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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 AT THE END OF THIS YEAR? It certainly seems that the answer to this question is, "Yes, LIFO will still be available for year-end 2009 inventory calculations." But, anything can happen between now and the end of the year.

After looking into the future with help from my somewhat cloudy crystal ball, I'm willing to bet that LIFO will still be around at least for the end of 2010 ... Possibly, even a year or two after that. Then, ***if*** LIFO should be repealed, one would hope that taxpayers will be given a few years to recover from their shock and pay the tax on their LIFO reserves.

Let me repeat what I said the last time in response to the same question ... ***"Let's skip all the baloney. No one really knows [if LIFO will still be around at the end of the year]. 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."***

I see no reason to change my mind at this time. It's been about 6 months since I wrote that paragraph, and many major and irreversible changes have taken place in the economy and the dealership environment since then. In my judgment, these changes have been calamitous, and the automobile dealership industry, in particular, as we once knew it, will never be the same.

For more thoughts, see "What's Going to Happen to LIFO?" on page 6.

In the midst of all these changes and uncertainty, I think it's best for most dealerships and other taxpayers on LIFO to stay the course as suggested above. I believe they should remain on LIFO until the very last dollar is squeezed out of their LIFO reserves by legislation, fiat or otherwise and until all reasonable alternatives have been exhausted.

LOOKOUT LOOKS INTO

One other thought... Amid all of the discussion and proposals to eliminate LIFO, there is another tax accounting method whose repeal is usually discussed in the same breath or sentence ... Namely, the repeal of the use of the Lower-of-Cost-or-Market (LCM) method for valuing inventories. In my opinion... another disaster.

Proposals to eliminate both LIFO and the LCM method have been included in the President's description of policy options in the Report to the Senate Finance Committee dated May 20, 2009.

#2. IN THE MEANTIME, WHAT CAN YOU DO TO PROTECT YOUR LIFO ELECTIONS? The first thing is to ***start considering some intelligent planning strategies*** for anticipated year-end inventory situations. Continue focusing careful attention on LIFO calculations that are already in place until some finalizing event occurs with respect to the mortality of LIFO.

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For the present, you should take whatever measures are available to maximize the size of your LIFO reserves under the circumstances. This involves evaluating the changes in year-end inventory levels that either are inevitable or can reasonably be anticipated and projecting the consequences on your LIFO reserves.

As we go to press, both Chrysler and General Motors are in bankruptcy. Some dealerships have already vanished, and others will soon vanish from the scene after they complete their "winding down" activities. And, many other dealers, not necessarily Chrysler or GM dealers, may be terminated (or otherwise forced out of business) in the near future.

For dealerships who have already had their new vehicle selling agreements terminated by Chrysler or GM, or for those who expect this to happen in the near future, planning now - far in advance of the tax return filing deadline - is critical. In this Mid-Year Edition of the *Lookout*, I have included some thoughts and observations for dealers in these stressful situations. These will be developed more fully in the Year-End Edition of the *LIFO Lookout* (which I hope to have in your hands well before the end of the year). Please do not hesitate to call me any time with your questions or if you want to discuss any thoughts that occur to you.

The second thing you can do is to ***write to your representatives in Congress***, and urge them not to allow LIFO to be repealed in the quest to raise revenue.

Right now, the easiest, most effective thing you can do is to write directly to the members of the Senate Finance Committee. They need to hear from you, as taxpayers using and relying on the LIFO method, just how important the use of LIFO is to you and how devastating the loss of the this method would be if LIFO were repealed.

Obviously, each situation is different and may involve different points of emphasis or clarification. To make it easier for you to send your personal message to Congress, we've included some information and a sample letter on page 10. All you need to do is take a few minutes to fill in the blanks. ***Please ... Just do it ... Now!***

#3. AUTO DEALERS ON LIFO DID VERY WELL LAST YEAR. "How did automobile dealers using LIFO do last year?" Very well, thank you.

In connection with the first item on the ***Bulletin Board*** on page 12, there are a few observations. ***First***, many auto dealers on LIFO received 5 years' worth of inflation benefits in their LIFO computations for 2008. In other words, the inflation indexes for 2008 for their LIFO pools were 5 times greater than their inflation indexes for last year. In some cases, their 2008 inflation indexes were greater than the sum of the inflation indexes for the 5 preceding years. Any way you look at it, 2008 was a very good year for auto dealers to be on LIFO for their new vehicles.

Second, dealers using the IPIC method for their LIFO calculations should consider switching to the Alternative LIFO Method for New Vehicles (and using the single, combined pool method) for 2008 if they have not already filed their 2008 income tax returns.

Third, most of the dealers who were still on LIFO for their used vehicle inventories found 2008 to be the year that was "the straw that broke the camel's back." Another year of deflation or negligible inflation in their pools was just too much to bear ... and they terminated their LIFO elections for used vehicles.

#4. *LIFO BULLETIN BOARD*. Since LIFO is still very much alive, at least for the time being, we don't want to ignore some other developments that warrant your attention.

The items on pages 13 and 14 reinforce the importance of filing Forms 970 in special circumstances in order to notify the IRS that a LIFO election is being made or is being continued by a successor entity.

The item on page 15 relates only to taxpayers using the IPIC LIFO method and describes how they are to go about selecting the appropriate reference month for their IPIC calculations.

#5. IRS COMMENTS AT THE NADA CONVENTION FOR AUTO DEALERSHIPS USING LIFO. In January, Ms. Terri Harris, the IRS Motor Vehicle Technical Advisor, presented a workshop on dealer tax issues at the National Automobile Dealers Association Convention in New Orleans. A complete report on her workshop comments is included in the *2009 Mid-Year Dealer Tax Watch*.

In her capacity as an unofficial spokesperson for the IRS, Ms. Harris discussed procedures for terminating LIFO elections and for combining LIFO pools for all new vehicles under the Vehicle-Pool Method. She also made some general comments concerning the pooling treatment of crossover vehicles that we've attempted to clarify below.

LIFO election terminations. Ms. Harris discussed the fact that the National Tax Office has now made it easier to terminate LIFO elections by allowing dealerships to use the ***automatic*** consent process and procedures. The changes made by the IRS in Revenue Procedure 2008-52 updated (and simplified) the procedures for all taxpayers who want to voluntarily terminate their LIFO elections. (For related material, see Update Item #6 below.)

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In our last Edition of the *Lookout*, we discussed the problem all dealers were faced with in "terminating" their LIFO elections under the "old" (i.e., pre-Rev. Proc. 2008-52) procedures. Mercifully, this problem has now been eliminated on a prospective basis.

"Catch-22." You'll note that the preceding sentence said that the "problem" was eliminated on a *prospective* basis. But, what about Forms 3115 that were incorrectly filed as "automatic" LIFO terminations before Rev. Proc. 2008-52 relaxed the requirements? Unfortunately, there are still many dealers who used the wrong procedure in previously filing to "request permission" to terminate their LIFO elections.

In other words, some dealers (CPAs?) thought they could use the automatic change filing procedure to terminate their LIFO elections before 2008, and they filed Form 3115 ***after*** the end of the year of change. As a result, they did not obtain permission from the IRS ***in advance*** to terminate their LIFO elections.

Revenue Procedure 2008-52 does not say anything about whether these dealers are still on LIFO, or are off LIFO or whether they should re-file another Form 3115 under the current automatic provisions. And, if they are to re-file Form 3115, will the year of change/termination be retroactive to the year "intended" by the dealer? Or will the year of change be the later year for which the subsequent Form 3115 is timely filed? For dealers in this quandary, this limbo state is theoretically a mess.

Combining LIFO pools for all new vehicles. Ms. Harris discussed at some length the Vehicle-Pool LIFO Method (i.e., the single, combined LIFO pool method for all new automobiles and all new light-duty trucks) which the IRS announced last year in Revenue Procedure 2008-23. This method could be adopted as early as 2007, although many dealers waited until 2008 to do so.

Ms. Harris emphasized the IRS's issuance of informal guidance on how dealerships implementing the change should go about combining their pools.

This guidance from the IRS was contained in Chief Counsel Office Memo (CCM) No. 200825044, and it included two detailed examples. Our 2008 Year-End Edition of the *LIFO Lookout* analyzed the CCM and these examples, and it pointed out some very interesting consequences and results.

Ms. Harris stressed that if a dealership combines its pools in the manner set forth in the CCM, it will have the certainty that the National Tax Office would approve that approach (i.e., Step 1: combine the pools, then Step 2: rebase the single pool after the two pools have been combined).

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[To digress briefly, in this regard, you might want to carefully review the schedules on pages 41, 47 and (especially) 53. These are an integral part of the three case studies that we are presenting on pages 36 through 53 in this Mid-Year Edition of the Lookout. These schedules show how much the contributions to the LIFO reserve have been shifted among LIFO layers (i.e., years having increments) when the combining process occurs. We have found that, depending on the facts and circumstances, these differences can be very significant, especially where (large) decrements are anticipated to be experienced in the pools in the year of change ... or, in fact, are experienced in the year of change. **And, with some dealers on the verge of losing substantial portions of their inventories in 2009 and/or 2010 due to actions taken in manufacturer bankruptcies, this shifting effect could take on added importance.***]*

"Crossover" confusion? Ms. Harris may have created some confusion by her remarks concerning the classification of crossover vehicles for LIFO pooling purposes if a dealership does not change to the Vehicle-Pool Method.

She pointed out that the question of which LIFO pool a "crossover" vehicle should be placed in would be moot if the dealership elected to use the Vehicle-Pool Method. However, a dealership is not required to elect the Vehicle-Pool Method, and if it doesn't, then it must continue to maintain one pool for new automobiles and one pool for new light-duty trucks under the Alternative LIFO Method. So far, so good.

Ms. Harris continued by saying that if a dealership does not make the change (i.e., if it stays on the two-pool method required by Rev. Proc. 97-36) ... "I guess, frankly, the same old rule applies." This is where there may be some confusion.

That old rule was the rule for the classification of crossover vehicles that applied only where a dealership was using the Alternative LIFO Method for ***Used*** Vehicles. Ms. Harris described that rule succinctly and correctly, saying "Pick a pool, put it there, and leave it there."

In other words, in the first year when the dealership had a used crossover vehicle in ending inventory, it was to (1) determine whether that crossover vehicle belonged in the used automobile pool or in the used light-duty truck pool, (2) place that vehicle in the appropriate (used) vehicle LIFO pool, ***and*** (3) in all future years, whenever other crossover (used) vehicles were present in the ending inventory, those crossover vehicles were also required to be placed in the same pool (i.e., the auto pool or the truck pool) that the first (used) crossover vehicle had been place in.

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This rule for pooling crossover vehicles was specifically only for used vehicles on LIFO under Revenue Procedure 2001-23. The exact wording is in Section 4.02(3) of Rev. Proc. 2001-23 ... "Used sport utility vehicles and used hybrid vehicles (e.g., vans and mini-vans) may be included initially in either the used automobile or the used light-duty truck dollar-value LIFO pool; ***however, once a choice is made, all like vehicles must be similarly treated in subsequent years***."

Restating this requirement, which was for used vehicles only, if the first year a used crossover vehicle was placed in the used automobile pool, then in all future years, any other crossover vehicles automatically were to be placed in the same used automobile pool.

However, Revenue Procedure 97-36 applies to new vehicles using the Alternative LIFO Method, and it makes no mention of (i.e., it is silent on) how new crossover vehicles should be pooled.

Let me try to clarify Ms. Harris' comments which seemed somewhat hurried because she had so much material to cover in such a short period of time.

The fact is that Revenue Procedure 2008-23 introduces a ***new***, different rule for classifying crossover vehicles for LIFO pooling purposes. This new rule is effective for taxable years ending on or after March 7, 2008. This new rule does not mandate that all crossover vehicles will always be placed in the same pool year after year. Instead, each year, a facts and circumstances determination must be applied on a case-by-case basis to the crossover vehicle in question, and that crossover vehicle is to be assigned to whichever pool (i.e., either to the automobile pool or to the light-duty truck pool) is more reasonable under all the facts and circumstances.

This new rule applies for pooling all crossover vehicles on LIFO, regardless of whether they are new or used, and as mentioned above, it became effective for calendar year 2008.

For more on this, see pages 8, 14 and 18 in our article, "Evaluating the 'New & Improved' Single, Combined LIFO Pool Method for New Vehicles" in the 2008 Spring/Mid-Year Edition of the *LIFO Lookout*.

[In re-reading this for the nth time, somehow, I can't help but wonder if *"Brevis esse laboro, obscurus fio"* (Laboring to be concise, I become obscure). You can be the judge. On the other hand, if you're already using the Vehicle-Pool Method ... It won't really matter, will it?]

#6. FORM 3115 FOR TERMINATING LIFO ELECTIONS. Picking up on Ms. Harris' comments at NADA in January, in connection with voluntary terminations of LIFO elections, we have included sample proforma Form 3115 materials beginning on page 30.

You might want to consider these if, for whatever reason, you are going to be voluntarily terminating a dealership's LIFO elections. We have recently seen many dealers voluntarily terminate their LIFO elections for used vehicles, and the proforma materials can be adapted to that situation.

Another situation where terminating a LIFO election for new vehicles warrants consideration involves those (Chrysler or General Motors) dealers who have received so-called "death letters" telling them that their franchises will be terminated. In some cases, the franchise being terminated is the only one the dealer has, and the dealer plans to stay in business selling used vehicles and providing other automotive-related services.

For these dealers whose new vehicle inventories will likely be zero - or negligible, if demonstrators are still around - at the end of the year, in certain cases, terminating the LIFO election (if the tax return has not already been filed) may be considered as a preemptive strike to delay the full impact of having to repay all of the LIFO reserve in a single year.

There may be other alternatives available to the dealership, and it is important to carefully consider the provisions in Section 5 of Revenue Procedure 2008-52. (See page 33.) This Section prescribes certain events and situations that will accelerate or shorten the period of time over which the Section 481(a) adjustment, ordinarily 4 years, may be spread. Caution: Be sure you read these provisions with a sharp eye. More about this in our next Edition.

We hope our sample proformas will spare you from having to "reinvent the wheel," by giving you a head-start in the process. However, these proformas have to be modified to fit your exact situation. So, please, please, be sure to read the Form, instructions and our proforma supplementary responses carefully. Be sure to tailor your responses on the Form 3115 that you are preparing to the specific facts and circumstances of the situation and the type of business you are dealing with.

#7. THREE CASE STUDIES FROM THE REAL WORLD. Most of the coverage in the *LIFO Lookout* during 2008 was addressed to the IRS issuance of Revenue Procedure 2008-23, which allowed automobile dealers to elect to combine their separate LIFO pools for new automobiles and for new light-duty trucks into a single, combined LIFO pool for all new vehicles. Basically, the use of this new Vehicle-

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Pool Method avoided the problem of having to deal with the treatment of "crossover" vehicles for LIFO pooling purposes.

The Spring/Mid-Year 2008 Edition of the *LIFO Lookout* contained a thorough analysis of Rev. Proc. 2008-23 and a number of case studies and practice guides that I had developed. The Year-End 2008 Edition of the *LIFO Lookout* contained a detailed analysis of the informal guidance issued by the IRS on how dealerships implementing the change to the Vehicle-Pool Method should combine their LIFO pools. This analysis also pointed out some potential differences in result, depending on the sequence of computations employed in combining the pools.

I thought it would be interesting at this time to present several case studies drawn from my own recent experiences. These will show you how I've used the materials presented in last year's *LIFO Lookout*. Each case study has been selected to focus on one aspect of the intricacies involved in guiding your dealership clients in this area.

Case Study #1 - ABC Dealership. The technical twist in the ABC case is that the pools being combined went on to LIFO in different years. New automobiles went on LIFO in 1974 and new light-duty trucks did not go onto LIFO in 1998 (i.e., the dealership did not have new light-duty trucks in ending inventory until the end of 1998) ... almost 25 years later.

Therefore, in this situation, $296,033 "base dollars" had to "disappear" from the light-duty truck pool before it could be combined with the autos pool. There was no change in the total dollars in the LIFO reserves for both pools before or after the adjusting and combining process. The only thing that happened was that an adjustment was made for inflation over the 25 year interval so that "base" dollars with equivalent purchasing power could be combined. Without this adjustment, you'd be comparing apples with oranges.

Note that these schedules follow the guidance for combining LIFO pools issued by the IRS in CCM 200825044.

Case Study #2 - RST Dealership. This case has been selected because it resulted in a very pleasant (and unexpected) surprise when the final results were tallied after the pools had been combined and the addition to the LIFO reserve was computed for 2008.

The increase in the LIFO reserve resulting from the combination of pools was $156,000 greater because of the impact of combining the inflation rates for the two separate pool into one weighted inflation rate for the single pool.

There was also a benefit from minimizing the impact of the carryback of the decrement, but that's not the point of this case study.

Case Study #3 - XYZ Dealership. This study is a good example of a situation where it was not advisable to change to the single pool method ... if one followed the sequence of combining LIFO pools set forth in the guidance issued by the IRS in CCM 200825044.

The bottom line in this case was that the LIFO reserve would have been $58,000 smaller (under the Vehicle-Pool Method) if the decrement experienced in the year of change (2007) were carried back against 2006 - the year immediately preceding the year of change . This was because a contribution to the LIFO reserve in the amount of $64,000 had been shifted forward from earlier years to become associated with the layer of increment for 2006.

Could this be important to you? Please take a moment and re-read the (italicized) comment I inserted at the top of the right-hand column on page 3 in discussing Ms. Harris' remarks at NADA on this subject.

Conclusion from case studies. The change to the Vehicle-Pool Method can be far from a "one size fits all" solution. Somehow, the expression about the "devil lurking in the details" comes to mind. Any CPA firm that blindly went ahead and changed all of its clients to the Vehicle-Pool Method ... or refrained from changing any of its clients to the Method ... may have missed some significant opportunities to help their clients.

Clearly, to change or not to change? ... That is the question. And the answer, my friends, depends on the facts and circumstances of each situation.

#8. PROPER ITEM DEFINITIONS & GROUPING ... STILL CRITICAL TO LIFO ELECTIONS. In the December 2007 issue of the *LIFO Lookout* (Update item #6 on page 2), we called your attention to the issuance of TAM 200735020. In this TAM, the IRS disapproved of how a rather complicated consolidated group of corporations was using LIFO in two situations.

The IRS rationale common to the resolution of both issues was that the definitions used (in both cases) compensated the taxpayers for the effects of artificial inflation resulting from changes in quality and product mix. And, that is a "no-no."

In that December 2007 Update, we promised to analyze this TAM in greater detail and thought that we would do this in 2008. Unfortunately, other matters were addressed in both 2008 Editions of

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Latest Proposal We've Heard on LIFO Repeal

- In the *President's Budget Green Book*, released May 11, 2009, proposals for revenue increases included
  - Full repeal of the LIFO method for all businesses, regardless of industry or size.
  - Repeal would be effective in 2012.
  - Spread period for repaying LIFO reserves would be over 8 years (presumably taking 1/8 of the amount of the LIFO reserve into income starting in year 2012 and 1/8 of the amount of the LIFO reserve in each of the 7 years thereafter).
- According to the LIFO Coalition, "The best way for us to ensure that LIFO is not repealed is to keep repeal out of any tax legislation proposed by the Chairmen of the House Ways and Means and/or Senate Finance Committees; in legislative language, to keep repeal out of a Chairman's 'Mark.'"
- Based on meetings of representatives of the LIFO Coalition with various members of Congress, "it is increasingly clear that LIFO repeal is simply all about the money - Congress needs new tax revenues to offset the spending and deficits they are proposing. There is little discussion of the merits of LIFO; it's just seen as a source of new tax dollars."
- The LIFO Coalition adds... "We absolutely ***MUST*** convince the members of the tax-writing committees that LIFO is an appropriate means of evaluating inventory which accomplishes the same purpose as FIFO, and the repeal of LIFO would cause great economic harm, and that voting for repeal of LIFO would be a potentially damaging anti-business vote."
- Source: *Memo to Members of the LIFO Coalition*, dated May 12, 2009

What Would Be the Impact of Repeal of LIFO?

- Various estimates have reported the dollar "score" from repealing LIFO to be in the $60 to $80 billion range.
  - However, there are many different assessments and estimates of how much revenue would actually be raised by the repeal of LIFO.
- ***In short, nobody really knows.***
- ***Down & dirty*** ... Multiply the LIFO reserve by 33% (or any other percentage up to 40%) and that should tell you the amount of tax that would be paid on the recapture of the LIFO reserve if LIFO is repealed.
  - Cash flow impact might vary somewhat, particularly if some, or all, of the income generated by the recapture of the LIFO reserve is, or can be, offset against net operating losses that are being carried forward.
  - If the tax on the LIFO reserve can be repaid in 8 installments of 1/8 per year, then the impact of the repayment would be reduced by the discounted (present value) of the dollar repayments stretched out over 8 years.

The Best Study We've Seen Regarding the Impact of Repeal

- This recent analysis is based on data from a stratified sample of corporate income tax returns compiled by the IRS Statistics of Income Division for the tax years 1996 and 2006.
- Conclusions from this analysis are prefaced by "This brief analysis suggests that..."
  - "LIFO repeal is likely to disproportionately affect some industries.
  - "Because tax data do not reveal the actual market value of LIFO inventories, the true impact across industries is unknown.
  - "It is possible, even likely, that some industries reporting relatively small LIFO amounts will incur greater tax liability from LIFO repeal compared with industries reporting larger amounts.
  - "The impact of repeal will depend on product-specific price trends and the vintage of the LIFO inventory. In turn, the vintage of LIFO inventories is a function of firm longevity and the ability of LIFO firms to maintain a low cost 'inventory buffer' over time, thereby maintaining their ability to use prices that are many years removed from the current tax year to value ending inventories.
  - "... it would not be uncommon for certain LIFO firms to have used this LIFO valuation method for 30 years or more. Hence, it is conceivable that some LIFO firms use prices that are several decades old to value at least a portion of their inventory."
- A comprehensive chart accompanying this analysis indicates that for the year 2006, out of 22,601 motor vehicle retailers, with a combined ending inventory of $135 billion, 6,438 (or 28%) used LIFO to value their ending inventories.
- See *"How Prevalent is LIFO? Evidence from Tax Data"* by Matthew J. Knittel (a financial economist at the Treasury's Office of Tax Analysis) in *Tax Notes* (March 30, 2009, pages 1587-1589).

What About IFRS ... GAAP ... and LIFO Book-Tax Conformity Violations?

- Much of the previous, more academic discussions over the propriety the LIFO Method and whether or not LIFO is an "abusive" tax method have lost their impact.
- Why? ... Because the emphasis in more recent discussions about the repeal of LIFO has shifted to focus solely on the "enormous" dollar amount of estimated revenue that the repeal of LIFO would generate.
- The use of LIFO is not accepted under IFRS (International Financial Reporting Standards).
  - If a U.S. company adopts IFRS, that could trigger a host of LIFO (conformity) problems.
- It seems that when the U.S. economy went into its downward spiral late last year, much of the attention and emphasis that had been placed on the adoption by U.S. companies of IFRS lost its momentum.
  - The SEC is the active regulatory body involved in this issue at the present time, and there has been a change in top personnel at the SEC. SEC Chairman Mary Schapiro does not seem to be pushing aggressively on the IFRS adoption issue which she inherited from former SEC Chairman Christopher Cox.
  - The period for companies to submit comments on the SEC's proposed "road map" for IRS adoption closed on April 20. It is expected that the SEC will not take any significant action on this before the end of the year.
- It would appear that support for U.S. adoption of the IFRS has significantly weakened.
- A analysis by BNA discusses some of the objections most recently raised by companies in replying to the SEC's proposed "road map" for IFRS adoption.
  - Under the following self-explanatory headings, the BNA analysis discusses "the chorus of companies questioning the benefits of preparing to switch to IFRS in the face of current economic troubles."
    - SEC Chairman Mary Schapiro Has Signaled Only Lukewarm Support for the IFRS Proposal
    - Costs Higher Than Suggested
    - "Unrealistic" Timetable
    - Milestones Seen as Insufficient
    - U.S. Urged to Adopt IFRS Gradually
    - Dual Gap, IFRS Filings Faulted
    - FEI (Financial Executives Institute) Asks for Delay
    - Unconsidered Tax Consequences
  - See *"Support Weak for U.S. IFRS Adoption as Commenters Address Details"* in the Bureau of National Affairs' *Daily Tax Report* dated May 6, 2009.
- Other LIFO and tax-related objections to LIFO repeal are discussed in ...
  - *"LIFO Ban a Factor in U.S. Firms' Objection to IFRS Switch," Tax Notes*, April 27, 2009, page 405.
  - *"IRS Coping with IFRS," Tax Notes*, June 8, 2009, page 1177.
  - *"The LIFO, IFRS Conversation: An Explosive Concoction," Tax Notes*, May 11, 2009, page 741.
  - *"CFOs on IFRS: Forget About It,"* by Sarah Johnson and Marie Leone, on CFO.com, April 17, 2009.

Lobbying Efforts Against the Repeal of LIFO

- The LIFO Coalition the single largest group lobbying against the repeal of LIFO. Its mission is to preserve the right of companies to value their inventories pursuant to the LIFO method for Federal income tax purposes.
  - The LIFO Coalition is an *ad hoc* group of over 120 trade associations representing hundreds of thousands of separate businesses reflecting a cross-section of industries in which inventories are an integral part of business operations. This group includes both publicly-held companies which are subject to the jurisdiction of the SEC and privately-held businesses.
- LIFO Coalition members met in late May of 2009 with Senate Finance Committee members or aides and they reported that now there is a strong possibility that LIFO will be repealed.
  - Until meeting recently with members of the Senate Finance Committee, the LIFO Coalition has concentrated on trying to persuade Congress that the LIFO method is every bit as legitimate as FIFO.
  - ***Now, it appears that the need to raise revenue renders moot any discussion of the legitimacy of LIFO.***
  - The Senate Finance Committee seems to be receptive to receiving information from their constituents who are actually using LIFO concerning how they would be affected by the repeal of LIFO.
- Recent submissions by the LIFO Coalition...
  - February 18, 2009 ... Comments to the SEC with Respect to the Road Map for the Potential Use of Financial Statements Prepared in Accordance with IFRS by U.S. Issuers
  - March 24, 2009 ... Comments to the Chairman of the House Committee on the Budget
  - April 1, 2009 ... Letter to All Members of the U.S. Senate and the House of Representatives Urging them to Oppose LIFO Repeal
- Other online sources include: SaveLIFO.org ... CFO.com (then search "LIFO repeal") ... LIFOpro.com

What Can You Do About It? ... Part 1 ... Plan Intelligently

- The basic planning objective should be to ***delay, defer or diffuse*** the impact of significant reductions in LIFO inventories and reserves to the greatest extent possible.
- For many automobile dealers who received termination or "wind-down" letters from Chrysler and/or General Motors, different strategies can be adapted to different scenarios depending on whether or not the dealership is going to remain in existence.
  - ***Possibility #1.*** Dealership with multiple franchises, only one (or two or three) of which is (are) being terminated ...
    - Don't overlook obvious basic planning opportunities here.
      - Benefit of dollar-value LIFO treating inventory as an investment of dollars
      - Advantages of Alternative LIFO Method
      - Further benefit of electing to combine pools for new cars and light-duty trucks into a single, combined new vehicle pool under Rev. Proc. 2008-23
  - ***Possibility #2.*** Dealership with single franchise which is terminated (either directly or indirectly) by manufacturer bankruptcy ... Dealership intends to stay in business just selling used cars ...
    - Possible acquisition of another new vehicle franchise
    - IPIC election to defer impact vs. immediate repayment of entire LIFO reserve for new vehicles
    - Possible filing of Form 3115 to terminate LIFO election for the year before all new vehicle inventory is sold.
  - ***Other possibilities ...***
  - ***Potential adverse interpretations***
- Don't accept the repeal of LIFO as a foregone conclusion.
  - Don't voluntarily terminate your LIFO election until you've considered all of the possible alternatives. Hold off on filing any Forms 3115 until the very last timely filing date. (You never know what can happen in the meantime!)
  - Then, if LIFO is repealed and you can't dodge that bullet, then it's best to start planning now for various ways to come up with the cash to pay the tax on the recapture of the LIFO reserves.

What Can You Do About It? ... Part 2 ... Write to Your Congressmen

- Most Members of the Senate Finance Committee (SFC) don't really know much about LIFO, don't understand the impact of repeal and think it will affect only a small number of publicly-traded companies and do little economic damage. However, they have very explicitly asked for real data from companies on LIFO, and that's information the LIFO Coalition can't and won't provide.
- The Senate Finance Committee is the Committee that is or will be deciding whether or not to repeal LIFO. Contact information for all Senate Finance Committee members is on Page 6 of 6.
  - If your company has operations in any of the states represented by SFC Committee members, you should contact them immediately to explain the harmful effects that repealing LIFO would have on your business.
  - ***Important.*** If you are not a resident voter or doing business in any one of the SFC members' states, you could also send a letter to your specific representatives, stating your case and asking them to personally give your letter to one of their colleagues on the SFC along with their support in favor of keeping LIFO.
    - You can find the internet and mailing contact information for every U.S. Senator at the following site: http://www.senate.gov/general/contact_information/senators_cfm.cfm.
    - You can find the internet and mailing contact information for every U.S. Representative at the following site: https://writerep.house.gov/writerep/welcome.shtml.
  - Each Senator is a member of several Committees. Your Senators may also be sitting on different Committees with a member of the Senate Finance Committee, so that shared Committee responsibility may provide a basis for a common interest in preserving the LIFO method.
- Members of the Senate Finance Committee really need to receive ***letters stating real life facts (not anecdotal evidence provided by trade groups) about how the repeal of LIFO would hurt their constituents***.
  - These letters can only come from businesses using LIFO, so direct contact from the companies using LIFO is necessary.
  - CPAs and trade groups and associations cannot do this as effectively for them.

- ***E-mail.*** You can use the web site page of the National Association of Wholesalers (NAW) as a convenient way to send an e-mail message to your Senator. (http://www.naw.org/govrelations/grtools.php)
  - If you go to this web site, you can type in an office/store/location address and the site will take you to a page where you can write and fax a letter. You would need to identify yourself as an employer in their state in each letter separately, but beyond that distinction, you could copy and paste letters to each of them (if your company has operations in more than one state) and send directly from this web site.
- ***More personalized letters.*** A personalized letter may take a little longer to write, but it may be more effective. Here are a few suggestions...
  - Keep your letter brief. The Senate Finance Committee has already received many "briefing papers" describing what LIFO is, why it is beneficial, etc.
  - ***The most important content for your letter*** is to explain how LIFO repeal will affect your company, with as much specificity as possible. For example, consider reporting ...
    - The percentage increase in your tax liability if LIFO were repealed
    - The relationship between your LIFO tax liability and net worth and/or working capital, etc.
    - The impact that the repeal of LIFO would have on jobs (will you have to reduce your workforce or not hire new workers?), capital investments (will you delay or cancel planned investments?), employee benefits (would you have to reduce costs by changing health care benefits or payments to 401(k) plans, etc.?).
  - Be sure to identify yourself as an employer in the Senators' states so they know you are writing as a constituent business.
  - To round out your letter, you might want to include very briefly one or two of the general points below. However, your specific facts are far more important than these general statements. Consider selecting one or two that most directly bear on your current situation, and present them with passion.
    - LIFO is an accurate and appropriate means of evaluating inventory to calculate actual earnings for tax purposes.
    - Both LIFO and FIFO achieve the same purpose. They both accurately reflect taxable income depending on whether the price of product rises or falls.
    - Repeal of LIFO with recapture of taxes on reserves is a highly unfair retroactive tax increase, punishing companies which have done absolutely nothing wrong. The consequence would be similar to retroactively repealing business' ability to use accelerated depreciation methods.
    - There is no LIFO cash reserve accompanying a LIFO reserve. The LIFO reserve is simply the difference between FIFO and LIFO. Therefore, the LIFO reserve is the result of an accounting calculation ... it is not a pot of money sitting in a bank.
    - Requiring retroactive payment of income taxes on the LIFO reserves would be a tax with no income with which to pay it, so the money would have to come from reduced expenditures elsewhere or borrowing ... and credit is very difficult to obtain today.
    - Repeal of LIFO on a going-forward basis would force companies which sell a product which rises in price to pay income taxes on illusory inflation-generated income.
    - Allowing FIFO while repealing LIFO would unfairly advantage industries which sell a product that falls in price over those whose product is subject to price inflation. In general, that would place at a disadvantage the established "brick and mortar" American businesses which do not outsource their jobs and on which good U.S. jobs depend.
    - The LIFO method is a very important inventory financing source for small businesses. LIFO repeal would be more harmful to small companies because they don't have the inventory financing resources available to larger companies and losing an important inventory financing source in today's tough credit environment would be especially harmful.
  - A suggested format for your personalized letter and contact information for members of the Senate Finance Committee are on the following pages.
- ***Right to reproduce these materials.*** Please feel free to copy, use or pass along any and all of this 6-page discussion (including the sample letter) to your clients, associates and/or trade associations or groups with whom you have contact.
- ***Acknowledgement:*** Thanks to Lee Richardson of LIFO-PRO, Inc. for his permission to use portions of the excellent content from his web site which provides a discussion of the LIFO repeal situation and additional materials. I urge you to visit his web site (www.lifopro.com/liforepeal.html) to read these for yourselves.
  - On his web site, you will also find excerpts from a document describing reasons why LIFO should not be repealed by Congress. This was used by Lee Richardson and Susan Wells when they recently met with a Congressional aide in support of preserving LIFO.

PLEASE DON'T REPEAL LIFO

(To Be Tailored to Your Specific Situation)

Date_____, 2009

Honorable (Senator's Name)
U.S. Senate
Address
Washington, DC 20510

Dear Senator _____:

We are the owner of a [business - state nature of business, i.e., auto dealership, manufacturer of _____]. We have been in business in [list locations - city, state, etc.] since [indicate year].

For filing our income tax returns, we made the election to use the Last-In, First-Out (LIFO) inventory method to value our inventories [X number of years ago ____] or starting in [year ____].

LIFO was accepted in the Internal Revenue Code as a legitimate method for valuing inventories when we started our business. We adopted this method because of the inflationary costs of goods, products and materials used in our business, and because LIFO allowed us to defer the payment of tax on inflationary profits, when we had to replace our inventory goods.

Over the years, we have built up a LIFO reserve of [$____ indicate amount] as of the end of [indicate year-end ____].

If LIFO is repealed, and we are required to pay tax on the LIFO reserve, we will have to pay [$____ indicate amount computed as 33% or 35% or 40%, whichever is applicable, of the LIFO reserve amount].

We want to stay in business (and be able to pass it along to our children). But, we are fearful that if LIFO is repealed and we have to pay the tax on our LIFO reserves, we will not have cash in the bank (or a line of credit that we would be able to draw upon) to do so.

The impact of repealing the LIFO method on our business will be devastating.

We have [____ number] employees and, undoubtedly, many - if not the majority of them - would have to be let go if we lose LIFO and have to repay our LIFO reserves.

[Be as specific as possible here ... refer to some of the talking points regarding reduction in operations, number of employees that might have to be terminated, impact on existing personal business loan guarantees and covenants, etc.]

Furthermore, even if there is only a little inflation over the next few years, LIFO will continue to allow us to defer the payment of tax on the impact of inflation that will be part of the cost of replacement goods in future year-end inventories. We would be extremely thankful for that, also, as we need all the help we can get.

As we said, without going out of business, if LIFO is repealed, it would be (almost) impossible for us to come up with the money to pay the tax on our LIFO reserves. And, that's true even if part of the repeal would allow us to make that repayment over several years. Many banks and other lenders are reluctant to loan money to finance year-end inventories. They will be even more reluctant to loan money to pay the tax on LIFO reserves. ***Until we go out of business, funds to pay the tax on LIFO reserves simply will not be available.***

Accordingly, the repeal of LIFO, even with some grace period, would place a terrible, if not fatal, financial strain on our business. It would do the same to many of our friends who also use LIFO in their businesses.

Therefore, we are asking you to please expend all efforts you possibly can to keep LIFO in the Tax Code. Please don't force us to give up this life support method for our business.

Sincerely,

_____
/S/ Business Owners

- Note: If this letter is being sent to a U.S. Representative or to a Senator who is not a member of the Senate Finance Committee, you'll need to modify it accordingly. You might add the following...
  "Please give this letter to [one of the members of the Senate Finance Committee] with your personal recommendation that he/she fight against the repeal of LIFO on your constituent's behalf."

PLEASE DON'T REPEAL LIFO

(To Be Tailored to Your Specific Situation)

Senate Finance Committee Members

Democrats		*Republicans*	
Max Baucus 511 Hart Senate Office Building Washington, DC 20510	**Montana**	***Jim Bunning*** 316 Hart Senate Office Building Washington, DC 20510	**Kentucky**
Jeff Bingaman 703 Hart Senate Office Building Washington, DC 20510	**New Mexico**	***John Cornyn*** 517 Hart Senate Office Building Washington, DC 20510	**Texas**
Maria Cantwell 511 Dirksen Senate Office Building Washington, DC 20510	**Washington**	***Mike Crapo*** 239 Dirksen Senate Office Building Washington, DC 20510	**Idaho**
Tom Carper 513 Hart Senate Office Building Washington, DC 20510	**Delaware**	***John Ensign*** 119 Russell Senate Office Building Washington, DC 20510	**Nevada**
Kent Conrad 530 Hart Senate Office Building Washington, DC 20510	**North Dakota**	***Mike Enzi*** 379A Russell Senate Office Building Washington, DC 20510	**Wyoming**
John F. Kerry 218 Russell Senate Office Building Washington, DC 20510	**Massachusetts**	***Chuck Grassley*** 135 Hart Senate Office Building Washington, DC 20510	**Iowa**
Blanche Lincoln 355 Dirksen Senate Office Building Washington, DC 20510	**Arkansas**	***Orrin G. Hatch*** 104 Hart Senate Office Building Washington, DC 20510	**Utah**
Robert Menendez 528 Hart Senate Office Building Washington, DC 20510	**New Jersey**	***Jon Kyl*** 730 Hart Senate Office Building Washington, DC 20510	**Arizona**
Bill Nelson 716 Hart Senate Office Building Washington, DC 20510	**Florida**	***Pat Roberts*** 109 Hart Senate Office Building, Washington, DC 20510	**Kansas**
John D. Rockefeller IV 531 Hart Senate Office Building Washington, DC 20510	**West Virginia**	***Olympia Snowe*** 154 Russell Senate Office Building, Washington, DC 20510	**Maine**
Charles E. Schumer 313 Hart Senate Office Building Washington, DC 20510	**New York**		
Debbie Stabenow 133 Hart Senate Office Building Washington, DC 20510	**Michigan**		
Ron Wyden 223 Dirksen Senate Office Building Washington, DC 20510	**Oregon**		

1. For 2008, Many Dealers Get 5 Years' Worth of Inflation in a Single Year

For Dec. 31, 2008 inventories, many dealers on LIFO received a significant increase in their LIFO reserves for new vehicles as a result of considerable inflation reflected in the dealer invoice costs. This happened almost across the board; in many instances, a dealer's inflation index for 2008 was almost 5 times greater than its inflation index for the previous years.

Ironically, as the industry was falling on its face, most of the manufacturers continued to raise dealer invoice costs, which are the reference points for the computation of vehicle inflation under the Alternative LIFO Method. True, there were rebates, "discounts" and all sorts of gimmicks offered to reduce the prices of vehicles to the ultimate customers, but these do not affect the computation for LIFO purposes of how much vehicle prices went up or down.

Unfortunately, many dealers had overall decreases in their ending inventories (compared to their beginning-of-the-year inventories), and as a result, their LIFO reserves were reduced because of these decrements.

Inflation indexes for 2008 under the Alternative LIFO Method again beat IPIC/BLS deflation. In 2007, two full issues of the *LIFO Lookout* were devoted to explaining why it would be inadvisable for an auto dealership electing LIFO to give up almost all of its LIFO benefits by electing to use the IPIC/BLS Method. These analyses demonstrated conclusively that ***the Alternative LIFO Method would result in higher cumulative inflation indexes ... and considerably greater LIFO reserves*** for an auto dealership than if the IPIC/BLS Method indexes, in whatever variation, had been used.

The table below shows the results for 2008 and the 5 previous years.

Source: Bureau of Labor Statistics (www.bls.gov)	2003	2004	2005	2006	2007	2008
PPI Indexes (Table 6)						
Passenger Cars (New) (141101)	2.0%	1.7%	-3.4%	-0.3%	-0.2%	3.1%
Trucks (New) <= 14,000 lbs. (141105)	2.3%	1.0%	-5.9%	1.5%	-1.6%	2.5%
CPI Indexes (Table 3)						
New cars (45011)	-2.1%	0.5%	0.8%	0.2%	-0.4%	0.0%
New trucks (45021)	-1.5%	0.5%	-1.9%	-2.0%	-0.2%	0.0%
Used cars & trucks (Seta02)	-11.8%	4.8%	1.4%	-2.2%	0.5%	0.6%

Source: Bureau of Labor Statistics (www.bls.gov)	2007 December Index	2008 December Index	2008 Index	2008 Rounded (Above)
PPI Indexes (Table 6)				
Passenger Cars (New) (141101)	127.3	131.2	1.0306	3.1%
Trucks (New) <= 14,000 lbs. (141105)	147.2	150.9	1.0251	2.5%
CPI Indexes (Table 3)				
New cars (45011)	136.9	136.371	0.9961	0.0%
New trucks (45021)	141.5	141.191	0.9978	0.0%
Used cars & trucks (Seta02)	136.2	136.943	1.0055	0.6%

2. When in Doubt, File Form 970

"When in doubt, file Form 970." This LIFO mantra is always worth repeating.

Last year, in Letter Ruling 200812010, the IRS granted a taxpayer an extension of time to file a ***second*** Form 970 in connection with the shuffling of assets and the restructuring of a corporate group which involved the use of disregarded entities (Single Member Limited Liability Companies) and subsequent elections and deemed transfers of assets. This extension of time to file Form 970 was granted under the special relief provisions found in Reg. Sec. 301.9100-1(c).

Background. A taxpayer had purchased all of the assets of a business unit through a Single Member Limited Liability Company (SMLLC). This SMLLC was a disregarded entity for Federal income tax purposes. Under the entity classification Regulations, a business entity with one owner is classified as either a corporation or a disregarded entity (Reg. Sec. 301.7701-1(a)(4)). The default classification of a domestic LLC with one owner is a disregarded entity (Reg. Sec. 301.7701-3(b)(1)(ii). If an entity is disregarded, its activities are treated in the same manner as a sole proprietorship, branch, or division of the owner (Reg. Sec. 301.7701-2(a)).

In the LTR situation, the assets purchased included inventory and the taxpayer filed Form 970, electing the LIFO inventory method for the inventory for the taxable year of the purchase.

In a subsequent year, the SMLLC elected to be treated as a corporation under Reg. Sec. 301.7701-3(a). For income tax purposes, this conversion from disregarded entity status to corporation status was treated as if there had been a contribution of all of the SMLLC's assets and liabilities (including its inventory) to a subsidiary of the taxpayer in exchange for stock in the subsidiary in accordance with Reg. Sec. 301.7701-3(g)(1)(iv).

As a result, according to the IRS, the taxpayer should have filed a second Form 970 on behalf of the newly created (for tax purposes) subsidiary to which the deemed transfer of assets and liabilities was made.

The taxpayer had filed consolidated Federal income tax returns for the taxable year of the conversion and for subsequent years using the LIFO method and consistent with its having made a timely LIFO election on behalf of the subsidiary (which election, in fact, it had not made).

A review of these transactions in a still later year revealed the taxpayer's oversight in not filing a second Form 970. After reviewing the facts and circumstances, the IRS granted the taxpayer an extension of time to file the necessary Form 970 for the subsidiary.

Two lessons from this Letter Ruling...

1. You've got to watch the Form 970 filing requirements when you're dealing with disregarded entities, SMLLCs, successor entities, and the like.
2. When in doubt, file Form 970.

3. File Form 970 When a Partnership Is Terminated by Section 708

LTR 200914015 provides another good example of the LIFO Form 970 filing lessons above.

The facts in this LTR involve a consolidated group consisting of a parent corporation and two subsidiaries. One of the subsidiaries was a partner in a two-partner partnership in which the other partner was an unrelated party. In a subsequent year, the partnership interest owned by the unrelated party was bought out by the other/second subsidiary.

The partnership was using LIFO for valuing most of its inventory. The acquisition of the partnership interest by the second subsidiary (from the unrelated party) caused a technical termination of the partnership under Section 708(b)(1)(B) of the Internal Revenue Code. This Section provides that a partnership is considered to be terminated if, within a 12-month period, there is a sale or exchange of 50% or more of the total interest in partnership capital and profits. The Regulations provide that the partnership's taxable year closes with respect to all partners on the date on which the partnership terminates, with special rules for multiple transfers which cumulatively result in a transfer of 50% or more interest in the partnership.

After this change in partnership ownership, the existing LIFO layers were collapsed into a single layer which became the new partnership's beginning LIFO inventory.

The new partnership failed to attach the required Form 970 to its Federal income tax return, although it did, in subsequent years continue to identify its inventory as being on the LIFO method.

The partnership discovered its failure to file the required Form 970 in a later year when it was considering making a change in its LIFO methodology. At that time, it applied to the IRS for an extension of time to file Form 970 under Reg. Sec. 301.9100-1(c) which gives the Commissioner discretion to grant a reasonable extension of time to make this election ... providing various conditions are satisfied by the taxpayer. We won't go into the technicalities of all of these conditions (they've been covered in other issues of the *LIFO Lookout*).

The taxpayer was granted permission to file a Form 970 to save its LIFO election. However, remember that in this case, the taxpayer proceeded for many years on the assumption that it had a valid LIFO election, when in fact, its failure to file a Form 970 completely jeopardized its LIFO election.

This LTR shows, once again, the importance of filing Form 970 for LIFO inventories when seemingly innocuous changes in business ownership take place ... and that includes certain changes in the ownership of partnership interests, as well.

One final observation ... The LTR states that the permission granted by the IRS to the taxpayer to make the belated election by filing Form 970 was not to be interpreted as an opinion, expressed or implied, concerning the correctness of the collapsing of the LIFO layers when the partnership technically terminated under Section 708. From this statement by the IRS, should one infer that when the change in ownership took place, the taxpayer should have retained the individual years' LIFO layers - instead of creating a single, collapsed LIFO layer (analogous to the procedure under Rev. Proc. 94-61 and Section 1363(d) when a C corporation changes to S corporation status)?

4. IPIC User Must Use December ... Not November ... As Its Reference Month for Calculations

In ILM 200911008, the IRS clarified the relationship between the two criteria in the IPIC Regulations that are used to determine the selection of the month for pricing dollar-value IPIC LIFO pools. In this IRS Legal Memorandum, the IRS held that the IPIC taxpayer ***must use December, and not November***, for purposes of pricing its dollar-value LIFO pools because December was the month that is most consistent with (1) its method of determining current-year cost under Reg. Sec. 1.472-8(e)(2)(ii) and (2) its history of inventory production or purchases during the taxable year.

The taxpayer was a retailer basically purchasing goods for resale. It elected to use the IPIC LIFO Method. Its monthly purchases and product mix were fairly uniform during the year 2007. The taxpayer did not purchase seasonal goods. During 2007, the taxpayer's inventories turned 6.5 times (or once every 1.83 months). Thus, the mid-point of the taxpayer's last inventory turn occurred in December.

The taxpayer had elected to use the ***Most-Recent-Acquisitions Method*** to determine the current-year cost of inventories. The taxpayer did not elect to use a representative month for selecting price indexes from a BLS table. In addition, the taxpayer did not adopt the retail method. When preparing the Federal income tax return for that first taxable year, the taxpayer used price indexes published by the BLS for November to compute the Inventory Price Index (IPI) for both pools.

After selecting the appropriate BLS table, a taxpayer must determine which monthly BLS price indexes to use to compute the IPI for each pool. A taxpayer may determine the "appropriate" month each year or may elect to use a "representative" month. In either case, the taxpayer's selection must be based on the criteria described in Reg. Sec. 1.472-8(e)(3)(iii)(B)(3).

The ***first*** criterion in this Regulation requires only the identification of the taxpayer's method of accounting. For example, when a taxpayer's method of determining the current-year cost of inventories is the Earliest-Acquisitions Method, an early month in the taxable year will be appropriate, and a late month in the taxable year will not be appropriate. Conversely, when a taxpayer's method of determining the current-year cost of inventories is the ***Most-Recent-Acquisitions Method***, a late month in the taxable year will be appropriate, and an early month in the taxable year will not be appropriate.

The ***second*** criterion in this Regulation requires an analysis of the taxpayer's annual acquisition of goods. This criterion can require a result different from what would have obtained if only the first criterion were required.

One example in the Regulations shows how the appropriate month would be determined by a wholesaler of seasonal goods. In this example, the IPIC taxpayer has elected to determine the current-year cost using the Earliest Acquisitions Method. Although this taxpayer purchases inventory items regularly throughout the year, the items purchased vary according to the seasons. The seasonal items on hand at year-end (i.e., Dec. 31) are purchased between October and December. Thus, based on the taxpayer's use of the Earliest Acquisitions Method of determining current-year cost and its experience with inventory purchases, the appropriate month for the items represented in the ending inventory at December 31 is October because October is the earliest month in that seasonal purchasing cycle.

The result in this example reflects the application of the Regulation's two criteria to the taxpayer's inventories of seasonal goods, but in reverse order. ***First,*** the taxpayer must consider the purchase history of the items in *ending* inventories. The purchase history of items not represented in ending inventories is irrelevant. In this example, the relevant purchase history is all purchases during the months of October, November, and December. ***Second,*** the taxpayer must consider its method of determining the current-year cost of the items in the pool, which in this example, is the Earliest-Acquisitions Method. Therefore, in this example, October is the appropriate reference month.

It should be noted that the result in this example might have been different if the facts were different. Presumably, the fact that the taxpayer regularly purchases goods throughout the year means that the taxpayer regularly purchases seasonal goods throughout October, November, and December, too. But if this taxpayer had purchased 92% of its seasonal goods in December, the holding might have been that December is the appropriate month. In other words, the second criterion would have trumped the first criterion twice.

Applying the two criteria in Reg. Sec. 1.472-8(e)(3)(iii)(B)(3) to the taxpayer's facts in ILM 200911008, the IRS held that for 2007, ***the taxpayer should have used December as its appropriate month for both pools***. Under the first criterion, December is the month most closely linked to the taxpayer's use of the Most-Recent-Acquisitions Method of determining the current-year cost of inventories. Under the second criterion, because the taxpayer's purchases and product mix were fairly uniform during 2007, a different result (i.e., a different reference month) is not required.

IN TECHNICAL ADVICE, THE IRS REJECTS "ITEM" & "PRODUCT GROUP" DEFINITIONS THAT DO NOT CLEARLY REFLECT INCOME

The dollar-value LIFO method tracks changes in the dollar value of a taxpayer's inventory by grouping "items" of goods in its year-end inventories into "pools."

Under the dollar-value LIFO method, taxpayers are permitted to select one out of several sub-methods in order to determine the base-year cost and the LIFO value of an inventory pool at yearend. A discussion of these dollar-value LIFO sub-methods (i.e., double-extension, link-chain, index and IPIC) is not germane to the purpose of this article.

Regardless of which choice or sub-method is selected from these alternatives, what is common to each one is the importance of properly defining which goods or items of inventory will be placed together, or pooled, for purposes of computing price change inflation indexes.

CRITERIA FOR ITEM DETERMINATION

LIFO practitioners, IRS representatives, and even Tax Court judges all seem to agree on two basic points concerning LIFO. ***First***, the definition or scope of an "item" is a critical element of the dollar-value LIFO inventory method. ***Second***, neither the Code nor the Regulations provide a definition of the technical term "item."

The Tax Court has held that the proper definition of an ***"item"*** for dollar-value LIFO purposes depends on the specific facts and circumstances of each case. Whether a taxpayer has properly defined its inventory "items" must be examined in light of the objectives of the dollar-value LIFO method.

These objectives are... (1) to eliminate from earnings any artificial profit resulting from inflationary increases in inventory cost, and (2) to insure that any increase in cost of property passing through the inventory during the year is reflected in the cost of goods sold.

In TAM 200624066, the IRS added what some might consider to be a third objective of the dollar-value LIFO method. In this TAM, the IRS said... "Another major objective of the dollar-value method is to free taxpayers from the requirement of taking into account minor technological changes in a product."

It should be expected that what a taxpayer considers to be an "item" for dollar-value LIFO purposes and how the taxpayer groups these "items" in its LIFO calculations will be subject to careful scrutiny by the IRS. In this regard, the taxpayer's determinations must be able to satisfy ... or pass the litmus tests ... of the three objectives described above.

What is of equal - if not greater - significance is the fact that ***LIFO index calculations should not include or reflect any factors other than inflation.***

In other words, LIFO computations should not include (as if they were inflation) the effects of different inventory mix or composition, nor should the LIFO computations reflect the effect of (major) technological changes in the products as if those changes were changes due to inflation.

GREATER IRS SURVEILLANCE OVER ITEM DEFINITIONS

The IRS significantly emphasized the importance it attaches to the term "item" when it revised the LIFO election Form 970 in December 2005. The revised Form (which is still current) added two new questions which require specific, detailed answers. On Page 2, one of the questions (#13) added simply reads... *"Attach a statement describing the applicant's method of defining 'items'."*

Obviously, a taxpayer's response to this question is intended to allow an IRS examining agent who is familiar with LIFO matters to quickly see whether the taxpayer electing LIFO has properly dealt with this nebulous issue.

The instructions for Form 970 include no further comments or explanation relative to what is meant by the use of the word "item." (For a full discussion of the revised Form 970, see "New LIFO Election Form 970 Gets More than a Face-Lift" in the March 2006 *LIFO Lookout*.)

WINERY'S ITEM DEFINITIONS

In the March 2007 issue of the *LIFO Lookout*, we analyzed the matter of item definition in connection with a winery's LIFO calculations. In Field Attorney Advice 20064301F, the IRS concluded that the winery's LIFO inflation indexes did not "clearly reflect income." Accompanying that article were supplementary discussion materials on the importance of item definition and analyses of a few of the LIFO "landmark" cases on this subject.

FURNITURE MANUFACTURERS' ITEM DEFINITIONS

In the December 2007 issue of the *LIFO Lookout* (Update item #6 on page 2), passing mention was →

(Continued from page 10)

made of TAM 200735020. A more detailed analysis of this TAM follows this brief introductory article.

This TAM involved a rather complicated consolidated group of corporations. They were all using LIFO, and, apparently, were engaged in the business of manufacturing furniture.

Six entities involved in this TAM were using the dollar-value LIFO method for their respective LIFO inventories. For these entities, the issue was whether (or not) their definitions of items were too broad. The IRS said they were.

The other two entities involved were using the specific-goods LIFO method for their respective LIFO inventories. For these entities, the issue was whether (or not) their definitions of product groups were too broad, and the IRS also said they were. The IRS added that for these entities using the specific-goods LIFO method, the term "product group" is broad enough to include all the stock-keeping units (SKUs) that may be combined into a single "item" under the dollar-value method.

In other words, the IRS held that all of the members of the consolidated group were using improper definitions (technically, methods of accounting) in their LIFO computations.

The IRS rationale common its conclusion on both issues was simply that ***the definitions used (in both cases) compensated the taxpayers for the effects of artificial inflation resulting from changes in quality and product mix.*** The problem was that the definitions used by the taxpayers allowed factors other than inflation to corrupt their LIFO inventory valuations.

The National Tax Office cited the Tax Court's decision in *Amity Leather Products Co.* in 1984 in its resolution of the issue for the members of the consolidated group using the dollar-value LIFO method. Because of the importance of this case, we've included a summary of it along with our analysis of the TAM.

Another case cited by the National Office in the TAM was *E.W. Richardson.* This case, decided by the Tax Court in 1996 involved the technicalities of item definitions in connection with an automobile dealership's use of the LIFO method to value its new vehicle inventories. The *Richardson* case is discussed at length in the September 1996 issue of the *LIFO Lookout.*

REFINERY'S ITEM DEFINITIONS

To emphasize the fact that this topic of item definition continues to be closely monitored by the IRS, an even more recent ruling of the IRS in 2008 held that an oil refiner's definitions of inventory items were too broad and, therefore, they did not clearly reflect income. A summary of IRS Field Attorney Advice (FAA) 20080401F follows the discussion of the TAM.

CONCLUSION

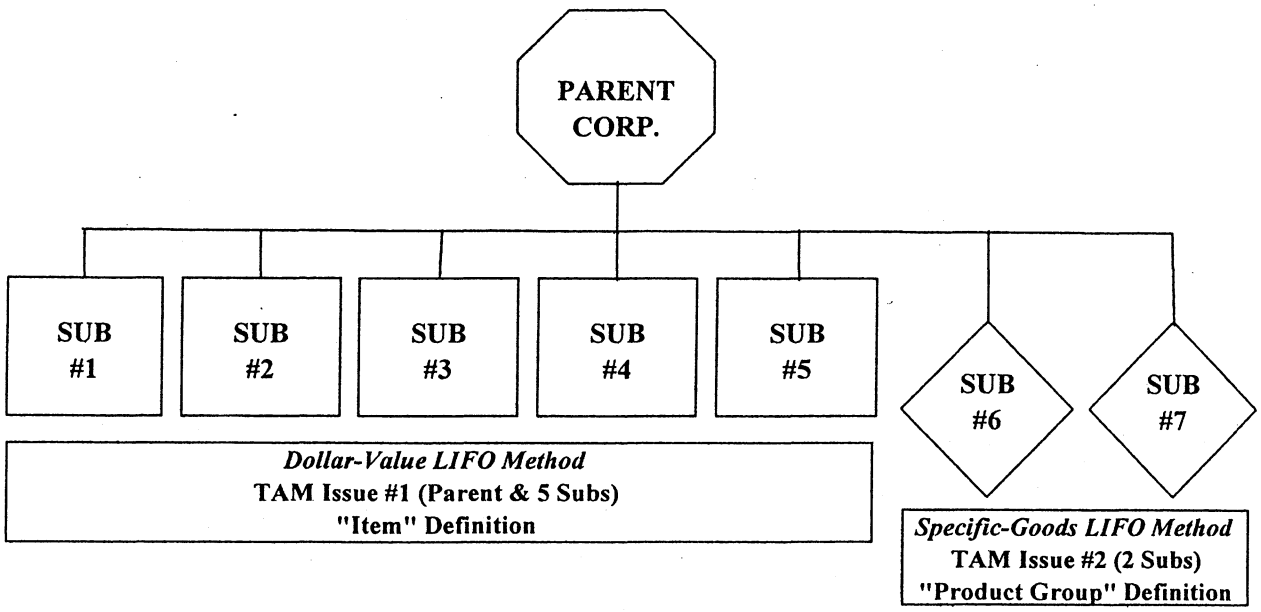
As evidenced by the list on page 27 of articles and previous coverage of this subject in the *LIFO Lookout*, there has been no shortage of controversies over "item definition" in the past. As long as the LIFO method is permitted, you can reasonably expect that controversies will continue to arise (in TAMs or Court cases) in the future.

TAM 200735020

IRS REJECTS LIFO METHODS THAT USE BROAD DEFINITIONS OF INVENTORY ITEMS & PRODUCT GROUPS

TAM 200735020 Facts	***IRS REJECTS CONSOLIDATED GROUP'S USE OF BROAD DEFINITIONS OF INVENTORY ITEMS & PRODUCT GROUPS***
Overview	• This TAM has a rather complicated factual background, and it involves 8 different entities (counting the parent corporation) that used LIFO for their raw materials inventories. • In a consolidated return setting, the parent and each member establishes its own LIFO methods and practices (the parent cannot make a binding LIFO election for its subsidiaries). ◆ Some members used the dollar-value method ... Others used the specific-goods method. • This TAM involves two issues, each of which addresses how broadly - or how narrowly - users of each LIFO method can define like items or product groups for computation purposes. • In both instances, the ultimate standard is whether the method used results in the "clear reflection of income."
Nature of the Business	• Taxpayer is the common parent of a consolidated group whose members collectively operate one of the five largest businesses of its type in the U.S. • The members acquire four different *Input* types from primary producers. These *Input* types are acquired in five different product *Input* forms, and other finished forms. • Upon receiving an order from a customer, a member processes or distributes, or both, products made from the applicable *Input* to meet the customer's specifications. • ***The majority of the goods in a member's inventories are classified as "raw materials."*** ◆ In general, the member changes only the shape or size, or both, of the product purchased from a primary producer. ◆ Though a member generally will not process *Input* until an order is received from a customer, it will process some standard-sized goods for quick turnaround.
LIFO Election Matters	• Some members' activities are more expansive than others in terms of the overall business. • The common parent of the consolidated group was the first to elect LIFO. ◆ It elected to the dollar-value LIFO inventory method (DVM). ◆ Since electing LIFO, Taxpayer has been under continuous examination by the IRS. • The parent corporation and its 7 subsidiaries made their LIFO elections in different years. ◆ ***Five members*** (subsidiaries) elected to use the dollar-value LIFO inventory method. ◆ ***Two members*** (subsidiaries) elected to use the specific-goods LIFO inventory method.
Dollar-Value Method Users	• ***Five members*** elected to use the dollar-value LIFO inventory method (DVM users). ◆ These members pooled their inventory items based on ***major line, type, or class of goods***. • Depending on the nature of its business, each member using DVM maintains from one to three dollar-value pools. ◆ ***Pool Type 1*** generally will include up to 8 different products. ◆ ***Pool Type 2*** generally will include up to 5 different products. ◆ ***Pool Type 3*** generally will include up to 5 different products.
Specific-Goods Method Users	• ***Two other members*** elected to use the specific-goods LIFO inventory method (SGM users). ◆ These members use *"units"* as the unit of measurement for each class or type of goods. • One of these SGM users processes or distributes, or both, only *Input Type 1* materials. ◆ These materials are accounted for as a single class or type of goods. • The other SGM user has more expansive activities insofar as it processes or distributes, or both, *Input Type 1*, *Input Type 2*, and *Input Type 3* materials. • These materials are accounted for in three distinct classes or types of goods.
Product Information	• Information submitted by one of the subsidiaries using the DVM indicates that it has inventories in several locations. Summary data is provided for 15 product groups at each location. ◆ Various types of goods (denoted as "product lines") are summarized into those 15 product groups. Information provided for each produce line includes (1) pieces on hand, (2) quantity on hand in unit of measurement ("UM"), (3) cost per UM, (4) value, (5) pieces available, and (6) quantity available in unit of measurement. ◆ Though some names differ, it appears that each "product group" has a corresponding *"Pool Type (Product)."* • Cost per unit of measurement varies among the product lines within a product group. ◆ For example, in *Product Group 1* for *Location A*, *Product Line 1* costs *$X* per UM; *Product Line 2* costs *$Y* per UM, and *Product Line 3* costs *$Z* per UM. • For book purposes, some members maintain records for each stock keeping unit (SKU).

TAM 200735020 ... CONSOLIDATED GROUP OF FURNITURE MANUFACTURERS



TAM 200735020	*THE CONSOLIDATED GROUP ... TAM REDACTION LEGEND TO CONVEY COMPLEXITY OF FACT PATTERNS*	
Member 1 = * * * Member 2 = * * * Member 3 = * * * Member 4 = * * * Member 5 = * * * Member 6 = * * * Member 7 = * * * Description of Business = * * * • (See Note below) Year 1 = * * * Year 2 = * * * Year 3 = * * * Year 4 = * * * Year 5 = * * * Input = * * * Input Type 1 = * * * Input Type 2 = * * * Input Type 3 = * * * Input Type 4 = * * * *Note: In our description, we are referring to this consolidated group as "furniture manufacturers."*	Pool Type 1 = * * * Pool Type 2 = * * * Pool Type 3 = * * * Pool Type 1 (Product 1) = * * * Pool Type 1 (Product 2) = * * * Pool Type 1 (Product 3) = * * * Pool Type 1 (Product 4) = * * * Pool Type 1 (Product 5) = * * * Pool Type 1 (Product 6) = * * * Pool Type 1 (Product 7) = * * * Pool Type 1 (Product 8) = * * * Pool Type 2 (Product 1) = * * * Pool Type 2 (Product 2) = * * * Pool Type 2 (Product 3) = * * * Pool Type 2 (Product 4) = * * * Pool Type 2 (Product 5) = * * * Pool Type 3 (Product 1) = * * * Pool Type 3 (Product 2) = * * * Pool Type 3 (Product 3) = * * * Pool Type 3 (Product 4) = * * * Pool Type 3 (Product 5) = * * *	Product Input Form 1 = * * * Product Input Form 2 = * * * Product Input Form 3 = * * * Product Input Form 4 = * * * Product Input Form 5 = * * * Product Group 1 = * * * Location A = * * * Product Line 1 = * * * Product Line 2 = * * * Product Line 3 = * * * Amount 1 = * * * Amount 2 = * * * Amount 3 = * * * Product Line 1-1-1 = * * * Product Line 1-1-2 = * * * Product Line 1-1-3 = * * * Product Line 1-1-4 = * * * Product Line 1-1-5 = * * * Product Line 1-1-6 = * * * Product Line 1-1-7 = * * * Product Line 1-1-8 = * * * Product Line 1-1-9 = * * * Product Line 1-1-10 = * * * Product Line 1-1-11 = * * * Product Line 1-1-12 = * * * Units = * * *

Issue #1 - DVM Item Definition	***ITEM DEFINITIONS EMPLOYED BY THE MEMBERS USING THE DOLLAR-VALUE LIFO METHOD DO NOT CLEARLY REFLECT INCOME***
Scope	• ***Issue...*** Have the members that use the dollar-value LIFO method defined their inventory "items" too broadly, and thus fail to satisfy the *clear reflection of income* standard? • This applies to the common parent and the 5 subsidiaries using the ***dollar-value method*** (DVM).
Taxpayer's & IRS' Positions	• Taxpayer's position is that an *"item"* (in the context of its LIFO application) should be defined broadly because of the nature of its inventories. ◆ Under Taxpayer's item-definition method, *Pool Type 1* will continue to have only 8 items, including *Pool Type 1 (Product 1)*. ▪ For example, in *Location A*, *Member 1's Pool Type 1 (Product 1)* includes the following "product lines": *Product Line 1-1-1*, *Product Line 1-1-2*, *Product Line 1-1-3*, *Product Line 1-1-4*, *Product Line 1-1-5*, *Product Line 1-1-6*, *Product Line 1-1-7*, *Product Line 1-1-8*, *Product Line 1-1-9*, *Product Line 11-10*, *Product Line 1-1-11*, and *Product Line 1-1-12*. • IRS Agent's position is that *"item"* should be defined as narrowly as each member's books and records will allow. ◆ Under IRS Agent's position, each member will have one item for each stock keeping unit (SKU). ◆ According to Exam's view, this (i.e., one item for each SKU) is the only item-definition method that will prevent the member's LIFO indexes from including artificial inflation caused by changes in quality and product mix.
National Tax Office Position	• The members using the DVM method have defined "item" too broadly to clearly reflect income. ◆ ***The members' definition of an "item" compensates them for the effects of artificial inflation resulting from changes in quality and product mix.*** ◆ For example, the 12 product lines comprising *Member 1's Pool Type 1 (Product 1)* have significantly different uses and unit costs. ◆ Furthermore, it is not at all clear that the same cannot be said about the various products that comprise each of these product lines.
Discussion	• The purpose of the LIFO method is to permit a taxpayer to exclude the effects of inflation (i.e., steadily rising cost of replacement goods) from its computation of gross income. • But the LIFO method was not designed to compensate for the effects of artificial inflation, which can result from changes in quality and product mix. (See *Amity Leather Products Co. v. Commissioner*, 82 T.C. 726, 733 (1984)) • To minimize the effects of artificial inflation under the dollar-value LIFO method, the regulations require taxpayers to assign "items" to one or more dollar-value pools. Unfortunately, neither the Code nor the applicable regulations define "item." • However, the Tax Court in *Amity Leather Products Co.* opined that ... ◆ ***A narrower definition will provide a more accurate measure of inflation*** (i.e., price index). ◆ The definition of "item" must be administratively feasible and not unduly burdensome from the standpoint of each of the parties (i.e., the taxpayer and Exam). • Stated differently, the definition of "item" depends on the taxpayer's facts and circumstances. • In our view (i.e., the view of the National Tax Office), Exam's proposed definition will exclude the effects of artificial inflation from each member's LIFO indexes without imposing an unnecessary administrative burden on those members because they already maintain inventory data at the SKU level. (See *Richardson v. Commissioner*, T.C. Memo. 1996-368 (1996))

Issue #1 - DVM Item Definition	***ITEM DEFINITIONS EMPLOYED BY THE MEMBERS USING THE DOLLAR-VALUE LIFO METHOD DO NOT CLEARLY REFLECT INCOME***
Possible Combination of 2 or More SKUs	• Because the definition of an "item" depends on the taxpayer's facts and circumstances, more than one item-definition method may clearly reflect income in a particular case. ◆ Thus, a taxpayer may combine two or more SKUs into a single "item" for LIFO purposes provided that: ▪ All the SKUs combined into that item are essentially the same product; and ▪ The characteristic(s) that distinguish one SKU from all the other SKUs combined into that item do not affect the unit cost of the goods assigned to those SKUs or to that item.
Example ***"Macho Man" Shirts***	• A department store pays $20 for each Brand X all-cotton "Macho Man" dress shirt (regardless of the shirt's color, collar size, or sleeve length). • It then assigns these shirts to specific stockkeeping numbers. ◆ Size 16-33 blue dress shirts are assigned to SKU #11 ◆ Size 17-34 blue dress shirts are assigned to SKU #12 ◆ Size 16-33 white dress shirts are assigned to SKU #21 ◆ Size 17-34 white dress shirts are assigned to SKU #22 • This department store may combine all four SKUs into one item (e.g., Item #1). ◆ This would be permissible because the differences in color, collar size, and sleeve length do not affect the unit cost of the shirts assigned to each of these SKUs or to Item #1. ◆ Thus, the department store's inflation index for "Macho Man" dress shirts will be the same regardless of changes in product mix. • In other words, the department store's inflation index for "Macho Man" dress shirts will continue to move in the same direction and at the same rate regardless of whether the department store treats each SKU as a separate item or combines all four SKUs into one item.
Example ***"Girlie Man" Shirts***	• If that same department store pays $25 for each Brand X "Girlie Man" all-cotton dress shirt (regardless of the shirt's color, collar size, or sleeve length), the department store may combine all the related SKUs into one item (e.g., Item #2). • ***However,*** the department store may not combine the "Macho Man" and the "Girlie Man" dress shirts into one item. ◆ Although both types of Brand X dress shirts are all-cotton, the cost of the cotton used in these dress shirts is only one of the factors that affects the prices set by the supplier of these shirts. • Similarly, if a manufacturer of ice cream pays $100 for a 100-pound bar of dark chocolate and $50 for 50-pound bar of dark chocolate, the unit cost (i.e., cost per pound of dark chocolate) paid for bars of dark chocolate should continue to move in the same direction. ◆ The manufacturer's inflation index will be the same regardless of whether the manufacturer treats 100-pound and 50-pound bars of dark chocolate as separate items or combines them into the same item.
Conclusion	• The TAM conclusion is that the members of Taxpayer's consolidated group that use the dollar-value LIFO method have defined their inventory "items" too broadly to clearly reflect income.

Issue #1 *Dollar-Value Regulations*	*ISSUE #1 ... LIFO REGULATIONS ON POOLING APPLICABLE TO ITEM DEFINITIONS EMPLOYED BY MEMBERS USING THE DOLLAR-VALUE LIFO METHOD*
In General	• The dollar-value method of valuing LIFO inventories (DVM) is a method of determining cost by using "base-year" cost expressed in terms of total dollars rather than the quantity and price of specific goods as the unit of measurement. • Although the Regulations use the term "item" ... that term is not defined in the Regulations. • Under the DVM, the goods/items contained in the inventory are grouped into a pool or pools.
Multiple Pools **Reg. Sec. 1.472-8(b)(3)(i)(a)**	• A taxpayer may elect to establish multiple pools for inventory items which are not within a natural business unit as to which the taxpayer has adopted the natural business unit method of pooling. • Each such pool shall ordinarily consist of a group of inventory items which are substantially similar. • In determining whether such similarity exists, consideration shall be given to all the facts and circumstances. • The formulation of detailed rules for selection of pools applicable to all taxpayers is not feasible. • Important considerations to be taken into account include, for example, whether... ◆ There is substantial similarity in the types of raw materials used or in the processing operations applied, ◆ The raw materials used are readily interchangeable ◆ There is similarity in the use of the products ◆ The groupings are consistently followed for purposes of internal accounting and management, and ◆ The groupings follow customary business practice in the taxpayer's industry. • The selection of pools in each case must also take into consideration such factors as... ◆ The nature of the inventory items subject to the dollar-value LIFO method and ◆ The significance of such items to the taxpayer's business operations. • Where similar types of goods are inventoried in natural business units and multiple pools of the taxpayer, the Commissioner may apportion or allocate such goods among the natural business units and the multiple pools, if he determines that such apportionment or allocation is necessary ***in order to clearly reflect the income of the taxpayer.***
Raw Materials **Reg. Sec. 1.472-8(b)(3)(i)(b)**	• Raw materials which are substantially similar shall be pooled together. • However, inventories of raw or unprocessed materials of an unlike nature may not be placed into one pool, even though such materials become part of otherwise identical finished products.
Finished Goods & Goods In Process **Reg. Sec. 1.472-8(b)(3)(i)(c)**	• Finished goods and goods-in-process in the inventory shall be placed into pools classified by major classes or types of goods. ◆ The same class or type of finished goods and goods-in-process shall ordinarily be included in the same pool. • Where the material content of a class of finished goods and goods-in-process included in a pool has been changed, for example, to conform with current trends in an industry, a separate pool of finished goods and goods-in-process will not ordinarily be required unless the change in material content results in a substantial change in the finished goods.
Acceptability of Pooling Methods **Reg. Sec. 1.472-8(d)**	• Whether the number and the composition of the pools used by the taxpayer is appropriate, as well as the propriety of all computations incidental to the use of such pools, will be determined in connection with the examination of the taxpayer's income tax returns. • ***Adequate records must be maintained to support the base-year unit cost as well as the current-year unit cost for all items priced on the dollar-value LIFO inventory method.*** ◆ This requirement must be met regardless of the method authorized by Reg. Sec. 1.472-8(e) (i.e., double-extension, link-chain, index, IPIC, etc.) which is used by the taxpayer to compute the LIFO value for its dollar-value pool(s). • The pool or pools selected must be used for the year of adoption and for all subsequent taxable years unless a change is required by the Commissioner in order to clearly reflect income, or unless permission to change is granted by the Commissioner or required under other provisions of the Regulations.

Amity Leather Products

FACTORING THE EFFECTS OF CHANGE IN PRODUCT MIX & DIFFERENT PRODUCTION LOCATIONS OUT OF LIFO INDEXES

Amity Leather Products Co. ... 82 T.C. 726 (1984)

In this "LIFO landmark" case, the Tax Court explained the importance of determining exactly what an "item" is ...

"The nature of "items" in a pool must be similar enough to allow a comparison between ending inventory and base-year inventory. Because the change in the price of an item determines the price index and that index affects the computation of increments or decrements in the LIFO inventory, the definition and scope of an item are extremely important to the clear reflection of income. ***If factors other than inflation enter into the cost of inventory items, a reliable index cannot be computed.***

"For example, if a taxpayer's inventory experiences mix changes that result in the substitution of less expensive goods for more expensive goods, the treatment of those goods as a single item increases taxable income. This occurs because any inflation in the cost of an item is offset by the reduction in cost resulting from the shift to less expensive goods. Conversely, if ***changes in mix of the inventory*** result in the substitution of more expensive goods for less expensive goods, the treatment of those goods as a single item decreases taxable income because the increase in inventory costs is eliminated from the LIFO cost of the goods as if such cost increase represented inflation.

"***A narrower definition of an item within a pool will generally lead to a more accurate measure of inflation (i.e., price index) and thereby lead to a clearer reflection of income.*** At the same time, the method of inventory accounting must be administratively feasible and not unduly burdensome from the standpoint of each of the parties. Within limits of reasonableness, regulations governing LIFO inventory accounting have to be applicable across the board. Whether they achieve the best result in a particular fact situation is not controlling."

The pricing of ***new items*** entering a pool for the first time can also be especially significant for inventories subject to technological change. Generally, over the long run, repricing new items entering an inventory for the first time may result in significant differences depending on how they are repriced. Reconstructing base year costs for new items will usually result in lower inventory values and correspondingly lower reported income and taxes than if the current cost approach is used in determining the comparative cost of these new items (because the current approach will assign higher, more current costs of new items, thereby creating a higher inventory valuation and correspondingly higher reported income and taxes).

In *Amity Leather Products*, the Tax Court held that the taxpayer was required to treat leather goods acquired from a division located in Puerto Rico as a different or separate pool from its own domestic manufactured goods. This was based on a finding that the corporation was a wholesaler - and not a manufacturer - with respect to the Puerto Rican goods. As such, it was required to break its single inventory pool comprised of leather goods manufactured domestically by it and finished goods acquired from its foreign subsidiaries into two (2) inventory pools, one for manufactured goods and a separate pool for purchased or acquired goods.

With respect to the issue of whether leather goods manufactured by the division located in Puerto Rico constituted a new "item," the Tax Court found for the taxpayer. The Court held that the taxpayer was entitled to reconstruct the base year unit cost(s) of that item - apparently the reconstructed base year cost would be lower than the current costs. The Court concluded, "we are unaware, however, of any authority that defines that term (i.e., the term "item") as it applies ***to a manufacturer***. Our task, therefore, is to view that term in the context of a manufacturing operation in a manner that most closely satisfies the purpose of maintaining inventories, i.e., the clear reflection of income."

The Tax Court rejected the IRS position that would have treated billfolds manufactured by Amity in Puerto Rico and those manufactured in the United States as being the same item since that approach "would lead to an inaccurate measure of any inflation or deflation." The Tax Court pointed out that ...

1. Puerto Rican billfolds cost substantially less than domestic billfolds to manufacture. Therefore, the IRS approach would result in the assumed or "constructive" substitution of less expensive goods for more expensive goods in the cost of goods sold computation.
2. Any inflation in the cost of domestic billfolds would be at least partially offset by a shift to Puerto Rican billfolds in the LIFO valuation of the inventory.
3. The ratio of billfolds manufactured in the United States in relation to billfolds manufactured in Puerto Rico may change in the future.
4. It is likely that the rate of inflation in Puerto Rico may vary from the rate of inflation in the United States.
5. The taxpayer's treatment of the billfolds manufactured in Puerto Rico as a separate item from domestically manufactured billfolds results in a more narrow definition of the term "item." Under that approach, the impact of inflation is more accurately eliminated and income is more clearly reflected.

Issue #2 - SGM Product Groups	***PRODUCT GROUP DEFINITIONS EMPLOYED BY THE MEMBERS USING THE SPECIFIC-GOODS LIFO METHOD DO NOT CLEARLY REFLECT INCOME***
Scope	• ***Issue...*** Have the members that use the specific-goods LIFO method defined their inventory "product groups" too broadly, and thus fail to satisfy the *clear reflection of income* standard? • This addresses the 2 subsidiaries in the group that are using the ***specific-goods method*** (SGM).
Taxpayer's Four Arguments	• *#1* ... Taxpayer argues that "product group" should be defined broadly. Under Taxpayer's approach, its inventories of *Input Type 1* will continue to have only 8 product groups analogous to the items used by the members using dollar-value LIFO. • *#2* ... Taxpayer contends that when Congress enacted the LIFO method in 1938 to benefit smelters, refiners, and producers of primary metals, Congress could not have intended for these taxpayers to account for inventories at the SKU level because computers and calculators, the tools needed to compute LIFO inventories at the SKU level, had not been invented. • *#3* ... Taxpayer cites Reg. Secs. 1.472-1(e) (concerning the cotton textile industry) and 1.472-1(f) (concerning the pork-packing industry) for the proposition that not all "marked" differences in raw materials require a taxpayer to assign them to different product groups. • *#4* ... Taxpayer argues that the price it pays for the goods assigned to a particular product group (e.g., *Product Group 1*) depends primarily on the commodity prices of the materials used to produce those goods. • ***Taxpayer's conclusion...*** Taxpayer's method of accounting for LIFO inventories in readily determinable units of measurement (e.g., pounds, tons, feet, yards, gallons, barrels) is permissible.
National Tax Office Position	• The two members of the consolidated group using the SGM have defined "product group" too broadly to clearly reflect income. ◆ ***The members' definition of "product groups" compensates them for the effects of artificial inflation resulting from changes in quality and product mix.*** • Under the specific-goods LIFO method, a product group functions as something akin to an item-pool. ◆ In other words, goods within a single product group must be similar, but need not be identical. • However, Taxpayer has not shown that the product group definition method used actually results in the assignment of inventoriable goods to product groups based on "character, quality, and price" as required by the Regulations. (See Reg. Sec. 1.472-1(d)) • The National Tax Office is not persuaded by the arguments that Taxpayer has raised as a result of its reliance on Reg. Secs. 1.472-1(e) and (f). This is discussed further below
"Pork Packing Industry" Example in Regs Does Not Support Taxpayer's Position	• Reg. Sec. 1.472-1(f) provides that, as to the pork packing industry, a live hog is considered as being composed of various raw materials, different cuts of a hog varying markedly in price and use. ◆ The Regulation adds ... "Generally a hog is processed into approximately 10 primal cuts and several miscellaneous articles. However, due to similarity in price and use, ***these*** may be grouped into fewer classifications, each group being classed as one raw material." [Emphasis added] • *[But exactly what grouping in that sentence is referred to by the use of the word "these"?]* • According to the National Tax Office (NTO), although the use of the word "these" in the preceding sentence in the Regulations creates ambiguity, the better reading of the sentence is that "these" refers to the "several miscellaneous articles/cuts," which are more likely to have a "similar price and use" than the "different articles/cuts," which the first sentence states "vary markedly" in price and use. • The NTO goes on to state that ... "Regardless, Taxpayer has not shown that the various goods falling within each member's product group are analogous in any way to the cuts of pork that come from a hog, especially those several miscellaneous cuts of pork that are similar in price and use."

"Cotton Industry" Example in Regs Does Not Support Taxpayer's Position	• Reg. Sec. 1.472-1(e) provides that in the cotton textile industry there may be different raw materials depending upon marked differences in length of staple, in color or grade of the cotton. ◆ However, where different staple lengths or grades of cotton are being used at different times in the same mill to produce the same class of goods, such differences would not necessarily require the classification into different raw materials. • According to the National Tax Office, Reg. Sec. 1.472-1(e) provides that "cotton" might have to be treated as more than one raw material depending upon marked differences in the length of staple, in color, or in grade, ***it also provides a potential exception*** when the various types of cotton are used interchangeably in the same mill to produce the same class of goods. • ***Taxpayer has not shown that the various goods falling within each member's product group*** (e.g., *Product Group 1*) ***are interchangeable***, in the sense of Reg. Sec. 1.472-1(e), ***with the other goods in that product group.*** • In addition, Taxpayer's argument concerning commodity prices applies equally to the wood products used by furniture manufacturers. • The National Tax Office provides two examples… ◆ ***Example 1.*** A reasonable furniture manufacturer will recognize that sheets of exterior-grade plywood, sheets of medium density fiberboard (MDF), cherry boards, and cherry posts are not members of the same product group because these products do not share the same character, quality, and price. ▪ However, when defining "product groups," that furniture manufacturer may not end its analysis at this point ("first cut"). ◆ ***Example 2.*** The furniture manufacturer may not assign all cherry posts (e.g., 2x2 posts, 4x4 posts, 6x6 posts) to a single product group. ▪ Although all cherry posts are made from the same input (i.e., cherry wood), a 2x2 post generally is not interchangeable with a 6x6 post. ▪ Furthermore, a 2x2 post generally will cost less per board foot than a 6x6 post of the same grade of cherry. ◆ Regrettably, when defining their "product groups," the members of the consolidated group using the specific-goods method stopped at their equivalent of the "first cut."
Possibly, Some Good News	• The NTO added that because the definition of "product group" depends on the taxpayer's facts and circumstances, ***more than one definition method may clearly reflect income in a particular case.*** • It concluded … "Thus, each member of Taxpayer's consolidated group (using the SGM) may be permitted to combine two or more SKUs into a single 'product group' for LIFO purposes, provided that all the SKUs combined into that product group are similar in character, quality, and price." • Whether a group of SKUs are similar in character, quality and price is a factual issue. ◆ For example, in the case of our furniture manufacturer, 2x2 cherry posts of various lengths may be part of the same product group. • In any event, "product group" is broad enough to include all the SKUs that may be combined into a single "item" under the dollar-value method.
Conclusion	• The TAM conclusion is that the members of Taxpayer's consolidated group that use the specific-goods LIFO method defined their inventory "product groups" too broadly to clearly reflect income.

Issue #2 *Specific-Goods Regulations*	*ISSUE #2 ... LIFO REGULATIONS APPLICABLE TO PRODUCT GROUP DEFINITIONS EMPLOYED BY MEMBERS USING THE SPECIFIC GOODS LIFO METHOD*
In General	• Under the specific-goods Last-In, First-Out (LIFO) inventory method, the taxpayer is permitted to treat those goods remaining on hand at the close of the taxable year as being: ◆ Those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof, and ◆ Those acquired during the taxable year. • The LIFO inventory method is not dependent upon the character of the business in which the taxpayer is engaged, or upon the identity or want of identity through commingling of any of the goods on hand.
Manufacturer or Processor **Reg. Sec. 1.472-1(c)**	• A manufacturer or processor who has adopted the LIFO inventory method as to a class of goods may elect to have such method apply to the raw materials only (including those included in goods in process and in finished goods) expressed in terms of appropriate units. • If such method is adopted, the adjustments are confined to costs of the raw material in the inventory and the cost of the raw material in goods in process and in finished goods produced by such manufacturer or processor and reflected in the inventory.
Raw Material Comparisons **Reg. Sec. 1.472-1(d)**	• Raw material in the opening inventory must be compared with similar raw material in the closing inventory. • There may be several types of raw materials, depending upon the character, quality, or price, and each type of raw material in the opening inventory must be compared with a similar type in the closing inventory.
Specific Industry Examples	• Cotton textile industry ... Reg. Sec. 1.472-1(e) ... See TAM analysis • Pork packing industry ... Reg. Sec. 1.472-1(f) ... See TAM analysis
Use of Average Cost **Reg. Sec. 1.472-2(c)**	• Goods of the specified type included in the opening inventory of the taxable year for which the LIFO method is first used shall be considered as having been acquired at the same time and at a unit cost equal to the actual cost of the aggregate divided by the number of units on hand. • The actual cost of the aggregate shall be determined pursuant to the inventory method employed by the taxpayer under the regulations applicable to the prior taxable year with the exception that restoration shall be made with respect to any writedown to market values resulting from the pricing of former inventories.
Goods in Ending Inventory **Reg. Sec. 1.472-2(d)**	• Goods of the specified type on hand as of the close of the taxable year in excess of what were on hand as of the beginning of the taxable year shall be included in the closing inventory, regardless of identification with specific invoices and regardless of specific cost accounting records. • These goods (in ending inventory), are to be included at costs which will be dependent upon the character of the transactions in which the taxpayer is engaged. In other words, different rules for determining costs will apply depending on the nature of the business. ◆ ***(1) If the taxpayer is engaged in the purchase and sale of merchandise*** (such as a retail grocer or druggist), ***or engaged in the initial production of merchandise and its sale without processing*** (such as a miner selling his ore output without smelting or refining), ***such costs shall be determined...*** (a) By reference to the actual cost of the goods most recently purchased or produced; (b) By reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; (c) By application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced, the goods reflected in such inventory increase being considered for the purposes of *Section 472* as having been acquired all at the same time; or (d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income. ◆ ***(2) If the taxpayer is engaged in manufacturing, fabricating, processing, or otherwise producing merchandise,*** such costs shall be determined... ▪ In the case of raw materials purchased or initially produced by the taxpayer, in the manner elected by the taxpayer under (1) above to the same extent as if the taxpayer were engaged in purchase and sale transactions; and ▪ In the case of goods in process, regardless of the stage to which the manufacture, fabricating or processing may have advanced, and in the case of finished goods, pursuant to any proper method which, in the opinion of the Commissioner, clearly reflects income.

LIFO Lookout Articles Involving "Item" Definition Issues

FAA 20080401F	IRS REJECTS OIL REFINERY'S "ITEM" DEFINITIONS THAT ARE TOO BROAD & DO NOT CLEARLY REFLECT INCOME Page 1 of 2
Overview	• In this Field Attorney Advice (FAA), the IRS held that the item definitions used by an oil refinery for both of its LIFO pools were too broad and did not clearly reflect income. • The National Tax Office (NTO) analyzed in great detail the nature of the refinery's inventories ... and that detailed analysis is omitted from this summary. • The language used by the NTO in holding that the item definitions were too broad is identical to the language used in TAM 200735020. (i.e., the item definitions used ***"compensates them for the effects of artificial inflation resulting from changes in quality and product mix."***)
Facts	• Taxpayer is engaged in the purchase of crude oil and other feedstocks, the refining of such crude oil and other feedstocks in refined products and marketing such refined products to customers. • All of Taxpayer's inventories are maintained in one subsidiary that uses LIFO. • Taxpayer purchases a wide array of crude oils including sour crude oils, intermediates and resid (residual oil; oil products that remain after petroleum has been distilled), which can typically be purchased at a discount to West Texas Intermediate, a benchmark crude oil. • About two-thirds of Taxpayer's crude oil requirements are purchased through long-term contracts. • The other third of Taxpayer's crude oil requirements are generally purchased on the spot market. • Taxpayer's term supply agreements include arrangements to purchase crude oils directly or indirectly from various foreign national oil companies and domestic integrated oil companies at market-related prices. • Other Taxpayer activities include... ◆ Participation in refined product exchange and purchase agreements, ◆ The sale of a variety of other products produced at its refineries including asphalt, lube base oils and commodity petrochemicals ◆ The production and marketing of a large volume of asphalt to customers in the paving and roofing industries. • Taxpayer maintains two LIFO pools ... one for crude oil and other feedstocks and one for refined products. These are discussed further below.
Principles to Be Applied	• The purpose of the LIFO method is to permit a taxpayer to exclude the effects of inflation (i.e., steadily rising cost of replacement goods) from its computation of gross income. • However, the LIFO method was not designed to compensate for the effects of artificial inflation, which can result from changes in quality and product mix. See, e.g., *Amity Leather Products Co., 82 T.C. 726, 733 (1984).* • To minimize the effects of artificial inflation under the dollar-value LIFO method, the regulations require taxpayers to assign "items" to one or more dollar-value pools. • Neither the Code nor the applicable regulations define "item," but the *Amity* Court opined that a narrower definition will provide a more accurate measure of inflation (i.e., price index). ◆ The Court in *Amity* opined, however, that the definition of "item" must be administratively feasible and not unduly burdensome from the standpoint of each of the parties (i.e., the taxpayer and Compliance). • In other words, the definition of "item" depends on the taxpayer's facts and circumstances.
Analysis of LIFO Pool for Refined Products	• Taxpayer maintained twelve "items" in its refined product pool. ◆ These items were comprised of approximately 4 SKUs in the case of by-product. ◆ These items were comprised of approximately 108 SKUs in the case of gasoline. • There is a vast difference in the quality and in the product mix within these items. ◆ These changes in quality and product mix could resulted in artificial inflation being included in Taxpayer's LIFO price indices. ◆ A detailed analysis of Taxpayers "items" of "distillate" and "gasoline" by the NTO supported this conclusion. • Over a period of years analyzed by the National Tax Office, it found that many of the distillate items that were present in the inventory at the beginning of the year were not present in the inventory at the end of the year, and vice versa. • Finally, there was a significant variation in prices of many of the SKU items.

FAA 20080401F	***IRS REJECTS OIL REFINERY'S "ITEM" DEFINITIONS THAT ARE TOO BROAD & DO NOT CLEARLY REFLECT INCOME***
Analysis of LIFO Pool for Crude Oil & Other Feedstocks	• For purposes of computing its price index for crude oil and other feedstocks under the double-extension method, Taxpayer maintains three items of inventory. ◆ Feedstock crude oil ... Approximately 65 different stock-keeping units (SKUs) ◆ Feedstock intermediates ... Approximately 70 SKUs ◆ Feedstock light ... Approximately 5 SKUs • Feedstocks are raw materials required for some industrial processes used in making petrochemicals and gasoline. • The physical characteristics of crude oil tend to vary depending on whether the crude oil is heavy or light (i.e., measured by its API specific gravity) and on whether the crude oil is sweet or sour. ◆ While lighter gravities of crude oil tend to yield higher proportions of light refined products, such as gasoline and distillates, the range of types of crude oil that could produce a given range of refined product output is relatively broad. • The price of crude oil also tends to vary with its specific gravity. ◆ Lighter gravity crude oils tend to be more expensive than heavier gravities of crude oil. ◆ However, this price disparity between different gravities of crude oil may be outweighed by a taxpayer's ability to refine any type of crude oil into the desired finished product. • The other major variation in the character and quality of crude oil relates to the sulfur content of the crude oil (i.e., sour crude oil has a relatively high percentage of sulfur, whereas sweet crude oil has a lower concentration of sulfur. ◆ Sulfur is an impurity that must be removed from the crude oil in order to make the refined products usable. ◆ Refineries vary on the extent they are equipped to remove the sulfur content. • A detailed analysis by the National Tax Office of the inventory in this pool showed that... ◆ Disparate item prices are dependent on (or were the result of) differences in specific gravity, sulfur content and place of origin. ◆ Transportation costs (freight-in) make it much more costly to acquire crude oil from foreign national companies in the Middle East than it would domestic crude oil with similar density and sulfur content. ◆ There were marked changes in Taxpayer's crude oil and other feedstocks product mix over a 3-year period. ◆ Due to the location of Taxpayer's refineries and their refining capabilities, Taxpayer has to purchase a variety of different types of crude oil from both domestic and foreign sources.
IRS Conclusions	• Conclusions are driven by the taxpayer's facts and circumstances. • Taxpayer has defined "item" too broadly for both its crude oil and refined products pools to clearly reflect income. • The definitions of "item" used by Taxpayer for its LIFO pools ***compensates them for the effects of artificial inflation resulting from changes in quality and/or product mix.***

Automatic Termination

TERMINATION OF LIFO ELECTION FOR NEW VEHICLES BY AUTOMOBILE DEALERSHIP

This section (pages 30 to 35) contains discussion and proforma Form 3115 materials for filing by an automobile dealership that is terminating its LIFO election for new vehicles under the recently liberalized automatic change in accounting method procedures of Rev. Proc. 2008-52.

This proforma reflects a previous election by the dealership to use the Alternative LIFO Method in Rev. Proc. 97-36.

Page

31 ***Discussion of Procedures for Terminating LIFO Elections, Including Permitted Method(s) for Inventory Valuation After Termination of LIFO Election***

32 ***Instructions for Completing Form 3115***, tailored to terminating the Alternative LIFO Method election

- Because of the length of Form 3115 (8 pages), a filled-in sample is not included.
- Section 22.01 of Appendix to Rev. Proc. 2008-52 applies if change is under the automatic change procedures.
  - Designated automatic accounting method change number ... **56**.
  - No user fee is required since this filing is being made under an automatic change procedures.
- Reg. Sec. 1.472-6 applies if LIFO termination is under the advance consent request procedures of Rev. Proc. 97-27.

34-35 ***Form 3115: Narrative Statements & Other Information***

- This statement consists of 2 pages to be attached to Form 3115.
  - This includes a disclosure by auto dealerships that ***not*** all non-LIFO inventories are valued using the same method.
  - Used vehicles are valued at cost or market, whichever is lower, and
  - Parts and accessories inventories are valued using the replacement cost method.
- Computation of the positive Section 481(a) adjustment is a part of this attachment.

33
- The spread period for Section 481(a) adjustment is usually 4 years; however, certain events will shorten (i.e., accelerate) the spread period.

-- ***File the Original Form 3115 as Part of the Federal Income Tax Return for the Year-of-Change***

- The original Form 3115 must be attached to the dealership's timely-filed (including extensions) original Federal Income Tax Return for the year of change.
  - An officer of the corporation should sign and date the Form 3115 and also print his/her name below his/her signature on the left-hand side.
- In addition, Form 3115 should be signed by the preparer at the bottom of Page 1.

-- ***A Copy of Form 3115 Should Also Be Mailed to (or Otherwise Filed with) the IRS National Office***

- This copy of the Form 3115 must be filed with the IRS National Office in Washington, D.C. no later than when the original is filed with the Federal Income Tax Return for the year of change.

33
- Sample Transmittal Letter to the IRS National Office in Washington, D.C.
  - This letter should appear under the dealership's letterhead, and it should be signed and dated.
  - The mailing/filing address for the letter to the IRS National Office is on the proforma.
- You will not receive any acknowledgement from the IRS regarding its receipt of your Form 3115.

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- ***Reminders ...***
  - Taxpayer name and employer ID number need to be inserted at the top of each page.
  - Appropriateness of statement (on Page 2 of 2) regarding use of a *simplified resale method* in connection with Section 263A Inventory Cost Capitalization Rules should be confirmed.
    - Question 3 in Part II on Page 6 of Form 3115 usually will be answered ... "Yes."
  - Copies of Forms 970 filed and any subsequent Forms 3115 should be attached.
  - Include Form 2848 *Power of Attorney*.
  - Request a *Conference of Right* on Page 3 (Item 16).

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- Note: The last sample-proforma filing package for terminating a LIFO election was in the March 2006 issue of the *LIFO Lookout* on pages 22-27.

Termination of LIFO Elections Under Automatic Change in Accounting Method Procedures of Rev. Proc. 2008-52	
In General	• It's now easier to terminate LIFO elections than it used to be. ◆ The termination of a LIFO election is a "change ***from*** the LIFO inventory method." • Revenue Procedure 2008-52 significantly relaxed the technical interpretations that the National Office was making which would have required many taxpayers (including, specifically, automobile dealerships) to first obtain permission from the IRS before terminating their LIFO elections. ◆ Effective for Forms 3115 filed for a year of change ending on or after Dec. 31, 2007. ◆ Rules are found in Section 22.01 of the Appendix to Rev. Proc. 2008-52. ◆ Designated automatic accounting method change number ... **56**. ◆ Form 3115 is filed after the end of the year of change; no user fee is required. • A LIFO termination cannot be made under the automatic change in method procedures if the taxpayer does not meet specific requirements. (For a discussion of these requirements, see page 24 in the article on Rev. Proc. 2008-52 included in the *Year-End 2008 LIFO Lookout*.) ◆ If a taxpayer cannot use the automatic change provisions of Rev. proc. 2008-52, it must file its Form 3115 to terminate its LIFO election before the end of the year of change and follow all of the requirements of Revenue Procedure 97-27 for advance permission.
Permitted Methods	• 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. • ***Definition of a "permitted" method.*** An inventory method (identification or valuation, or both) is a permitted method if it meets two requirements. ◆ ***First,*** the method 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, ***and*** ◆ ***Second,*** 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 automobile dealership. • ***Interplay with Section 263A.*** 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.
Recapture of LIFO Reserve	• Upon termination of the LIFO election, the LIFO reserve must be repaid by including the amount of the LIFO reserve in income 25% per year over a 4-year period beginning with the year of termination. The cut-off method may not be used. • This is the Section 481(a) adjustment. See Form 3115, Page 3, Part IV, Questions 24-27.
Audit Protection	• Generally, audit protection applies if the taxpayer is not under IRS audit at the time of filing Form 3115. • Applicants must indicate whether or not audit protection for their change applies, regardless of whether filing is under the advance consent request procedures or the automatic change procedures. • The Revenue Procedures indicate circumstances under which audit protection may not be applicable.
Other Information to Provide	• Page 6, Schedule D, Part II should be completed. ◆ Items 1 and 2 require the attachment of descriptions of ▪ The inventory goods which are being changed from LIFO to another method, and ▪ The inventory goods which are ***not*** being changed (i.e., all other inventory goods). • Section 263A information is required. ◆ If the applicant is subject to, but not in compliance with, Section 263A, generally on the same Form 3115 the applicant must first comply with Section 263A ***before*** changing an inventory valuation method.

Instructions for Completing Form 3115

For Termination of the LIFO Method for New Vehicle Inventories

Under Section 22.01 of the Appendix to Rev. Proc. 2008-52

This change is Automatic Change No. 56 on the ***List of Automatic Accounting Method Changes*** (included on page 11 in the 12 pages of Instructions to Form 3115). The current revision of Form 3115, *Application for Change in Accounting Method*, is dated Dec. 2003 and consists of 8 pages. You will complete only Pages 1, 2, 3 (except for Part III) and Pages 5 & 6.

Page 1 ... ***Part I, Line 1(a)*** ... Identify as change #56 on Line (a). Do not make any other entries on (b). It is not necessary to include any information in the top right-hand section where *appropriate box* is asked to be checked. For automatic change requests, this informational change requirement is satisfied by properly completing Part I, Line 1.

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

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

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

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

Part III ... Part III (Questions 18-23) is not required to be completed for automatic change requests.

Part IV, Line 24 ... Answer should be, "No." The cut-off method is not applicable where LIFO elections are being terminated ... the taxpayer must repay the amount of LIFO reserve attributable to the inventory going off of LIFO when it terminates its LIFO election for those goods.

Part IV, Line 25 ... Generally, the Sec. 481(a) adjustment is the amount of the LIFO reserve as of the end of the last year on LIFO for the goods going off of LIFO. Further discussion may be warranted in the case of the termination of new vehicle LIFO elections.

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

Page 5 ... ***Schedule C*** ... Either leave blank or in white space portion at bottom of page 5, enter the following: "Taxpayer is applying for permission to terminate its LIFO method for valuing its new vehicle inventory. See statement attached."

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

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

For inventory being changed (i.e., new vehicles), Present Method: Check the boxes for "LIFO" and for "Cost."

For inventory being changed (i.e., new vehicles), Proposed Method: Check the boxes for "specific identification" and for "cost or market, whichever is lower."

For inventory not being changed (i.e., used vehicles), Present Method: Cost or market, whichever is lower.

For inventory not being changed (i.e., parts & accessories inventories), Present Method: Check the box for "Other" and explain as "Parts - Replacement Cost" or reference Rev. Proc. 2002-17.

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

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

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

Spread Periods	*SECTION 481(a) ADJUSTMENTS*
Sec. 481(a) Adjustment Period **... General Rules**	• For a net positive Sec. 481(a) adjustment, the spread period is 4 years. • For a net negative Sec. 481(a) adjustment, the spread period is 1 year. • ***De minimis rule.*** If the net positive Sec. 481(a) adjustment for the change in method is less than $25,000, a taxpayer may elect to use a one-year Sec. 481(a) adjustment period, in lieu of the 4-year spread period. ♦ The taxpayer must complete the appropriate line on Form 3115 to elect this treatment. • ***Short period as a separate taxable year.*** If the year of change or any other taxable year during the Sec. 481(a) adjustment period is a short taxable year, the Sec. 481(a) adjustment must be included in income as if that short taxable year were a full 12-month taxable year.

Certain Events *"Will"* Shorten the Spread Period
 	
Section 5 of Rev. Proc. 2008-52
	• The spread period will be shortened if the taxpayer ceases to engage in the trade or business or if it terminates its existence.
	  ♦ If a taxpayer ceases to engage in a trade or business or terminates its existence, it must take the remaining balance of any Sec. 481(a) adjustment relating to the trade or business into account in computing taxable income in the taxable year of the cessation or termination.
	• In general, a taxpayer is treated as ceasing to engage in a trade or business if the operations of the trade or business cease or substantially all the assets of the trade or business are transferred to another taxpayer.
	  ♦ The "substantially all" requirement is met if ... "there is a transfer of assets representing at least 90% of the fair market value of the net assets ***and*** at least 70% of the fair market value of the gross assets held by the corporation immediately prior to the transfer.
	  ♦ This is the definition of "substantially all" that is provided in Section 3.01 of Rev. Proc. 77-37 (1977-2 C.B. 568).
	• Examples of the cessation of a trade or business include
	  ♦ the incorporation of the trade or business,
	  ♦ the purchase of the trade or business by another taxpayer in a transaction to which Section 1060 applies,
	  ♦ the transfer or termination of the trade or business pursuant to a taxable liquidation, or
	  ♦ the contribution of the assets of the trade or business to a partnership.

LETTER OF TRANSMITTAL FOR FORM 3115 *

Internal Revenue Service
Attn: CC:ITA - Automatic Rulings Branch
P. O. Box 7604
Ben Franklin Station
Washington, DC 20044

Date_____, 2009

Re: Leaving LIFO Dealership, Inc.

EI No. _____

Form 3115: ***Termination of LIFO Accounting Method for New Vehicles Using Automatic Change Procedures under Rev. Proc. 2008-52 For The Calendar Year Ending December 31, 2008***

Dear Sir or Madam:

Enclosed is a copy of the Form 3115 for the taxpayer identified above reflecting that taxpayer's request for permission to terminate its use of the Last-In, First-Out (LIFO) method for its new automobile and new light-duty truck inventories.

This change is to be effective for the calendar year ending December 31, 2008.

The original Form 3115 will be attached to Taxpayer's timely filed (including extensions) original Federal income tax return for 2008, the year of change. This copy of Form 3115 is also being filed at this time with the IRS National Office in Washington, D.C.

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

No user fee is required in connection with this filing since it is being made under the published automatic change procedures set forth in Rev. Proc. 2008-52.

Respectfully submitted, etc.

** This letter should be prepared on dealership letterhead. The letter, with a copy of the Form 3115 and any attachments, should be mailed to the IRS National Office at the time when the dealership files its income tax return for the year of change.*

Form 3115: Application for Change in Accounting Method

w/r/t Taxable Year Ending December 31, 2008

Form 3115: Narrative Statements & Other Information

This request is for Change No. 56 ... ***Termination of Taxpayer's LIFO Election for New Vehicle Inventories.***

This change is being made under Section 22.01 of the Appendix to Revenue Procedure 2008-52 effective for the calendar year beginning Jan. 1, 2008 and ending Dec. 31, 2008. This is an automatic accounting method change, and applicants filing Form 3115 under a designated automatic change procedure are not required to pay a user fee.

The original of Form 3115 is attached to 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 reports on the basis of a calendar year-end and it employs the accrual method of accounting for maintaining its books and records and for filing its Federal and State income tax returns. 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.

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

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

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

Methods for New Vehicle Inventories (Statements Required by Sec. 22.01(5) of the Appendix to Rev. Proc. 2008-52)

(a) After the termination of Taxpayer's LIFO election for new vehicles, the new method of ***identifying*** new vehicle inventory goods is the specific identification method.

(b) After the termination of Taxpayer's LIFO election for new vehicles, the new method for ***valuing*** new vehicle inventory goods is cost or market, whichever is lower.

Section 263A Inventory Cost Capitalization Matters

Taxpayer is subject to the Section 263A Inventory Cost Capitalization Rules and uses a *Simplified Resale Method* as its method of accounting for inventories to reflect the Section 263A Uniform Cost Capitalization Rules. No changes are contemplated in connection with its Section 263A method of accounting.

Part IV, Page 3 - Computation of Net Positive Section 481(a) Adjustment

LIFO Inventories at Beginning of Year of Change (i.e., at the End of the Year Preceding the Year of Change)	*Pool #1 New Automobiles*	*Pool #2 New Light-Duty Trucks*	*Total All LIFO Inventories*
* Inventory at Cost (Dec. 31, 2007 / Jan. 1, 2008)	1,500,000	4,000,000	5,500,000
** LIFO Valuation of Above Inventory	900,000	3,200,000	4,100,000
Section 481(a) Adjustment (LIFO Reserve)	600,000	800,000	1,400,000

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

Notes: *(1) If a LIFO election for used vehicles is being terminated, then it will be necessary to take into consideration lower-of-cost-or-market adjustments at the beginning and the end of the year of change.*

(2) In some instances, the changes in the amounts of inventory costs capitalized under Section 263A at the beginning and the end of the year of change will become part of the net Section 481(a) adjustment.

ALTERNATIVE PRESENTATION FORMAT FOR COMPUTATION OF SECTION 481(a) ADJUSTMENT

The presentation format below is usually found in consent letters which the IRS sends back to the taxpayer where advance permission to terminate the LIFO election is required. You should delete this section if you use the above format presentation for the Section 481(a) adjustment.

	Pool #1 New Automobiles	*Pool #2 New Light-Duty Trucks*	*Total All LIFO Inventories*
Beginning Inventory Revalued Under Taxpayer's ***Proposed*** Method	-	-	-
Beginning Inventory Revalued Under Taxpayer's ***Present*** Method	-	-	-
Section 481(a) Adjustment (Increase in Computing Taxable Income)	-	-	-

Forms 970 Original LIFO Election

☐ A copy of the original Form 970 LIFO election for New vehicle inventories is attached.

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

I certify that to the best of my knowledge and belief ***Leaving LIFO Dealership, Inc.*** properly elected the LIFO inventory method by filing Form 970 with its income tax return for the taxable year ended Dec. 31, _____, and otherwise complied with the provisions of Section 472(d) and Reg. Sec. 1.472-3.

/S/ _____

Case Study #1 ... ABC ... is presented so that you can see exactly how we use the materials that were presented in the *LIFO Lookout* in 2008 as "proformas" or "examples" for a combination of LIFO pools that was being made as of January 1, 2008 where calendar year 2008 is the year of change to the Vehicle-Pool Method.

Our schedules are set up in the presentation formats in IRS Chief Counsel Memorandum CCM 200825044 which were analyzed in the Year-End 2008 Edition of the *LIFO Lookout* on pages 33-46. Our schedules also show the related composition and proof of the LIFO reserves as of Dec. 31, 2007.

- ***Page 2 of 6*** shows the LIFO layer history for both pools in the format of Tables 1, 2 and 3 of the CCM.
- ***Page 3 of 6*** shows the data for the single, combined pool in the format of Tables 4 and 5 of the CCM.
- ***Page 4 of 6*** shows the data for the single, combined pool, after rebasing to 1.000 in the format of Table 6. Table 6 shows the LIFO layer history as of the beginning of the year (Jan. 1, 2008), upon which the 2008 LIFO inventory calculation is to be made.
- ***Page 5 of 6*** is included to show a more detailed computation of the "disappearing base dollars" due to the difference in LIFO pool starting dates. Notes (A) through (J) explain the process in more detail.
- ***Page 6 of 6*** shows the significant difference in the contributions to the LIFO reserve by layer depending on the sequence of calculations used in combining separate LIFO pools. One of the major points of emphasis in our analysis of CCM 200825044 in the Year-End 2008 Edition of the *Lookout* was that there could be significant differences in result if the sequence of steps as illustrated by the IRS were reversed. We included one example on page 47 (of the Year-End 2008 Edition of the *LIFO Lookout*).

Notes Re: Table 3 ... Different Starting Dates for the LIFO Pools Being Combined

The combination of the LIFO pools as of Dec. 31, 2007 is complicated by the fact that the two LIFO pools came into existence in different years, and therefore, they have different base dates. As a result, the LIFO layer histories of the two pools cannot simply be combined or "added across" as of Dec. 31, 2007.

Pool #1 started on LIFO in 1974, and Pool #2 started in 1998.

Reg. Sec. 1.472-8(g)(2)(iv) provides that the LIFO pools are to be combined reflecting 1974 as the common base date, with appropriate adjustments to the base dollar amounts recorded in the other pool (i.e., Light-Duty Trucks) for which LIFO began at a later date. These adjustments are intended to compensate for the time factor difference in price levels that occurred (over almost 25 years) between the earlier start of the LIFO election in Pool #1 and the later starting date in Pool #2.

Despite these computational adjustments made to the base dollars in Pool #2, no changes are made to the corresponding LIFO valuations for each layer (or to the corresponding portion of the LIFO reserve that is associated with each year's layer). Therefore, no amounts of pre-combination LIFO reserve have been lost in the process.

The LIFO reserve for Pool #1 as of the combination date is $3,206,314 and the LIFO reserve for Pool #2 as of that date is $101,920. Accordingly, the LIFO reserve for the single, combined pool after the combination (and after the rebasing) must be $3,308,235 ... the same amount as the sum of the separate pools' LIFO reserves before they were combined.

The end result is that, after these adjustments are made to the base dollars, there is a lesser/smaller amount of "base" dollars (i.e., adjusted base dollars) in Pool #2 supporting the previously established LIFO valuations for the corresponding annual layers / increments. $296,033 of "base" dollars have "disappeared" from Pool #2.

Reg. Sec. 1.472-8(g)(2)(iv) treats the base inventory of the pool (or entity) with the later LIFO election(s) in the combination as an increment incurred *in the previous year*. Accordingly, in Table 3, the first inventory layer for Pool #2 is reflected as having been incurred in 1997 (i.e., the year *before* the start of the LIFO election for Pool #2), and it does not appear on the line for 1998 (i.e., the year that otherwise corresponds to the first year of LIFO for that pool).

CASE STUDY #1 ... ABC DEALERSHIP

Case Study #1 - ABC Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2007 ... CCM 200825044

Year of Change to the Vehicle-Pool Method Is Calendar Year 2008

	Base Dollars	Valuation Factor	LIFO Valuation	Base Dollars	Proof Factor	Composition of LIFO Reserve
Table 1 - Pool #1 - New Automobiles						
January 1, 1974 Base Year	942,675	0.329340	310,461	942,675	1.076250	1,014,554
Calendar Year 1977 Increment	620,570	0.434400	269,576	620,570	0.971190	602,691
Calendar Year 1979 Increment	1,066,511	0.498550	531,709	1,066,511	0.907040	967,368
Calendar Year 1984 Increment	446,904	0.698030	311,952	446,904	0.707560	316,211
Calendar Year 1991 Increment	319,183	1.000000	319,183	319,183	0.405590	129,457
Calendar Year 1997 Increment	-	1.216520	-	-	0.189070	-
Calendar Year 1998 Increment	300,460	1.241460	373,009	300,460	0.164130	49,314
Calendar Year 2000 Increment	4,889	1.253970	6,131	4,889	0.151620	741
Calendar Year 2001 Increment	-	-	-	-	1.405590	-
Calendar Year 2002 Increment	13,676	1.313090	17,958	13,676	0.092500	1,265
Calendar Year 2003 Increment	1,057,316	1.340950	1,417,808	1,057,316	0.064640	68,345
Calendar Year 2004 Increment	1,213,231	1.359130	1,648,939	1,213,231	0.046460	56,367
Cumulative Index as of Dec. 31, 2007		1.405590	-	-	-	-
						-
Totals	5,985,415		5,206,725	5,985,415		3,206,315
Less: Ending Inventory at Current Cost			8,413,039			
LIFO Reserve at End of Year (Separate Pool)			3,206,314			
Table 2 - Pool #2 - New Light-Duty Trucks						
Calendar Year 1997	-	-	-	-	1.109610	-
January 1, 1998 Base Year	41,315	1.000000	41,315	41,315	0.109610	4,529
Calendar Year 2001 Increment	759,458	1.021230	775,581	759,458	0.088380	67,121
Calendar Year 2002 Increment	10,571	1.058660	11,191	10,571	0.050950	539
Calendar Year 2003 Increment	851,923	1.074710	915,570	851,923	0.034900	29,732
Cumulative Index as of Dec. 31, 2007		1.109610		-	-	-
Totals	1,663,267		1,743,658	1,663,267		101,920
Less: Ending Inventory at Current Cost			1,845,578			
LIFO Reserve at End of Year (Separate Pool)			101,920			
Table 3 - Pool #2 - New Light-Duty Trucks With Layers Reflecting Restated Base Costs						
Calendar Year 1997	33,962	1.216520	41,315	33,962	0.133343	4,529
January 1, 1998 (41,315 ÷ 1.21652)	-	-	-	-	-	-
Calendar Year 2001 Incr. (759,458 ÷ 1.21652)	624,287	1.242347	775,581	624,287	0.107516	67,121
Calendar Year 2002 Incr. (10,571 ÷ 1.21652)	8,690	1.287881	11,191	8,690	0.061982	539
Calendar Year 2003 Incr. (851,923 ÷ 1.21652)	700,295	1.307406	915,570	700,295	0.042457	29,732
Truck Cum. Index (1.109610 x 1.216520)		1.349863				
Totals (1,663,267 ÷ 1.216520)	1,367,234		1,743,658	1,367,234		101,920
Less: Ending Inventory at Current Cost			1,845,578			
LIFO Reserve at End of Year (Separate Pool)			101,920			

Note: Disappearing Base Dollars Resulting from Restated Base Costs = [1,663,267 - 1,367,234 = 296,033]
(1 ÷ 1.21652 = 0.822017) ... (1 - 0.822017 = 0.177983) ... (1,663,267 x 0.177983 = 296,033)

Case Study #1 - ABC Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2007 ... CCM 200825044

Year of Change to the Vehicle-Pool Method Is Calendar Year 2008

Table 4 - New Vehicle Pool - Before Rebasing (This adds results from Tables 1 & 3 above)	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2007*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
January 1, 1974 Base Year	942,675	0.329340	310,461	942,675	1.065887	1,004,785
Calendar Year 1977 Increment	620,570	0.434400	269,576	620,570	0.960827	596,261
Calendar Year 1979 Increment	1,066,511	0.498550	531,709	1,066,511	0.896677	956,316
Calendar Year 1984 Increment	446,904	0.698030	311,952	446,904	0.697197	311,580
Calendar Year 1991 Increment	319,183	1.000000	319,183	319,183	0.395227	126,150
Calendar Year 1997 Increment	33,962	1.216520	41,315	33,962	0.178707	6,069
Calendar Year 1998 Increment	300,460	1.241460	373,009	300,460	0.153767	46,201
Calendar Year 2000 Increment	4,889	1.253970	6,131	4,889	0.141257	691
Calendar Year 2001 Increment	624,287	1.242347	775,581	624,287	0.152881	95,441
Calendar Year 2002 Increment	22,366	1.303296	29,149	22,366	0.091932	2,056
Calendar Year 2003 Increment	1,757,611	1.327585	2,333,378	1,757,611	0.067642	118,889
Calendar Year 2004 Increment	1,213,231	1.359130	1,648,939	1,213,231	0.036097	43,795
* Cumulative Index as of Dec. 31, 2007		1.395227				-
Totals	7,352,649		6,950,382	3,922,844		3,308,235
Less: Ending Inventory at Current Cost			10,258,617			
LIFO Reserve at End of Year (Combined Pool)			3,308,235			

* 1.395227 = 10,258,617 / 7,352,649

Table 5 - Rebasing Conversion Computation	Old Base Dollars (Before)	Conversion Factor	New Base Dollars (After)
January 1, 1974 Base Year	942,675	1.395227	1,315,246
Calendar Year 1977 Increment	620,570	1.395227	865,836
Calendar Year 1979 Increment	1,066,511	1.395227	1,488,025
Calendar Year 1984 Increment	446,904	1.395227	623,533
Calendar Year 1991 Increment	319,183	1.395227	445,333
Calendar Year 1997 Increment	33,962	1.395227	47,384
Calendar Year 1998 Increment	300,460	1.395227	419,210
Calendar Year 2000 Increment	4,889	1.395227	6,821
Calendar Year 2001 Increment	624,287	1.395227	871,023
Calendar Year 2002 Increment	22,366	1.395227	31,205
Calendar Year 2003 Increment	1,757,611	1.395227	2,452,266
Calendar Year 2004 Increment	1,213,231	1.395227	1,692,733
Cumulative Index as of Dec. 31, 2007	-	1.395227	-
	7,352,649		10,258,614

Case Study #1 - ABC Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2007 ... CCM 200825044

Year of Change to the Vehicle-Pool Method Is Calendar Year 2008

Table 6 - New Vehicle Pool - After Rebasing	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2007*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
January 1, 1974 Base Year	1,315,246	0.236048	310,461	1,315,246	0.763952	1,004,785
Calendar Year 1977 Increment	865,836	0.311347	269,576	865,836	0.688653	596,260
Calendar Year 1979 Increment	1,488,025	0.357325	531,709	1,488,025	0.642675	956,316
Calendar Year 1984 Increment	623,533	0.500299	311,952	623,533	0.499701	311,580
Calendar Year 1991 Increment	445,333	0.716729	319,183	445,333	0.283271	126,150
Calendar Year 1997 Increment	47,384	0.871915	41,315	47,384	0.128085	6,069
Calendar Year 1998 Increment	419,210	0.889791	373,009	419,210	0.110209	46,201
Calendar Year 2000 Increment	6,821	0.898757	6,131	6,821	0.101243	691
Calendar Year 2001 Increment	871,023	0.890426	775,581	871,023	0.109574	95,441
Calendar Year 2002 Increment	31,205	0.934110	29,149	31,205	0.065890	2,056
Calendar Year 2003 Increment	2,452,266	0.951519	2,333,378	2,452,266	0.048481	118,888
Calendar Year 2004 Increment	1,692,733	0.974128	1,648,939	1,692,733	0.025872	43,794
Cumulative Index as of Dec. 31, 2007	-	1.000000	-	-	-	-
	3					3
Totals	10,258,617		6,950,382	10,258,614		3,308,235
Less: Ending Inventory at Current Cost			10,258,617			
LIFO Reserve at End of Year (Combined Pool)			3,308,235			

Additional Comments Regarding Rebasing of Indexes to 1.000

Through the rebasing procedure a new base year (i.e., 2008, the first year for which the dealership will use the new LIFO Method [i.e., the Single New Vehicle Pool Method per Rev. Proc. 2008-23]) is created solely for computation purposes.

Under this procedure, the original or oldest base year (i.e., 1974) and the layer increments experienced before the year of change (i.e., before the new or substitute base year) are restated in terms of the new base year levels.

The cumulative index as of the end of the last year before the year of change (i.e., the cumulative index as of Dec. 31, 2007) of 1.395227 becomes the conversion factor by which the base dollars for each layer are multiplied. The LIFO valuation of the inventory does not change in the process.

The ***general principle*** underlying the rebasing requirement appears to be that the index for each year's increment is restated by creating a fraction, the numerator of which is the cumulative index for valuing that year's increment and the denominator of which is the cumulative index as of the end of the last year before the year of change. Then each year's LIFO valuation index or factor is multiplied by that fraction to reduce it to a decimal that is less than 1.000.

Since all prior year increments retain their same LIFO valuations in the rebasing process, this simply "forces" all of the prior indexes or valuation factors to be changed to become the quotients produced by dividing (A) the fixed/unchanged LIFO valuation amount for that year's layer by (B) the corresponding "grossed up" or "new" base dollar amount. This "new" base dollar amount, in turn, is determined as the product of multiplying (1) the "old" base dollar inventory amount for that year by (2) the deflator index that was used at the end of the last year under the old method to reduce that ending inventory at cost to its equivalent amount expressed in original base dollars.

Assume the inflation rate for the first year after the rebasing (i.e., for calendar 2008) is 3%. Since the cumulative inflation rate as of Dec. 31, 2007 has been rebased to 1.000, the cumulative inflation rate as of Dec. 31, 2008 will be 1.0300 [1.0000 x 1.0300].

Case Study #1 - ABC Dealership, Inc.

Adjusting Base Dollars to Reflect Difference in Starting Dates in LIFO Pools

As of Dec. 31, 2007

Pool to Be Adjusted for Later Starting Date on LIFO Is Pool #2

Before Adjusting Layers in Pool #2 to Redetermine Base Dollars

	Pool #2 New Light-Duty Trucks			Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Calendar Year 1997	-	-	-	-	1.109610	-
January 1, 1998 Base Year	41,315	1.000000	41,315	41,315	0.109610	4,529
Calendar Year 2001 Increment	759,458	1.021230	775,581	759,458	0.088380	67,121
Calendar Year 2002 Increment	10,571	1.058660	11,191	10,571	0.050950	539
Calendar Year 2003 Increment	851,923	1.074710	915,570	851,923	0.034900	29,732
Cumulative Index as of Dec. 31, 2007		1.109610				
Totals	1,663,267		1,743,658	1,663,267		101,920
Ending Inventory at LIFO Valuation			1,743,658			
Less: Ending Inventory at Current Cost			1,845,578			
LIFO Reserve at End of Year			101,920			

After Adjusting Layers in Pool #2 to Redetermine Base Dollars

	Pool #2 New Light-Duty Trucks			Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Calendar Year 1997 *	33,962	1.216520	41,315	33,962	0.133343	4,529
January 1, 1998 Base Year	-	-	-	-	-	-
Calendar Year 2001 Increment	624,287	1.242347	775,581	624,287	0.107516	67,121
Calendar Year 2002 Increment	8,690	1.287881	11,191	8,690	0.061982	539
Calendar Year 2003 Increment	700,295	1.307406	915,570	700,295	0.042457	29,732
Cumulative Index as of Dec. 31, 2007		1.349863	-	-	-	-
Totals	1,367,234		1,743,658	1,367,234		101,920
Ending Inventory at LIFO Valuation			1,743,658			
Less: Ending Inventory at Current Cost			1,845,578			
LIFO Reserve at End of Year			101,920			

* *Note:* First year on LIFO was 1998. When combining pools with different base years, base year of the later pool is treated as increment in the prior year.

	Old Base Dollars (Before)	Redeter-mination Factor	Adjusted Base Dollars
Calendar Year 1997 *	-	0.822017	-
January 1, 1998 Base Year	41,315	0.822017	33,962
Calendar Year 2001 Increment	759,458	0.822017	624,287
Calendar Year 2002 Increment	10,571	0.822017	8,690
Calendar Year 2003 Increment	851,923	0.822017	700,295
Cumulative Index as of Dec. 31, 2007	-		-
	1,663,267		1,367,234

Adjusted base dollars	1,367,234
Disappearing base dollars	296,033
Total	1,663,267

(A) Starting date for Pool with the earlier starting date on LIFO ... Pool #1 New Automobiles ... is calendar year 1974.
Starting date for Pool with the later starting date on LIFO ... Pool #2 Light-Duty Trucks ... is calendar year 1998.

(B) Pool #1 Cumulative inflation index as of Dec. 31, 1997 (end of year before first year on LIFO for Pool #2) ... 1.21652.

(C) Conversion/redetermination factor to be used to adjust/redetermine the base dollars in Pool #2 is 0.822017 (1.0000 divided by 1.21652)

(D) Base dollars in Pool #2 as of Dec. 31, 2007 (date of combination of LIFO pools) ... $1,663,267

(E) Base dollars in Pool #2 as of Dec. 31, 2007 after adjusting for difference in LIFO starting dates ($1,663,267 x 0.822017) ... $1,367,234
(Adjusted/redetermined base dollars in Pool #2 as of Dec. 31, 2007)

(F) Each layer in the LIFO layer history of Pool #2 is multiplied by the redetermination factor (0.822017) to compute redetermined base dollars for that layer

(G) The total LIFO value for each layer as of the date of combination (Dec. 31, 2007) does not change. The total LIFO valuation remains at $1,743,657.

(H) The valuation factor for each layer is determined by dividing the LIFO valuation for that layer by the redetermined amount of base dollars for that layer.

(I) The amount of base dollars removed or disappearing from Pool #2 as a result of its later start on LIFO is (1.0000 minus the conversion factor) ... (1.0000 minus 0.822017 = 0.177983). Disappearing base dollars from Pool #2 = $1,663,267 x 0.177983 = $296,033.

(J) When combining pools with different base years, the base year of the later pool is to be treated in the combination as an increment in the prior year.
Accordingly, the year of reference becomes the "calendar year 1997" above.

Case Study #1 - ABC Dealership, 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, 2007 (the End of the Year Immediately Preceding the Year of Change)

	(A)	(B)	(C) = (A) + (B)	CCM Method (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					
January 1, 1974 Base Year	1,014,554	-	1,014,554	1,004,785	9,769
Calendar Year 1977 Increment	602,691	-	602,691	596,260	6,431
Calendar Year 1979 Increment	967,368	-	967,368	956,316	11,052
Calendar Year 1984 Increment	316,211	-	316,211	311,580	4,631
Calendar Year 1991 Increment	129,457	-	129,457	126,150	3,307
Calendar Year 1997 Increment	-	-	-	6,069	(6,069)
Calendar Year 1998 Increment	49,314	4,529	53,843	46,201	7,642
Calendar Year 2000 Increment	741	-	741	691	50
Calendar Year 2001 Increment	-	67,121	67,121	95,441	(28,320)
Calendar Year 2002 Increment	1,265	539	1,804	2,056	(252)
Calendar Year 2003 Increment	68,345	29,732	98,077	118,888	(20,811)
Calendar Year 2004 Increment	56,367	-	56,367	43,797	12,570
	-	-	-	-	-
	1	(1)	-	-	-
LIFO Reserve Totals	3,206,314	101,920	3,308,234	3,308,235	(1)
Ending Inventory at LIFO Valuation	5,206,725	1,743,658	6,950,383		
Ending Inventory at Current Cost	8,413,039	1,845,578	10,258,617		

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 Chief Counsel Memo (CCM) 200825044.

It can be seen from the above that under the CCM approach (column (D)), if there is a decrement in the pool in the year of change (i.e., 2008) or in a later year that is large enough to eliminate the increments experienced in the more recent years before the combination, the payback of the LIFO reserve will be significantly different because of the shifting of the amounts contributed to the LIFO reserve by each year for which there is an increment.

Under the alternative sequence approach (column (C)) 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 2008 (or in a later year) would be limited to the amounts actually contributed to the LIFO reserve (as of the beginning of the year of change) by each year's layer that is being invaded by the carryback of the decrement.

Note: Year of change to the Vehicle-Pool Method is calendar year 2008.

Case Study #2 ... RST ... has been selected for analysis because it resulted in a very pleasant (and unexpected) surprise when we tallied the final results to show the benefit of changing to the Vehicle-Pool Method for 2008.

In processing new vehicle LIFO inventory calculations, our typical procedure is/was to review the summary information for the new car pool and for the new light-duty truck pool to "get a feel for" whether it might be obviously better to combine the pools for 2008. In the majority of situations, a review comparing the inventory amounts at the beginning and the end of the year in each pool would give a quick sense of whether there might be a significant decrement in one or both pools which would be carried back against prior years at relatively high repayment rates. All of this, of course, hinges on knowing the amount of total LIFO reserve that is contributed by each year's layer of increment. Generally, the older the LIFO year layer, the greater the rate of payback associated with that layer ... and conversely, the more recent the LIFO year layer, the smaller the rate of payback associated with that layer.

This review or "triage" ordinarily considered only the reduction in inventory levels and the estimated related LIFO reserve payback/recapture impact if the year-end inventory was (significantly) smaller than the beginning inventory.

However, when pools were combined and computations had been made under both the two-pool and the single, combined pool methods, there were two factors contributing to the net "benefit" from changing to the Vehicle-Pool Method. One factor was due to the net difference in the impact of inflation; the other factor was due to the ability to avoid a larger amount of repayment when decrements were experienced.

In general, our findings were that the net difference due to the impact of inflation was usually very small. In most cases, it was a few dollars ... or a few hundred dollars, more or less. See the worksheets in the Spring/Mid-Year 2008 Edition of the *LIFO Lookout* analyzing the proof of change (pages 37, 41 and 45 of that issue) or see Page 5 of 6 of Case Study #3 in this Edition where the difference due to inflation is only $293.

However, this case study shows that the impact of using a different, weighted inflation percentage for the single pool can create a significantly large increase in the LIFO reserve. The problem is that it's usually difficult to know how large this impact will be unless you do the calculations both ways.

In this case, a quick analysis suggested that if the LIFO pools were combined for 2008, the LIFO reserve would be "around $38,000 greater." This estimate was based solely on considering the avoidance of a larger recapture of the LIFO reserve due to decrements in the pools.

Based on a "mere" benefit of increasing the LIFO reserve by $38,000 by combining pools, the dealership said, "Go ahead and combine them." And, we did. To our surprise, in analyzing the final calculations, we found the increase in the LIFO reserve to be considerably larger than we anticipated. Aha! ... another learning experience ... one that was purely fact-driven.

In this case, the LIFO reserve was increased by an additional $156,000 over and above the benefit of increasing the LIFO reserve by an additional $38,000 to avoid the impact of the decrement/recapture aspect.

In this case, the two LIFO pools being combined had the same base year. Therefore, the presentation of the factual background is a little less cumbersome than that of Case Study #1 (where adjustments first had to be made because the LIFO pools had different base years). And, we've used the two-page analysis format that was illustrated on pages 40-49 of the Spring/Mid-Year 2008 Edition of the *LIFO Lookout*.

- ***Page 2 of 6*** shows the LIFO layer history for both pools as of December 31, 2007. Note the specific fact pattern ... difference in layers ... more dollars in Pool #2 ... no increment in either pool in 2007.
- ***Page 3 of 6*** shows the data for the single, combined pool before and after the pools is rebased to 1.000 in accordance with CCM 200525044.
- ***Page 4 of 6*** shows the significant difference in the contributions to the LIFO reserve by layer depending on the sequence of calculations used in combining separate LIFO pools (i.e., *"the CCM 200525044 effect"*).
- ***Page 5 of 6*** shows the proforma computation results for calendar year 2008 under both pooling methods.
- ***Page 6 of 6*** analyzes the composition of the changes in the LIFO reserves under both scenarios. From this it can be seen that the net benefit from changing to the Vehicle-Pool Method for 2008 was to increase the LIFO reserve by an additional $195,000, of which $156,000 was due to the greater impact of the weighted inflation factor in the single pool and $38,000 was due to reducing the LIFO reserve payback resulting in the decrement in inventory for the year.

Case Study #2 - RST Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2007... CCM 200825044

Year of Change to the Vehicle-Pool Method Is Calendar Year 2008

Pool #1 New Automobiles	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2007*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
Analysis of Year-End LIFO Inventory Layers						
Base Inventory - Jan. 1, 1978	512,693	0.297870	152,716	512,693	1.209690	620,200
Calendar Year 1994 Increment	-	-	-	-	-	-
Calendar Year 1995 Increment	-	-	-	-	-	-
Calendar Year 1996 Increment	-	-	-	-	-	-
Calendar Year 1997 Increment	-	-	-	-	-	-
Calendar Year 1998 Increment	-	-	-	-	-	-
Calendar Year 1999 Increment	-	-	-	-	-	-
Calendar Year 2000 Increment	-	-	-	-	-	-
Calendar Year 2003 Increment	-	-	-	-	-	-
Calendar Year 2005 Increment	211,604	1.484750	314,179	211,604	0.022810	4,827
Calendar Year 2006 Increment	522,045	1.494880	780,395	522,045	0.012680	6,620
Cumulative Index as of Dec. 31, 2007		1.507560	-	-	-	-
						(1)
Totals	1,246,342		1,247,290	1,246,342		631,645
Ending Inventory at LIFO Valuation			1,247,290			
Less: Ending Inventory at Current Cost			1,878,935			
LIFO Reserve at End of Year			631,645			

Pool #2 New L/D Trucks	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2007*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
Analysis of Year-End LIFO Inventory Layers						
Base Inventory - Jan. 1, 1978	917,750	0.297870	273,370	917,750	1.339990	1,229,776
Calendar Year 1994 Increment	324,705	1.148870	373,044	324,705	0.488990	158,777
Calendar Year 1995 Increment	281,254	1.220960	343,400	281,254	0.416900	117,255
Calendar Year 1996 Increment	530,034	1.261930	668,866	530,034	0.375930	199,256
Calendar Year 1997 Increment	63,071	1.310850	82,677	63,071	0.327010	20,625
Calendar Year 1998 Increment	379,377	1.331370	505,091	379,377	0.306490	116,275
Calendar Year 1999 Increment	322,861	1.331100	429,760	322,861	0.306760	99,041
Calendar Year 2000 Increment	119,624	1.373870	164,348	119,624	0.263990	31,580
Calendar Year 2003 Increment	1,088,945	1.566130	1,705,429	1,088,945	0.071730	78,110
Calendar Year 2005 Increment	-	-	-	-	-	-
Calendar Year 2006 Increment	3,113,388	1.614240	5,025,755	3,113,388	0.023620	73,538
Cumulative Index as of Dec. 31, 2007		1.637860		-	-	-
	-					(12)
Totals	7,141,009		9,571,740	7,141,009		2,124,221
Ending Inventory at LIFO Valuation			9,571,740			
Less: Ending Inventory at Current Cost			11,695,961			
LIFO Reserve at End of Year			2,124,221			

Case Study #2 - RST Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2007... CCM 200825044

Year of Change to the Vehicle-Pool Method Is Calendar Year 2008

Single Pool Before Rebasing Indexes

	Single Pool All New Vehicles Combined			Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Base Inventory - Jan. 1, 1978	1,430,443	0.297870	426,086	1,430,443	1.320626	1,889,081
Calendar Year 1994 Increment	324,705	1.148870	373,044	324,705	0.469626	152,490
Calendar Year 1995 Increment	281,254	1.220960	343,400	281,254	0.397536	111,809
Calendar Year 1996 Increment	530,034	1.261930	668,866	530,034	0.356566	188,992
Calendar Year 1997 Increment	63,071	1.310850	82,677	63,071	0.307646	19,404
Calendar Year 1998 Increment	379,377	1.331370	505,091	379,377	0.287126	108,929
Calendar Year 1999 Increment	322,861	1.331100	429,760	322,861	0.287396	92,789
Calendar Year 2000 Increment	119,624	1.373870	164,348	119,624	0.244626	29,263
Calendar Year 2003 Increment	1,088,945	1.566130	1,705,429	1,088,945	0.052366	57,024
Calendar Year 2005 Increment	211,604	1.484750	314,179	211,604	0.133746	28,301
Calendar Year 2006 Increment	3,635,433	1.597100	5,806,150	3,635,433	0.021396	77,785
Cumulative Index as of Dec. 31, 2007 *	-	1.618496				
Totals	8,387,351		10,819,030	8,387,351		2,755,866
Ending Inventory at LIFO Valuation			10,819,030			
Less: Ending Inventory at Current Cost			13,574,896			
LIFO Reserve at End of Year			2,755,866			

* 1.618496 = 13,574,896 / 8,387,351

Single Pool After Rebasing Indexes

	Single Pool All New Vehicles Combined			Composition & Proof of LIFO Reserve as of Dec. 31, 2007		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Base Inventory - Jan. 1, 1978	2,315,167	0.184041	426,086	2,315,167	0.815959	1,889,081
Calendar Year 1994 Increment	525,534	0.709838	373,044	525,534	0.290162	152,490
Calendar Year 1995 Increment	455,209	0.754379	343,400	455,209	0.245621	111,809
Calendar Year 1996 Increment	857,858	0.779693	668,866	857,858	0.220307	188,992
Calendar Year 1997 Increment	102,080	0.809918	82,677	102,080	0.190082	19,404
Calendar Year 1998 Increment	614,020	0.822597	505,091	614,020	0.177403	108,929
Calendar Year 1999 Increment	522,549	0.822430	429,760	522,549	0.177570	92,789
Calendar Year 2000 Increment	193,611	0.848856	164,348	193,611	0.151144	29,263
Calendar Year 2003 Increment	1,762,453	0.967645	1,705,429	1,762,453	0.032355	57,024
Calendar Year 2005 Increment	342,480	0.917364	314,179	342,480	0.082636	28,301
Calendar Year 2006 Increment	5,883,935	0.986780	5,806,150	5,883,935	0.013220	77,785
Cumulative Index as of Dec. 31, 2007	-	1.000000	-	-	-	-
Totals	13,574,896		10,819,030	13,574,896		2,755,866
Ending Inventory at LIFO Valuation			10,819,030			
Less: Ending Inventory at Current Cost			13,574,896			
LIFO Reserve at End of Year			2,755,866			

RST Dealership, 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, 2007 (the End of the Year Immediately Preceding the Year of Change)

	(A)	(B)	(C) = (A) + (B)	CCM Method (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 - Jan. 1, 1978	620,200	1,229,776	1,849,975	1,889,081	(39,105)
Calendar Year 1994 Increment	-	158,777	158,777	152,490	6,288
Calendar Year 1995 Increment	-	117,255	117,255	111,809	5,446
Calendar Year 1996 Increment	-	199,256	199,256	188,992	10,263
Calendar Year 1997 Increment	-	20,625	20,625	19,404	1,221
Calendar Year 1998 Increment	-	116,275	116,275	108,929	7,346
Calendar Year 1999 Increment	-	99,041	99,041	92,789	6,252
Calendar Year 2000 Increment	-	31,580	31,580	29,263	2,316
Calendar Year 2003 Increment	-	78,110	78,110	57,024	21,086
Calendar Year 2005 Increment	4,827	-	4,827	28,301	(23,475)
Calendar Year 2006 Increment	6,620	73,538	80,158	77,785	2,373
	-	-	-	-	-
	(1)	(12)	(12)		(12)
LIFO Reserve Totals	631,645	2,124,221	2,755,866	2,755,866	0
Ending Inventory at LIFO Valuation	1,247,290	9,571,740	10,819,030		
Ending Inventory at Current Cost	1,878,935	11,695,961	13,574,896		
Cumulative Index as of Dec. 31, 2007	1.507560	1.637860	1.618496		

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 Chief Counsel Memo (CCM) 200825044.

It can be seen from the above that under the CCM approach (column (D)), if there is a decrement in the pool in the year of change (i.e., 2008) or in a later year that is large enough to eliminate the increments experienced in the more recent years before the combination, the payback of the LIFO reserve will be significantly different because of the shifting of the amounts contributed to the LIFO reserve by each year for which there is an increment.

Under the alternative sequence approach (column (C)) 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 2008 (or in a later year) would be limited to the amounts actually contributed to the LIFO reserve (as of the beginning of the year of change) by each year's layer that is being invaded by the carryback of the decrement.

Case Study #2 ... RST Dealership, Inc.

Calculation of LIFO Inventory Valuations & LIFO Reserves

For the Year Ended December 31, 2008

	Pool #1 New Autos	Pool #2 New L/D Trucks	Single Pool All New Vehicles Combined As Rebased
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	1,246,342	7,141,002	13,574,896
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	4,646,050	7,748,459	12,394,509
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX: (Report #5) END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) RATIO OF: ---------- END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.06265	1.02971	1.04183
E. CUMULATIVE LINK-CHAIN INDEX: CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.60201	1.68652	1.04183
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	2,900,138	4,594,348	11,896,863
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS			
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	2,900,138	4,594,348	11,896,863
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(1,246,342)	(7,141,002)	(13,574,896)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	1,653,796	(2,546,654)	(1,678,033)
	1.60201	-	-
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	2,649,398	N/A	N/A

H. ANALYSIS OF YEAR-END INVENTORY LIFO "LAYERS"

New Automobiles	BASE DOLLARS		VALUATION FACTOR	
Base Inventory - Jan. 1, 1978	512,693	x	0.297870	152,716
Calendar Year 2005	211,604	x	1.484750	314,179
Calendar Year 2006	522,045	x	1.494880	780,395
Calendar Year 2008	1,653,796	x	1.602010	2,649,398
	2,900,138			3,896,687

New Light-Duty Trucks	BASE DOLLARS		VALUATION FACTOR	
Base Inventory - Jan. 1, 1978	917,750	x	0.297870	273,370
Calendar Year 1994	324,705	x	1.148870	373,044
Calendar Year 1995	281,254	x	1.220960	343,400
Calendar Year 1996	530,034	x	1.261930	668,866
Calendar Year 1997	63,071	x	1.310850	82,677
Calendar Year 1998	379,377	x	1.331370	505,091
Calendar Year 1999	322,861	x	1.331100	429,760
Calendar Year 2000	119,624	x	1.373870	164,348
Calendar Year 2003	1,088,945	x	1.566130	1,705,429
Calendar Year 2006	566,734	x	1.614240	914,845
	4,594,355			5,460,830

Single Combined Pool	BASE DOLLARS		VALUATION FACTOR	
Base Inventory - Jan. 1, 1978	2,315,167	x	0.184041	426,086
Calendar Year 1994	525,534	x	0.709838	373,044
Calendar Year 1995	455,209	x	0.754379	343,400
Calendar Year 1996	857,858	x	0.779693	668,866
Calendar Year 1997	102,080	x	0.809920	82,677
Calendar Year 1998	614,020	x	0.822597	505,091
Calendar Year 1999	522,549	x	0.822430	429,760
Calendar Year 2000	193,611	x	0.848856	164,348
Calendar Year 2003	1,762,453	x	0.967645	1,705,429
Calendar Year 2005	342,480	x	0.917364	314,179
Calendar Year 2006	4,205,902	x	0.986780	4,150,300
	11,896,863			9,163,179

	Pool #1	Pool #2	Single Pool
ENDING INVENTORY AT LIFO VALUATION, PER ABOVE	3,896,687	5,460,830	9,163,179
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	4,646,050	7,748,459	12,394,509
LIFO RESERVE AT END OF CURRENT YEAR	749,363	2,287,629	3,231,330
LIFO RESERVE AT END OF PREVIOUS YEAR	631,646	2,124,221	2,755,867
INCREASE IN LIFO RESERVE AT END OF CURRENT YEAR	117,717	163,408	475,463
		117,717	
Total Increase in LIFO Reserve at Dec. 31, 2008 Using Separate Pools		281,125	(281,125)
Net Greater LIFO Reserve From Using a Single Pool for All New Vehicles for 2008			194,338

Case Study #2 ... RST Dealership, Inc.
Proof of LIFO Inventory Valuations & LIFO Reserves
For the Year Ended December 31, 2008

I. Proof of Increase in LIFO Reserve for Pool #1 New Automobiles

Increase due to inflation ... Base dollars that remained in tact throughout year 2008	1,246,342	x	0.09445	=	(1.60201 - 1.50756)		117,717
Less: Decrease or payback due to decrement carried back against prior year layers - *NONE*							
Decrease due to invading previous layer	0	x	0.00000	or	(0.00000 - 0.00000)	=	0
Decrease due to invading previous layer	0	x	0.00000	or	(0.00000 - 0.00000)	=	0
	0						0
Net Increase in LIFO Reserve for 2008 - Pool #1 New Automobiles							117,717

II. Proof of Increase (Decrease) in LIFO Reserve for Pool #2 New Light-Duty Trucks

Increase due to inflation ... Base dollars that remained in tact throughout year 2008	4,594,348	x	0.04866	=	(1.68652 - 1.63786)		223,561
Less: Decrease or payback due to decrement carried back against prior year layers							
Decrease due to invading Year 2006 layer	2,546,654	x	0.02362	or	(1.63786 - 1.61424)	=	(60,152)
	2,546,654						
Total Reduction in LIFO Reserve Due to Decrement							(60,152)
						Rounding	(1)
Net Increase in LIFO Reserve for 2008- Pool #2 New Light-Duty Trucks							163,408

III. Proof of Increase in LIFO Reserve for Single Combined Pool for All New Vehicles

Increase due to inflation ... Base dollars that remained in tact throughout year 2008	11,896,863	x	0.04183	=	(1.04183 - 1.00000)		497,646
Less: Decrease or payback due to decrement carried back against prior year layers							
Decrease due to invading Year 2006 layer	1,678,033	x	0.013220	or	(1.00000 - 0.986780)	=	(22,184)
	1,678,033						
Total Reduction in LIFO Reserve Due to Decrement							(22,184)
						Rounding	1
Net Increase in LIFO Reserve for 2008 - Single, Combined Pool							475,463

IV. Proof of Composition of LIFO Reserve for Single, Combined LIFO Pool as of Dec. 31, 2008

Base Inventory - Jan. 1, 1978	2,315,167	0.857789	or (1.04183 - 0.184041)	1,985,925
Calendar Year 1994	525,534	0.331992	or (1.04183 - 0.709838)	174,473
Calendar Year 1995	455,209	0.287451	or (1.04183 - 0.754379)	130,850
Calendar Year 1996	857,858	0.262137	or (1.04183 - 0.779693)	224,876
Calendar Year 1997	102,080	0.231912	or (1.04183 - 0.809918)	23,674
Calendar Year 1998	614,020	0.219233	or (1.04183 - 0.822597)	134,613
Calendar Year 1999	522,549	0.219400	or (1.04183 - 0.822430)	114,647
Calendar Year 2000	193,611	0.192974	or (1.04183 - 0.848856)	37,362
Calendar Year 2003	1,762,453	0.074185	or (1.04183 - 0.967645)	130,748
Calendar Year 2005	342,480	0.124466	or (1.04183 - 0.917364)	42,627
Calendar Year 2006	4,205,902	0.055050	or (1.04183 - 0.986780)	231,535
	11,896,863		Rounding	-
Composition of the LIFO Reserve for the Single, Combined Pool for All New Vehicles as of Dec. 31, 2008				3,231,330

V. Comparison of Results - Single, Combined LIFO Pool vs. Two Separate LIFO Pools

Difference in LIFO Reserve Recapture Due to Carryback of Decrements

Total Reduction in LIFO Reserve Due to Decrement - Single Pool, Per Above		22,184
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools - Pool #1 New Autos		0
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools - Pool #2 New Light-Duty Trucks		60,152
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools		60,152
Combined Pool Results in Smaller Payback in LIFO Reserve Due to Decrement Carryback (60,152 - 22,184)		37,968

Difference in LIFO Reserve Increase or Decrease Due to Inflation

Increase in LIFO Reserve Due to Inflation - Separate Pools - Pool #1 New Autos	117,717	
Increase in LIFO Reserve Due to Inflation - Separate Pools - Pool #2 New L/D Trucks	223,561	
Subtotal	341,278	
Increase in LIFO Reserve Due to Inflation - Single Pool - All New Vehicles, Per Above	497,646	
Combined Pool Results in a Greater Increase in the LIFO Reserve Due to Inflation	156,368	156,368
	Rounding	2
Net Greater LIFO Reserve From Using a Single, Combined Pool for All New Vehicles for 2008		194,338

XYZ DEALERSHIP ... AN EXAMPLE OF THE INADVISABILITY OF CHANGING TO THE VEHICLE-POOL METHOD FOR 2007

In analyzing the impact and practicality of changing to the single, combined pool LIFO method, it should be obvious that each dealership situation needs to be evaluated based on its own fact pattern. In general, most dealerships sooner or later should find it advisable to change to the Vehicle-Pool Method. We did expect that there might be some situations where changing from the two-pool method to the single, combined pool method might actually result in decreasing the LIFO reserve, rather than increasing it.

This Case Study is a good example of a situation where it was inadvisable to make the change for 2007.

- ***Page 2 of 6*** shows the LIFO layer history for both pools as of Dec. 31, 2006.
  - The inventory cost in Pool #2 is about 6 times larger than in Pool #1 ($13.6 million vs. $2.2 million).
  - Pool #1, the smaller pool, does have a relatively large layer associated with calendar year 2006. The increase in this layer in 2006 contributed $0 (zero) to the LIFO reserve as of Dec. 31, 2006. Accordingly, any decrement in this pool in 2007 carried back against the 2006 layer would result in $0 (zero) repayment of the LIFO reserve for that pool.
  - Pool #2 does not have a LIFO layer associated with either 2006 or 2005.
- ***Page 3 of 6*** shows the data for the single, combined pool, before and after the pool is rebased to 1.000.
- ***Page 4 of 6*** shows the significant difference in the contributions to the LIFO reserve by layer depending on the sequence of calculations used in combining separate LIFO pools. One of the major points of emphasis in our analysis of CCM 200825044 in the Year-End 2008 Edition of the *Lookout* was that there could be significant differences in result if the sequence of steps as illustrated by the IRS were reversed.
  - ***Alternative calculation.*** If the LIFO pools were rebased to 1.000 before they were combined, would the result have been different? Absolutely ... All the details are right there in the proofs on Page 6 of 6.
  - The conclusion that the dealership should not change to the single, combined pool method for 2007 is driven by the fact that there has been a shift of the contribution to the LIFO reserve in the amount of $64,122 to the calendar year 2006 layer of inventory, and this 2006 layer is being invaded by the carryback of the decrement experienced in 2007 (the year that would be the year of change).
  - If the separate pools were combined, the decrement experienced in the combined pool would be carried back and require the repayment of the $64,122 (as part of the overall carryback application). However, if the LIFO pools are not combined for 2007, the decrements experienced in each pool have significantly smaller amounts of LIFO reserve recapture of payback associated with them.
- ***Page 5 of 6*** shows a proforma computation of the results for calendar year 2007, if a change were made from the two-pool method to the Vehicle-Pool Method.
  - This schedule shows the results of the 2007 LIFO calculation under both pooling methods (i.e., either [1] using two separate pools or [2] combining the two pools into a single pool).
    - If separate LIFO pools were maintained (i.e., the dealership does not change to the Vehicle-Pool Method), the result would be an increase in the LIFO reserve for 2007 of $181,823 ($6,083 increase in Pool #1 plus the $175,820 net increase in Pool #2).
    - If the Vehicle-Pool Method were used, the result would be an increase of the LIFO reserve for 2007 of only $123,811. This is not too shabby, but it could be much higher if the Vehicle-Pool Method is not used.
    - Therefore, the LIFO reserve at the end of 2007 is greater by approximately $58,000 (ignoring rounding) if the dealership does not change to the Vehicle-Pool Method.
- ***Page 6 of 6*** analyzes the composition of the changes in the LIFO reserves under both scenarios.
  - The year-end 2007 inventory at cost in Pool #1 is almost 50% less than it was at the end of 2006 (actual cost $1,093,275 vs. $2,203,173, respectively). As a result, maintaining separate pools for 2007 would result in the decrement (of $931,968 expressed in base dollars) in Pool #1 being carried back against the calendar year 2006 increment, with no repayment of the LIFO reserve.
  - The year-end 2007 inventory at cost in Pool #2 is only slightly less than it was at the end of 2006 (actual cost $13,049,764 vs. $13,602,501, respectively). As a result, maintaining separate pools for 2007 would result in the decrement (of $584,150 expressed in base dollars) in Pool #2 being carried back against the calendar year 2003 increment, with a small repayment of the LIFO reserve ($15,801) attributable to the carryback.

Case Study #3 - XYZ Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2006 ... CCM 200825044

Year of Change to the Vehicle-Pool Method Being Evaluated Is Calendar Year 2007

Pool #1 New Automobiles	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2006*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
Analysis of Year-End LIFO Inventory Layers						
Base Inventory January 1, 1996	563,828	1.000000	563,828	563,828	0.197360	111,277
Calendar Year 1997	-	-	-	-	-	-
Calendar Year 2002	268,555	1.148720	308,494	268,555	0.048640	13,063
Calendar Year 2003	-	-	-	-	-	-
Calendar Year 2005	30,061	1.195160	35,928	30,061	0.002200	66
Calendar Year 2006	977,582	1.197360	1,170,518	977,582	-	-
Cumulative Index as of Dec. 31, 2006		1.197360	-	-	-	-
			(1)		Rounding	-
Totals	1,840,026		2,078,767	1,840,026		124,406
Ending Inventory at LIFO Valuation			2,078,767			
Less: Ending Inventory at Current Cost			2,203,173			
LIFO Reserve at End of Year			124,406			

Pool #2 New L/D Trucks	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Composition & Proof of LIFO Reserve as of Dec. 31, 2006*		
				Base Dollars	*Proof Factor*	*Composition of LIFO Reserve*
Analysis of Year-End LIFO Inventory Layers						
Base Inventory January 1, 1996	4,314,538	1.000000	4,314,538	4,314,538	0.274260	1,183,305
Calendar Year 1997	440,813	1.020740	449,955	440,813	0.253520	111,755
Calendar Year 2002	-	-	-	-	-	-
Calendar Year 2003	5,919,487	1.247210	7,382,843	5,919,487	0.027050	160,122
Calendar Year 2005	-	-	-	-	-	-
Calendar Year 2006	-	-	-			-
Cumulative Index as of Dec. 31, 2006		1.274260		-	-	-
			(1)			(17)
Totals	10,674,838		12,147,336	10,674,838		1,455,165
Ending Inventory at LIFO Valuation			12,147,336			
Less: Ending Inventory at Current Cost			13,602,501			
LIFO Reserve at End of Year			1,455,165			

Case Study #3 - XYZ Dealership, Inc.

Analysis of LIFO Layers as of Dec. 31, 2006... CCM 200825044

Year of Change to the Vehicle-Pool Method Being Evaluated Is Calendar Year 2007

Before Rebasing Indexes

	Single Pool All New Vehicles Combined			Composition & Proof of LIFO Reserve as of Dec. 31, 2006		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars*	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Base Inventory January 1, 1996	4,878,366	1.000000	4,878,366	4,878,366	0.262952	1,282,777
Calendar Year 1997	440,813	1.020740	449,955	440,813	0.242212	106,770
Calendar Year 2002	268,555	1.148720	308,494	268,555	0.114232	30,678
Calendar Year 2003	5,919,487	1.247210	7,382,843	5,919,487	0.015742	93,185
Calendar Year 2005	30,061	1.195160	35,928	30,061	0.067792	2,038
Calendar Year 2006	977,582	1.197360	1,170,518	977,582	0.065592	64,122
Cumulative Index as of Dec. 31, 2006 *	-	1.262952				
Totals	12,514,864		14,226,105	12,514,864		1,579,569
Ending Inventory at LIFO Valuation			14,226,105			
Less: Ending Inventory at Current Cost			15,805,674			
LIFO Reserve at End of Year			1,579,569			

* 1.262952 = 15,805,674 / 12,514,864

After Rebasing Indexes

	Single Pool All New Vehicles Combined			Composition & Proof of LIFO Reserve as of Dec. 31, 2006		
Analysis of Year-End LIFO Inventory Layers	*Base Dollars***	*Valuation Factor*	*LIFO Valuation*	*Base Dollars*	*Proof Factor*	*Composition of LIFO Reserve*
Base Inventory January 1, 1996	6,161,143	0.791796	4,878,366	6,161,143	0.208204	1,282,777
Calendar Year 1997	556,726	0.808217	449,955	556,726	0.191783	106,770
Calendar Year 2002	339,172	0.909552	308,494	339,172	0.090448	30,678
Calendar Year 2003	7,476,029	0.987535	7,382,843	7,476,029	0.012465	93,185
Calendar Year 2005	37,966	0.946322	35,928	37,966	0.053678	2,038
Calendar Year 2006	1,234,639	0.948064	1,170,518	1,234,639	0.051936	64,122
Cumulative Index as of Dec. 31, 2006	-	1.000000	-	-	-	-
Totals	15,805,674		14,226,105	15,805,674		1,579,569
Ending Inventory at LIFO Valuation			14,226,105			
Less: Ending Inventory at Current Cost			15,805,674			
LIFO Reserve at End of Year			1,579,569			

** Base dollar amounts for each year above are multiplied by 1.262952.

Case Study #3 - XYZ Dealership, 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 Being Evaluated)

	(A)	(B)	(C) = (A) + (B)	CCM Method (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, 1996	111,277	1,183,305	1,294,582	1,282,777	11,805
Calendar Year 1997	-	111,755	111,755	106,770	4,985
Calendar Year 2002	13,063	-	13,063	30,678	(17,615)
Calendar Year 2003	-	160,122	160,122	93,185	66,937
Calendar Year 2005	66	-	66	2,038	(1,972)
Calendar Year 2006	-	-	-	64,122	(64,122)
	-	-	-	-	-
	-	(17)	(17)	-	-
LIFO Reserve Totals	124,406	1,455,165	1,579,571	1,579,570	18
Ending Inventory at LIFO Valuation	2,078,767	12,147,336	14,226,103		
Ending Inventory at Current Cost	2,203,173	13,602,501	15,805,674		

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 Chief Counsel Memo (CCM) 200825044.

It can be seen from the above that under the CCM approach (column (D)), if there is a decrement in the pool in the year of change (i.e., 2008) or in a later year that is large enough to eliminate the increments experienced in the more recent years before the combination, the payback of the LIFO reserve will be significantly different because of the shifting of the amounts contributed to the LIFO reserve by each year for which there is an increment.

Under the alternative sequence approach (column (C)) 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 2008 (or in a later year) would be limited to the amounts actually contributed to the LIFO reserve (as of the beginning of the year of change) by each year's layer that is being invaded by the carryback of the decrement.

Note: Year of change to the Vehicle-Pool Method being evaluated is calendar year 2007.

The conclusion that the dealership should not change to the single, combined pool method for 2007 is driven by the fact that there has been a shift of the contribution to the LIFO reserve in the amount of $64,122 to the calendar year 2006 layer of inventory.

If the separate pools were combined, the decrement experienced in the combined pool in 2007 would be carried back against 2006 and require the invasion of that layer which shows a repayment of LIFO reserve potential in the amount of $64,122 (as part of the overall carryback application).

However, if the two LIFO pools are not combined for 2007, the decrements experienced in each pool have significantly smaller amounts of payback associated with them. See Page 6 of 6 which shows all of the proofs of increase and change in the respective LIFO pools under both pooling scenarios.

Case Study #3 ... XYZ Dealership, Inc.

Proforma Calculation of LIFO Inventory Valuations & LIFO Reserves

For the Year Ended December 31, 2007

	Pool #1 New Autos	Pool #2 New L/D Trucks	Single Pool All New Vehicles Combined As Rebased
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	1,840,026	10,674,824	15,805,674
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	1,093,275	13,049,764	14,143,039
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX: (Report #5) END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) RATIO OF: ---------- END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.00552	1.01490	1.01415
E. CUMULATIVE LINK-CHAIN INDEX: CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.20397	1.29325	1.01415
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	908,058	10,090,674	13,945,748
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS			
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	908,058	10,090,674	13,945,748
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(1,840,026)	(10,674,824)	(15,805,674)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(931,968)	(584,150)	(1,859,926)
	-	-	-
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	N/A	N/A	N/A

H. ANALYSIS OF YEAR-END INVENTORY LIFO "LAYERS"

New Automobiles	BASE DOLLARS		VALUATION FACTOR			
Base Inventory Jan. 1, 1996	563,828	x	1.000000	563,828		
Calendar Year 2002	268,555	x	1.148720	308,494		
Calendar Year 2005	30,061	x	1.195160	35,928		
Calendar Year 2006	45,614	x	1.197360	54,616		
	908,058			962,867		

New Light-Duty Trucks	BASE DOLLARS		VALUATION FACTOR			
Base Inventory Jan. 1, 1996	4,314,538	x	1.000000		4,314,538	
Calendar Year 1997	440,813	x	1.020740		449,955	
Calendar Year 2003	5,335,337	x	1.247210		6,654,286	
	10,090,688				11,418,779	

Single Combined Pool	BASE DOLLARS		VALUATION FACTOR			
Base Inventory Jan. 1, 1996	6,161,143	x	0.791796			4,878,368
Calendar Year 1997	556,726	x	0.808217			449,955
Calendar Year 2002	339,172	x	0.909552			308,495
Calendar Year 2003	6,888,707	x	0.987535			6,802,839
	13,945,748					12,439,658

ENDING INVENTORY AT LIFO VALUATION, PER ABOVE	962,867	11,418,779	12,439,658
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	1,093,275	13,049,764	14,143,039
LIFO RESERVE AT END OF CURRENT YEAR	130,408	1,630,985	1,703,381
LIFO RESERVE AT END OF PREVIOUS YEAR	124,405	1,455,165	1,579,570
INCREASE IN LIFO RESERVE AT END OF CURRENT YEAR	6,003	175,820	123,811
		6,003	
Total Increase in LIFO Reserve at Dec. 31, 2007 Using Separate Pools		181,823	(181,823)
*Net Smaller LIFO Reserve From Using a Single Pool for All New Vehicles for 2007 **			* (58,012)

(Conclusion: Change to single, combined pool method for 2007 is NOT advisable)*

Case Study #3 ... XYZ Dealership, Inc.

Proof of Proforma Calculation of LIFO Inventory Valuations & LIFO Reserves

For the Year Ended December 31, 2007

I. Proof of Increase in LIFO Reserve for Pool #1 New Automobiles

Increase due to inflation ... Base dollars that remained in tact throughout year 2007	908,058	x	0.00661	=	(1.20397 - 1.19736)		6,002
Less: Decrease or payback due to decrement carried back against prior year layers							
Decrease due to invading calendar year 2006 layer	931,968	x	0.00000	or	(1.19736 - 1.19736)	=	0
	931,968						1
Net Increase in LIFO Reserve for 2007 - Pool #1 New Automobiles							6,003

II. Proof of Increase in LIFO Reserve for Pool #2 New Light-Duty Trucks

Increase due to inflation ... Base dollars that remained in tact throughout year 2007	10,090,674	x	0.01899	=	(1.29325 - 1.27426)		191,622
Less: Decrease or payback due to decrement carried back against prior year layers							
Decrease due to invading calendar year 2003 layer	584,150	x	0.02705	or	(1.27426 - 1.24721)	=	(15,801)
	584,150						
Total Reduction in LIFO Reserve Due to Decrement							(15,801)
						Rounding	(1)
Net Increase in LIFO Reserve for 2007 - Pool #2 New Light-Duty Trucks							175,820

III. Proof of Increase in LIFO Reserve for Single Combined Pool for All New Vehicles

Increase due to inflation ... Base dollars that remained in tact throughout year 2007	13,945,748	x	0.01415	=	(1.01415-1.00000)		197,331
Less: Decrease or payback due to decrement carried back against prior year layers							
Decrease due to invading calendar year 2003 layer	587,321	x	0.01246	or	(1.00000 - 0.987535)	=	(7,321)
Decrease due to invading calendar year 2005 layer	37,966	x	0.05368	or	(1.00000 - 0.946322)	=	(2,038)
Decrease due to invading calendar year 2006 layer	1,234,639	x	0.05194	or	(1.00000 - 0.948064)	=	(64,122)
	1,859,926						
Total Reduction in LIFO Reserve Due to Decrement							(73,481)
						Rounding	(39)
Net Increase in LIFO Reserve for 2007 - Single Pool							123,811

IV. Proof of Composition of LIFO Reserve for Single, Combined LIFO Pool as of Dec. 31, 2007

Base Inventory Jan. 1, 1996	6,161,143	0.222354 or (1.01415 - 0.791796)		1,369,955
Calendar Year 1997	556,726	0.205933 or (1.01415 - 0.808217)		114,648
Calendar Year 2002	339,172	0.104598 or (1.01415 - 0.909552)		35,477
Calendar Year 2003	6,888,707	0.026615 or (1.01415 - 0.987535)		183,343
	13,945,748		Rounding	(42)
Composition of the LIFO Reserve for the Single, Combined Pool for All New Vehicles as of Dec. 31, 2007				1,703,381

V. Comparison of Results - Single, Combined LIFO Pool vs. Two Separate LIFO Pools

Difference in LIFO Reserve Recapture Due to Carryback of Decrements

Total Reduction in LIFO Reserve Due to Decrement - Single Pool, Per Above	73,481
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools - Pool #1 New Autos	n/a
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools - Pool #2 New Light-Duty Trucks	(15,801)
Total Reduction in LIFO Reserve Due to Decrement - Separate Pools	(15,801)
Single, Combined Pool Results in Greater Payback in LIFO Reserve Due to Decrement Carryback (73,481 - 15,801)	57,680

Difference in LIFO Reserve Increase or Decrease Due to Inflation

Increase in LIFO Reserve Due to Inflation - Separate Pools - Pool #1 New Autos	6,002	
Increase in LIFO Reserve Due to Inflation - Separate Pools - Pool #2 New L/D Trucks	191,622	
Subtotal	197,624	
Increase in LIFO Reserve Due to Inflation - Single Pool - All New Vehicles, Per Above	197,331	
Single, Combined Pool Results in a Smaller Increase in the LIFO Reserve Due to Inflation	(293)	293
	Rounding	39
Net Smaller LIFO Reserve From Using a Single, Combined Pool for All New Vehicles for 2007*	*	58,012

(* Conclusion: Change to single, combined pool method for 2007 is NOT advisable)

COMPARISON OF *SuperLIFO*™ & IRS NEW ITEM DETERMINATIONS FOR NEW VEHICLES IN YEAR-END 2008 INVENTORIES

We are pleased to present our ***SuperLIFO***™ 2009 New Items Lists in a Report comparing our determinations of new items with those previously made available by the office of the IRS Motor Vehicle Technical Advisor in Grand Rapids, Michigan.

The IRS lists were distributed as an attachment to an e-mail dated May 4, 2009. In the attachment, the IRS Motor Vehicle Technical Advisor stated the following ... ***"This list is similar to the guidance I provide to examiners who audit automobile dealers' Tax returns and is the result of research by my staff of the best information available to us. Since the list is not an 'Official List,' it does not reflect 'Service Position' and examiners are not required to follow it."***

The IRS used the following sources to compile its New Items Lists... *Edmunds.com*, *Cars.com*, *NADAguides.com*, *Kelley Blue Book New Car Price Manual* (4th Edition, 2008), *Black Book New Car Cost Guide* (July/August 2008 and October 2008 Editions) *Automotive News*, and when available, product brochures, manufacturers' price lists and vehicle order guides. Because *Kelley* changed the availability of its data, there may be some discontinuity in the data used by the IRS in compiling its New Items List, as it is now changed over to greater reliance on *Black Book* as its primary source.

HOW TO INTERPRET OUR *SuperLIFO*™ - IRS COMPARATIVE REPORT

Our Comparative New Item Report covers 21 pages ... New automobiles on pages 1-8 and new light-duty trucks (including sport utility vehicles, minivans and off-roads) on pages 9-21. An additional qualification added to the IRS Report states, ***"This list is not intended for pooling purposes."***

Our Comparative New Item Report shows complete make, model, body style, model code and item category information.

The left-hand side of each Report page shows our *SuperLIFO*™ New Items List.

The right-hand side of the Report (including the "Yes" column) shows the IRS' Motor Vehicle Industry Specialist's new item listing.

To make it easier to identify the differences in our respective new items listings, where a *new* item on our List also appears on the IRS' list, that detailed item category has not been listed again on the right-hand side.

The "Yes/No" columns should be read as follows: If an "X" appears in the "Yes" column, that item category has been determined by the IRS to be a *new* item category. Thus, every item category listed on the left-hand side of the page with a corresponding "X" in the "Yes" column indicates an item category where we are in agreement with the IRS.

Where there are blank spaces on the left-hand side of the page, but item category entries on the corresponding right-hand side of the page, you can clearly see those item categories (with model numbers) which the IRS concluded were new items, but which we concluded were not.

If an "X" appears in the "No" column, that item category is listed on the left-hand (i.e., *SuperLIFO*™) side, and that "X" indicates an item category that we treated as *new*, but which the IRS did not.

The IRS also used a calendar year cut-off, rather than a model year cut-off, in compiling its list. This eliminated many items that otherwise might have been differences resulting from overlapping time periods. But in some instances, varying introduction dates created differences in our respective determinations.

In summary: Everything listed on the left-hand (our) side with an "X" in the "Yes" column is an item category where we agree with the IRS that it is a *new* item. Everything with an "X" in the "Yes" column is on the IRS' new item list. Everything listed on the right-hand (IRS) side of the page is an item category that the IRS considers to be *new*... and we do not. Finally, everything with an "X" in the "No" column is something that we conclude should be a *new* item category, but the IRS does not.

With respect to the December 31, 2008 year-end vehicles, we identified a total of 704 new item categories (249 automobiles and 455 light-duty trucks) whereas the IRS identified a total of 473 (178 automobiles and 295 light-duty trucks). We both reached the same conclusion with respect to 314 new item categories.

We identified 390 item categories as *new*, but the IRS determined them to be *continuing*. The IRS identified 159 items as *new*, but we concluded that they should be treated as *continuing* items.

→

Comparison of SuperLIFO...

A table summarizing the details of these differences in treatment appears on page 56.

Again this year, one of the differences arising in our analyses related to the manufacturer regional pricing for many Chrysler and Dodge models ... there is different pricing (i.e., state surcharges that are included in dealer invoice base price for a number of states). The IRS only lists vehicles that do not include the states for which this special pricing exists. Our analyses reflected a total of 15 automobile items and 107 light-duty truck items that have differences due to regional pricing.

In some instances, we understand why we disagree with the IRS; in other situations, we're not quite sure why we don't agree - other than possibly because of conflicting information or timing differences in our respective resources.

In prior years' comparative lists, because of the format limitations involved in this side-by-side presentation, some of the new item vs. continuing item differences described as "due to timing" are not purely due to timing differences. Because we (i.e., *SuperLIFO*™) received the information sooner or more directly, some item categories were treated as new on an earlier compilation of new items ... and the IRS was simply catching up with treating them as new items on its "later" compilation.

In this year's comparative lists, information available to us for determining vehicle status was always (dated) earlier than the information the IRS was using for its determinations. This is clearly evident in the note at the bottom of page 56.

There are other instances involving models/vehicles that did not exist in the prior year where (1) we received information that the IRS did not, (2) we determined the item to be a new item, (3) the IRS did not even list that item (because the IRS did not have any information on it) and (4) that item appears in the "No" column and is "x'd" in the "No" column. The reason that these are not considered as timing differences between our respective lists is that the IRS had no information to evaluate. Therefore, that item will not result in a timing difference until, at some later date, the IRS receives information on the vehicle and then makes its determination as to its status.

(Continued)

DEFINITION OF A "NEW" ITEM

A *new* item category is defined as an item category not considered to be in existence in the prior taxable year.

Under Section 4.02(5) of Rev. Proc. 97-36, a new item category results from any one of the following:

- Any new or reassigned manufacturer's model code that was caused by a change in an existing vehicle,
- A manufacturer's model code created or reassigned because the classified vehicle did not previously exist, or
- If there is no change in a manufacturer's model code, but there has been a change to the platform (i.e., the piece of metal at the bottom of the chassis that determines the length and width of the vehicle and the structural set-up of the vehicle) that results in a change in track width or wheel base, whether or not the same model name was previously used by the manufacturer, a new item category is created.

NEW ITEM: WHAT DIFFERENCE DOES IT MAKE?

New item categories are required to be included at a 1.000 factor in the annual computation of the index of inflation or deflation. This is accomplished by using the same dollar amount for the end-of-the-year base cost as for the beginning-of-the-year base cost.

Since any number divided by itself equals 1.000, this new item treatment will contribute no inflation (or deflation) *for that item* to the annual index.

However, if there is overall inflation for the year, the inclusion of the same dollar amount for that new item in both the numerator and the denominator of the fraction will *reduce* the overall weighted index result (i.e., it will depress the index computed).

The opposite result occurs in an overall deflationary year. New item treatment (at 1.000) will *increase* the overall weighted index result if there would otherwise be overall deflation for the year.

DETAIL LISTINGS

We have included the first page of the New Automobiles Report (Page 1 of 21) on page 58 and the first page of the New Light-Duty Truck Report (Page 9 of 21) on page 59. If you would like a copy of the entire 21 page Report, please write or e-mail us with your request.

COMPARISON OF "UNOFFICIAL" NEW ITEM CATEGORY LISTS

SUPERLIFO™ AND IRS / MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM
NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
FOR CALENDAR YEAR DEALERS - DECEMBER 31, 2008

	LEFT-HAND COLUMN					RIGHT-HAND COLUMN
	SUPERLIFO SAID NEW (A)	IRS SAID NEW (B)	*SUPERLIFO* & IRS BOTH AGREE (A - C)	(B - D)	*SUPERLIFO* SAID NEW, IRS SAID CONTINUING (C)	IRS SAID NEW, *SUPERLIFO* SAID CONTINUING (D)
AUTOS						
Page 1	29	26	18	18	11	8
Page 2	36	12	6	6	30	6
Page 3	37	28	23	23	14	5
Page 4	29	27	15	15	14	12
Page 5	29	22	11	11	18	11
Page 6	29	23	11	11	18	12
Page 7	34	31	21	21	13	10
Page 8	26	9	6	6	20	3
TOTAL AUTOS	249	178	111	111	138	67
TRUCKS						
Page 9	34	12	8	8	26	4
Page 10	42	3	1	1	41	2
Page 11	39	16	14	14	25	2
Page 12	44	11	11	11	33	0
Page 13	36	12	6	6	30	6
Page 14	40	8	4	4	36	4
Page 15	37	46	37	37	0	9
Page 16	41	38	34	34	7	4
Page 17	40	19	17	17	23	2
Page 18	32	21	15	15	17	6
Page 19	12	38	9	9	3	29
Page 20	29	37	25	25	4	12
Page 21	29	34	22	22	7	12
TOTAL TRUCKS	455	295	203	203	252	92
TOTAL AUTOS & TRUCKS	704	473	314	314	390	159

Out of the differences in Columns C & D, 37 cars and 44 truck differences were not "interpretive" differences. Rather, these 81 differences were solely due to timing in the sense that S/L and the IRS obtained the vehicle data in different time periods and therefore the vehicles did (or did not) appear on one list, but not on the other. In other words, these 81 "timing" differences would not exist if the comparison of lists were made over a 2 year period.

TIMING DIFFERENCES

IRS RECEIVED INFO EARLIER OR LATER				SUPERLIFO RECEIVED INFO EARLIER OR LATER			
CARS - EARLIER	3	TRUCKS - EARLIER	0	CARS - EARLIER	34	TRUCKS - EARLIER	44
CARS - LATER	34	TRUCKS - LATER	44	CARS - LATER	3	TRUCKS - LATER	0

SUPERLIFO™ 2009 NEW ITEMS LISTS

VS.

IRS

COMPARISON OF "UNOFFICIAL" NEW ITEM CATEGORY LISTS
SUPERLIFO™ AND IRS MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM

NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
INVOLVING MANUFACTURER MODEL YEARS 2008, 2009 & 2010

SUPERLIFO™ - NEW ITEMS LIST FOR CALENDAR YEAR 2008 DEALERS & IRS MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM (DECEMBER, 2008 CALENDAR YEAR)

LEGEND / COMMENT CODE

E =	DIFFERENCE IN ENGINE / MOST DETAILED DESCRIPTION
OPTION =	OPTION PACKAGES / MOST DETAILED DESCRIPTION
REGION =	DIFFERENT PRODUCT REQUIREMENTS OR OPTION PACKAGES WHICH VARY DEPENDING ON REGIONAL CONSIDERATIONS
TIMING =	TIMING DIFFERENCE: IRS RECEIVED INFO EARLIER OR LATER
DIFSC =	DIFFERENT INFORMATION SOURCES AVAILABLE TO IRS AND / OR TO *SUPERLIFO*™

NUMBER OF NEW ITEMS

	SUPERLIFO™ CATEGORY	IRS CATEGORY
AUTOMOBILES	249	178
LIGHT-DUTY TRUCKS	455	295
TOTAL NEW ITEM CATEGORIES	704	473

COMPARISON OF "UNOFFICIAL" NEW ITEM CATEGORY LISTS
SUPERLIFO™ AND IRS MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM

NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
FOR CALENDAR YEAR DEALERS - DECEMBER 31, 2008

		SUPERLIFO™ - NEW ITEMS LIST FOR CALENDAR YEAR 2008 DEALERS		IRS MOTOR VEHICLE INDUSTRY (DECEMBER, 2008 CALENDAR YEAR)				PAGE 1 OF 21
MAKE	MODEL	BODY STYLE	MODEL CODE	YES	NO	BODY STYLE	COMMENT CODE	COMMENTS
		NEW AUTOMOBILES				NEW AUTOMOBILES		
ACURA	RL	4-DR SEDAN V6 3.7 AUTO	KB265	X				
		4-DR SEDAN V6 3.7 AUTO W/TECH	KB266	X				
		4-DR SEDAN V6 3.7 W/CMBS/PAX	KB266 CMBS	X				
	TL	4-DR SEDAN AUTO V6 3.5 AUTO W/TECH	UA865	X				
		4-DR SEDAN SH AWD V6 3.7 AUTO	UA962	X				
		4-DR SEDAN SH AWD V6 3.7 AUTO W/TECH/HP	UA965 TECHHP	X				
		4-DR SEDAN V6 3.5 AUTO	UA362	X				
		4-DR SEDAN V6 AUTO W/TECH	UA965 TECH	X				
	TSX	4-DR SEDAN 4CYL 2.4 6-SP	CU256	X				IRS MFRS CODE CU254
		4-DR SEDAN 4CYL 2.4 6-SP W/TECH	CU256 TECH	X				
		4-DR SEDAN 4CYL 2.4 AUTO	CU266	X				IRS MFRS CODE CU264
		4-DR SEDAN 4CYL 2.4 AUTO W/TECH	CU266 TECH	X				
AUDI	A3	4-DR WAGON 2.0T PZEV 6-SP	8PA5YC		X		REGION	
		4-DR WAGON 2.0T PZEV STRONIC AUTO	8PA5YX		X		REGION	
		4-DR WAGON 2.0T QUATTRO STRONIC AUTO	8PA59L	X			DIFSC	
			8PA59L	X		4D HATCHBACK 2.0T AT QTRO	DIFSC	
	A4	2-DR CABR 2.0 MULTITRONIC FT AUTO SE	8HEXEH		X		DIFSC	
		2-DR CABR 2.0 QUATTRO TIP AUTO SE	8HEXEL		X		DIFSC	
		2-DR CABR 3.2 QUATTRO TIP AUTO SE	8HEXPL		X		DIFSC	
		4-DR AVANT 2.0 QUATTRO TIP	8K556L	X				
		4-DR SEDAN 2.0 FRONT TRAK MULTI	8K256H		X		DIFSC	
		4-DR SEDAN 2.0 QUATTRO TIP	8K256L	X				
		4-DR SEDAN 3.2 QUATTRO TIP	8K25FL	X			DIFSC	
			8HE5EH	X		2D 2.OT CABRIO CVT FRONT TRAC	DIFSC	
			8HE5EL	X		2D 2.0T CABRIO TIP QUATTRO	DIFSC	
			8K256L	X		4D SEDAN 2.0T S-LINE TIP QUATTRO	DIFSC	
			8ED5EL	X		4D WAGON 2.0T S-LINE AVANT TIP QUATTRO	DIFSC	
			8HE5PL	X		2D CABRIO 3.2 TIP QUATTRO	DIFSC	
			8EC5PL	X		4D SEDAN 3.2 S-LINE TIP QUATTRO	DIFSC	
	A6	4-DR SEDAN 3.0T QUATTRO AUTO	4F25VL		X		DIFSC	09 MODEL SL INTRO 10/1/08
	A8	4-DR SEDAN 5.2 QUATTRO TIP AUTO	4E25SL		X		DIFSC	09 MODEL SL INTRO 4/14/08
	S5		8T35BL	X		2D AWD COUPE V8 4.2 QUATTRO AUTO	TIMING	08 MODEL SL INTRO 9/1/07
	TT	2-DR COUPE 2.0 STRONIC AUTO	8J359L	X				
		2-DR COUPE 2.0 STRONIC QUATTRO	8J354L		X		DIFSC	
		2-DR ROADSTER 2.0 QUATTRO STRONIC AUTO	8J959L	X				
BENTLEY	BROOKLANDS	4-DR SEDAN	BROOK		X		DIFSC	
	CONTINENTAL	FLYING SPUR SPEED	3W246A		X		DIFSC	

MAKE	MODEL	BODY STYLE	MODEL CODE	YES	NO	BODY STYLE	COMMENT CODE	COMMENTS
		NEW LIGHT-DUTY TRUCKS				NEW LIGHT-DUTY TRUCKS		
ACURA	RDX		TB1829JN	X		4D UTILITY	DIFSC	
			TB1859KN	X		4D UTILITY W/TECH PKG	DIFSC	
BMW	X5	4-DR SPORT UTILITY 35D	63		X		DIFSC	09 MODEL SL INTRO 9/1/08
CADILLAC	ESCALADE	4-DR 2WD SUV ESV PLAT ED W/R9I W/0 XA7	6C10906 EVSPLATR9I		X		OPTION	
		4-DR 2WD SUV ESV W/R9I W/O XA7	6C10906 ESVR9I	X				
		4-DR 2WD SUV HYBRID	6C10706 HY	X				
		4-DR 2WD SUV HYBRID W/R9I W/O XA7	6C10706 HYR9I		X		OPTION	
		4-DR 2WD SUV PLAT ED W/R9I W/O XA7	6C10706 PLATR9I	X				
		4-DR 2WD SUV W/R9I W/O XA7	6C10706 R9I		X		OPTION	
		4-DR 4WD SUV HYBRID	6K10706 HY	X				
		4-DR 4WD SUV W/R9I W/O XA7	6K10706 HYR9I		X		OPTION	
		4-DR AWD SUV W/R9I W/O XA7	6K10706 R9I		X		OPTION	
		4-DR AWD SUV ESV PLAT ED W/R9I W/O XA7	6K10706 ESVPLATR9I		X		OPTION	
		4-DR AWD SUV ESV W/R9I W/O XA7	6K10906 ESVR9I	X				
		4-DR AWD SUV PLAT ED W/R9I W/O XA7	6K10706 PLATR9I	X				
		4-DR SUV EXT W/R9I W/O XA7	6K10936 EXTR9I		X		OPTION	
CHEVROLET	AVALANCHE	2WD UTILITY V8 5.3 LT2	CC10936 LT2		X		OPTION	
		2WD UTILITY V8 5.3 LTZ	CC10936 LTZ		X		OPTION	
		2WD UTILITY V8 5.3 LTZ W/O XA7	CC10936 W/O XA7		X		OPTION	
		4WD UTILITY V8 5.3 LT2	CK10936 LT2		X		OPTION	
		4WD UTILITY V8 5.3 LTZ	CK10936 LTZ		X		OPTION	
		4WD UTILITY V8 5.3 LTZ W/O XA7	CK10936 WOXA7		X		OPTION	
	COLORADO	2WD CREW CAB 1VL	CS15643 1VL		X		DIFSC	
		2WD EXT CAB 1VL	CS15653 1VL		X		DIFSC	
			CT15643	X		2WD EXT CAB LT ZQ8	DIFSC	
			CS15653	X		2WD CREW CAB LT ZQ8	DIFSC	
	HHR	4-DR WAGON SS PANEL TURBO	1AU26	X				IRS LISTS IN AUTOS POOL
	SILVERADO 1500	1500 2WD CC SHORT BOX LTZ W/O XA7	CC10543 LTZWOXA7		X		OPTION	
		1500 2WD CC SHORT BOX XFE	CC10543 XFE		X		DIFSC	09 MODEL SL INTRO 12/22/08
		1500 2WD EXT CAB LONG BOX LTZ W/O XA7	CC10953 LTXWOXA7		X		OPTION	
		1500 2WD EXT CAB SHORT BOX LTZ W/O XA7	CC10553 LTZWOXA7		X		OPTION	
		1500 2WD EXT CAB STANDARD BOX 1LS	CC10753 1LS		X		DIFSC	08 MODEL SL INTRO 3/14/08
		1500 2WD EXT CAB STANDARD BOX LTZ W/O XA7	CC10753 LTZWOXA7		X		OPTION	
		1500 2WD HYBRID CC SHORT BOX 1HY	CC10543 1HY	X				
		1500 2WD HYBRID CC SHORT BOX 2HY	CC10543 2HY		X		OPTION	
		1500 4WD CC SHORT BOX LTZ W/O XA7	CK10543 LTZWOXA7		X		OPTION	
		1500 4WD EXT CAB LONG BOX LTZ W/O XA7	CK10953 LTZWOXA7		X		OPTION	
		1500 4WD EXT CAB SHORT BOX LTZ W/O XA7	CK10553 LTZWOXA7		X		OPTION	

(Continued from page 5)

the *LIFO Lookout*. So, at this time (on pages 16-27), we are *finally* making good on our promise to analyze the TAM.

To emphasize the fact that "item" definition continues to be closely monitored, a more recent ruling of the IRS held that an oil refiner's definitions of inventory items were too broad and did not clearly reflect income. A summary of this IRS Field Attorney Advice (FAA 20080401F) is on pages 28-29.

#9. COMPARISON OF IRS & *SuperLIFO*™ "UNOFFICIAL" NEW ITEM DETERMINATIONS. We have always compared our *SuperLIFO*™ new item determinations with those published by the Office of the IRS Motor Vehicle Technical Advisor.

The last comparison, involving manufacturer model years 2006-2007-2008, appeared in the September 2007 *LIFO Lookout*. In this Edition, we have summarized our current comparison for manufacturer model years 2008-2009-2010 new items with respect to Dec. 31, 2008 year-end inventories for auto dealers. This is based on the new items lists the IRS released in May of this year.

Our comparison schedules are set up so that you can see all of the vehicles which were treated as new items by the IRS, even if you don't care about how the IRS list compares with ours.

Our overview and related statistics begins on page 54. The full Lists are available upon request.

Many CPAs and/or dealers are using service bureaus for their LIFO calculations. To this extent, they are relying on the new item determinations made by their service bureaus. Other CPA firms and dealerships still do their own new vehicle LIFO calculations on spreadsheets of their own creation, so they must be making these new item determinations each year for themselves.

A glance at the IRS lists (and ours) makes it clear that item category determinations are required to be detailed down to the most precise level of differentiation. Calculations cannot be based on rough averages of models or other generalized groupings that might be forthcoming from other shortcuts, such as downloading less than all of the required information.

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Correction to Page References on Page 3

The first sentence at the top of the right-hand column of Page 3 reads, "*To digress briefly, in this regard, you might want to carefully review the schedules on pages 41, 47 and (especially) 53.*"

This sentence should read, "*To digress briefly, in this regard, you might want to carefully review the schedules on pages 41, 45 and (especially) 51.*"