.e., 2004).
  - In its analysis in the text of the CCM, the CCM states … "for example, if the oldest pool has a base year of 1997 and the newer pool as a base year of 2002, the taxpayer uses the oldest pool's 2002 cumulative index as the divisor."
  - In Example #2, the oldest (new auto) pool has a base year of 2002 and the newer (light-duty truck) pool has a base year of 2004. The table divides the base year cost for each layer in the newer light-duty truck pool by 1.1000 (i.e., the cumulative index for the 2004 layer in the older/new auto pool) in order to determine the restated amount of base cost for each year's layer in the newer light-duty truck pool.
- The result is shown in Table 3.
- The amount of "disappearing base dollars" as a result of adjusting for the later starting base date in the light-duty truck pool is $455 ($5,000 minus $4,545 = $455).

Steps 3-8

- Discussion of these steps continues on page 2 of 2

Our Comments

- Example #2 deals with the combination of LIFO pools, where the pools have different starting dates. It seems that the discussion and tabulation accompanying this example in this CCM is unduly confusing in its presentation.
- Our analysis presents this example in a series of tables (1 through 6). In order to present all of the information in Example #2 in a sequence that might be easier to follow, our table numbers on the following pages do not exactly correspond with the table numbers in the CCM example. However, all of the information is identical to the CCM and presents its results.
  - ***Our tables show the LIFO reserves and the composition*** of the LIFO reserve for each layer as of Dec. 31, 2007. These amounts are shown in the fourth, fifth and sixth columns.
- Sticking strictly to the facts presented in Example #2, it appears that in two instances the CCM incorrectly applies the key LIFO regulations which it cites for authority.
- ***First,*** in order to restate the base cost of the newer pool in terms of the older pool's base year, it would appear to be more correct to apply the cumulative index of 1.0500 from the new autos pool as of the end of 2003 (since that corresponds to the base date [January 1, 2004] of the newer light-duty truck pool).
  - CCM Example #2 applies the cumulative index of 1.10 which is the cumulative index at the *end* of the year 2004.
  - The description "2004 base layer" for the first layer in Pool #2 implies that that layer (of $3,500 base dollars valued at 1.000) is the base inventory in Pool #2 as of January 1, 2004, net of a decrement that was experienced in that pool at the end of 2004.
- ***Second,*** in combining the layers for Pool #1 and Pool #2, the CCM example adds the restated base dollar cost of $3,182 (and its corresponding LIFO valuation of $3,500) from the new truck pool (Pool #2) for the "2004 base layer" to the "2004 layer" in the new autos pool (Pool #1) which has a base dollar cost of $500 (and a corresponding LIFO valuation of $550).
  - According to the regulations, when combining pools with different base years (i.e., different starting dates on LIFO), the base year inventory of the later pool is to be treated as an increment in the year immediately preceding the base date (i.e., start) of the later pool.
  - The CCM example adds the 2004 layer from the truck pool to the wrong layer in the car pool (it should have been added to the 2003 layer from the new car pool).
  - See Reg. Sec. 1.472-8(g)(2)(iv) example section (d) which adds the $3,255 to the inventory for 1957 (and not to 1958).

Example #2 - Combination of LIFO Pools with Different Base Years
Analysis of LIFO Layers as of End of the Year Immediately Before the Year of Change
Tables 1, 2 & 3 ... CCM 200825044

	Base Dollars	Valuation Factor	LIFO Valuation	Composition & Proof of LIFO Reserve as of Dec. 31, 2007: Base Dollars	Proof Factor	Composition of LIFO Reserve
Table 1 - Pool #1 - New Automobiles						
2002 Base Layer	7,000	1.000000	7,000	7,000	0.200000	1,400
2003 Layer	1,000	1.050000	1,050	1,000	0.150000	150
2004 Layer	500	1.100000	550	500	0.100000	50
2005 Layer **	500	1.100000	550	500	0.100000	50
2006 Layer **	-	1.100000	-	-	0.100000	-
2007 Layer	1,000	1.200000	1,200	1,000	-	-
Cumulative Index as of Dec. 31, 2007		1.200000	-	-	-	-
Totals	10,000		10,350	10,000		1,650
Less: Ending Inventory at Current Cost			12,000			
LIFO Reserve at End of Year (Separate Pool)			1,650			
Table 2 - Pool #2 - New Light-Duty Trucks						
2004 Base Layer	3,500	1.000000	3,500	3,500	0.150000	525
2005 Layer	1,000	1.100000	1,100	1,000	0.050000	50
2006 Layer	500	1.150000	575	500	-	-
2007 Layer	-	1.150000	-	-	-	-
Cumulative Index as of Dec. 31, 2007	-	1.150000		-	-	-
Totals	5,000		5,175	5,000		575
Less: Ending Inventory at Current Cost			5,750			
LIFO Reserve at End of Year (Separate Pool)			575			
Table 3 - Pool #2 - New Light-Duty Trucks With Layers Reflecting Restated Base Costs						
2004 Base Layer (as restated 3,500 ÷ 1.100)	3,182	1.100000	3,500	3,182	0.165000	525
2005 Base Layer (as restated 1,000 ÷ 1.100)	909	1.210000	1,100	909	0.055000	50
2006 Base Layer (as restated 500 ÷ 1.100))	455	1.265000	575	455	-	-
2007 Layer	-	-	-	-	-	-
Cumulative Index as of Dec. 31, 2007 *	-	1.265000		-	-	-
* Truck Cum. Index 1.15 x 1.10						
Totals ($5,000 ÷ 1.1000 = $4,545)	4,545		5,175	4,545		575
Less: Ending Inventory at Current Cost			5,750			
LIFO Reserve at End of Year (Combined Pool)			575			

** Cumulative index for these years is 1.1000 (the same as for the 2004 layer). Therefore, there was no inflation in Pool #1 for the year 2005 or for 2006.

CCM Example #2	**_Chief Counsel Memo 200825044 - Example #2_** **_Combination of Pools with Different Base Years_** _Page 2 of 2_
Step 3	• ***Combine Layer Information (Using the Redetermined Base Costs for the Pool with the Later Date)*** • Step 3 involves combining the base costs of the two pools (year by year) to create base costs for the New Vehicle pool (year by year) and combining the LIFO values of the two pools (year by year) to create the LIFO values for the New Vehicle pool (year by year). • This is simply an addition process after the data for both pools are organized in the format shown in Table 4 and reflect the amounts of redetermined base cost for the (new light-duty truck) pool with the latter LIFO starting date. ◆ Note, this table reflects all of the years for which there is a layer in either one of the two pools. • This is shown as part of Table 4 in the CCM example and the results appear in the first and third columns in Table 4 on the facing page.
Step 4	• ***Compute Revised Indexes*** • This step involves computing revised indexes for each year's layer. These revised indexes are determined by dividing the total LIFO value for that year's layer by the total base cost for that year's layer. ◆ The revised cumulative index at Dec. 31, 2007 in Table 3 is determined by multiplying the new light-duty truck pool's 2007 cumulative index of 1.150 by the new automobile pool's 2004 cumulative index of 1.100 (1.15 x 1.10 = 1.265). • The results are shown in the second column of Table 4 on the facing page.
Step 5	• ***Determine the Restated Index*** • This involves restating the 2007 cumulative index (i.e., the index as of the end of the year preceding the year of change) for the (combined) New Vehicle pool. • This restated cumulative index is determined by dividing the [current-year cost of the New Vehicle pool] by the [base cost of the New Vehicle pool]. • In the example, the restated index is 1.2204 ($17,750 ÷ $14,545). Carried out to 6 decimal places, the index is 1.220313. The tables on the facing page reflect 1.220313 as the factor.
Step 6	• ***Restate the Base Dollars in the Pool*** • This involves restating the base year of the New Vehicle Pool to the current year. • As shown in Table 5 on the facing page, the restated base year cost for each year's layer is determined by multiplying base cost for that layer by the restated cumulative index. The LIFO valuations for each respective year's layer do not change. • This is shown in Table 6 of the CCM example.
Step 7	• ***Revise the Layer Indexes for Each Layer*** • Based on the information computed in Step 6 (which is shown in the first and third columns in Table 6 on the facing page), it is necessary to compute a revised index (or valuation factor) for each layer. • This revised index (or valuation factor) for each layer is determined by dividing the amount in the third column of Table 6 (the LIFO valuation for that layer) by the corresponding amount in the first column of Table 6 (the rebased cost for that layer). • The results are shown in the second column of Table 6 on the facing page.
Step 8	• ***Restate the Cumulative Index as of the End of the Year Preceding Year of Change to 1.000.*** • The CCM example states ... "Finally, Reseller restates the 2007 *cumulative* index of the New Vehicle pool as 1.0000 ($17,750 [current-year cost of New Vehicle pool] ÷ $17,750 [base cost of New Vehicle pool])."
Our Comments	• The above statement (in Step 8) could be interpreted in different ways. In our schedule, we have restated the cumulative index for 2007 to 1.000, but we have not changed the valuation factor for that layer from .983354 to 1.000. This retains the integrity of our schedules. To change the LIFO valuation factor for the 2007 layer to 1.000 would create a distortion in the layer history table. • Note, in doing the LIFO calculations for the year of change (2008), if the inflation rate for the year of change (i.e., 2008) were 10%, the result would be that the cumulative index for the combined pool at the end of the year of change (2008, i.e., as of Dec. 31, 2008) would be 1.1000. And this result is consistent with the CCM statement in Step 8 above.

Example #2 - Combination of LIFO Pools with Different Base Years
Analysis of LIFO Layers as of End of the Year Immediately Before the Year of Change
Tables 4, 5 & 6 ... CCM 200825044

Table 4 - New Vehicle Pool - Before Rebasing
(This adds results from Tables 1 & 3 above)

				Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Proof Factor	Composition of LIFO Reserve
2002 Base Layer	7,000	1.000000	7,000	7,000	0.220313	1,542
2003 Layer	1,000	1.050000	1,050	1,000	0.170313	170
2004 Layer	3,682	1.100000	4,050	3,682	0.120313	443
2005 Layer	1,409	1.170968	1,650	1,409	0.049345	70
2006 Layer	455	1.265000	575	455	(0.044688)	(20)
2007 Layer	1,000	1.200000	1,200	1,000	0.020313	20
* Cumulative Index as of Dec. 31, 2007		1.220313				-
Totals	14,545		15,525	14,545		2,225
Less: Ending Inventory at Current Cost			17,750			
LIFO Reserve at End of Year (Combined Pool)			2,225			

* 1.220313 = 17,750 / 14,545

Table 5 - Rebasing Conversion Computation

	Old Base Dollars (Before)	Conversion Factor	New Base Dollars (After)
2002 Base Layer	7,000	1.220313	8,542
2003 Layer	1,000	1.220313	1,220
2004 Layer	3,682	1.220313	4,493
2005 Layer	1,409	1.220313	1,720
2006 Layer	455	1.220313	555
2007 Layer	1,000	1.220313	1,220
Cumulative Index as of Dec. 31, 2007	-	1.220313	-
	14,545		17,750

Table 6 - New Vehicle Pool - After Rebasing

				Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Proof Factor	Composition of LIFO Reserve
2002 Base Layer	8,542	0.819462	7,000	8,542	0.180538	1,542
2003 Layer	1,220	0.860435	1,050	1,220	0.139565	170
2004 Layer	4,493	0.901408	4,050	4,493	0.098592	443
2005 Layer	1,720	0.959563	1,650	1,720	0.040437	70
2006 Layer	555	1.036619	575	555	(0.036619)	(20)
2007 Layer	1,220	0.983354	1,200	1,220	0.016646	20
Cumulative Index as of Dec. 31, 2007	-	1.000000	-	-	-	-
Totals	17,750		15,525	17,750		2,225
Less: Ending Inventory at Current Cost			17,750			
LIFO Reserve at End of Year (Combined Pool)			2,225			

See comments on page 40 for what may be two errors in the Chief Counsel Memo computation for this example.

BENEATH THE SURFACE . . .
REALLOCATION OF EACH YEAR'S LAYER CONTRIBUTION TO THE LIFO RESERVE AS OF DECEMBER 31, 2007

(Details for alternate sequencing of computations for Example #1 are on page 45 and details for Example #2 are on page 46.)

Single, Combined LIFO Pool for all New Vehicles — Composition & Proof of LIFO Reserve as of Dec. 31, 2007

Example #1 Combination of Pools with Same Starting Dates on LIFO (i.e., Same Base Years)	*CCM Sequence of Computations Combination of Pools First, Followed by Rebasing to 1.0000*			*Alternate Sequencing of Computations Rebasing of Separate Pools First, Followed by Combination of Pools*			*Amount of LIFO Reserve Shifted Between Layers*
	Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*	*Difference in Contribution to LIFO Reserve by Layer*
2005 Base Layer	19,143	0.216418	4,143	19,000	0.210526	4,000	143
2006 Layer	2,552	0.138060	352	2,400	0.083333	200	152
2007 Layer	5,105	(0.057836)	(295)	5,400	-	-	(295)
Totals	26,800		4,200	26,800		4,200	(0)
Ending Inventory at LIFO Valuation			22,600			22,600	
Ending Inventory at Current Cost			26,800			26,800	

Single, Combined LIFO Pool for all New Vehicles — Composition & Proof of LIFO Reserve as of Dec. 31, 2007

Example #2 Combination of Pools with Different Starting Dates on LIFO (i.e., Different Base Years)	*CCM Sequence of Computations Combination of Pools First, Followed by Rebasing to 1.0000*			*Alternate Sequencing of Computations Rebasing of Separate Pools First, Followed by Combination of Pools*			*Amount of LIFO Reserve Shifted Between Layers*
	Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*	*Difference in Contribution to LIFO Reserve by Layer*
2002 Base Layer	8,542	0.180538	1,542	8,400	0.166667	1,400	142
2003 Layer	1,220	0.139565	170	1,200	0.125000	150	20
2004 Layer	4,493	0.098592	443	4,625	0.124324	575	(132)
2005 Layer	1,720	0.040437	70	1,750	0.057143	100	(30)
2006 Layer	555	(0.036619)	(20)	575	-	-	(20)
2007 Layer	1,220	0.016646	20	1,200	-	-	20
Totals	17,750		2,225	17,750		2,225	0
Ending Inventory at LIFO Valuation			15,525			15,525	
Ending Inventory at Current Cost			17,750			17,750	

Example #1 - Combination of Pools with Same Base Years
Analysis of LIFO Layers as of End of the Year Immediately Before Year of Change (i.e., Dec. 31, 2007)
Alternative Calculation - Reflecting Rebasing of Pools to 1.0000 First, then Combining

				Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
	Base Dollars	***Valuation Factor***	***LIFO Valuation***	***Base Dollars***	***Proof Factor***	***Composition of LIFO Reserve***
Table 1 - Pool #1 - New Automobiles						
2005 Base Layer	10,000	1.000000	10,000	10,000	0.200000	2,000
2006 Layer	2,000	1.100000	2,200	2,000	0.100000	200
2007 Layer	1,000	1.200000	1,200	1,000	-	-
Cumulative Index as of Dec. 31, 2007 *		1.200000	-	-	-	-
						-
Totals	13,000		13,400	13,000		2,200
Less: Ending Inventory at Current Cost			15,600			
LIFO Reserve at End of Year (Separate Pool)			2,200			
Table 1A - Pool #1 - New Automobiles						
Rebased to 1.0000 at Dec. 31, 2007 Before Combining						
2005 Base Layer	12,000	0.833333	10,000	12,000	0.166667	2,000
2006 Layer	2,400	0.916667	2,200	2,400	0.083333	200
2007 Layer	1,200	1.000000	1,200	1,200	-	-
Cumulative Index as of Dec. 31, 2007		1.000000		-	-	-
* Conversion Factor is 1.20000						-
Totals	15,600		13,400	15,600		2,200
Less: Ending Inventory at Current Cost			15,600			
LIFO Reserve at End of Year (Separate Pool)			2,200			
Table 2 - Pool #2 - New Light-Duty Trucks						
2005 Base Layer	5,000	1.000000	5,000	5,000	0.400000	2,000
2006 Layer	-	-	-	-	-	-
2007 Layer	3,000	1.400000	4,200	3,000	-	-
Cumulative Index as of Dec. 31, 2007 *		1.400000		-	-	-
Totals	8,000		9,200	8,000		2,000
Less: Ending Inventory at Current Cost			11,200			
LIFO Reserve at End of Year (Separate Pool)			2,000			
Table 2A - Pool #2 - New Light-Duty Trucks						
Rebased to 1.0000 at Dec. 31, 2007 Before Combining						
2005 Base Layer	7,000	0.714286	5,000	7,000	0.285714	2,000
2006 Layer	-	-	-	-	-	-
2007 Layer	4,200	1.000000	4,200	4,200	-	-
Cumulative Index as of Dec. 31, 2007		1.000000		-	-	-
* Conversion Factor is 1.40000						
Totals	11,200		9,200	11,200		2,000
Less: Ending Inventory at Current Cost			11,200			
LIFO Reserve at End of Year (Separate Pool)			2,000			
Table 3 - New Vehicle Pool						
After Rebasing and Combining						
2005 Base Layer	19,000	0.789474	15,000	19,000	0.210526	4,000
2006 Layer	2,400	0.916667	2,200	2,400	0.083333	200
2007 Layer	5,400	1.000000	5,400	5,400	-	-
Cumulative Index as of Dec. 31, 2007		1.000000		-	-	-
Totals	26,800		22,600	26,800		4,200
Less: Ending Inventory at Current Cost			26,800			
LIFO Reserve at End of Year (Combined Pool)			4,200			

Example #2 - Combination of Pools with Different Base Years
Analysis of LIFO Layers as of End of the Year Immediately Before Year of Change (i.e., Dec. 31, 2007)
Alternative Calculation - Reflecting Rebasing of Pools to 1.0000 First, then Combining

	Base Dollars	Valuation Factor	LIFO Valuation	Composition & Proof of LIFO Reserve as of Dec. 31, 2007: Base Dollars	Proof Factor	Composition of LIFO Reserve
Table 1 - Pool #1 - New Automobiles						
2002 Base Layer	7,000	1.000000	7,000	7,000	0.200000	1,400
2003 Layer	1,000	1.050000	1,050	1,000	0.150000	150
2004 Layer	500	1.100000	550	500	0.100000	50
2005 Layer	500	1.100000	550	500	0.100000	50
2006 Layer	-	1.100000	-	-	0.100000	-
2007 Layer	1,000	1.200000	1,200	1,000	-	-
Cumulative Index as of Dec. 31, 2007 *		1.200000	-	-	-	-
						-
Totals	10,000		10,350	10,000		1,650
Less: Ending Inventory at Current Cost			12,000			
LIFO Reserve at End of Year (Separate Pool)			1,650			
Table 1A - Pool #1 - New Automobiles Rebased to 1.0000 at Dec. 31, 2007 Before Combining						
2002 Base Layer	8,400	0.833333	7,000	8,400	0.166667	1,400
2003 Layer	1,200	0.875000	1,050	1,200	0.125000	150
2004 Layer	600	0.916667	550	600	0.083333	50
2005 Layer	600	0.916667	550	600	0.083333	50
2006 Layer	-	-	-	-	1.000000	-
2007 Layer	1,200	1.000000	1,200	1,200	-	-
Cumulative Index as of Dec. 31, 2007		1.000000	-	-	-	-
* Conversion Factor is 1.20000						-
Totals	12,000		10,350	12,000		1,650
Less: Ending Inventory at Current Cost			12,000			
LIFO Reserve at End of Year (Separate Pool)			1,650			
Table 2 - Pool #2 - New Light-Duty Trucks With Layers Reflecting Restated Base Costs						
2004 Base Layer (as restated 3,500 ÷ 1.100)	3,182	1.100000	3,500	3,182	0.165000	525
2005 Base Layer (as restated 1,000 ÷ 1.100)	909	1.210000	1,100	909	0.055000	50
2006 Base Layer (as restated 500 ÷ 1.100))	455	1.265000	575	455	-	
2007 Layer	-	-	-	-	1.265000	-
Cumulative Index as of Dec. 31, 2007 *	-	1.265000	-	-	-	-
* Truck Cum. Index 1.15 x 1.10						
Totals ($5,000 ÷ 1.1000 = $4,545)	4,545		5,175	4,545		575
Less: Ending Inventory at Current Cost			5,750			
LIFO Reserve at End of Year (Separate Pool)			575			
Table 2A - Pool #2 - New Light-Duty Trucks Rebased to 1.0000 at Dec. 31, 2007 Before Combining						
2004 Base Layer	4,025	0.869565	3,500	4,025	0.130435	525
2005 Base Layer	1,150	0.956522	1,100	1,150	0.043478	50
2006 Base Layer	575	1.000000	575	575	-	
2007 Layer	-	-	-	-	1.000000	-
Cumulative Index as of Dec. 31, 2007		1.000000		-	-	-
* Conversion Factor is 1.265000						
Totals	5,750		5,175	5,750		575
Less: Ending Inventory at Current Cost			5,750			
LIFO Reserve at End of Year (Separate Pool)			575			
Table 3 - New Vehicle Pool After Rebasing and Combining						
2002 Base Layer	8,400	0.833333	7,000	8,400	0.166667	1,400
2003 Layer	1,200	0.875000	1,050	1,200	0.125000	150
2004 Layer	4,625	0.875676	4,050	4,625	0.124324	575
2005 Layer	1,750	0.942857	1,650	1,750	0.057143	100
2006 Layer	575	1.000000	575	575	-	-
2007 Layer	1,200	1.000000	1,200	1,200	-	-
Cumulative Index as of Dec. 31, 2007		1.000000		-	-	-
Totals	17,750		15,525	17,750		2,225
Less: Ending Inventory at Current Cost			17,750			
LIFO Reserve at End of Year (Combined Pool)			2,225			

XYZ Dealership in the Real World, Inc. - Combined Single LIFO Pool for all New Vehicles

Difference in the Contributions to the LIFO Reserve by Layer

Depending on Sequence of Calculations Used in Combining Separate LIFO Pools

As of December 31, 2006 (the End of the Year Immediately Preceding the Year of Change)

	(A)	(B)	(C) = (A) + (B)	(D)	(E) = (C) - (D)
	Pool #1 Separate Pool for New Automobiles	Pool #2 Separate Pool for New Light-Duty Trucks	Result by Layer ... Pools Rebased, Then Combined	Result by Layer ... Pools Combined, Then Rebased	Amount of LIFO Reserve Shifted Between Layers
	Composition of LIFO Reserve by Layer	Composition of LIFO Reserve by Layer	Total LIFO Reserves Both Pools Combined	Total LIFO Reserves Both Pools Combined	Difference in Contribution to LIFO Reserve by Layer
Analysis of Year-End LIFO Inventory Layers					
Base Inventory - January 1, 1980	2,276,805	2,559,464	4,836,269	4,952,318	(116,049)
1981 Increment	213,115	372,323	585,438	588,667	(3,228)
1982 Increment	210,463	155,077	365,541	385,224	(19,683)
1985 Increment	176,125	639,448	815,573	807,318	8,255
1986 Increment	228,291	293,656	521,948	543,151	(21,204)
1987 Increment	881,466	417,886	1,299,352	1,471,513	(172,161)
1988 Increment	-	860,798	860,798	780,540	80,258
1989 Increment	-	1,777,429	1,777,429	1,624,335	153,095
1990 Increment	-	1,791,339	1,791,339	1,619,127	172,212
1991 Increment	-	26,673	26,673	23,279	3,395
1992 Increment	-	664,546	664,546	573,084	91,463
1994 Increment	-	1,958,722	1,958,722	1,649,189	309,532
1995 Increment	-	294,040	294,040	232,707	61,333
1996 Increment	-	1,310,617	1,310,617	1,001,719	308,898
1999 Increment	-	171,184	171,184	104,049	67,135
2002 Increment	136,726	-	136,726	617,103	(480,377)
2004 Increment	14,912	-	14,912	67,685	(52,773)
2005 Increment	2,253	-	2,253	169,369	(167,116)
2006 Increment	-	-	-	222,983	(222,983)
	-	-	-	-	-
LIFO Reserve Totals	4,140,157	13,293,203	17,433,360	17,433,360	(0)

Dealership Facts

LIFO election was made for new vehicles in 1980 using the link-chain dollar-value method.
In 1992, election was made to change to the Alternative LIFO Method for New Vehicles.
Year of change to the Vehicle-Pool Method (under Rev. Proc. 2008-23) is 2007.
Separate pools for New Automobiles (Pool #1) and New Light-Duty Trucks (Pool #2) are to be combined as of Dec. 31, 2006.
LIFO computation for Pool #1 for 2006 reflected an increment of more than $2.3 million base dollars (before rebasing), for which there was no contribution to that pool's LIFO reserve as of Dec. 31, 2006.

As of Dec. 31, 2006, over the span of the LIFO election for Pool #1, there are 9 layers of increment contributing to its LIFO reserve of over $4 million.
As of Dec. 31, 2006, over the span of the LIFO election for Pool #2, there are 15 layers of increment contributing to its LIFO reserve of over $13 million.
There are only 6 layers represented in the layer history of both pools.
There are 9 years' layers in Pool #2 that are not in Pool #1 and all of these cluster in the middle years.
There are 3 years' layers in Pool #1 that are not represented in Pool #2 and these layers represent the more recent years (including 2006).

Note: Extensive detail schedules supporting the above calculations are not included with the summary above.

Column (C) data is based on the computation sequence of first rebasing the two separate pools to 1.000, followed by combining (i.e., by adding) the rebased results. This result is the same as adding the amounts in columns (A) and (B) and it retains the integrity of the contribution to the LIFO reserve made by each year's layer.
Column (D) data is based on the computation sequence of first combining the two separate pools, followed by rebasing the combined results to 1.0000. This result is obtained by following the sequence of computations (first combine the pools, then rebase the result) set forth in CCM 200825044.

Observation

It can be seen from the above that under the CCM approach, if there is a decrement in the pool in the year of change (2007 in this case study) that is large enough to eliminate the increments experienced in 2006 and 2005, the LIFO reserve will significantly decrease because of the creation of a contribution to the LIFO reserve of $222,983 with respect to the increment for 2006 and the creation of a contribution to the LIFO reserve of almost $170,000 for 2005.

Under the alternative sequence approach of rebasing the pools to 1.0000 first, then combining the pools, the maximum LIFO reserve recapture for the repayment due to the decrement experienced in the combined pool in 2007 would be limited to only $2,253 - the amount of the contribution with respect to the year 2005 layer in Pool #1.

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 summary table and charts are on pages 49-52. Based on our one-of-each new vehicle item category compilations for this year-end, we are expecting that many makes will reflect considerably more inflation than in previous years.

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 November 28, 2008 ... with intro-2009 model prices, unless the 2009 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2007 is the reference date for the equivalent of the calendar year 2008 beginning of the year date; i.e., December 31, 2007/January 1, 2008.

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 54 to 61.

Two Pools or Single Pool for New Vehicles? You'll note this year we've added information for those dealerships that have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method permitted by Revenue Procedure 2008-23.

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 in case the IRS ever wants to see them.

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

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

We will use the information on pages 49 to 61 in connection with many of our year-end LIFO reserve projection activities. In the December 2004 *LIFO Lookout*, we included an extensive look at how we do year-end projections including ***Practice Guides*** and sample formats showing ...

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

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

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

NOVEMBER 28, 2008

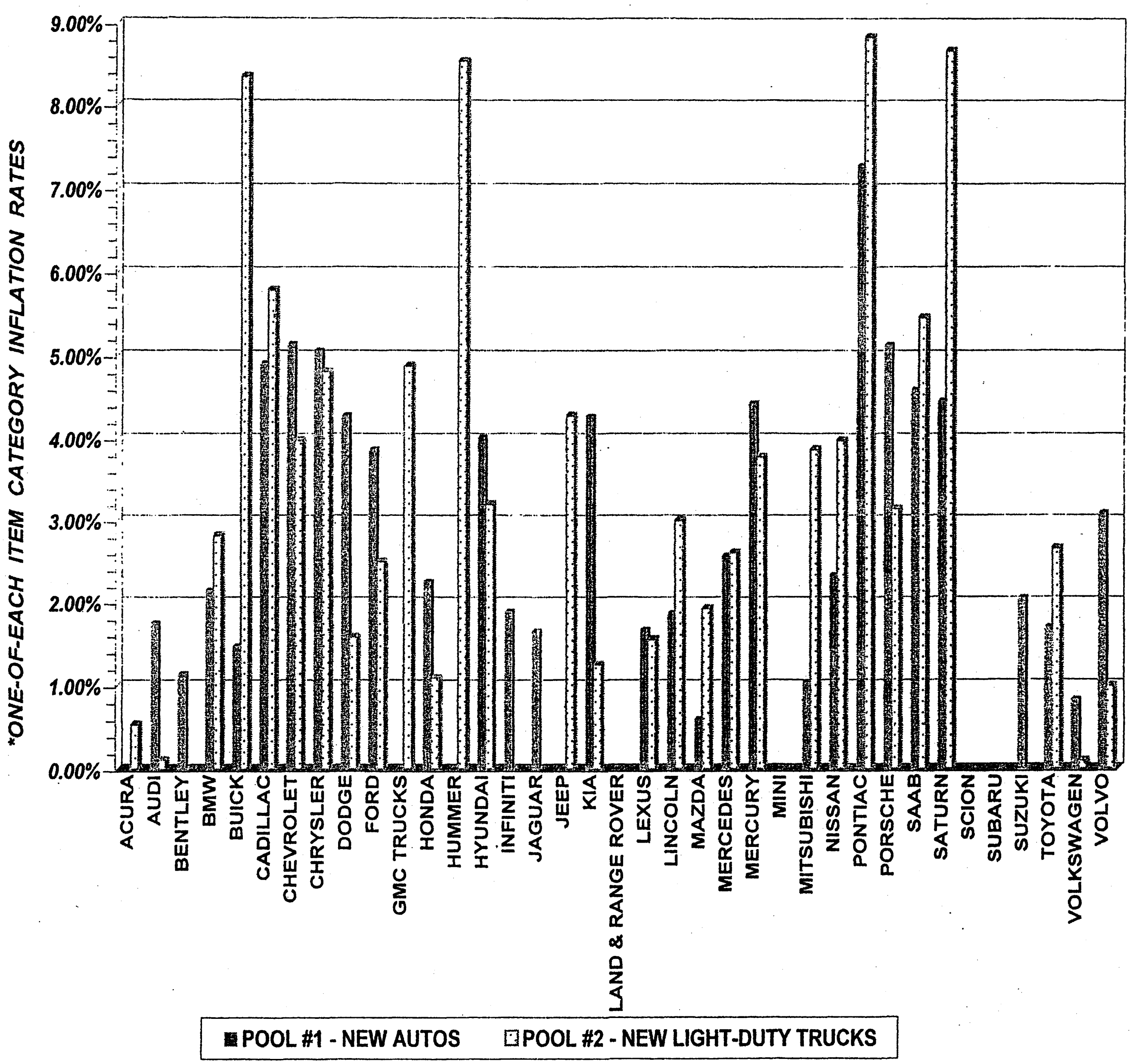
MODEL/ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
DEALER COST FOR THE YEAR ENDED 12/31/08

INFLATION ESTIMATE REPORT BY MAKE
BASED ON INFORMATION AVAILABLE

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS	ALL NEW VEHICLES COMBINED
ACURA	0.00%	0.54%	0.28%
AUDI	1.75%	0.12%	1.61%
BENTLEY	1.14%	0.00%	1.14%
BMW	2.15%	2.82%	2.20%
BUICK	1.47%	8.35%	2.83%
CADILLAC	4.91%	5.79%	5.27%
CHEVROLET	5.14%	3.98%	4.09%
CHRYSLER	5.06%	4.81%	4.97%
DODGE	4.28%	1.58%	1.94%
FORD	3.87%	2.50%	2.60%
GMC TRUCKS	0.00%	4.88%	4.88%
HONDA	2.26%	1.09%	1.80%
HUMMER	0.00%	8.54%	8.54%
HYUNDAI	4.02%	3.20%	3.80%
INFINITI	1.89%	0.00%	1.33%
JAGUAR	1.65%	0.00%	1.65%
JEEP	0.00%	4.28%	4.28%
KIA	4.27%	1.25%	2.34%
LAND ROVER/RANGE ROVER	0.00%	0.00%	0.00%
LEXUS	1.67%	1.55%	1.65%
LINCOLN	1.87%	3.00%	2.52%
MAZDA	0.60%	1.93%	1.16%
MERCEDES	2.57%	2.61%	2.58%
MERCURY	4.43%	3.78%	4.05%
MINI	0.00%	0.00%	0.00%
MITSUBISHI	1.04%	3.87%	2.02%
NISSAN	2.33%	3.98%	3.54%
PONTIAC	7.28%	8.84%	7.66%
PORSCHE	5.13%	3.14%	4.68%
SAAB	4.59%	5.46%	4.79%
SATURN	4.46%	8.67%	6.51%
SCION	0.00%	0.00%	0.00%
SUBARU	0.00%	0.00%	0.00%
SUZUKI	2.06%	0.00%	2.06%
TOYOTA	1.70%	2.66%	2.29%
VOLKSWAGEN	0.83%	0.10%	0.65%
VOLVO	3.09%	0.99%	2.60%

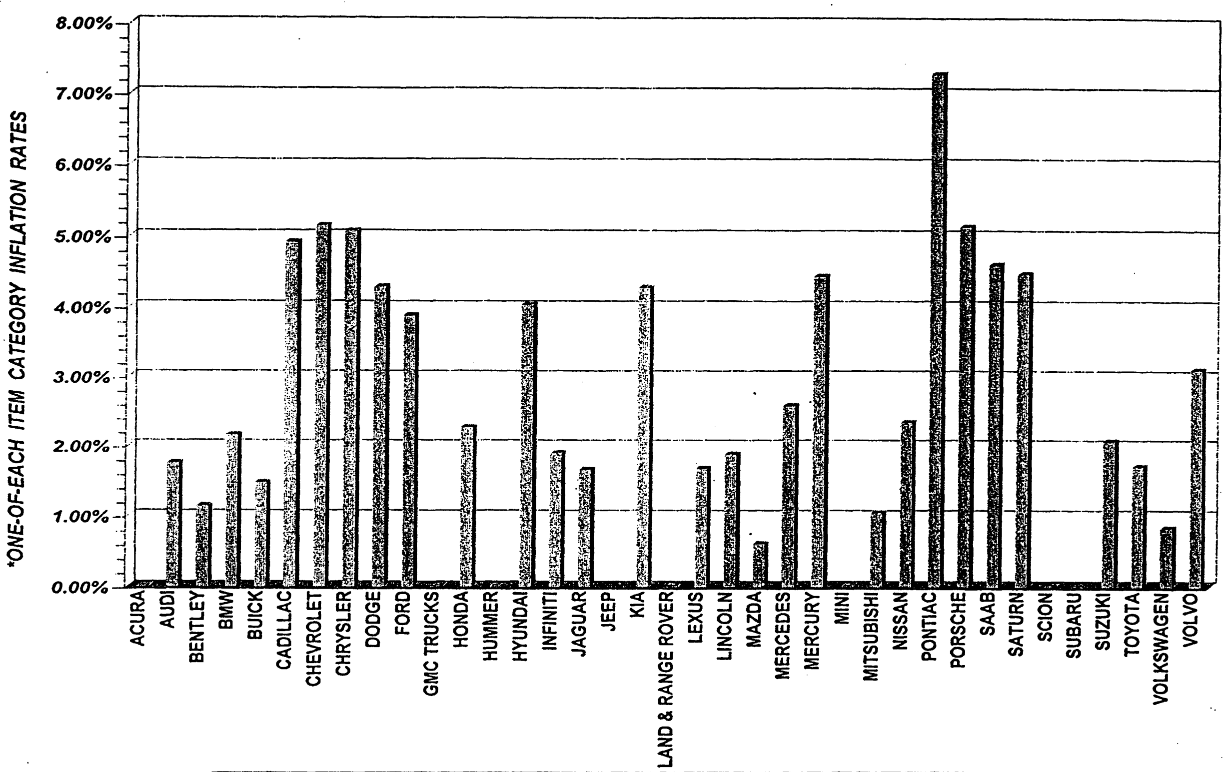
Source: De Filipps' ***SuperLIFO***™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/08

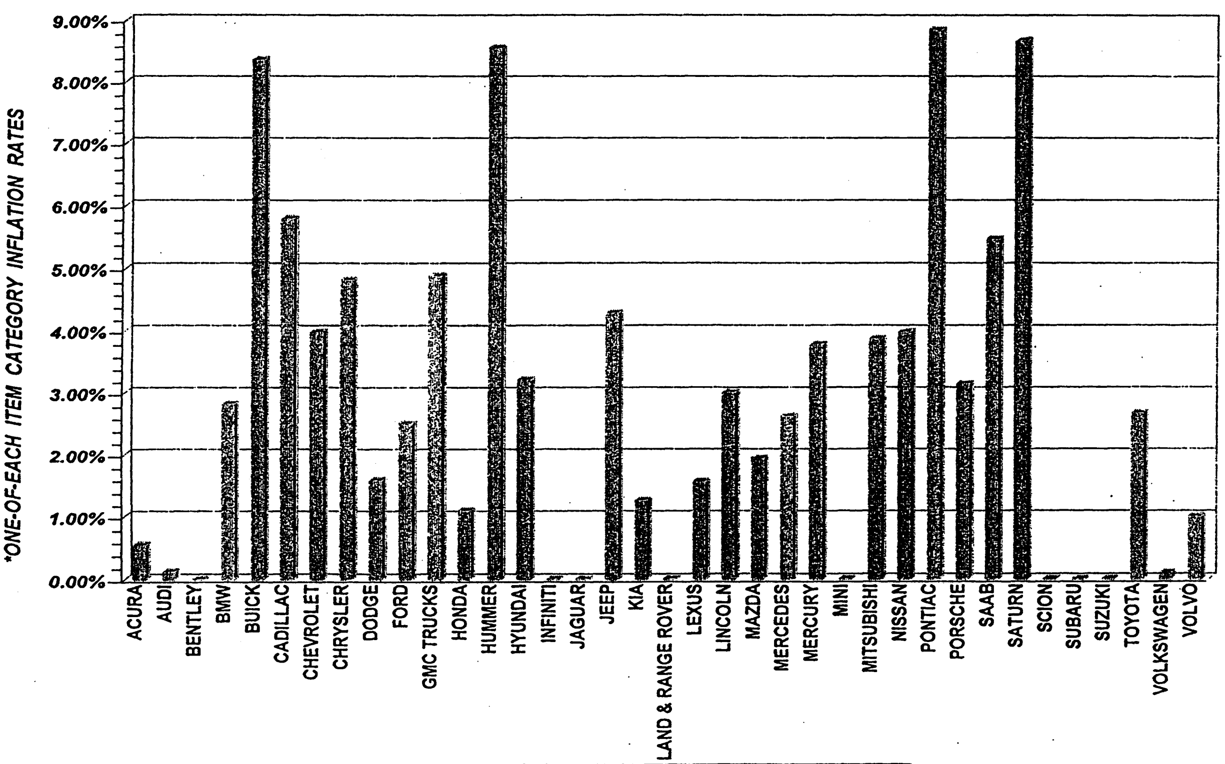


Source: De Filipps' *SuperLIFO*™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/08

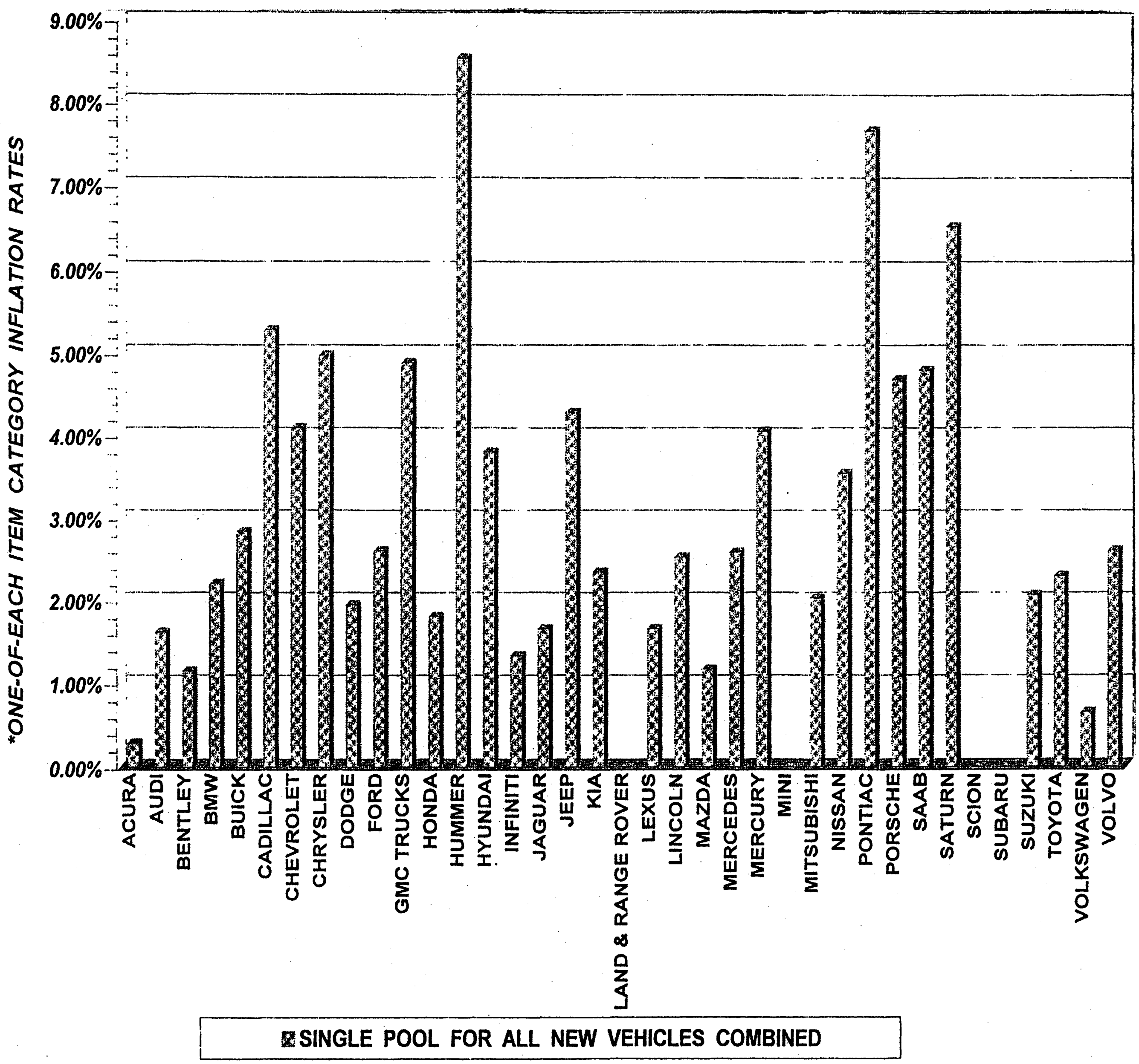


WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/08



Source: De Filipps' *SuperLIFO*™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/08



Source: De Filipps' *SuperLIFO*™

PROJECTED LIFO RESERVE CHANGES FOR 2008

SAMPLE LETTER

November ___, 2008

Mr./Ms. Dealer and/or CFO
XYZ Dealership, Inc.

Dear _________________:

This will summarize our discussion regarding the projected changes in your new vehicle LIFO reserves at year-end.

Currently, the dealership maintains separate pools for new autos and for new light-duty trucks. For purposes of our discussion, I used the anticipated inventory levels of roughly $1,600,000 for new automobiles and $1,700,000 for new light-duty trucks. Also, I did not factor in any inflation. However, it appears that there will be some inflation for the vehicles in both pools and, to the extent there is inflation, this will work to increase the LIFO reserve for each pool at year-end.

Pool #1. In the LIFO pool for new automobiles, the year-end anticipated inventory level ($1,600,000) will be significantly greater than last year's inventory level. Accordingly, this pool will experience an increment for LIFO purposes, but this increment will not increase the amount of the LIFO reserve for 2008. The only increase in the LIFO reserve for this pool at year-end will be due to the inflation factor that is experienced by the mix of vehicles in the ending inventory.

Pool #2. In the new light-duty truck pool, the projected year-end inventory amount ($1,700,000) is almost one-half of the amount of last year's ending inventory. This will result in an overall decrement in this pool and (excluding the impact of inflation) will result in a recapture or repayment of the LIFO reserve at year-end of ***approximately $420,000.*** To simplify our discussion here, I'll omit the details of how the decrement is carried back against prior years resulting in the recapture of the LIFO reserve.

Opportunity to use a single LIFO pool for all new vehicles. We have previously discussed the opportunity that the dealership has to elect to use a single, combined LIFO pool for all new vehicles for its 2008 calculations. This was a change you decided not to make for 2007 and said you would reconsider for 2008.

If this change to a single LIFO pool for all new vehicles were made for 2008, a portion of the overall decrement that will be experienced (in what would have been a separate pool) for new light-duty trucks would be offset against the increment that will be experienced (in what would have been a separate pool) for new automobiles.

The amount of net decrement (in the single LIFO pool that would combine new autos and trucks) would be approximately $540,000 less than if the separate LIFO pool for new light-duty trucks were maintained. This translates into the following conclusion. ***By electing to combine the new vehicle LIFO pools for 2008, the dealership would (1) limit the overall amount of LIFO recapture in that single pool to roughly $80,000 and thereby (2) avoid a payback of the LIFO reserve of approximately $340,000.***

These amounts are rough, rounded numbers based on certain generalizations. However, the principles underlying this analysis will not change given the estimated year-end inventory levels. If you'd like, we can do a more detailed calculation to eliminate some of the generalizations.

In summary. The anticipated decrease in the light-duty truck inventory at the end of 2008 is significant. This will cause a recapture of some of the LIFO reserves regardless of whether or not the LIFO pools are combined for 2008. However, a significant portion of this recapture ($340,000 out of $420,000) can be avoided if the pools are combined.

If your objective is to reduce your overall LIFO reserves, then you will not want to combine the LIFO pools (since keeping the LIFO pools separate will result in a greater LIFO payback under the separate pool approach). A second strategy for reducing your overall LIFO reserve - if that is your objective - would be to do as much as you possibly can to drop the level of inventory of new light-duty trucks at year-end. In other words, the fewer the number of light-duty truck units in inventory, the better.

On the other hand, if you want to preserve or retain the highest LIFO reserve possible, then the strategy to accomplish this goal would be to combine the new vehicle LIFO pools for 2008.

Please call at your convenience so we can discuss this further.

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NOVEMBER 28, 2008

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
RL	0	3	3		134,628	134,628	0	0.00%
TL	0	0	0				0	N/A%
TSX	0	4	4		112,598	112,598	0	0.00%
TOTAL NEW AUTOS	0	7	7		247,226	247,226	0	0.00%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	5	0	5	203,064		206,754	3,690	1.82%
RDX	2	0	2	64,219		61,960	(2,259)	(3.52)%
TOTAL NEW L-D TRUCKS	7	0	7	267,283		268,714	1,431	0.54%
TOTAL ACURA	7	7	14	267,283	247,226	515,940	1,431	0.28%
AUDI								
NEW AUTOS - POOL #1								
A3	3	3	6	82,077	79,814	165,649	3,758	2.32%
A4	0	6	6		222,830	222,830	0	0.00%
A5	2	0	2	75,423		76,911	1,488	1.97%
A6	0	0	0				0	N/A%
A8	3	1	4	246,895	89,465	342,473	6,113	1.82%
R8	2	0	2	211,110		220,875	9,765	4.63%
RS4	0	0	0				0	N/A%
S4	2	0	2	106,718		107,369	651	0.61%
S5	2	0	2	95,141		96,813	1,672	1.76%
S6	0	0	0				0	N/A%
S8	0	0	0				0	N/A%
TT	6	2	8	229,158	71,242	303,385	2,985	0.99%
TOTAL NEW AUTOS	20	12	32	1,046,522	463,351	1,536,305	26,432	1.75%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q7	3	0	3	138,988		139,149	161	0.12%
TOTAL NEW L-D TRUCKS	3	0	3	138,988		139,149	161	0.12%
TOTAL AUDI	23	12	35	1,185,510	463,351	1,675,454	26,593	1.61%
BENTLEY								
NEW AUTOS - POOL #1								
ARNAGE	3	0	3	677,943		688,173	10,230	1.51%
AZURE	1	0	1	306,891		311,541	4,650	1.52%

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NOVEMBER 28, 2008

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
BROOKLANDS	0	1	1		317,121	317,121	0	0.00%
CONTINENTAL	0	0	0				0	N/A%
TOTAL NEW AUTOS	4	1	5	984,834	317,121		14,880	1.14%
TOTAL BENTLEY	4	1	5	984,834	317,121	1,316,835	14,880	1.14%
BMW								
NEW AUTOS - POOL #1								
1 SERIES	0	0	0				0	N/A%
3 SERIES	12	0	12	427,610		439,755	12,145	2.84%
5 SERIES	6	0	6	279,955		287,410	7,455	2.66%
6 SERIES	2	0	2	145,635		149,500	3,865	2.65%
7 SERIES	0	0	0				0	N/A%
M3	0	3	3		163,900	163,900	0	0.00%
M5	1	0	1	76,270		78,290	2,020	2.65%
M6	2	0	2	188,045		192,465	4,420	2.35%
X6	0	2	2		111,965	111,965	0	0.00%
Z4	0	0	0				0	N/A%
TOTAL NEW AUTOS	23	5	28	1,117,515	275,865		29,905	2.15%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	1	0	1	34,960		36,250	1,290	3.69%
X5	2	0	2	92,370		94,665	2,295	2.48%
TOTAL NEW L-D TRUCKS	3	0	3	127,330		130,915	3,585	2.82%
TOTAL BMW	26	5	31	1,244,845	275,865	1,554,200	33,490	2.20%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	4	0	4	101,738		109,403	7,665	7.53%
LUCERNE	0	13	13		419,547	419,547	0	0.00%
TOTAL NEW AUTOS	4	13	17	101,738	419,547	528,950	7,665	1.47%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENCLAVE	4	0	4	128,486		139,220	10,734	8.35%
TOTAL NEW L-D TRUCKS	4	0	4	128,486		139,220	10,734	8.35%
TOTAL BUICK	8	13	21	230,224	419,547	668,170	18,399	2.83%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CADILLAC								
NEW AUTOS - POOL #1								
CTS	2	2	4	62,449	74,061	143,354	6,844	5.01%
DTS	5	0	5	213,905		224,053	10,148	4.74%
STS	3	0	3	158,737		168,833	10,096	6.36%
XLR	2	0	2	163,612		169,578	5,966	3.65%
TOTAL NEW AUTOS	12	2	14	598,703	74,061	705,818	33,054	4.91%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	5	2	7	263,251	133,892	419,040	21,897	5.51%
SRX	2	0	2	75,974		81,457	5,483	7.22%
TOTAL NEW L-D TRUCKS	7	2	9	339,225	133,892	500,497	27,380	5.79%
TOTAL CADILLAC	19	4	23	937,928	207,953	1,206,315	60,434	5.27%
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	1	5	6	11,496	66,997	78,304	(189)	(0.24)%
COBALT	4	6	10	53,280	104,982	165,690	7,428	4.69%
CORVETTE	3	1	4	151,537	95,652	252,913	5,724	2.32%
IMPALA	6	1	7	139,155	23,857	176,967	13,955	8.56%
MALIBU	6	0	6	122,420		135,073	12,653	10.34%
MALIBU CLASSIC	0	0	0				0	N/A%
TOTAL NEW AUTOS	20	13	33	477,888	291,488		39,571	5.14%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	4	6	10	127,506	234,561	369,688	7,621	2.10%
COLORADO	11	2	13	194,472	40,719	257,123	21,932	9.33%
COLORADO CHASSIS CAB	2	0	2	34,993		38,986	3,993	11.41%
EQUINOX	8	0	8	192,514		209,674	17,160	8.91%
EXPRESS CARGO VAN	10	0	10	240,370		262,847	22,477	9.35%
EXPRESS CUTAWAY VAN	3	0	3	68,579		72,918	4,339	6.33%
EXPRESS PASSENGER VAN	5	0	5	130,324		142,471	12,147	9.32%
HHR	4	1	5	63,900	23,568	96,804	9,336	10.67%
SILVERADO 1500	34	11	45	868,412	343,875	1,261,893	49,606	4.09%
SILVERADO 2500HD	28	8	36	828,032	288,024	1,155,571	39,515	3.54%
SILVERADO 3500	30	8	38	903,720	290,385	1,233,807	39,702	3.32%
SILVERADO 3500HD CHASSIS CAB	12	0	12	323,461		339,211	15,750	4.87%
SUBURBAN	12	14	26	437,812	597,632	1,063,134	27,690	2.67%
TAHOE	8	8	16	294,790	331,793	632,777	6,194	0.99%
TRAILBLAZER	8	0	8	235,356		253,474	18,118	7.70%
TRAVERSE	0	10	10		328,521	328,521	0	0.00%
TOTAL NEW L-D TRUCKS	179	68	247	4,944,241	2,479,078	7,718,899	295,580	3.98%
TOTAL CHEVROLET	199	81	280	5,422,129	2,770,566	8,527,846	335,151	4.09%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHRYSLER								
NEW AUTOS - POOL #1								
300	24	0	24	741,032		771,513	30,481	4.11%
SEBRING	21	0	21	493,119		525,090	31,971	6.48%
TOTAL NEW AUTOS	45	0	45	1,234,151		1,296,603	62,452	5.06%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ASPEN	6	3	9	184,996	122,805	318,376	10,575	3.44%
PACIFICA	0	0	0				0	N/A%
PT CRUISER	5	0	5	95,723		101,761	6,038	6.31%
TOWN & COUNTRY	9	0	9	238,104		252,327	14,223	5.97%
TOTAL NEW L-D TRUCKS	20	3	23	518,823	122,805	672,464	30,836	4.81%
TOTAL CHRYSLER	65	3	68	1,752,974	122,805	1,969,067	93,288	4.97%
DODGE								
NEW AUTOS - POOL #1								
AVENGER	12	0	12	229,593		245,977	16,384	7.14%
CALIBER	20	0	20	347,101		368,417	21,316	6.14%
CHALLENGER	0	8	8		191,114	191,114	0	0.00%
CHARGER	28	0	28	754,167		789,025	34,858	4.62%
VIPER	6	0	6	460,856		473,088	12,232	2.65%
TOTAL NEW AUTOS	66	8	74	1,791,717	191,114	2,067,621	84,790	4.28%
NEW LIGHT-DUTY TRUCKS - POOL #2								
DAKOTA	101	0	101	2,450,747		2,484,172	33,425	1.36%
DURANGO	38	4	42	1,122,526	163,169	1,324,823	39,128	3.04%
GRAND CARAVAN	8	0	8	180,250		190,254	10,004	5.55%
JOURNEY	0	20	20		464,651	464,651	0	0.00%
NITRO	24	0	24	516,517		540,841	24,324	4.71%
RAM CHASSIS CAB	0	0	0				0	N/A%
RAM PICKUP	166	80	246	5,489,660	2,697,437	8,287,390	100,293	1.23%
SPRINTER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	337	104	441	9,759,700	3,325,257		207,174	1.58%
TOTAL DODGE	403	112	515	11,551,417	3,516,371	15,359,752	291,964	1.94%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	6	0	6	149,904		152,473	2,569	1.71%
FOCUS	4	2	6	56,153	32,932	93,343	4,258	4.78%
FUSION	7	0	7	136,448		142,321	5,873	4.30%
MUSTANG	10	0	10	268,762		278,090	9,328	3.47%
TAURUS	4	1	5	96,385	22,163	126,023	7,475	6.31%
TOTAL NEW AUTOS	31	3	34	707,652	55,095	792,250	29,503	3.87%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY VAN	9	2	11	205,976	45,444	255,069	3,649	1.45%
E-SERIES	16	0	16	407,820		423,165	15,345	3.76%
EDGE	6	2	8	161,284	63,440	231,040	6,316	2.81%
ESCAPE	11	4	15	238,737	107,276	363,718	17,705	5.12%
EXPEDITION	10	0	10	330,068		351,776	21,708	6.58%
EXPEDITION EL	10	0	10	355,856		377,064	21,208	5.96%
EXPLORER	16	2	18	471,545	55,645	543,971	16,781	3.18%
EXPLORER SPORT TRAC	10	0	10	264,553		282,385	17,832	6.74%
F150 PICKUP	0	64	64		1,827,749	1,827,749	0	0.00%
F250 SUPER DUTY PICKUP	38	0	38	1,118,786		1,193,456	74,670	6.67%
F350 SUPER DUTY CHASSIS CAB	47	0	47	1,336,965		1,344,945	7,980	0.60%
F350 SUPER DUTY PICKUP	65	0	65	1,983,661		1,993,736	10,075	0.51%
FLEX	0	5	5		153,805	153,805	0	0.00%
RANGER	17	0	17	299,195		319,795	20,600	6.89%
TAURUS X	6	0	6	163,777		169,617	5,840	3.57%
TOTAL NEW L-D TRUCKS	261	79	340	7,338,223	2,253,359	9,831,291	239,709	2.50%
TOTAL FORD	292	82	374	8,045,875	2,308,454	10,623,541	269,212	2.60%
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACADIA	6	0	6	190,066		203,344	13,278	6.99%
CANYON	10	2	12	177,286	40,719	239,780	21,775	9.99%
CANYON CHASSIS CAB	2	0	2	34,993		38,986	3,993	11.41%
ENVOY	4	0	4	112,789		123,869	11,080	9.82%
ENVOY DENALI	2	0	2	65,665		70,316	4,651	7.08%
SAVANA CARGO VAN	10	0	10	240,370		262,847	22,477	9.35%
SAVANA CUTAWAY VAN	3	0	3	68,579		72,912	4,333	6.32%
SAVANA PASSENGER VAN	5	0	5	130,324		142,471	12,147	9.32%
SIERRA 1500 SERIES PICKUP	42	2	44	1,101,547	52,764	1,216,167	61,856	5.36%
SIERRA 2500HD SERIES PICKUP	36	0	36	1,086,372		1,138,413	52,041	4.79%
SIERRA 3500 SERIES PICKUP	38	0	38	1,169,068		1,220,076	51,008	4.36%
SIERRA 3500HD CHASSIS CAB	14	0	14	390,157		406,408	16,251	4.17%
SIERRA DENALI	2	0	2	73,008		75,332	2,324	3.18%
YUKON	12	21	33	488,445	858,496	1,375,961	29,020	2.15%
TOTAL NEW L-D TRUCKS	186	25	211	5,328,669	951,979	6,586,882	306,234	4.88%
TOTAL GMC TRUCKS	186	25	211	5,328,669	951,979	6,586,882	306,234	4.88%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
HONDA								
NEW AUTOS - POOL #1								
ACCORD	25	0	25	578,379		588,309	9,930	1.72%
CIVIC	34	6	40	629,471	111,723	764,055	22,861	3.08%
FIT	0	6	6		96,012	96,012	0	0.00%
S2000	3	0	3	97,683		99,069	1,386	1.42%
TOTAL NEW AUTOS	62	12	74	1,305,533	207,735	1,547,445	34,177	2.26%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CR-V	8	0	8	183,642		186,692	3,050	1.66%
ELEMENT	5	2	7	100,764	45,751	148,144	1,629	1.11%
ODYSSEY	7	0	7	214,825		218,829	4,004	1.86%
PILOT	0	11	11		342,546	342,546	0	0.00%
RIDGELINE	3	0	3	87,092		89,061	1,969	2.26%
TOTAL NEW L-D TRUCKS	23	13	36	586,323	388,297	985,272	10,652	1.09%
TOTAL HONDA	85	25	110	1,891,856	596,032	2,532,717	44,829	1.80%
HUMMER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
H2	2	0	2	102,704		114,816	12,112	11.79%
H3	3	0	3	98,974		109,358	10,384	10.49%
H3T	0	2	2		61,758	61,758	0	0.00%
TOTAL NEW L-D TRUCKS	5	2	7	201,678	61,758	285,932	22,496	8.54%
TOTAL HUMMER	5	2	7	201,678	61,758	285,932	22,496	8.54%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	6	0	6	77,278		78,780	1,502	1.94%
AZERA	2	0	2	49,891		50,628	737	1.48%
ELANTRA	4	0	4	59,396		61,849	2,453	4.13%
GENESIS	0	2	2		64,764	64,764	0	0.00%
SONATA	7	0	7	138,457		149,442	10,985	7.93%
TIBURON	0	0	0				0	N/A%
TOTAL NEW AUTOS	19	2	21	325,022	64,764		15,677	4.02%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENTOURAGE	0	0	0				0	N/A%
SANTA FE	0	0	0				0	N/A%
TUCSON	6	1	7	122,168	21,447	148,207	4,592	3.20%
VERACRUZ	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	6	1	7	122,168	21,447		4,592	3.20%
TOTAL HYUNDAI	25	3	28	447,190	86,211	553,670	20,269	3.80%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
INFINITI								
NEW AUTOS - POOL #1								
G35	4	0	4	119,707		122,089	2,382	1.99%
G37	3	0	3	96,369		98,157	1,788	1.86%
M35	2	0	2	80,730		82,290	1,560	1.93%
M45	2	0	2	92,968		94,618	1,650	1.77%
TOTAL NEW AUTOS	11	0	11	389,774		397,154	7,380	1.89%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EX35	0	1	1		33,880	33,880	0	0.00%
FX35	0	2	2		76,927	76,927	0	0.00%
FX50	0	1	1		53,893	53,893	0	0.00%
QX56	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	0	4	4		164,700		0	0.00%
TOTAL INFINITI	11	4	15	389,774	164,700	561,854	7,380	1.33%
JAGUAR								
NEW AUTOS - POOL #1								
X-TYPE	0	0	0				0	N/A%
XF	0	0	0				0	N/A%
XJ SERIES	5	0	5	350,284		353,721	3,437	0.98%
XK SERIES	4	0	4	303,704		311,038	7,334	2.41%
TOTAL NEW AUTOS	9	0	9	653,988		664,759	10,771	1.65%
TOTAL JAGUAR	9	0	9	653,988		664,759	10,771	1.65%
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMMANDER	14	0	14	442,641		459,722	17,081	3.86%
COMPASS	12	0	12	219,587		234,929	15,342	6.99%
GRAND CHEROKEE	21	0	21	712,484		731,858	19,374	2.72%
LIBERTY	12	0	12	263,254		277,942	14,688	5.58%
PATRIOT	12	0	12	212,032		226,228	14,196	6.70%
WRANGLER	36	3	39	807,624	76,181	920,075	36,270	4.10%
TOTAL NEW L-D TRUCKS	107	3	110	2,657,622	76,181	2,850,754	116,951	4.28%
TOTAL JEEP	107	3	110	2,657,622	76,181	2,850,754	116,951	4.28%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
KIA								
NEW AUTOS - POOL #1								
AMANTI	0	0	0				0	N/A%
OPTIMA	4	0	4	69,155		73,615	4,460	6.45%
RIO	9	0	9	114,975		118,375	3,400	2.96%
SPECTRA	0	0	0				0	N/A%
TOTAL NEW AUTOS	13	0	13	184,130			7,860	4.27%
NEW LIGHT-DUTY TRUCKS - POOL #2								
BORREGO	0	7	7		192,740	192,740	0	0.00%
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	132,420		136,495	4,075	3.08%
TOTAL NEW L-D TRUCKS	7	7	14	132,420	192,740	329,235	4,075	1.25%
TOTAL KIA	20	7	27	316,550	192,740	521,225	11,935	2.34%
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER LR2	0	0	0				0	N/A%
LAND ROVER LR3	0	0	0				0	N/A%
RANGE ROVER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	0	0	0				0	N/A%
TOTAL LAND ROVER/RANGE ROVER	0	0	0				0	0.00%
LEXUS								
NEW AUTOS - POOL #1								
ES 350	1	0	1	29,899		30,431	532	1.78%
GS 350	2	0	2	79,419		80,651	1,232	1.55%
GS 450H	1	0	1	48,312		49,632	1,320	2.73%
GS 460	1	0	1	45,779		46,388	609	1.33%
IS 250	3	0	3	84,620		86,468	1,848	2.18%
IS 350	1	0	1	31,596		32,212	616	1.95%
IS F	0	1	1		49,816	49,816	0	0.00%
LS 460	2	2	4	115,710	125,548	244,959	3,701	1.53%
LS 600H	1	0	1	90,480		92,118	1,638	1.81%
SC 430	1	0	1	56,945		58,120	1,175	2.06%
TOTAL NEW AUTOS	13	3	16	582,760	175,364	770,795	12,671	1.67%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 470	1	0	1	40,728		41,425	697	1.71%
LX 570	0	0	0				0	N/A%
RX 350	2	0	2	67,437		67,969	532	0.79%
RX 400H	2	0	2	74,542		76,144	1,602	2.15%
TOTAL NEW L-D TRUCKS	5	0	5	182,707		185,538	2,831	1.55%
TOTAL LEXUS	18	3	21	765,467	175,364	956,333	15,502	1.65%
LINCOLN								
NEW AUTOS - POOL #1								
MKS	0	2	2		71,137	71,137	0	0.00%
MKZ	2	0	2	58,082		61,743	3,661	6.30%
TOWN CAR	4	0	4	169,566		171,483	1,917	1.13%
TOTAL NEW AUTOS	6	2	8	227,648	71,137	304,363	5,578	1.87%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARK LT	4	0	4	143,901		144,861	960	0.67%
MKX	2	0	2	67,001		70,489	3,488	5.21%
NAVIGATOR	4	0	4	187,046		194,546	7,500	4.01%
TOTAL NEW L-D TRUCKS	10	0	10	397,948		409,896	11,948	3.00%
TOTAL LINCOLN	16	2	18	625,596	71,137	714,259	17,526	2.52%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA3	16	2	18	285,248	32,505	325,427	7,674	2.42%
MAZDA6	0	10	10		215,276	215,276	0	0.00%
MIATA MX-5	12	0	12	273,628		275,167	1,539	0.56%
RX-8	6	1	7	162,406	29,538	188,700	(3,244)	(1.69)%
TOTAL NEW AUTOS	34	13	47	721,282	277,319	1,004,570	5,969	0.60%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-7	6	0	6	146,126		147,819	1,693	1.16%
CX-9	6	0	6	178,141		180,324	2,183	1.23%
MAZDA5	4	0	4	74,793		75,585	792	1.06%
TRIBUTE	6	7	13	132,944	153,239	295,058	8,875	3.10%
TRUCK	3	0	3	55,088		55,828	740	1.34%
TOTAL NEW L-D TRUCKS	25	7	32	587,092	153,239	754,614	14,283	1.93%
TOTAL MAZDA	59	20	79	1,308,374	430,558	1,759,184	20,252	1.16%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	5	1	6	159,197	51,243	216,727	6,287	2.99%
CL CLASS	4	0	4	543,120		563,766	20,646	3.80%
CLK CLASS	5	0	5	285,882		293,229	7,347	2.57%
CLS CLASS	2	0	2	149,544		152,056	2,512	1.68%
E CLASS	8	0	8	466,860		481,414	14,554	3.12%
S CLASS	5	0	5	596,688		613,290	16,602	2.78%
SL CLASS	3	1	4	386,601	125,550	527,589	15,438	3.01%
SLK CLASS	3	1	4	145,127	42,734	192,279	4,418	2.35%
SLR MC CLAREN	1	0	1	460,350		460,350	0	0.00%
TOTAL NEW AUTOS	36	3	39	3,193,369	219,527	3,500,700	87,804	2.57%
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	2	1	3	182,373	93,232	286,346	10,741	3.90%
GL CLASS	2	1	3	123,202	54,126	184,791	7,463	4.21%
ML CLASS	3	1	4	169,912	45,198	216,086	976	0.45%
R CLASS	2	0	2	80,259		80,631	372	0.46%
TOTAL NEW L-D TRUCKS	9	3	12	555,746	192,556	767,854	19,552	2.61%
TOTAL MERCEDES	45	6	51	3,749,115	412,083	4,268,554	107,356	2.58%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	2	0	2	49,848		50,878	1,030	2.07%
MILAN	6	0	6	123,996		131,354	7,358	5.93%
SABLE	4	0	4	97,196		100,828	3,632	3.74%
TOTAL NEW AUTOS	12	0	12	271,040		283,060	12,020	4.43%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	8	2	10	183,212	46,986	240,583	10,385	4.51%
MOUNTAINEER	6	0	6	166,081		170,675	4,594	2.77%
TOTAL NEW L-D TRUCKS	14	2	16	349,293	46,986	411,258	14,979	3.78%
TOTAL MERCURY	26	2	28	620,333	46,986	694,318	26,999	4.05%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	8	0	8	188,838		192,054	3,216	1.70%
GALANT	2	2	4	45,524	41,985	87,932	423	0.48%
LANCER	4	7	11	59,029	160,690	221,244	1,525	0.69%
TOTAL NEW AUTOS	14	9	23	293,391	202,675	501,230	5,164	1.04%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	0	0	0				0	N/A%
OUTLANDER	8	0	8	174,256		177,524	3,268	1.88%
RAIDER	4	0	4	88,092		94,968	6,876	7.81%
TOTAL NEW L-D TRUCKS	12	0	12	262,348		272,492	10,144	3.87%
TOTAL MITSUBISHI	26	9	35	555,739	202,675	773,722	15,308	2.02%
NISSAN								
NEW AUTOS - POOL #1								
350Z	14	0	14	459,780		470,575	10,795	2.35%
ALTIMA	14	1	15	295,823	19,078	322,987	8,086	2.57%
GT-R	0	2	2		133,416	133,416	0	0.00%
MAXIMA	0	2	2		57,725	57,725	0	0.00%
SENTRA	6	0	6	100,271		105,765	5,494	5.48%
VERSA	7	0	7	94,964		97,587	2,623	2.76%
TOTAL NEW AUTOS	41	5	46	950,838	210,219	1,188,055	26,998	2.33%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	8	0	8	291,182		309,766	18,584	6.38%
FRONTIER PICKUP	26	0	26	567,539		601,738	34,199	6.03%
MURANO	0	5	5		135,917	135,917	0	0.00%
PATHFINDER	11	0	11	332,779		344,831	12,052	3.62%
QUEST	4	0	4	104,523		109,378	4,855	4.64%
ROGUE	8	0	8	155,036		160,011	4,975	3.21%
TITAN	47	0	47	1,348,842		1,388,460	39,618	2.94%
XTERRA	12	0	12	279,642		293,298	13,656	4.88%
TOTAL NEW L-D TRUCKS	116	5	121	3,079,543	135,917	3,343,399	127,939	3.98%
TOTAL NISSAN	157	10	167	4,030,381	346,138	4,531,454	154,937	3.54%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
PONTIAC								
NEW AUTOS - POOL #1								
G5	2	0	2	32,186		35,211	3,025	9.40%
G6	6	0	6	138,009		149,008	10,999	7.97%
G8	2	0	2	53,128		56,459	3,331	6.27%
SOLSTICE	2	1	3	46,484	27,792	78,595	4,319	5.81%
VIBE	0	0	0				0	N/A%
TOTAL NEW AUTOS	12	1	13	269,807	27,792		21,674	7.28%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TORRENT	4	0	4	96,620		105,160	8,540	8.84%
TOTAL NEW L-D TRUCKS	4	0	4	96,620		105,160	8,540	8.84%
TOTAL PONTIAC	16	1	17	366,427	27,792	424,433	30,214	7.66%
PORSCHE								
NEW AUTOS - POOL #1								
911	12	0	12	996,844		1,052,280	55,436	5.56%
BOXSTER	2	0	2	88,513		90,990	2,477	2.80%
CAYMAN	2	0	2	94,642		97,290	2,648	2.80%
TOTAL NEW AUTOS	16	0	16	1,179,999		1,240,560	60,561	5.13%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	3	2	5	170,197	173,690	354,680	10,793	3.14%
TOTAL NEW L-D TRUCKS	3	2	5	170,197	173,690	354,680	10,793	3.14%
TOTAL PORSCHE	19	2	21	1,350,196	173,690	1,595,240	71,354	4.68%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SAAB								
NEW AUTOS - POOL #1								
9-3	4	10	14	133,147	380,633	528,930	15,150	2.95%
9-5	4	0	4	142,194		157,150	14,956	10.52%
TOTAL NEW AUTOS	8	10	18	275,341	380,633	686,080	30,106	4.59%
NEW LIGHT-DUTY TRUCKS - POOL #2								
	0	2	2		80,580	80,580	0	0.00%
9-7X	3	0	3	116,703		127,471	10,768	9.23%
TOTAL NEW L-D TRUCKS	3	2	5	116,703	80,580	208,051	10,768	5.46%
TOTAL SAAB	11	12	23	392,044	461,213	894,131	40,874	4.79%
SATURN								
NEW AUTOS - POOL #1								
ASTRA	3	0	3	46,914		48,316	1,402	2.99%
AURA	4	1	5	82,200	22,940	113,629	8,489	8.07%
SKY	2	4	6	50,873	113,912	169,030	4,245	2.58%
TOTAL NEW AUTOS	9	5	14	179,987	136,852	330,975	14,136	4.46%
NEW LIGHT-DUTY TRUCKS - POOL #2								
OUTLOOK	4	0	4	113,552		125,618	12,066	10.63%
VUE	7	1	8	164,107	23,530	201,672	14,035	7.48%
TOTAL NEW L-D TRUCKS	11	1	12	277,659	23,530	327,290	26,101	8.67%
TOTAL SATURN	20	6	26	457,646	160,382	658,265	40,237	6.51%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SCION								
NEW AUTOS - POOL #1								
TC	0	0	0				0	N/A%
XB	0	0	0				0	N/A%
XD	2	0	2	28,404		28,404	0	0.00%
TOTAL NEW AUTOS	2	0	2	28,404		28,404	0	0.00%
TOTAL SCION	2	0	2	28,404		28,404	0	0.00%
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	0	0	0				0	N/A%
LEGACY	0	0	0				0	N/A%
TOTAL NEW AUTOS	0	0	0				0	N/A%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FORESTER	0	7	7		168,198	168,198	0	0.00%
OUTBACK	0	0	0				0	N/A%
TRIBECA	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	0	7	7		168,198		0	0.00%
TOTAL SUBARU	0	7	7		168,198	168,198	0	0.00%
SUZUKI								
NEW AUTOS - POOL #1								
FORENZA	0	0	0				0	N/A%
RENO	0	0	0				0	N/A%
SX4	8	13	21	125,528	200,373	332,613	6,712	2.06%
TOTAL NEW AUTOS	8	13	21	125,528	200,373	332,613	6,712	2.06%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GRAND VITARA	0	0	0				0	N/A%
XL7	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	0	0	0				0	N/A%
TOTAL SUZUKI	8	13	21	125,528	200,373	332,613	6,712	2.06%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	3	0	3	82,083		84,124	2,041	2.49%
CAMRY	11	0	11	223,583		225,059	1,476	0.66%
COROLLA	0	8	8		125,218	125,218	0	0.00%
MATRIX	0	7	7		121,754	121,754	0	0.00%
PRIUS	3	0	3	61,560		64,480	2,920	4.74%
SOLARA	11	0	11	243,553		246,030	2,477	1.02%
YARIS	8	2	10	97,284	26,724	131,762	7,754	6.25%
TOTAL NEW AUTOS	36	17	53	708,063	273,696	998,427	16,668	1.70%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	11	0	11	324,452		330,952	6,500	2.00%
FJ CRUISER	3	0	3	64,064		66,183	2,119	3.31%
HIGHLANDER	8	0	8	230,065		233,203	3,138	1.36%
LAND CRUISER	1	0	1	55,300		56,659	1,359	2.46%
RAV4	12	0	12	266,411		272,351	5,940	2.23%
SEQUOIA	0	0	0				0	N/A%
SIENNA	9	0	9	236,851		238,463	1,612	0.68%
TACOMA PICKUP	18	0	18	341,571		361,376	19,805	5.80%
TUNDRA	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	62	0	62	1,518,714			40,473	2.66%
TOTAL TOYOTA	98	17	115	2,226,777	273,696	2,557,614	57,141	2.29%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/08
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/07 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
VOLKSWAGEN								
NEW AUTOS - POOL #1								
CC	0	5	5		153,405	153,405	0	0.00%
EOS	6	0	6	180,980		181,957	977	0.54%
GLI	2	2	4	46,261	46,955	93,910	694	0.74%
GTI	8	0	8	175,688		178,088	2,400	1.37%
JETTA	10	20	30	186,860	429,466	618,984	2,658	0.43%
NEW BEETLE	11	0	11	220,357		226,754	6,397	2.90%
PASSAT	11	0	11	309,222		309,136	(86)	(0.03)%
R32	0	0	0				0	N/A%
RABBIT	8	0	8	130,916		133,466	2,550	1.95%
TOTAL NEW AUTOS	56	27	83	1,250,284	629,826	1,895,700	15,590	0.83%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ROUTAN	0	10	10		308,294	308,294	0	0.00%
TIGUAN	0	6	6		155,258	155,258	0	0.00%
TOUAREG 2	3	0	3	143,375		143,985	610	0.43%
TOTAL NEW L-D TRUCKS	3	16	19	143,375	463,552	607,537	610	0.10%
TOTAL VOLKSWAGEN	59	43	102	1,393,659	1,093,378	2,503,237	16,200	0.65%
VOLVO								
NEW AUTOS - POOL #1								
30 SERIES	0	2	2		48,786	48,786	0	0.00%
40 SERIES	1	2	3	22,939	62,181	89,018	3,898	4.58%
50 SERIES	1	1	2	25,242	33,370	61,382	2,770	4.73%
60 SERIES	3	0	3	91,854		97,572	5,718	6.23%
70 SERIES	3	1	4	102,078	37,130	140,483	1,275	0.92%
S80	3	0	3	121,783		124,972	3,189	2.62%
TOTAL NEW AUTOS	11	6	17	363,896	181,467	562,213	16,850	3.09%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	2	2	4	79,224	86,207	167,069	1,638	0.99%
TOTAL NEW L-D TRUCKS	2	2	4	79,224	86,207	167,069	1,638	0.99%
TOTAL VOLVO	13	8	21	443,120	267,674	729,282	18,488	2.60%

ABC DEALERSHIP ***EI#*** ________

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

FOR THE CALENDAR YEAR ENDING DECEMBER 31, 2008

NARRATIVE STATEMENTS & OTHER INFORMATION

General Information

This request is for ***Change No. 112***... Change to the Vehicle-Pool Method prescribed in Revenue Procedure 2008-23 from Taxpayer's existing LIFO pooling method under the Alternative LIFO Method for New Vehicles, as described in Revenue Procedure 97-36. This change to the Vehicle-Pool Method is designated change #112 of the published automatic change procedures, as more fully described in Section 22.08 of the Appendix to Revenue Procedure 2008-52.

This change in LIFO pooling method is being made for the calendar year ending Dec. 31, 2008. This Form 3115 is attached to the Taxpayer's timely filed (including extension of time) income tax return for the year of change. A duplicate copy of this Form 3115 has been sent to the IRS National Office in Washington, D.C.

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

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

Applicants filing under a designated automatic change procedure are not required to pay a user fee.

Page 2, Part II, Line 12 and Page 5, Schedule C, Part 1:
Description of Changes within the LIFO Inventory Method

Taxpayer previously elected to use the "safe harbor" LIFO methodology set forth in Revenue Procedure 97-36 for retail automobile dealers. This election was made in order to significantly reduce expensive and time-consuming disagreements that might otherwise arise between automobile dealerships and the IRS over the acceptability of various LIFO computation methodologies that dealerships might apply.

Under Revenue Procedure 97-36, Taxpayer is required to comply with the LIFO pooling criteria described in Section 4.02(1). Accordingly, for LIFO purposes, Taxpayer has previously used two pools:

Old Pool #1: ***All new automobiles*** (regardless of manufacturer), including demonstrators.

Old Pool #2: ***All new light-duty trucks*** (regardless of manufaeturer), including demonstrators.

On March 7, 2008, the IRS issued Revenue Procedure 2008-23 in which it provided an alternative LIFO pooling method, the Vehicle-Pool Method, which automobile dealers may automatically elect to use.

Accordingly, effective for the taxable year ending Dec. 31, 2008, Taxpayer will use a single pool for all new vehicles, including demonstrator vehicles, in accordance with the "Vehicle-Pool Method" permitted by Section 4.01 of Revenue Procedure 2008-23. This single or combined vehicle pool will include all new automobiles and all new light-duty trucks (i.e., a truck with a gross vehicle weight that does not exceed 14,000 pounds, commonly referred to as Class 1, Class 2 or Class 3 trucks). This Vehicle Pool will also include all new crossover vehicles, sport utility vehicles (SUVs), vans, minivans and other similar vehicles (i.e., hybrids, etc.) and all demonstrator vehicles.

New Pool #1: ***All new vehicles*** (regardless of manufacturer), including demonstrator vehicles, as described above.

(continued)

NARRATIVE STATEMENT ATTACHMENT FOR FORM 3115 ... CHANGING TO THE VEHICLE-POOL (SINGLE, COMBINED LIFO POOL) METHOD FOR 2008

ABC DEALERSHIP **EI# ________**

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

FOR THE CALENDAR YEAR ENDING DECEMBER 31, 2008

NARRATIVE STATEMENTS & OTHER INFORMATION

Manner of Making Change - Cut-Off Method - No Section 481(a) Adjustment

In making the change to the Vehicle-Pool Method, taxpayer will comply with the provisions of Section 22.08(2) of the Appendix to Revenue Procedure 2008-52 which provide that this change is to be made on a cut-off basis and applies only to the computation of ending inventories after the beginning of the year of change.

Accordingly, a Section 481(a) adjustment is neither permitted nor required. In changing its method of pooling under Revenue Procedure 2008-23 and Section 22.08 of the Appendix to Revenue Procedure 2008-52, taxpayer will do so in compliance with Reg. Sec. 1.472-8(g).

Instead of using the earliest taxable year for which taxpayer adopted the LIFO method for any items in a pool, taxpayer will use the year of change (i.e., calendar year 2008) as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years. The cumulative index at the beginning of the year of change (i.e., as of Dec. 31, 2007/Jan. 1, 2008) will be 1.0000.

Taxpayer will restate the base-year cost of all layers of increment in a pool at the beginning of the year of change in terms of new base-year cost.

Page 3, Part IV - Section 481(a) Adjustment ... This change requires use of the cut-off method ... See Above

Section 263A Inventory Cost Capitalization Matters

Taxpayer is subject to the Section 263A Inventory Cost Capitalization Rules, and no changes are contemplated in connection with its method of accounting for capitalizing inventory costs under Section 263A. Taxpayer has elected to determine the capitalization and inclusion in inventory costs of certain expenses in accordance with:

- ☐ The *Simplified Resale Method Without Historic Absorption Ratio Election* (Reg. Sec. 1.263A-3(d)(3))
- ☐ The *Simplified Resale Method With Historic Absorption Ratio Election* (Reg. Sec. 1.263A-3(d)(4))
- ☐ A method other than either of the Simplified Resale Methods indicated above (Reg. Sec. 1.263A-3(d)(5))

Previously Filed Forms 970 and 3115

- ☐ A copy of the original Form 970 LIFO election for new vehicle inventories is attached.
- ☐ A copy of the original Form 3115 to change to the Alternative LIFO Method for New Vehicles is attached.
- ☐ A copy of the original Form 970 LIFO election for new vehicle inventories and/or a copy of Form 3115 (if applicable) to elect to use the Alternative LIFO Method for New Vehicles is not attached.

  I certify that to the best of my knowledge and belief (____________Dealership) properly elected the LIFO inventory method by filing Form 970 with its return for the tax year(s) ended (___________), and otherwise complied with the provisions of Section 472(d) and Reg. Sec. 1.472-3, and with the provisions of Revenue Procedure 97-36 (formerly Revenue Procedure 92-79).

/S/ ______________________________________

Note: Sample narrative included in Mid-Year 2008 *LIFO Lookout* on pages 56-57 reflected Rev. Proc. 2002-9 (which has been superseded by Rev. Proc. 2008-52).

(Continued from page 37)

nated automatic accounting method change number as 114.

LIFO inventories. For a taxpayer using the LIFO inventory method, this change to a rolling-average method for determining current year cost must be made using a cut-off basis. This change applies only to the computations of current-year cost after the beginning of the year of change. Accordingly, a Section 481(a) adjustment is neither permitted nor required. Section 22.02(3) of the Appendix to Revenue Procedure 2008-52 identifies the designated automatic accounting method change number as 57.

Concurrent changes to a rolling-average method. A taxpayer is permitted to concurrently make both a change to a rolling-average method of determining current-year cost for its LIFO inventory (under Appendix Section 22.02 of Rev. Proc. 2008-52) ***and*** a change to a rolling-average method of accounting for non-LIFO inventories (under Appendix Section 21.14 of Rev. Proc. 2008-52). The taxpayer should file a single Form 3115 for both changes and enter the designated automatic accounting method change numbers for both changes on the appropriate line on that Form 3115.

Revenue Procedure 2008-43 adds one more choice for taxpayers filling out question 17 on page 2 of the LIFO election Form 970.

De Filipps' LIFO LOOKOUT
Willard J. De Filipps, C.P.A., P.C.
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Mt. Prospect, IL 60056

First-class postage paid at Mt. Prospect, IL