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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. <u>WILL LIFO BE AROUND NEXT YEAR</u>? Yes. Almost everyone (including me) seems to believe that LIFO will still be around for at least one more year (2010) and possibly even two or three (2010-2011-2012).

But after that, it's anyone's guess even though the President's "Green Book" suggested a little more life, plus a fairly generous (8-year) period for the repayment of LIFO reserves.

However, many things could happen to alter LIFO's life expectancy - either prematurely shortening it or granting it a new lease on life. That leads to one of the most critical questions facing dealers on LIFO right now ...

#2. WHAT'S GOING TO HAPPEN TO DEALERS' <u>LIFO RESERVES AT THE END OF THIS YEAR</u>? ... Especially if they've lost a franchise or two ... or just simply can't get any more inventory? First, the good news. We are expecting some inflation to be present in inventories at year-end, and this will help to increase an automobile dealer's LIFO reserve.

Next, the bad news. Unfortunately, in many instances, that positive result will be more than offset by the recapture of LIFO reserves due to the anticipated significantly lower year-end inventory levels.

With all that's happened during 2009 ... the fallout from the bankruptcy of General Motors and Chrysler and the severe impact that the Cash for Clunkers program had on depleting dealers' inventories ... most dealers are looking at the prospect of significantly lower new vehicle inventories at year-end.

Some dealers fortunate enough not to have received a franchise termination letter are anticipating year-end inventory levels that are 30-40-50%, or more, lower than last year. For a dealer who is able to buy more inventory before year-end, there may be barriers to doing so because of floorplan / credit limitations and the other additional costs of carrying that inventory.

LOOKOUT LOOKS INTO

In other cases, there simply isn't any inventory out there for a dealer to "get." The manufacturers don't have it, or they have it, but won't allocate it.

Bottom line ... Many dealers who are running low on inventory face stiff recapture of their LIFO reserve if they cannot "get" inventory by the end of the year.

So, the ***number one tax concern*** for many dealers right now is not one that the IRS is stirring up (like it has with its recent Directive on applying Section 263A inventory cost capitalization rules to dealerships). These dealers face the double whammy of (1) reduced sales and profits while fixed costs

see **LIFO UPDATE**, page 2

(Continued from page 1)

continue and (2) the potential of paying income tax on "paper profits" as their LIFO reserves turn around.

It's a problem that has been brought about by adverse economic conditions far beyond any dealer's ability to control.

#3. LIFO RECAPTURE CONSEQUENCES ARE BY NO MEANS HITTING ALL DEALERS IN THE SAME WAY OR WITH THE SAME IMPACT. Each dealer's LIFO layer history is unique or specific to that dealership. Think of a dealership's LIFO layer history as being similar to its DNA.

As a result, three factors will cause dealers on LIFO to be hit differently ... (1) the LIFO layer structure of their new vehicle inventory pools, (2) the amount of base-dollars in each layer and (3) the relative amount of LIFO reserve recapture potential that is embedded in each of the annual layers that has been built up over the years.

As demonstrated by the case studies included in this and in previous editions of the *LIFO Lookout*, a dealer's base inventory and every annual increment has a different LIFO reserve payback potential ... even the different inventory pools (automobiles vs. light-duty trucks) have different payback potentials for each annual increment.

A further consequence of note is that when a LIFO layer is reduced at year-end and LIFO benefits are recaptured, that "lost" layer with its lower cost can never be re-established or replaced if the inventory level is restored to a more "normal" level...which may be as early as the end of the next year. (See Update item #8.)

There is much that can be done to make projections of LIFO reserve changes accurately, so that the real thought and effort can go into considering the alternatives.

In addition to reviewing calculations showing the potential recapture impact by layer as the inventory goes down, there are other related considerations. Dealers whose franchises have been terminated by a manufacturer as part of its bankruptcy proceedings may or may not have other franchises, so they may have even further LIFO recapture problems if these other inventories are depleted as well.

Dealers and/or CPAs who do not understand the full impact of invading the LIFO layers will be in the dark until they finally find out how "big" the "big hit" really is. *[In the middle of dictating the previous paragraph, I took a call from a CPA (... naturally, not a subscriber to the LIFO Lookout ... who works for a firm with many dealer clients), and he doesn't have a clue! I pity his dealer clients. Pardon the aside, but if some CPAs think spending some money to become educated on these matters is too costly, then how much is their ignorance costing their clients? How many of you have taken over dealership clients from folks like this pretending to know something about LIFO?... OK ... I feel better getting that off my chest, so let's get back on track ...]*

Everybody knows there's going to be some recapture ... It becomes a matter of quantifying the extent or amount of the recapture and thinking about whether reasonable steps can be taken to avoid some of the payback. And, of course, steps to build up inventory should only be considered if it makes sense from an economic and/or a business standpoint to do so.

There are several planning alternatives (or strategies) that dealers should be considering. The alternative or approach that is better for one dealer may not be the better alternative for another dealer.

For many dealerships who haven't changed to the single, combined pool method for new vehicles in 2007 or 2008, it's possible that 2009 will be the year to make that change. But remember, as we have pointed out in previous *Lookout* articles, there are some situations where it may not be advantageous to change to the single pool method if certain IRS "guidance" is followed.

Beginning on page 20, you'll find a lengthy refresher article that addresses many of these situations and considerations.

#4. IRS "GUIDANCE" FOR DEALERS TERMINATING LIFO. In ILM 200935024, the IRS issued some guidance on LIFO terminations in situations where dealers have had their franchises terminated in 2009.

This IRS guidance is in the form of answers to three questions arising out of different LIFO termination scenarios, and it relates to the 4-year spread period for the recapture of the LIFO reserves.

Two of the three scenarios involve dealerships that were not using the Alternative LIFO Method ... so these may be of less general application. However, the third scenario contains the nuggets of what might be a good planning opportunity for a dealership if it has the right fact pattern. This ILM is discussed as part of the broader planning article mentioned above and analyzed in detail on pages 33-35.

#5. SHOULD DEALERS CONSIDER ELECTING (OR SWITCHING BACK) TO LIFO FOR USED VEHICLES? This year may be a good year for an automobile dealer to consider electing, or in some cases re-electing, LIFO for valuing his/her used vehicles.

For the first time in many years, according to information on wholesale prices from a few reliable →

sources, it is possible that used vehicles at year-end will be reflecting (significant) inflation. With enough dollars in the beginning and ending inventory levels, that inflation may result in a sizable LIFO reserve.

Assuming inflation continues in used vehicle prices over several years, valuing used vehicles using LIFO is preferable to writing them down at year-end because writedowns reverse immediately in the next year (i.e., they're only a shift between years). LIFO, on the other hand, compounds the effect of inflation as a deduction over time, and thus provides a more permanent deferral of income.

But, if in 2010 or 2011, used vehicle prices fall (because new vehicle sales regain strength, or for other reasons), the net effect of using LIFO over two or three years could be less beneficial than originally anticipated. Unfortunately, no one can look into the future and know what is going to happen. So, you've got to do the best you can under the circumstances.

In 2009, some dealers may have no way of avoiding a significant recapture of the LIFO reserve they have built up over the years for their new vehicle inventories. These dealers should not overlook the possibility that electing LIFO for their used vehicle inventories might significantly offset some of the new vehicle reserve recapture impact on the bottom line.

This idea, with some planning tips, is explored on page 37.

#6. MIGHT A CHANGE TO THE IPIC METHOD REDUCE THE LIFO RECAPTURE FOR NEW VEHICLES? If some of the more conventional alternatives (termination of the LIFO election and/or electing LIFO for used vehicles) aren't palatable ... you might want to consider changing to the IPIC method.

Good grief! ... Wait. Did I say that? ... especially after writing several lengthy articles a few years ago critical of the use of the IPIC method by automobile dealers. Well, ya know, beggars can't be choosers. And, maybe the IPIC method might just save your bacon.

For more on this aspect, see page 38.

#7. SOLD ... OUT OF SIGHT ... OUT OF MIND ... OUT OF INVENTORY? General Motors (the new one) recently announced that it will extend its 60-day "customer satisfaction guaranteed" program that was supposed to end November 30, 2009. The program will now continue to run for vehicles sold through January 4, 2010.

This is part of the new GM's "May the Best Car Win" aggressive advertising campaign. Dealers, no doubt, will be happy to sell as many GM vehicles as they can. These sales will help a dealer's bottom line, but at the same time, they will aggravate the year-end lower LIFO inventory problems.

What about the fine print in these deals? Is there a devil or two in the details?

If we're led to believe that the customer unilaterally can decide to return the vehicle ... "No questions asked, etc., etc." ... (and, you'll have to check the fine print on this ...), is the vehicle sold under the "May the Best Car Win" program really considered to be ***"sold"*** as of year-end for accounting and/or tax purposes? Have "all events" really occurred to make that sale ***final*** as of Dec. 31, 2009? Or, is it a "contingent sale" of sorts?

Think about LIFO for a minute (more). If the vehicle hasn't been sold, then shouldn't it be included in the dealer's ending inventory for LIFO purposes? Hmmm...

We'll let the accounting theory folks work on this one for a while.

#8. NO SPECIAL RELIEF FOR *"INVENTORY-CHALLENGED"* DEALERS. There is a Section in the Revenue Code, Section 473, that allows certain taxpayers to avoid the full impact of LIFO recapture when they experience "qualified liquidations" of their LIFO inventories.

Unfortunately, this Section requires that the qualified liquidation of the LIFO inventory must be attributable to a "qualified inventory interruption" of the type described in a Department of Energy notice or regulation.

Section 473 goes back to the Energy Crisis in the early '80s and is limited to Department of Energy regulations with respect to energy supplies, embargoes, international boycotts or other major foreign trade interruptions.

Consequently, as written, Section 473 is not applicable to automobile dealers facing (government induced?) inventory shortages at the end of the year. This Section has no other counterpart that might help today's depressed auto dealers who are facing their even more depressed inventory levels.

Perhaps dealers can mount a strong lobbying effort for relief under the current circumstances. In fact, it appears NADA has informally recommended this. However, the inventory shrinkage situation has become much more severe than it was when NADA proposed relief before the *Cash for Clunkers* stimulus really depleted inventories.

#9. TAX REFUNDS MAY BE LARGER UNDER YEAR-END CHANGE IN TAX LAW. Earlier this year, the enactment of the *American Recovery & Reinvestment Tax Act of 2009 (ARRA)* included a

see **LIFO UPDATE**, page 4

(Continued from page 3)

provision to allow certain businesses to carryback net operating losses for up to 5 years.

Under the provisions of *ARRA*, if the taxpayer was an "eligible small business," it could elect to carry back any net operating losses occurring in tax years beginning or ending in 2008 for three, four or five years (instead of only two years). However, this provision applied only to businesses with average gross receipts of less than $15 million. Therefore, almost all automobile dealerships were excluded from this provision because they were not eligible small businesses ... They were "too big to be small."

Just recently, however, with the enactment of the *Worker, Homeownership and Business Assistance Act of 2009 (WHBA),* Section 172(b)(1) was amended to allow ***all businesses*** to carryback losses incurred in 2008 or in 2009 for up to 5 years preceding the year of the net operating loss.

There is one limitation: any loss carried back under *WHBA* to the 5th preceding year cannot offset more than 50% of the income in that 5th preceding year. However, the excess of the amount of loss over 50% of the taxable income for the carryback taxable year can be carried to the other later taxable years. There are corresponding limitations with respect to the carryback of alternative tax net operating losses.

All of the details for making these elections, timely filing requirements and forms required to be filed, are contained in Revenue Procedure 2009-52.

Use LIFO planning to maximize your tax refunds. By maximizing the reduction of LIFO reserve recapture caused by lower inventory levels or by expanding the LIFO election to used vehicles, a dealership may create or increase a net operating loss in the current year for itself or for its shareholder/ partners if it is operating as a pass-through entity.

#10. MORE LIFO METHOD CHANGES BECOME <u>AUTOMATIC</u>. On August 27, 2009, the IRS issued Revenue Procedure 2009-39 in which it updated its list of LIFO accounting method changes that do not require advance approval from the IRS. This list of automatic changes is included as the Appendix to Revenue Procedure 2008-52, and it was discussed in the 2008 Year-End Edition of the *LIFO Lookout.*

LIFO method changes that are promoted to "automatic" status by Rev. Proc. 2009-39 include certain changes in the Inventory Price Index method and changes to the dollar-value pools of manufacturers.

It does not appear that any of these newer additions to the list of automatic changes in LIFO methods will directly affect automobile dealers. However, one of the changes ... the combination "pool split and partial termination" change(s) ... for certain manufacturers is discussed in the context of dealership planning in the article on page 36.

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

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

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

One can't overdo reminders about year-end projections, estimates and the importance of placing proper LIFO disclosures in all year-end financial statements. This would include putting an estimate of the LIFO change for used vehicles if that will be part of your overall planning strategy for 2009 ... or, if you are even considering it. Our year-end coverage of these financial statement conformity issues begins on page 5.

#12. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX AS<u>SUMPTION</u>. To assist you in making year-end projections, each year we provide a listing for *new* vehicle LIFO inventories showing weighted average inflation (or deflation) information for each model. The summaries are on pages 48-52 and the detail lists are on pages 54-61.

This includes the weighted One-of-Each-Item-Category inflation indexes for those dealerships that have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method for new vehicles.

#13. <u>THANK YOU</u>. With this Edition of the *Lookout*, I am completing 19 years of writing about nothing but LIFO in this publication. When I first started, I was gravely concerned that there might not be enough to write about to sustain a specialized publication like this.

Now, I find that there is usually more than enough and my problem is boiling it all down - while being as accurate as possible - so that you've got material that is useful and practical.

Thanks for your continued interest in the *LIFO Lookout*. We're looking forward to 2010.

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

YEAR END ALERT

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 6

SPECIAL YEAR-END CHALLENGES FOR LIFO USERS

CONFORMITY REPORTING REQUIREMENTS

YEAR-END PROJECTIONS FOR PLANNING PURPOSES

(Continued from page 5)

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

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

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

TERMINATION SITUATIONS

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

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

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

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

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

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

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

FORM 970 QUESTIONS REGARDING CONFORMITY

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

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

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

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CONFORMITY REQUIREMENTS... THERE ARE MANY

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

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

TWO SETS OF REQUIREMENTS

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

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

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

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

EVERY YEAR, ALL OF THE CONFORMITY REQUIREMENTS MUST BE MET

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

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

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

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 8

 (Continued from page 7)

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

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

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

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

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

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

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

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

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

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

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

IRS TESTS

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 10

(Continued from page 9)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

HOW SOME BUSINESSES GET AROUND THE LIFO CONFORMITY LIMITATIONS

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 12

(Continued from page 11)

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

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

INTERIM REPORTS

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

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

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

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

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

"CONFORMITY" ... WHERE FOREIGN CORPORATIONS ARE INVOLVED

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

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

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

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

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

In this Ruling, the Service held that ...

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 14

Rev. Rul. 78-246

Foreign Corporations & Foreign Operations

Financial Statement Conformity Requirements & the 30% Test or Threshold

Background

- The LIFO financial statement reporting requirements were enacted to ensure that the LIFO method "conforms as nearly as may be to the best accounting practice in the trade or business. ..." (H. Rep. No. 2330, 75th Cong., 3d Sess. 34 (1938)).
- The legislative history of Section 472 indicates that the conformance "to the best accounting practice" is to be made on the basis of United States standards of accounting practice.
- Congress was concerned solely with domestic accounting practice. Therefore, the conformity requirements of Section 472 should not be extended to determine what is the "best accounting practice" in foreign countries.

Are Operating Assets of "Substantial Value" Used in the Foreign Operations?

- If a foreign parent owns ***operating assets of substantial value which are used in foreign operations,*** the LIFO financial statement conformity requirements ***do not apply*** to the consolidated financial statements.
  - This applies to ownership by the parent either directly or indirectly through members of its group.
- Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that ... (1) are members of the consolidated group, (2) are ***foreign*** corporations, (3) ***do not use the LIFO method*** of accounting for Federal income tax purposes, and (4) ***engage in a business outside the United States.***
- For purposes of this test, operating assets are all the assets necessary for the conduct of an active operating company.

30% or More Threshold

- The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes ***30% or more*** of the total operating assets of the consolidated group.
- This determination will be made annually.
- This determination ***will normally be made on the basis of the asset valuation*** reflected in the consolidated financial statements of the group for the year.

Facts & Circumstances

- ***If the consolidated group does not satisfy the 30% test,*** the IRS may waive the 30% test and make a determination on the basis of all of the ***facts and circumstances*** presented.

LTR 200540005 ... Dated June 20, 2005

LTR Summary

- In LTR 200540004, the IRS was dealing with a foreign parent corporation that had to issue consolidated financial statements to its shareholders and creditors in which it was reporting its own operations and the operations of subsidiaries acquired by its own wholly-owned U.S. subsidiary.
- The taxpayer persuaded the IRS that, although it failed to have operating assets in excess of the 30% threshold, it should be considered to have satisfied the alternative "facts and circumstances" test.
- As a result, the parent was permitted to issue consolidated financial statements on a non-LIFO basis without violating the LIFO financial statement conformity requirements ... ***but only for the one year in question.***

LTR Facts

- The parent (a foreign corporation, not reporting under U.S. GAAP) made an agreement whereby the taxpayer (its wholly-owned U.S. subsidiary) would acquire all of the outstanding stock of a group of new subsidiaries.
  - Prior to the acquisition, the taxpayer also had other wholly-owned U.S. subsidiaries ("old subs").
  - Following the acquisition, the activities of the parent, the taxpayer, and the taxpayer's subsidiaries (old subs and new subs) would be reported in the consolidated financial statements of the Parent.
- Prior to the acquisition, the new subs used LIFO for valuing their inventories. The parent and the taxpayer used a non-LIFO method for valuing inventory for U.S. and for the parent's foreign country tax purposes.

LTR Discussion

- The taxpayer conceded that it did not meet the more than 30% test for establishing substantial foreign operations under Rev. Rul. 78-246. However, it said that it should be allowed to make certain distinctions in order to qualify under the alternative "facts and circumstances" test.
- The taxpayer argued that as a result of the stepped-up basis in the assets involved in the acquisition, financial statement comparisons did not fairly represent its situation. The assets of the new subsidiaries reflected current value because the acquisition was recorded as a purchase pursuant to U.S. GAAP.
- Accordingly, the taxpayer argued that it should be allowed to compare the higher ***market values*** (i.e., instead of the lower asset book values) of the foreign operations to its total operations.
  - In determining the market value of new subsidiaries, the taxpayer proposed to use the purchase price of the new subsidiaries.
  - For the market value of the remainder of the Group, the taxpayer proposed to use EBITDA (earnings before interest, taxes, depreciation and amortization) as a basis for allocating the Group's market value, prior to the acquisition, between its foreign and domestic operations.
- As a result of this alternative analysis, the computed percentage of assets used in foreign operations (to total operations) would only be slightly less than the 30% minimum threshold set forth in Rev. Rul. 78-246.

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

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

CONCLUDING CONFORMITY WARNINGS

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

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

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

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

(Continued from page 12)

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

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

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

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

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

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

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

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

PROJECTION MECHANICS, STEP-BY-STEP

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

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

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

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

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Conformity Reporting Requirements

(Continued)

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

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

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

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

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

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

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

PROJECTIONS STEP-BY-STEP

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 17

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

(Continued from page 15)

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

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

ALTERNATIVES

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

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

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

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

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

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 18

(Continued from page 17)

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

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

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

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

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

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

SOMETIMES THE IRS REVERSES YEAR-END LIQUIDATION AVOIDANCE MEASURES

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

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

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

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

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

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

PLANNING CHECKLIST

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

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

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

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

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

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

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

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

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

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

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

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

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

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

DEALERS LOW ON NEW VEHICLE INVENTORY AT YEAR-END MAY FACE STIFF LIFO RESERVE RECAPTURE ... PLANNING MAY LESSEN THE BLOW

2009 ... FOR SOME DEALERS, THE "PERFECT STORM"

The Last-In, First-Out (LIFO) method for valuing inventory has been a great tax deferral for automobile dealers for many years, and for some, even for several decades. True to its promise, LIFO has allowed dealers to deduct the impact of inflation in their inventories while the vehicles are still on hand at year-end ... instead of making the dealers wait until the next year when those vehicles are sold.

Over the years, many dealers have built up substantial LIFO reserves. The LIFO reserve is simply the difference between (1) the actual cost of the inventory at year-end and (2) the valuation that is assigned to that inventory by the LIFO method which is intended to eliminate the impact of inflation that is part of the cost of those vehicles.

The ups and downs of a dealership's inventory levels at the beginning and the end of every year make it desirable - if not imperative - to know and keep track of how much each year's layer of inventory (since the start of the LIFO election) has contributed to the total amount of the LIFO reserve for each pool.

"What goes around...comes around." Even LIFO lives up to this adage, sometimes rearing its recapture potential at the worst of times. With year-end 2009 approaching, for many dealers this is truly the "worst of times."

Never before has there been anything like this. Over the years, dealers have faced severe liquidation of their LIFO inventories at year-end because of events like strikes at the factory, or by the Teamsters or other disruptions that "eventually" would even out when things return to normal. This year, dealers may be facing significant LIFO recapture because their franchises have been terminated (through no fault of their own) or because the manufacturers simply do not have product available to ship to the dealers ... assuming the dealer has an ample line of credit.

This article will focus on the problems dealers face if they are still in business at the end of the year and they have very small new vehicle inventories compared to what they had at the beginning of the year.

As mentioned, some dealers have had their franchises terminated by General Motors and/or Chrysler due to these manufacturers going through bankruptcy/restructurings earlier this year. Other dealers have had their franchises terminated by other manufacturers who were not involved in bankruptcies - they just pulled the plug on the dealers for other reasons as overall economic conditions darkened.

If a dealer has lost a franchise, the consequences of that loss may have been almost immediate ... occurring within a matter of weeks or months ... and, by now all of the inventory for that franchise has been liquidated.

In other situations, the dealer may have had several franchises and suffered the loss/termination of only one of those franchises. So the dealer still has other franchise new vehicle inventories for sale. There are multiple variations on the "lost franchise" scenario in terms of LIFO reserve recapture impact that will be discussed throughout this article.

A second reason why a dealer may be anticipating a significant decrease in year-end inventory is because that dealer experienced a severe sell-off of new vehicle inventory due to the "Cash for Clunkers" stimulus program for auto dealers in August, 2009. For many dealers, they were simply borrowing from future sales as customers spent free money from the U.S. government.

The good news was a welcome short-term spurt in showroom traffic, and hopefully, profitability. The bad news (for many of these dealers) is that they will be unable to replenish their new vehicle inventory to a more desirable level before year-end.

Some of these dealers simply don't have the floorplan or credit capacity to acquire more new vehicles. In other instances, the manufacturer (Chrysler, in particular) may have no new vehicles that it can sell to dealers, either as a result of the extended production shutdowns that the manufacturers chose to incur earlier in the year, or because of the manufacturers' inability to obtain parts from the chain of suppliers on whom they are dependent.

As a result, in the closing months of 2009, what many dealers are facing might be termed "perfect storm" conditions producing significant LIFO reserve recapture consequences.

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Year-End Planning

DEALERS LOW ON NEW VEHICLE INVENTORY AT YEAR-END MAY FACE STIFF LIFO RESERVE RECAPTURE ... PLANNING MAY LESSEN THE BLOW

FOUR RECENT IRS PRONOUNCEMENTS AFFECT PLANNING ALTERNATIVES

Some dealers and CPAs may recall that during the summers of 1984 and 1996 there was concern about the possibility of strikes affecting dealers' year-end inventory levels. In response to those events, much was written about how dealers might try to "dodge the LIFO recapture bullet."

Since then, even with the introduction of the Alternative LIFO Method in 1992 for new vehicles (and a similar safe-harbor Alternative LIFO Method for used vehicles in 2001), there have been some refinements and developments that require consideration in planning to minimize the adverse impact of year-end 2009 inventory liquidations.

Four recent developments - all occurring within the past 2 years - require special consideration.

#1 ... SINGLE, COMBINED POOL FOR ALL NEW VEHICLES

For about sixteen years, from 1992 until 2008, automobile dealers using the IRS safe-harbor Alternative LIFO Methods were required to maintain two separate pools: Pool #1 for new automobiles and Pool #2 for new light-duty trucks (or Pool #1 for used automobiles and Pool #2 for used light-duty trucks). Over time with the creeping advent of so-called "cross-over" vehicles, it became increasingly difficult to maintain a bright line between which vehicles should be classified as "automobiles" and which should be classified as "light-duty trucks." The IRS solved this dilemma in 2008.

Accordingly, the ***first refinement*** (to affect planning for year-end) is the introduction of the *"Vehicle-*

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 24

Executive Summary	***Overview of LIFO Planning Article***
Inflation Will Help ... A Little	• For many automobile dealers, regardless of the cause of their anticipated lower ending inventories, LIFO recapture will be inevitable to some extent. • Inflation in 2009 will help offset some of the LIFO recapture due to the lower inventory levels. The net decrease in the LIFO reserve at year-end may be far lower than initially feared because of the combination of ... ◆ Inflation in the cost of vehicles in the ending inventory. ◆ The build-up of LIFO increments in more recent years (which have lesser payback potential when invaded by the carryback of the decrement in the current year) • These two factors are netted in arriving at the final amount of the LIFO reserve/change for the year.
Four Recent Developments Affect Planning Alternatives	• Introduction of the *"Vehicle-Pool"* Method (predicated on the use of one or both of the Alternative LIFO Methods) by Revenue Procedure 2008-23. ◆ When a dealer's LIFO pools for new automobiles and new light-duty trucks are combined, there may be a significant shifting of contributions to LIFO reserves. • Chief Counsel Memo (CCM) 200825044 provides guidance on the sequence of calculations to be followed in combining LIFO pools. ◆ First, combine the annual layers of the two LIFO pools into a single pool. ◆ Second, rebase the combined pool to 1.0000 as of the beginning of the year of change. ◆ The CCM contains this disclaimer ... "This advice may not be used or cited as precedent." • Termination of LIFO elections has been made easier under Revenue Procedure 2008-52 which contains updated procedures by which taxpayers may obtain automatic consent from the IRS for certain changes in methods of accounting. • ILM 200935024 provides guidance on the treatment of Section 481(a) adjustment spread periods in LIFO termination situations.
Coincidental Benefit from ILM	• The answer given by the IRS in the third question/issue in ILM 200935024 discusses an alternative two-step approach that may be very helpful in certain situations where a dealer has one franchise terminated, but still has one or more others. But, watch the timing of the filing of the Forms 3115 on this.
Planning Objectives... The 4 Ds	• Dealerships must ***determine*** the amount of LIFO recapture they are facing based on anticipated year-end inventory levels. The greater the degree of accuracy in the projections, the better. • After making this determination, planning strategies should address all of the alternatives or options that are reasonably available to ***delay, defer*** or ***diffuse*** the impact of the significant reductions in LIFO reserves to the greatest extent possible. • It is advisable to have a "game plan" or sense of the strategic changes that will be made before year-end.
Facing Page	• *Step-by-Step Planning Considerations for Year-End LIFO Inventories*
Most ... But not all ... Forms 3115 Can Be Filed with the IRS After Year-End	• There is no need to rush to judgment before year-end, because many of the changes in accounting method that will be employed to mitigate LIFO reserve recapture are accomplished by filing Form 3115 when the 2009 income tax return is filed. • ***One important exception ...*** Form 3115 to split the dealership's LIFO pools in order to terminate LIFO for a lost franchise, while retaining LIFO for remaining franchises, ***must be filed with the IRS before the end of the year (with the payment of a user fee).*** • ***You can allow yourself plenty of time for hindsight.*** If the filing date for the dealership's 2009 income tax return is extended, that extension of time will provide additional time in which to evaluate the situation for 2010. ◆ This could be particularly important for a dealer who has had a franchise terminated in 2009, but hopes to obtain another franchise in 2010. Obviously, the closer you get to the end of 2010, the more information you will have available.
Keep Your Options Open	• ***Conformity Requirement.*** If electing LIFO for used vehicles is an option, then the dealership must provide an estimate of the change/increase in the LIFO reserve for the used vehicle pool on all of the 2009 year-end financial statements to the manufacturer and to all other interested parties. • If changing to the IPIC LIFO method is an option, it may be necessary to use preliminary estimates of the inflation for the year because of Bureau of Labor Statistics delays in releasing the final PPI and CPI indexes after year-end.

Step-by-Step	*PLANNING CONSIDERATIONS FOR YEAR-END LIFO INVENTORIES*
Step #1	• ***Project the year-end LIFO reserve change, including proofs and reconciliations.*** • Be sure the projection includes in transit vehicles. • See Projection Case Studies on pages 38-47.
Step #2 ***Single, Combined LIFO Pool Possibility***	• If the dealership is still using separate pools for new automobiles and for new light-duty trucks, evaluate the results from combining the two pools into a single pool under the Vehicle-Pool Method (Rev. Proc. 2008-23). ◆ Advance permission from IRS is not required - this would be an automatic change in accounting method. • This change may be desirable ... even if there is some shifting of contribution to the LIFO reserve from LIFO layers for earlier years to the more recent (i.e., 2008-2007-2006) layers. • There are situations where the change would be detrimental unless the sequence of computations followed in combining the pools is to first rebase each pool to 1.000 as of the beginning of the year of change and then to combine the (rebased) pools.
Step #3 ***Evaluate Results***	• Discuss the results with the dealer. Are the results acceptable? • If the results are not acceptable, can some of the recapture be mitigated by increasing the level of year-end inventory? If yes, will the dealer actually be able to increase ending inventory (i.e., does the manufacturer have product)? If yes, is it economically feasible ... i.e., does it make sense to increase the ending inventory?
Step #4 ***Consider Terminating the LIFO Election***	• Generally, if the entire LIFO election is terminated, the dealer will be able to recapture the LIFO reserve in income over a 4-year spread period if the dealer continues its trade or business. • If the dealer's year-end inventories are significantly lower because a franchise was terminated, alternative situations and expectations to be taken into account include: ◆ Is the dealer going to stay in business (selling used vehicles and parts and providing repair and other services) or is the dealership being shut down entirely? ◆ How many other franchises does the dealer have to continue his/her business with ... one, two, or several? ◆ What are the dealer's profitability expectations for continuing the remaining franchises? ◆ Will the dealer be able to obtain another franchise ... or more franchises? • IRS guidance issued in ILM 200935024 should be considered as part of the overall LIFO termination evaluation. This deals with whether the 4-year spread period might be accelerated. • If the dealership has a franchise that is being wound down over a period extending into 2010, what can be done as far as planning for continuing or (partially) terminating the LIFO election in 2010?
Step #5 ***Consider Electing LIFO for Used Vehicles***	• If there is significant inflation in used vehicle inventories at year-end, electing LIFO for used vehicles may be strategically important, even though the dealership's new vehicle inventory levels are not projected to be significantly lower. • ***Income Statement Offset.*** The election of LIFO for used vehicles could create a significant deduction that would offset the income created by the recapture of LIFO reserve from the new vehicle inventory pool(s). • ***Inventory Writedowns.*** The beginning inventory in the year LIFO is elected must be stated at cost. Writedowns against the used vehicle inventory at the end of the year are not permitted. ◆ The extent of the dealership's writedowns as of the beginning of the year must be considered in connection with this requirement. Note that the dealership has already recorded in current year (2009) income 100% of the writedowns that were taken as of Dec. 31, 2008. Therefore, two-thirds of this writedown reversal can be deferred from 2009 and taken into income over 2 years.
Step #6 ***Consider Including More Inventory By Changing to the IPIC Method***	• Pooling variations under the IPIC method might permit combining all of the dealership's inventories (new vehicles, used vehicles and parts & accessories) into a broader, single pool. • Alternatively, perhaps only the used vehicles might be combined with the new vehicles. • The "writedown issue" will have to be addressed if a change to the IPIC method is made. • ***Computation Simplicity.*** The IPIC method eliminates the need for computation of detailed inflation indexes. • ***Inflation Rates.*** It is possible that the PPI or CPI category selected might show (somewhat) higher inflation for 2009 than the inflation rate that would otherwise be computed for certain manufacturers under the Alternative LIFO Methods for new and for used vehicles.
Step #7 ***Follow-up***	• After considering the above planning alternatives, make a best-efforts attempt to quantify the results under these different scenarios. • Depending on the strategy or combination of strategies selected, identify the reporting and/or filing requirements with the IRS to implement these changes. ◆ Forms 3115 for changes in LIFO methods ... automatic vs. advance permission required. ◆ Forms 970 if LIFO is being extended to used vehicle inventories or in certain IPIC (pool) changes.

(Continued from page 21)

Pool" Method by Revenue Procedure 2008-23. This approach is predicated on the use of one or both of the Alternative LIFO Methods (i.e., either for new vehicles or for used vehicles). Using the Vehicle-Pool method, automobile dealerships are allowed to pool all new vehicles in a single, combined pool for LIFO purposes.

This change from two pools to a single pool can be made as an automatic change in method simply by filing Form 3115 with the tax return for the year of change and meeting certain other relatively easily satisfied filing requirements.

If a dealership has not already made the change to the "*Vehicle-Pool"* Method in either 2007 (the first year this opportunity became available) or in 2008, then it seems very likely that this change will be attractive to dealers experiencing inventory level declines who are going to stay on LIFO in 2009. The last three editions of the *LIFO Lookout* have contained numerous articles explaining the mechanics of the change to the "*Vehicle-Pool*" Method.

We are continuing to find surprising results buried in the LIFO calculations for some dealers converting to the Vehicle-Pool (i.e., single, combined pool) Method. Usually, the benefit from changing to the single pool results from being able to minimize or partially avoid the LIFO reserve recapture impact where there is a significant decrement in one of the two pools (or both pools) where the inventory levels have declined.

Generally, there is not much benefit resulting from the recomputed, weighted inflation rate for the single pool (as compared to the separate inflation rates calculated for each pool). However, in a few instances, there has been a significant increase in the LIFO reserve attributable to this factor alone. In this regard, see "Case Study #2 ... An Unexpected, Pleasant Surprise" in the 2009 Mid-Year Edition of the *LIFO Lookout*, pages 42-47.

In its detailed analysis, this case study shows that the impact of using a different, weighted inflation percentage for the single pool can create a significantly large ***extra*** increase in the LIFO reserve. The problem is that it is usually difficult to quantify how large this impact will be unless the calculations are done both ways.

#2 ... IRS GUIDANCE ON COMBINING POOLS

The second refinement or recent development to consider in year-end 2009 planning arises from informal guidance issued by the IRS for dealers making the pooling change to the Vehicle-Pool Method.

When the LIFO pools for new automobiles and new light-duty trucks are being combined, there may be a significant shifting of some years' layers contributions to LIFO reserves. In other words, another benefit - or detriment - resulting from changing to the Vehicle-Pool Method could be the shifting (as of the beginning of the year of change) in contribution to the LIFO reserve among prior year layers.

In May 2008, the IRS issued "guidance" on how dealerships implementing the change to the "Vehicle-Pool" Method (for either new or used vehicles on LIFO) should combine their existing LIFO pools. This guidance is found in Chief Counsel Memo (CCM) 200825044, dated May 7, 2008 and released June 20, 2008.

Basically, this CCM says that the sequence of calculations in combining LIFO pools should be to (1) first combine the respective annual layers in the two pools into a single pool and (2) then to rebase the resulting annual layers in the combined pool to 1.0000 as of the beginning of the year of change.

This IRS guidance contains the qualifying disclaimer ... "This advice may not be used or cited as precedent."

CCM 200825044 provides two examples showing how to establish the year of change (which is 2008 in both examples) as the new base year for making the change to the single, combined pool method. The examples in the CCM follow the format found in the LIFO Regulations for taxpayers using the double-extension, dollar-value LIFO method.

The first example in the CCM shows the combination of the two new vehicle pools in a situation where both pools have the same base year. This example is pretty straight-forward. Just add the base-year cost and the corresponding LIFO value of each layer of all pools to obtain the total base-year cost and total LIFO value, respectively, for each of the layers in the newly combined pool.

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

In this situation, the taxpayer treats the base year of the oldest pool as the base year of the newly combined pool and treats all subsequent base years as increments. In addition, the taxpayer restates the base-year cost of all increments arising from each pool other than that oldest pool (i.e., the "newer pool")

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in terms of the base-year cost of the base layer of that oldest pool.

In adapting the procedures for combining dealership pools to the underlying use of the link-chain method, the CCM guidance creates a result that often shifts the amount of the LIFO reserve allocable to a specific year's LIFO layer to different years' LIFO layers.

This result may significantly affect the amount of LIFO recapture if the combined pool experiences a decrement in the year of change or thereafter.

The 2008 Year-End Edition of the *LIFO Lookout* included a comprehensive analysis of the CCM and these examples. It also examined the consequences and results that would occur if the sequence of operations in combining the pools were reversed. Three case studies were included in the 2009 Mid-Year Edition of the *LIFO Lookout* to show how much the contributions to the LIFO reserve are 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.

For many dealers, this difference in result may be relatively unimportant if their inventory levels at the end of 2009 and/or 2010 fall so far that they basically offset these differences in contribution to the LIFO reserve allocated to the more recent years' layers.

Stated more broadly, with some dealers on the verge of losing substantial portions of their inventories at the end of 2009 and/or 2010 (due to actions taken in manufacturer bankruptcies or by their general inability to obtain inventory to replace vehicles sold), the shifting of contributions to the LIFO reserve to the more recent years can take on added importance in situations where large decrements are experienced in the combined LIFO pool in the year of change or a succeeding year.

As important as this difference might be, as a practical matter, some dealers may experience such a drastic drop in inventory level that any planning opportunities in regard to this refinement may be lost. But for some, it should still be considered.

#3 ... RESTRICTIONS EASED ON TERMINATING LIFO ELECTIONS ALLOW MORE HINDSIGHT

The third refinement or recent development to consider in year-end 2009 planning relates to the fact that in Revenue Procedure 2008-52 the IRS updated the procedures by which taxpayers may obtain automatic consent for certain changes in methods of accounting, including the termination of LIFO elections.

In general, before the issuance of Rev. Proc. 2008-52, the termination of the LIFO election by an automobile dealership could not be made as an automatic change in accounting method simply by including Form 3115 to notify the IRS of the termination as part of the income tax return filed for the year of change.

This technical problem for auto dealership, and related practical consequences, have been discussed fully in prior editions of the *LIFO Lookout.* [See *"Revised Procedures for Securing Automatic Consent from the IRS to Make Changes in LIFO & Other Methods of Accounting,"* 2008 Year-End *LIFO Lookout*, page 20.]

Revenue Procedure 2008-52 eliminated the technical "problem" (that was also inherent in Revenue Procedure 2002-9) which previously required a dealership to obtain advance consent from the IRS by filing Form 3115 before the end of the year in order to terminate the LIFO election.

Greater hindsight. As a result, Revenue Procedure 2008-52 now affords dealers significant opportunity to evaluate the advisability of terminating a LIFO election based on "after-the-fact" information. Dealers can now make a more informed decision based on facts that are available after the end of the year. Being able to look almost 9 months into the succeeding year to see what has happened (or to consider what might happen) is far better than having to make a decision not later than by the end of the preceding year based on more limited information.

The bottom line is that in most cases, Revenue Procedure 2008-52 makes the dealership's termination of its LIFO election an automatic change in accounting method.

Accordingly, the binding decision to terminate the LIFO election does not have to be made until well after the end of the year. That decision is confirmed by completing and including Form 3115 (*Application for Change in Accounting Method*) as part of the income tax return that is filed for the year of change and by filing a copy of that Form 3115 with the National Office in Washington, DC.

Two points to keep in mind here. First, if a dealer lost a franchise in 2009, but might have the possibility of obtaining another franchise in 2010, the extending of the time for filing the tax return for the automatic change year (LIFO termination) Form 3115 affords

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 26

(Continued from page 25)

the dealer more time to evaluate and reassess what has happened (i.e., the "known") ... and, what he or she reasonably believes is likely to happen in the following year (i.e., the "unknown").

Don't rush to judgment ... keep your options open. The second point is that if, by December 31, 2009, the dealer is not sure whether or not it will terminate the LIFO election, the dealer must "keep its option open" to remain on LIFO in 2010. In order to comply with the LIFO financial statement conformity requirements, this option can only be kept open by reflecting an adjustment for the 2009 change in the LIFO reserve (assuming the dealer stays on LIFO) on all 2009 year-end financial statements.

For further discussion on termination requirements and planning, see page 30.

#4 ... GUIDANCE ON SECTION 481(a) ADJUSTMENT SPREAD PERIODS

The fourth recent development or refinement arises from guidance that the IRS provided in response to some questions raised by an examining agent in connection with the termination of a LIFO election by a dealer who had "lost" his franchise as a result of a manufacturer's bankruptcy restructuring.

In ILM 200935024 (dated August 17, 2009), the agent was questioning whether the more usual 4-year spread period for the Section 481(a) adjustment resulting from the termination of the LIFO election should be accelerated because the dealership no longer had new vehicle inventory specific to the franchise that was terminated.

In the first two fact situations in the ILM, the dealership involved was not using the Alternative LIFO Method for new vehicles. Instead, this dealership was using a separate LIFO pool for the new vehicles for each ***franchise*** ... the dealership had 5 different franchises, and it had 5 separate LIFO pools.

The IRS discussion of the third fact situation seems to provide a "blueprint" that might be beneficial to certain dealerships that have lost their franchises. The IRS guidance in this case may help them to stay on LIFO for some of their new vehicle inventories, while losing only the benefit of the LIFO reserve attributable to the lost franchise.

As discussed more fully on page 36, with the right fact pattern, adopting the procedure suggested in the third situation/fact pattern in the ILM might result in keeping "half-a-loaf" (i.e., staying on LIFO for the new vehicle inventory of the continuing franchise(s)). This might be better than "none" (i.e., repaying all of the LIFO reserve for all of the new vehicle inventory, including the LIFO reserve related to the new vehicles in the continuing franchise(s)).

See also pages 33-35 for a complete analysis of the ILM.

INFLATION SHOULD MITIGATE PAYBACK SLIGHTLY

Another important factor to consider in estimating the amount of LIFO reserve recapture that a dealer might face at the end of the year is the expectation that the inventory on hand at year-end will reflect some amount of ***inflation***.

A glance at our "One-of-Each Item Category" inflation indexes, which are discussed and presented on pages 48-61, will give you a general idea of which franchises have more inflation in their year-end vehicles than others.

Interestingly, General Motors, Chrysler and Ford are the manufacturers whose vehicles are expected to reflect greater amounts of inflation at year-end.

This anticipated inflation for 2009 will help offset some of the LIFO recapture due to the lower inventory levels.

LIVING WITH ... AND PLANNING FOR ... UNCERTAINTY ... THE FOUR *Ds*

As the inventory levels and the LIFO reserves decrease at year-end, this produces an increase in the dealer's gross profit based on the "paper income" or previously deferred "inflation" which comes into 2009 taxable income (through Cost of Goods Sold) because the inventory levels at the beginning of the year cannot be restored by year end.

Everyone knows this is coming. What everyone does not know is that the degree of recapture ... or pain ... can vary widely from one dealership situation to another.

In some instances we've looked at, the projected decrease in the LIFO reserve at year-end has been far lower than the amount initially feared by the dealer because of the combination of (1) the build-up of LIFO increments in more recent years (which have lesser payback potential when invaded by the carryback of the current year's decrement) and (2) the increase in the LIFO reserve projected in 2009 due to inflation.

These two factors are, of course, netted against each other in arriving at the final amount of the LIFO reserve/change for the year.

We have seen situations where a $6 million new vehicle inventory at the beginning of 2009 is expected to be only $3 million at the end of the year and for this dealer on LIFO, the net reduction in the LIFO reserve at the end of the year is projected to be not much more

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than $10,000. In other situations, a similar reduction of a dealer's inventory level from $6 million to $3 million could result in a LIFO reserve recapture of $2 million or more.

What causes such radically different results? It's all in the dealership's LIFO DNA ... or, more accurately, the year-by-year (net) accumulation of inventory in the LIFO layer history for the dealership's LIFO pools.

The basic year-end planning strategy for all dealerships seems to boil down to four *D*s ... ***determine*, *delay*, *defer*** and ***diffuse***.

Dealers must ***determine*** the amount of LIFO recapture they are facing based on reasonably anticipated year-end inventory levels. After making this determination, their planning strategies should address all of the alternatives or options that are reasonably feasible to ***delay, defer*** or ***diffuse*** the impact of the significant reductions in LIFO reserves to the greatest extent possible.

DETERMINING THE PROJECTED LIFO RESERVE RECAPTURE AT YEAR-END

It is unrealistic to attempt any serious planning for a dealership without first making projections of the change in the LIFO reserves for the upcoming year-end. These projections should be made far enough in advance so that the dealer can consider not only the financial impact of what is likely to happen, but also whether legitimate steps, motivated by sound business reasons, can or should be undertaken to produce a result different from that shown by the projections.

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

Even if a dealer concludes that nothing can be done to avoid the payback consequences, it is far better to know the extent of the impending "hit" than it is to be caught entirely by surprise, without any idea of how big the hit is going to be. If a dealer knows what to expect, (1) ***proper amounts of estimated tax payments for the year can be made and potential underpayment penalties avoided***, and (2) other buffering actions may be taken to absorb the shock.

The ***net change*** in the LIFO reserve for any year is the result of the complementing or offsetting price and/or inventory investment payback factors summarized in the table below.

If year-end LIFO projections show that the dollar amount of the ending inventory (expressed in terms

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 28

Why LIFO Reserves Change The Way They Do For Automobile Dealers Using the Alternative LIFO (IRS Safe-Harbor) Methods	
Change Factors	• The *net amount of change* in the LIFO reserve for any year results from two factors ◆ ***Price changes***, i.e., inflation or deflation ... prices either increased or decreased, and ◆ ***Quantity changes***, i.e., changes in the dollar amount of the inventory investment levels
	↑ ... *Factors Causing LIFO Reserves to Increase* ... ↑
Upward ... Increases	• ***Price/Cost increases ... inflation*** • Quantity increases ... do not affect the change in the LIFO reserve for the year of the increase
	↓ ... *Factors Causing LIFO Reserves to Decrease* ... ↓
Downward ... Decreases	• ***Price/Cost decreases ... deflation*** • ***Decreases in inventory investment levels*** - these cause paybacks of previously built-up annual LIFO increments and LIFO reserves because of the carryback of a current year quantity decrease (referred to as a "decrement") against the increases ("increments") that were built up in prior years. ◆ An inventory decrease/decrement may not necessarily cause, or result in, any pay-back of some or any of the LIFO reserve at the beginning of the year. ◆ Whether or not there is a "pay-back" ... and the amount of the payback ... depends on ▪ The order in which the prior years' layers were built up over time, ▪ How the prior years' layers were valued for LIFO purposes, ▪ Whether deflation was experienced in any of the prior years, and ▪ The sequence of calculations followed in combining LIFO pools in changing to the Vehicle-Pool Method (Rev. Proc. 2008-23 and CCM 200825044).

 (Continued from page 27)

of base dollars) is projected to be lower than the beginning of the year inventory amount (also expressed in base dollars), that means there is going to be a liquidation or decrement in the LIFO pool.

However, that liquidation or decrement may not necessarily cause, or result in, payback of some or all of the LIFO reserve at the beginning of the year.

Whether or not there is a "payback" depends on how the prior year layers have been built up over time and how they have been valued for LIFO purposes. [For more comprehensive analyses, see: *"Why Do Some LIFO Reserves Go Up Even Though Inventory Levels Go Down?"* in the March, 1992 *LIFO Lookout* and *"Another Rebasing Example - With Proofs: Why LIFO Reserves Go Up Even Though Inventory Levels Go Down and Despite Rebasing Indexes to 1.000 in Between"* in the June, 1993 *LIFO Lookout*.]

Dealers are often pleasantly surprised, but understandably skeptical, when they are told by their CPAs that even though their inventory levels are projected to be lower at year-end, their LIFO reserves will only go down slightly or that they may actually be expected to ***increase***. Although this may not be likely for many dealers this year, the actual LIFO reserve payback will vary considerably from dealer to dealer because every dealership LIFO calculation has its own unique history of fluctuating inventory levels.

Precise quantification is possible ... and provable. Although many other aspects of using the LIFO methodology may be subjective, computing LIFO reserves and how they change is ***absolutely mathematically precise***. Given the inflation rates and ending inventory levels, the corresponding LIFO reserve can be precisely computed and independently verified as being correct.

The LIFO recapture, or payback, can be ***precisely calculated*** based on the different recapture potential that is associated with each annual layer of LIFO "increment" that has been built up over the years. Often, the payback potential is greater in one pool (either new automobiles or new light-duty trucks) than in the other pool for new vehicles. This has to be taken into account in planning which pool to try to replenish if it is not possible to replenish them both. If a dealership has not already changed its LIFO method to combine its two vehicle pools (one for new automobiles and one for new light-duty trucks), that change certainly becomes the first strategy to consider.

DECREMENT CARRYBACKS

The amount of LIFO inventory liquidation or decrement (expressed in base dollars) for a given year is carried back against layers built up in prior years on a Last-In, First-Out or reverse-chronological order/ sequence.

This means that the most recent or last LIFO layer that has been accumulated is the first layer to be eliminated, and then prior years' layers are eliminated in reverse-chronological order.

In other words, a 2009 decrement will be first carried back against any 2008 increment, then against 2007, then against 2006, then against 2005, etc. until the entire amount of 2009 decrement (expressed in base dollars) has been fully accounted for. In some instances, a decrement may end up being carried all the way back to reduce the original first LIFO year base inventory.

When there is a liquidation and the decrement carryback order described above is followed, any prior layer that is eliminated is gone forever. If the dealer restores or replaces his inventory to a higher level in a later year, the later year's increase in inventory cannot claim or reclaim the lower cost basis that was associated with the increments that were liquidated by a decrement carryback against a prior year. Instead, that later year's increment must be valued at that later year's higher current cost.

PROJECTION CASE STUDIES

Two case studies have been included with this article to illustrate and expand the discussion on LIFO reserve projection computations.

Case Study #1 ...pages 39-43 ... presents a detailed analysis of the LIFO reserve recapture (or payback) rates that come into play when a current year decrement in a LIFO pool is carried back against LIFO layers built up in preceding years. This dealership had changed to the single, combined LIFO pool (Vehicle Pool Method) in a previous year.

This dealership expects its current year-end inventory of new vehicles to be considerably lower than it was at the end of the prior year. The dealership is not sure how far its inventory level will fall as of Dec. 31, 2009; accordingly, the schedules in this case study project the change in the LIFO reserve at six (6) different inventory levels starting with $3,500,000 and decreasing successively by $500,000 to $1,000,000.

Case study #1 shows that for 2009, the rate of LIFO reserve recapture increases in a range from 23% up to 68% as the successive inventory levels decrease. This is entirely consistent with the analysis of the composition of the LIFO reserve at Dec. 31, 2008 in terms of the potential recapture for each year's layer of inventory, expressed in base dollars.

In ***Case Study #2*** ... pages 44-47..., the dealer has the opportunity, and the financial capacity, to add

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units to inventory before year-end. The dealer wants to know how much inventory he/she should add in order to be at the "break-even point" for the LIFO reserve.

Usually, this is the equivalent of asking, "What should my inventory level be at year-end in order for my LIFO reserve to stay the same as it was at the beginning of the year?" In other words, the dealer is content to accept no change in the LIFO reserve at the end of the year.

Case Study #2 shows the projections and conveys in a simple graph (on page 45) the answer to the dealer's question.

WHAT CAN A DEALER FACED WITH LOWER LIFO INVENTORIES DO?

The starting point is to estimate, or more preferably, calculate the pay-back potential that arises from a series of reduced inventory levels to determine what the real impact is likely to be.

For auto dealers, this recapture impact will be different for the new auto pool compared to what it will be for the new light-duty truck pool. The LIFO reserve repayment potential should be computed for ***each*** LIFO pool and expressed as a dollar amount that the dealer can ***easily*** understand. See, in particular, the bar graph at the top of page 45.

In prior years and more normal times, dealers facing depleted inventories at year-end often had several alternatives they might pursue in order to try to restore their inventory levels to a more desirable level at year-end.

The alternatives discussed elsewhere in this edition of the *LIFO Lookout* in the article on *Conformity Reporting Requirements and Projections for Year-End Planning* would be more appropriate. These discussions include *"Working out of anticipated year-end liquidation or decrement situations"* (see page 15), *"Ideas Dealers Might Consider if faced with significant projected decrements"* (see page 17 for six "hair of the dog" suggestions) and *"Sometimes the IRS reverses year-end liquidation avoidance measures"* (see page 18 which describes three tax cases that went to court where the IRS successfully challenged some year-end inventory increasing maneuvers that were designed to avoid LIFO recapture).

As discussed on pages 18-19 in the article in this edition of the *Lookout*, the IRS has been successful in challenging transactions that appeared to be motivated by the desire to avoid LIFO recapture impact. In these cases, the IRS ignored the last-ditch efforts that resulted in inventory on hand at year-end which was not "intended to be sold or placed in the normal inventory channels."

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

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

PLANNING STRATEGIES TO DELAY, DEFER OR DIFFUSE LIFO RECAPTURE

Notwithstanding the foregoing, most would agree that it would be a stretch to refer to the year 2009 as a "normal year." Many dealers are scrambling to get more inventory, but there's little, if any, "product" or new vehicles available from others dealers or from the manufacturers. Accordingly, other strategies are more appropriate for our consideration.

Several strategies are available to try to mitigate the full impact of recapturing 100% of a dealer's LIFO reserve in a single year. Each has its own advantages, disadvantages and cautions. One cannot be certain how long LIFO will continue to be in the law. However, even if LIFO is available only for a few more years, "time is money," and if significant inflation occurs in the years before the use of LIFO is prohibited, that inflation will simply further build up the LIFO reserves which ultimately will have to be recaptured over a period of time which, hopefully, will be more than 4 years.

Alternatives relating to ***combining multiple LIFO pools*** for new vehicles have already been mentioned in connection with the discussion of Revenue Procedure 2008-23 and the change to the Vehicle-Pool Method.

Alternatives relating to ***terminating the LIFO election*** by a dealer in distress include (1) preemptively terminating the entire LIFO election in the year before the year in which the inventory level drops significantly, (2) terminating the entire LIFO election effective for the year the inventory level drops significantly, (3) terminating the LIFO election for a portion of the new vehicles on LIFO (as suggested by Situation 3 in ILM 200935024). But, watch this third situation carefully in terms of the times for filing Forms

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 30

(Continued from page 29)

3115 and the number of additional franchises the dealer has.

Alternatives relating to ***broadening the LIFO election*** in an effort to mitigate the anticipated recapture involve changing to the IPIC (Inventory Price Index Computation) Method to include used vehicles (and/or Parts & Accessories) in the overall IPIC pool.

The June 2007 and the September, 2007 issues of the *LIFO Lookout* included extensive analyses of the operation of the IPIC method and its perceived (or actual) shortcomings when the IPIC method was compared to the Alternative LIFO Method for new vehicles. These articles emphasized the absence of practical guidance on many key questions, including what goods may or may not be placed in the same pool for a dealership's "trade or business," and which Bureau of Labor Statistics index (the Producer Price Index or the Consumer Price Index) must or may be selected for use in the inflation computation.

Given the unusual circumstances currently faced by many dealers, it's possible that the IPIC method may be a "white knight" of sorts if it can be made to accommodate the inclusion of inventories other than new vehicles under more broader pooling approaches.

Finally, it's possible in most cases for a dealership to ***extend LIFO to its used vehicles*** if it (1) has not previously elected to use LIFO for its used vehicles, or (2) it used LIFO many years ago and terminated its LIFO election more than five years ago. Even though the used vehicles would be in a separate pool from the new vehicles for LIFO purposes, an increase in the LIFO reserve for used vehicles in the first year would offset the decrease in the LIFO reserve for the new vehicles.

TERMINATING ... PARTIAL OR COMPLETE ... THE LIFO ELECTION FOR NEW VEHICLES

In General. In many respects, since the issuance of Revenue Procedure 2008-52, it has become easier to terminate LIFO elections than it used to be. Technically, the termination of a LIFO election is a "change ***from*** the LIFO inventory method" and it is designated automatic accounting method change number 56 in Section 22.01 of the Appendix to Revenue Procedure 2008-52.

This Revenue Procedure significantly relaxed the technical interpretations that the National Office was making which would have required most automobile dealerships to first obtain permission from the IRS before they could terminate their LIFO elections.

Form 3115, *Application for Change in Accounting Method,* is filed after the end of the year of change and, because the change is automatic, no user fee is required to be paid. As discussed further below, if the dealership cannot use the automatic change provisions in Revenue Procedure 2008-52, it must follow all of the requirements found in Revenue Procedure 97-27 for advance permission to terminate its LIFO election.

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 four-year period beginning with the year of termination. This is the adjustment required by Section 481(a) and referred to in Form 3115 on page 3, Part IV, Questions 24 through 27.

Because the a dealership will be using different methods for identifying and valuing different classes of inventory goods, the taxpayer is required to attach a statement to the Form 3115 in which it (1) describes "the new method of identifying the goods" and (2) the new method of valuing those goods. For an automobile dealership, "*specific identification*" is the method of identifying the new vehicle inventory and the "*lower or cost or market*" is the method of valuing those goods.

The original Form 3115 must be attached to the dealership's timely filed (including extensions) original Federal income tax return when it is filed for the year of change. A copy of Form 3115 must also be filed with the IRS National Office in Washington, DC. [A sample proforma Form 3115 filing package for terminating a LIFO election for new vehicles was included in the 2009 Mid-Year Edition of the *LIFO Lookout* at pages 30-35. This includes a detailed narrative attachment to Form 3115 and a sample transmittal letter to the IRS National Office.]

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

Scope limitations. Revenue Procedure 2008-52 contains two scope limitations that might prevent a taxpayer from being able to use the automatic change provisions where that taxpayer has made certain changes in the previous five years. This prior 5-year period includes the year of change, so it is really the year of change plus the four immediately →

preceding years that need to be examined to see if the taxpayer is eligible for an automatic change.

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

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

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

Under this provision, if a dealership elected to use LIFO three years ago, it could not terminate its LIFO election in its 4th year as an automatic change in method because that falls within the 5-year period. Accordingly, that dealership would have to obtain permission in advance from the IRS to make the change (i.e., using Rev. Proc. 97-27).

In a different context, if the dealership previously had both new vehicles and used vehicles on LIFO, and it terminated its LIFO election for used vehicles two years ago, the dealership now should be able to terminate its LIFO election for new vehicles under the automatic change in method provisions (i.e., using Rev. Proc. 2008-52) because the termination of the used vehicle LIFO election a few years ago involved a change for a different class of goods ... It was not a change for the same specific item, type or class of goods for which the LIFO election is now being terminated.

Similarly, if within the last 5 years (i.e., in 2007 or 2008) the dealership changed to the Vehicle-Pool Method, having made that change within 5 years should not prevent the dealership from now terminating its LIFO election under the automatic change provisions (i.e., using Rev. Proc. 2008-52) because the dealership has not changed its inventory identification method for its pools within the proscribed 5-year period. See Section 4.02(7)(c) Example #2 of the Rev. Proc.

Changes in LIFO sub-methods. Although not directly related to the termination of a LIFO election, per se, changes in LIFO sub-methods may be important in considering year-end planning alternatives.

A taxpayer is not prohibited from changing a LIFO inventory ***sub-method*** (for example, the method of determining current-year cost or the method of computing a dollar-value pool index) within five years of adopting or changing to the LIFO inventory method or ***another*** LIFO inventory ***sub-method.***

In discussing the prior 5-year item change scope limitation, Section 7.02(2) of R.P. 2008-52 states that taxpayers have no audit protection in situations where they are making changes in LIFO sub-methods. This should be kept in mind in reading the discussion of ILM 200935024 Situation 3 on page 36.

This seems to indicate that even though a taxpayer may automatically change one of its sub-methods under its broader LIFO method (such as changing its pooling method to the Vehicle-Pool Method), the IRS still can go back to prior years and make adjustments (or possibly even terminate the taxpayer's LIFO election in an earlier year ... with no spread period) if the IRS finds a financial statement conformity violation, a cost violation or some other critical omission such as the failure to file Form 970 in the tax return for the initial year of election.

Terminating a LIFO election where advance consent from the IRS is required. If a taxpayer/dealership cannot use the automatic change provisions in Revenue Procedure 2008-52 to terminate its LIFO election, it must file its Form 3115 to terminate its LIFO election ***before*** the end of the year of change. It must also pay the IRS a user fee for processing Form 3115 and follow all of the requirements in Revenue Procedure 97-27 in order to secure advance permission from the IRS to make the change.

Delays in resolving various issues that might arise in this process can create severe practical problems for the taxpayer if the IRS has not granted permission to make the change terminating the LIFO election by the time in the following year when the income tax return for the year of change is required to be filed.

If permission to terminate has not been received from the IRS by this time, a taxpayer is required (1) to file its tax return using the LIFO method (for the year of intended change), and (2) subsequently to file an amended return after permission to change has been received. This becomes cumbersome (a nightmare?) where individual returns for many partners or shareholders of flowthrough entities are involved and/or where multiple state income tax return filings must be made.

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 32

"Pre-emptive" termination of LIFO election in the year before the inventory level drops. In early 2009, some dealerships terminated their LIFO elections effective for calendar year 2008 in order to spread the repayment of their entire LIFO reserve as of December 31, 2007 over four years (i.e., over the years 2008-2009-2010-2011). This was done, rather than staying on LIFO for 2008, in an effort to avoid facing significant recapture of much - if not all - of their LIFO reserve all in one year (2009) due to the zero or significantly depressed inventory level they expected to have as of Dec. 31, 2009.

At that time, these dealerships were aware of the impending manufacturer bankruptcy proceedings of General Motors and Chrysler that would be taking place over the summer months in 2009, and they acted in anticipation of adverse bankruptcy consequences.

Did these dealers act wisely? ... or, did they jump the gun on terminating their LIFO elections?

Other dealers might be contemplating similar action terminating LIFO elections effective for the calendar year 2009 if they (1) had their franchises terminated during 2009 but were still in business at the end of 2009 or (2) have received so-called "wind down" letters from the manufacturers informing them that their franchise agreements would not be renewed in October of 2010.

As noted previously, generally when a LIFO election is terminated, the LIFO reserve must be repaid by including 25% of the LIFO reserve as of the end of the last year on LIFO in income over a 4-year period beginning with the year of termination. If the amount of recapture is less than $25,000, the taxpayer may elect to take 100% of the LIFO reserve into income in the year of change.

In general, as long as the dealership continues its "trade or business" ... i.e., it does not "cease to engage in its trade or business" ... it will be allowed the 4-year spread period for the recapture of its LIFO reserve. It's important to know what these terms mean.

"Trade or business" ... What does this term mean? The term "trade or business" for an automobile dealership is generally accepted to include ***all of the operations*** conducted by the dealership (i.e., the sale of new and used vehicles and the sales of parts, labor and service). The term is not necessarily limited (in the case of an automobile dealership) to only the sale of new vehicles.

"Cessation of trade or business" ... What does this term mean? Section 5 of Revenue Procedure 2008-52 provides that a taxpayer is treated as ceasing to engage in a trade or business if (1) the operations of the trade or business cease or (2) 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).

In many cases, the activities and investments in assets associated with the loss of the franchise right to sell new vehicles constitute less than the percentages set forth in the preceding paragraph.

Examples of the cessation of a trade or business include (1) the incorporation of the trade or business, (2) the purchase of the trade or business by another taxpayer in a transaction to which Section 1060 applies, (3) the transfer or termination of the trade or business pursuant to a taxable liquidation, or (4) the contribution of the assets of the trade or business to a partnership.

Conclusion. 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.

If after losing a (or its only) franchise, the dealership remains in business selling used vehicles and parts and service, either or both of those activities should not be considered to constitute the cessation of the dealership's trade or business.

Accordingly, for many dealers, if the termination of the LIFO election is properly timed, the loss of a franchise does not necessarily warrant immediate recapture of 100% of their LIFO reserve in the year the franchise is lost.

The planning opportunities will be different for dealerships depending on the answers to at least four questions. First, does the dealer intend to stay in business (selling used vehicles and parts and providing repair and other services) or is the dealership going to be shut down entirely?

Second, how many other franchises does the dealer presently have to continue his/her business with?

Third, what are the prospects for the franchises the dealer hopes to continue doing business with?

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 36

ILM Facts

ILM 200935024
Chief Counsel Advice on the Acceleration of a Section 481(a) Adjustment
Section 481(a) - Accelerated Adjustment Not Required after Accounting Method Change

Situation 1

- In 1990, an automobile dealer ("Taxpayer") obtained a franchise to sell new Pontiac-brand vehicles ("Pontiacs"). At Taxpayer's dealership, Taxpayer also sells used vehicles and new automotive parts and accessories. In addition, Taxpayer's service department provides vehicle maintenance and repair service for customers as well as for used vehicles acquired for resale.
- ***Taxpayer has treated all these activities as a single trade or business since Taxpayer obtained its Pontiac franchise.***
- Between 1991 and 1992, Taxpayer expanded its single trade or business as it obtained franchises to sell new (1) Fords, (2) Chevrolets, (3) Toyotas and (4) Hondas.
- Effective for the taxable year ending December 31, 2001, ***Taxpayer elected*** to use the dollar-value LIFO method for all inventories and ***to maintain multiple pools based on the vehicles sold under each franchise.***
  - ***Thus, Taxpayer maintains five dollar-value LIFO pools***: (1) Pontiacs, (2) Fords, (3) Chevrolets, (4) Toyotas and (5) Hondas.
  - On Jan. 1, 2009, Taxpayer's LIFO reserve attributable to each pool was $8x ($40x total).
- Taxpayer lost its Pontiac franchise on July 7, 2009, and it quickly liquidated its inventories of new Pontiacs.
  - Taxpayer did not have any new Pontiacs in ending inventories on December 31, 2009.
- ***Despite the loss of its Pontiac franchise, Taxpayer*** still sells new Fords, Chevrolets, Toyotas, and Hondas and ***still operates the other activities of its trade or business*** (*i.e.*, selling used vehicles, selling vehicle parts and accessories, and servicing and repairing vehicles).
- In March of 2010, Taxpayer decided it wanted to terminate its LIFO election in order to begin using the specific identification method for new Pontiacs effective for the taxable year ending December 31, 2009 ("year of change").
  - Taxpayer determined that it can obtain automatic consent to change its inventory-identification method from the LIFO method to another permissible inventory method for one or more dollar-value pools. (Section 22.01(a) of the Appendix of Rev. Proc. 2008-52).
  - Taxpayer also determined that the Section 481(a) adjustment attributable to a change from the LIFO method to the specific identification method is $8x (a positive amount).
  - Finally, Taxpayer determined that one-fourth of the Section 481(a) adjustment ($2x) must be included in the taxable income of each year of the four-year adjustment period.
- On March 15, 2010, Taxpayer carefully completed and signed a Form 3115, Application for Change in Accounting Method, and attached that copy to its timely filed original federal income tax return for the year of change. On the same day, Taxpayer mailed a duplicate copy to the National Office. [See Section 6.02(3)(a) of Rev. Proc. 2008-52.]
  - Taxpayer computed its taxable income for the year of change using the new method for Pontiac vehicles and included one-fourth of the Section 481(a) adjustment in the taxable income computation on its timely filed original federal income tax return for the year of change.
- While examining the tax return for the year of change, the Revenue Agent questioned whether Taxpayer's inclusion of only one-fourth (or 25%) of the Section 481(a) adjustment in the taxable income of the year of change was proper, given the fact that Taxpayer's inventories on December 31, 2009 contained no Pontiacs subject to the new method.
  - Stated differently, the Revenue Agent wanted to know whether Taxpayer must accelerate the reporting of the Section 481(a) adjustment and, thus, must include the entire amount of the $8x adjustment in the taxable income of the year of change (i.e., the year in which the LIFO election was terminated).

Situation 2

- The facts in Situation 2 are the same as the facts in Situation 1, except that Taxpayer never acquired the Ford, Chevy, Toyota and Honda franchises. In other words, Taxpayer had only the Pontiac franchise.
- After losing the Pontiac franchise, Taxpayer continued to operate the remaining activities of its trade or business (*i.e.*, selling used vehicles; selling automotive parts and merchandise; servicing and repairing vehicles) in the year 2010.

ILM Questions & Answers

ILM 200935024
Chief Counsel Advice on the Acceleration of a Section 481(a) Adjustment
Section 481(a) - Accelerated Adjustment Not Required after Accounting Method Change

Situation Questions	*Answers & Comments*
Situation 1. If an automobile dealer that loses one of its five dealer franchises ("franchises") properly obtains automatic consent to terminate its election to use the LIFO method for the dollar-value pool that includes only the new vehicles sold under that lost franchise, must the taxpayer accelerate the corresponding Section 481(a) adjustment because its ending inventories for the year of change do not include any of those new vehicles?	*No...* The automobile dealer must include only one-fourth of the Section 481(a) adjustment in the taxable income of each year of the four taxable years that begin with the year of change ("four-year adjustment period"). *Comment:* The fact pattern for Situations 1 & 2 appear on the facing page.
Situation 2. Is the answer in Situation 1 the same if the automobile dealer loses its only franchise but still operates the remaining portions of its trade or business?	***Yes...*** There is no acceleration of the Sec. 481(a) adjustment if the dealer continues to operate the remaining portions of its trade or business.
Situation 3. If the automobile dealer maintains one pool for all new vehicles, may the automobile dealer change from the LIFO method for only the vehicles sold under the lost franchise? ***Facts in Situation 3*** The facts in Situation 3 are the same as in Situation 1, except that effective for the taxable year ending December 31, 2007, the dealership had elected to use the Vehicle-Pool Method for all new vehicles. (Rev. Proc. 2008-23) On January 1, 2009, the LIFO reserve attributable to the single pool was $40x. If Taxpayer used its LIFO method for the taxable year ending December 31, 2009, the LIFO reserve would be reduced by $8x as a result of having no Pontiac vehicles in ending inventory.	***The automobile dealer may not change its method of accounting for some of the vehicles that are within the scope of a single dollar-value pool.*** However, the automobile dealer may either • Change from the LIFO method for its single dollar-value pool that includes all new vehicles (i.e., terminate its entire LIFO election), or • Change its dollar-value pooling method to a method of pooling based on vehicles sold under each franchise ***and*** change from the LIFO method for the dollar-value pool that includes only the vehicles sold under the lost franchise. ***Comments:*** • The two changes suggested in the second part above could not both be made as automatic changes, not requiring advance consent from the IRS. • The computation of the amount of the LIFO reserve attributable to the new vehicles related to the lost (Pontiac) franchise could be problematic. The amount is simply given as $8x, with no further explanation. (See Reg. Sec. 1.472-8(g)) • ***Query:*** Could the dealership change its pooling method to include "all new vehicles manufactured by the same ***manufacturer***," rather than by ***franchise***? In many cases, pooling by manufacturer would be broader than pooling by franchise, although there might be some tradeoffs.

Source: ILM 200935024 ... dated August 17, 2009 ... release date of August 28, 2009.
This Chief Counsel Advice responds to a request for technical assistance from the IRS Motor Vehicle Industry Counsel. It contains the following caveat: "This advice may not be used or cited as precedent."

ILM Law & Analysis	***ILM 200935024*** ***Chief Counsel Advice on the Acceleration of a Section 481(a) Adjustment*** ***Section 481(a) - Accelerated Adjustment Not Required after Accounting Method Change***
Law	• Rev. Proc. 97-27 provides the procedures concerning method changes that require the advance consent of the IRS Commissioner. ◆ A shortened or accelerated adjustment period for the Section 481(a) adjustment is required for "... taxpayers that cease to engage in the trade or business before the adjustment period ends." [Section 7.03 of Rev. Proc. 97-27] • Rev. Proc. 2008-52 provides procedures concerning automatic method changes. In general, it provides that the Sec. 481(a) adjustment period is four taxable years for a net positive Sec. 481(a) adjustment for an accounting method change, and one taxable year for a net negative Sec 481(a) adjustment for an accounting method change. ◆ A similar acceleration provision for the Sec. 481(a) adjustment is required for "... taxpayers that cease to engage in the trade or business before the adjustment period ends." [Section 5.04(3) of Rev. Proc. 2008-52] • Sec. 22.01(a) of the Appendix of Rev. Proc. 2008-52 applies to a taxpayer that wants to change from the LIFO method for all its LIFO inventory or for one or more dollar-value pools and that changes to a permitted method or methods of accounting as determined in Sec. 22.01(1)(b) of this Appendix. ◆ The language in Sec. 22.01(b) of the Appendix of R.P. 2008-52 does not appear to present any problem for an automobile dealership desiring to terminate its LIFO election. • Rev. Proc. 2008-23 *(Vehicle-Pool Method)* authorizes a reseller of automobiles and light-duty trucks to assign all new automobiles and new light-duty trucks to one LIFO pool. If the dealership is using LIFO for used vehicles, it may also assign all used automobiles and used light-duty trucks to a second LIFO pool.
Analysis ***Situation 1***	• In Situation 1, Taxpayer is required to include only one-fourth of the Sec. 481(a) adjustment in the taxable income of the year of change. • Taxpayer properly obtained automatic consent under Rev. Proc. 2008-52 to change from the LIFO method to the specific identification method for new Pontiacs. Thus, the terms and conditions of Rev. Proc. 2008-52 apply to this case. • Sec. 5.04(3) of Rev. Proc. 2008-52 does not require the acceleration of a Sec. 481(a) adjustment attributable to a change in inventory method when there is no ending inventory of the goods for which the change was made. • Thus, Taxpayer may continue to spread the Sec 481(a) adjustment over the four-year period in accordance with Rev. Proc. 2008-52.
Analysis ***Situation 2***	• In Situation 2, Taxpayer is required to include only one-fourth of the Sec. 481(a) adjustment in the taxable income of the year of change. The rationale applicable to Situation 1 applies here, also. • However, if Taxpayer actually ceases to engage in this trade of business or terminates its existence, the acceleration rules of Sec. 5.04(3)(c) of Rev. Proc. 2008-52 will apply. If applicable, they will likely require Taxpayer to include any remaining Sec. 481(a) adjustment in the taxable income of the taxable year that includes the cessation or termination.
Analysis ***Situation 3***	• In Situation 3, Taxpayer uses a single dollar-value pool for all of its new vehicle LIFO inventories. • Taxpayer may not change from the LIFO method for some of the goods properly includible in a single dollar-value pool. • Taxpayer may change from the LIFO method for the entire dollar-value pool under R.P. 2008-52. • ***Alternatively,*** Taxpayer may (1) change its pooling method to a method of pooling based on the vehicles sold under each ***franchise*** pursuant to Rev. Proc. 97-27 by filing a Form 3115 ***before the end of its taxable year*** and (2) change from the LIFO method (i.e., terminate its LIFO election) for the dollar-value pool that includes vehicles sold under the Pontiac franchise by filing a Form 3115 pursuant to Rev. Proc. 2008-52 (i.e., as an automatic change in method by filing Form 3115 ***after the end of its taxable year***). To do this, two different Forms 3115 must be filed in two (consecutive) different years.

(Continued from page 32)

Fourth, does the dealer reasonably expect to be able to acquire additional franchises - and if so, how much time is it expected to take for the dealer to acquire those franchises?

CHANGING TO SPLIT UP LIFO POOLS, WHILE STAYING ON LIFO

At this point, the IRS guidance in ILM 200935024 in answer to questions on the Section 481(a) adjustment spread period becomes relevant. This ILM was referred to earlier in this article as the third of four recent developments affecting current year-end planning. It is more fully covered on pages 33-35.

In particular, the IRS analysis in the ILM Situation 3 may be helpful in certain cases where a dealer has one franchise terminated, but still has one or more other franchises still in effect.

In ILM Situation 3, the automobile dealership maintained one combined pool for all new vehicles (i.e., it used the Vehicle-Pool Method) and it wanted to change from the LIFO method (i.e., it wanted to terminate its LIFO election) for ***only the vehicles sold under the lost franchise***, which happened to be Pontiac. The IRS held that the dealership could not terminate its LIFO election only with respect to the vehicles sold under the lost franchise. The Service said that the dealership may not change its method of accounting for ***some*** of the vehicles that are ***within the scope of a single dollar-value pool***.

Doing the "two-step." In further discussing Situation 3, the IRS said that the dealership could (1) change its dollar-value pooling method to a method of pooling based on vehicles sold under each of its franchises ***and*** (2) change from the LIFO method (i.e., terminate its LIFO election) for the dollar-value pool that includes only the vehicles sold under the franchise that was terminated (Pontiac).

However, the two changes suggested above cannot both be made as automatic changes which do not require advance consent from the IRS. Only one of them can. The change in the pooling method to a method of pooling based on the vehicles sold under each ***franchise*** is not an automatic change. It would have to be made pursuant to Rev. Proc. 97-27 ... by filing a Form 3115 with the IRS ***before the end of the dealership's taxable year of change***.

The change from the LIFO method for the dollar-value pool that includes new vehicles sold under the Pontiac franchise (i.e., the termination of the LIFO election with respect to the Pontiac new vehicle pool) could be made as an automatic change by filing Form 3115 with the IRS pursuant to Rev. Proc. 2008-52.

If the IRS is trying to encourage taxpayer compliance and reduce the number of Form 3115 filings requiring advance permission, then it seems rather inconsistent and unrealistic of the Service to expect that a dealership would be able to accomplish the desired result without running afoul of these Form 3115 filing technicalities.

As a matter of fact, Revenue Procedure 2009-39 recently modified Revenue Procedure 2008-52 to permit manufacturers to make automatic changes to (1) split a pool and (2) terminate the LIFO election for a portion of the goods that were split out from that pool.

Section 3.28 of R.P. 2009-39 adds the following new Section 22.01(6) to the Appendix of R.P. 2008-52 which lists changes in accounting method that may be made as automatic changes ... "(6) ***Pool split and partial termination.*** If a taxpayer must remove goods from a pool because those goods are not within the scope of that pool (for example, removing resale goods from a manufacturing pool), and if the taxpayer wants to change from the LIFO inventory method for those removed goods, the taxpayer may split the pool pursuant to Section 22.10 of this Appendix (dealing with changes to the dollar-value pool of manufacturers) and then may change from the LIFO method pursuant to Section 22.01 of this Appendix. (See Section 22.10(2) of this Appendix.) The taxpayer must file a separate Form 3115 for each such change." In other words, separate Forms 3115 are required, but both changes are automatic.

For the dealership in Situation 3 of the ILM, the Pontiac vehicles were required to be included in the pool. Therefore, the narrow language in the newly added Section of Rev. Proc. 2009-39 would not apply in an auto dealer situation. It would seem that automobile dealers losing franchises ought to be afforded a similar, less strenuous filing procedure for pool splits and partial terminations of their new vehicle pools. The problem is not filing two Forms 3115 for these changes. The problem is having to file one Form 3115 before year-end (and paying a user fee) and then having to file a second Form 3115 after year-end with the tax return.

In the ILM Situation 3, the dealer had 5 franchises: one franchise was lost and four remained. If the dealership took the action described, it would end up with 4 separate LIFO pools ... one for the vehicles sold under each franchise. In future years, dollar increases in one franchise inventory would not be able to offset dollar decreases in the pool for another franchise. This could pose a greater risk to overall LIFO reserve recapture in later years as inventory

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levels fluctuated. But, that disadvantage might be worth the "price to pay" in a future year in order to be able to remain on LIFO for the new vehicles sold under the remaining/retained franchises.

One situation where the suggested "two-step" change approach could be beneficial is where a dealer has only two franchises, and one of them is lost and the dealer does not expect to acquire another franchise to replace it in the future. In this case, the dealer gets the best of both worlds as far as LIFO treatment is concerned: the dealer stays on LIFO (single pool) for the retained franchise and the dealer goes off of LIFO ... with a 4-year spread ... for the LIFO inventory associated with the terminated franchise.

If the dealer in this situation thought it might be possible to obtain another franchise from the same manufacturer or from a different manufacturer, or even if that were not possible, would it be better for the dealer to stay on LIFO and try to get more new vehicles in inventory before year-end? ... or try to get another franchise (with vehicles) before year-end? It all depends on (1) the facts and circumstances which vary from dealership to dealership and (2) what assumptions the dealer is willing to make about the future.

There are also a few practical computational problems to consider. In Situation 3 of the ILM, the facts presented include the following statements ... (1) On January 1, 2009, the LIFO reserve attributable to all of the vehicles in the single pool was $40x. (2) If the taxpayer used its LIFO method for the taxable year ending December 31, 2009, then the LIFO reserve would be reduced by $8x as a result of having no Pontiac vehicles in ending inventory.

Queries: How, or by what process, were these amounts determined?

As a practical matter, in some situations, it might take considerable effort to develop the corresponding amounts for a real-life dealership LIFO inventory.

Finally, there seems to be another variation on the Situation 3 scenario and the action suggested. What if the dealer follows the two-step approach, but it requests that its pooling method include "all new vehicles manufactured by the same ***manufacturer***," instead of "all new vehicles manufactured under the same ***franchise***?" In many cases, the resulting pooling by "manufacturer" would be far broader than a more narrow pooling by "franchise."

If General Motors is trying to come up with a dealer network which has basically three stand-alone facilities ... Cadillac, Chevrolet and Pontiac-Buick-GMC ... then pooling new vehicles by manufacturer (GM) might be more beneficial than pooling new vehicles by specific franchises. Similarly for Ford, Lincoln and Mercury and similarly for Chrysler and Jeep.

EXTENDING LIFO ELECTION TO USED VEHICLES

Electing LIFO for used vehicles may be strategically important if there is significant inflation in the used vehicle inventories at year-end. For a dealer facing a fairly large recapture of LIFO reserve from its new vehicle inventories, the election of LIFO for used vehicles could create a significant reduction of income to offset that recapture. Even if the new vehicle inventory levels are not projected to be significantly lower at Dec. 31, 2009, electing LIFO for used vehicles could be a good move for 2009.

Basically, there are two factors that signal the potential advisability of making a LIFO election. One factor is that there should be a significant amount of dollars invested in the inventory. The other factor is that there should be some, or a reasonable amount, of inflation in the year-end inventories, and it should be expected that inflation will continue in future years.

For the first time in several years, according to some recent reliable sources on wholesale prices, it is possible that used vehicle inventories will be reflecting (significant) inflation. With enough dollars in the beginning and ending used vehicle inventories, that inflation may result in a sizable LIFO reserve.

The advantage of electing LIFO for used vehicles, instead of taking traditional writedowns at year-end is simply that these writedowns reverse immediately in the next year when the vehicles are sold. The LIFO reserve, on the other hand, compounds over time as inflation continues and is a more permanent deferral. With a used vehicle inventory of roughly $2 million, if the inflation rate in year-end inventory is 3%, then the LIFO election would reduce income by roughly $60,000. If inflation were 5%, then LIFO deduction would be closer to $100,000.

There are several other important considerations.

Inventory on LIFO must be stated at cost (i.e., writedowns are not permitted). The (beginning) inventory going onto LIFO has to be valued at cost. Section 472(d) provides that any change in the inventory amount resulting from this requirement is taken into account ratably over each of the three taxable years beginning with the first taxable year of the LIFO election.

This means that any writedowns of used vehicles to their lower-of-cost-or-market value at the beginning of the year have to be restored/removed. Unless

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 38

(Continued from page 37)

there are no writedowns against used vehicles as of the beginning of the year, this requirement has to be taken into account.

This requirement actually may prove to be beneficial for some dealers. It would allow them to reduce this year's income by two-thirds of the amount written down from cost at the beginning of the year because these writedowns have already been taken into income in the current year as those vehicles were sold in the early months of the year.

Therefore, income equal to 2/3 of the amount of used car writedowns as of Dec. 31, 2008 (i.e., the beginning-of-the-year writedown) can be deferred into 2010 and 2011 in accordance with Section 472(d).

Financial statement conformity requirement. It is necessary to comply with the financial statement LIFO conformity requirement which is discussed in great detail beginning on page 5. If the dealership is going to consider the possibility or alternative strategy of electing LIFO for used vehicles, it will be necessary to include an estimate of the LIFO reserve for used vehicles in all 2009 year-end financial statements issued by the dealership.

Form 970 filing requirement. Technically, the election of LIFO for used vehicles would be an extension of the LIFO election for new vehicles to an additional class of goods, with those goods being placed in a separate LIFO pool. Therefore, it is necessary to file a Form 970 (not Form 3115) with the income tax return for the first year of the LIFO election for used vehicles.

Method for computing LIFO for used vehicles. In Revenue Procedure 2001-23, the IRS set forth a methodology ... the Alternative LIFO Method for Used Vehicles ... that it will accept for an automobile dealership's used vehicle LIFO calculations. This safe-harbor methodology is relatively unambiguous and easy to use. Many dealerships applying LIFO to their used vehicle inventories use this method.

In addition, the Vehicle-Pool Method (described in Rev. Proc. 2008-23) may be used, and it permits all used vehicles to be included in a single, combined LIFO pool. In most cases, it would be desirable for a dealership electing LIFO for used vehicles to use the single, combined (or Vehicle-Pool) method in conjunction with the Alternative LIFO Method for Used Vehicles.

See the June 2001 issue of the *LIFO Lookout* for a discussion of the Used Vehicle Alternative LIFO Method (Rev. Proc. 2001-23).

CHANGING TO ADOPT THE IPIC METHOD TO INCLUDE OTHER INVENTORIES

Some practitioners have steadfastly advised their dealers on LIFO to use the IPIC (Inventory Price Index Computation) method available under Reg. Sec. 1.472-8(e)(3). One reason for their general acceptance of this method, notwithstanding some of its limitations, is that the dealer using the IPIC method may place ***all*** of his inventory dollars on LIFO, rather than only the dollar amount of investment in new vehicles.

Consequently, a dealer using the IPIC method may be able to offset the loss of dollars in ending inventory caused be the inability to replace new vehicles by increasing (where it makes economic sense to do so) dollars invested in its other used vehicle and/or parts inventories.

A dealership using the BLS indexes may have had a lower LIFO reserve and lost some LIFO benefit because it was required to use lower/smaller inflation indexes (from the Producer Price Index (PPI) or the Consumer Price Index (CPI)) by the IPIC method. But this may have been regarded as a trade-off against the benefits the IPIC method provided by allowing broader pooling of inventories for IPIC computation purposes.

In connection with considering an automatic change in LIFO method to the IPIC method, Section 22.06 of the Appendix to Rev. Proc. 2008-52, generally provides that this change can be made by filing Form 3115 after the end of the year, so long as it is made before the tax return for the year end is filed and all of the other procedural requirements are satisfied. This change could also require the filing of Form 970 and/or Forms 3115 for other concurrent (automatic) changes depending on what steps are being taken to broaden the IPIC election.

Evaluating this possibility of changing to IPIC will require some additional computations and projections as to what the "trade-offs" might be in future years relative to the anticipated differential between inflation rates anticipated to be experienced if invoice-specific computations were made under the Alternative LIFO Method versus the more generalized and diluted results available under the PPI or CPI index approaches.

Some IRS agents require or believe that auto dealers using the BLS/IPIC approach should use the Consumer Price Index /CPI Detailed Report, Table 3; others believe that the index should be determined from the Producer Price Indexes, Table 6.

see **DEALERS LOW ON NEW VEHICLE INVENTORY...**, page 64

Case Study #1

ANALYSIS OF LIFO RESERVE RECAPTURE RATES

Case Study #1 presents a detailed analysis of the LIFO reserve recapture (or payback) rates that come into play when a current year decrement in a LIFO pool is carried back against LIFO layers built up in preceding years. This dealership had changed to the single, combined LIFO pool (Vehicle Pool Method) in a previous year.

The dealership had an ending inventory of new vehicles as of Dec. 31, 2008 of $4,100,000 (exactly $4,131,111). This dealership expects its current year-end inventory of new vehicles to be considerably lower than it was at the end of the prior year. The dealership is not sure how far its inventory level will fall as of Dec. 31, 2009. Accordingly, the schedules in this case study project the change in the LIFO reserve at six (6) different inventory levels starting with $3,500,000 and decreasing successively by $500,000 to $1,000,000.

Schedule I shows the step-by-step computations of the LIFO valuation of the ending inventory as of Dec. 31, 2008 (the prior year information) and the six corresponding projection calculations for 2009 based on the six different inventory levels ... and the rate of inflation for the vehicles in ending inventory is assumed to be 1.5% for the year.

The facts associated with the LIFO reserve at the end of the ***preceding*** year are shown in the table ... *Analysis of LIFO Reserve as of Dec. 31, 2008* ... in the top half of Schedule II.

The first three columns in this table show the build up of annual layers of increment and their respective base dollar amounts, valuation factors, and LIFO valuations. The remaining four columns in this table show the computation of the amount of LIFO reserve that is contributed by each of the five different layers of inventory (expressed in base dollars) that make up the entire LIFO inventory. In other words, these columns show the computation of the LIFO reserve recapture potential by layer as of December 31, 2008. This is the real/critical diagnostic information that it is necessary to have in order to gauge the impact of falling inventory levels.

A summary of the projections for the year-end 2009 is shown in the table at the bottom of Schedule II, with the net decrease in the LIFO reserve being $143,000 (rounded) if the year-end inventory is $3,500,000. The net decrease in the LIFO reserve can be as much as $1,655,000 (rounded) if the year-end inventory level falls as low as $1,000,000.

This summary of the projected results for 2009 also shows the two components operating to produce the net decreases in the LIFO reserve. The first component is a slight upward influence on the LIFO reserve due to the 1.5% inflation for the year–which translates effectively into 1.825% as a result of the compounding. However, this inflation impact is offset by the LIFO reserve recapture as the previous annual increment layers are eroded by the 2009 decrement and yield (or repay) their previously deferred inflation in the process.

Schedules III and IV (pages 42-43) show the proofs and reconciliations for the LIFO reserve changes for each of the six assumed inventory levels–$3,500,000 down to $1,000,000–in terms of the specific prior year layers that are invaded as the inventory level falls and the corresponding decrements (expressed in base dollars) increase.

The ***rate of payback*** is not a constant. Successive decreases in inventory level result in successive or corresponding increases in the rate of recapture. The rate of payback increases as the inventory level falls.

This can be seen by comparing the net decrease in the LIFO reserve as the ending inventory levels drop and calculating that change as a percentage of the loss of successive $500,000 inventory amounts. As the year-end inventory level drops from $3,500,000 to $3,000,000 the LIFO reserve payback is a net $257,270 or approximately 51.4% of that $500,000 inventory level decrease. As successive $500,000 decrements in the inventory level occur, one would expect the rate of LIFO reserve repayment/payback to increase ... And it does. As inventory levels decrease, there is an accelerating increase in the payback factor for the lost base dollars due to the penetration deeper into the annual increment layers in the earlier years.

This case study shows that the rate of payback increases in a range from 23% up to 68% as the successive inventory levels decrease. This is relatively consistent with the second part of the table in the top half of Schedule II showing the LIFO reserve recapture potential by layer as of Dec. 31, 2008.

Note also that as the inventory levels decrease, there is also a decrease in the amount of increase in the LIFO reserve attributable to the 1.5% assumed inflation for the year. The amount of the net change in the LIFO reserve that is due to inflation at each inventory level is simply 1.825% (the assumed 1.5% inflation rate, as compounded) multiplied by the amount on Line G(1) in Schedule I which is the end-of-the-year inventory expressed in base date cost dollars.

With this type of analysis and information available, one has the "X-rays" or diagnostic information that can be read to help a dealer see how his/her efforts to increase inventory levels (in whatever ways may be most appropriate and feasible under the circumstances) can offset some of the otherwise unpleasant consequences foretold by this analysis.

As a dealer is able to move the inventory level farther along from "right to left" on Line B of Schedule I, the payback amount decreases. With the help of this information, a dealer may be able to (significantly) limit the repayment at year end ... if inventory is available.

	2008 ACTUAL POOL #1	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST -AS REBASED	6,626,240	3,395,843	3,395,843	3,395,843	3,395,843	3,395,843	3,395,843
B. END OF YEAR INVENTORY AT END OF YEAR -ACTUAL COST	4,131,111	3,500,000	3,000,000	2,500,000	2,000,000	1,500,000	1,000,000
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX — RATIO OF: END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) / END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.01339	1.01500	1.01500	1.01500	1.01500	1.01500	1.01500
E. CUMULATIVE LINK-CHAIN INDEX — CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.21652	1.23477	1.23477	1.23477	1.23477	1.23477	1.23477
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	3,395,843	2,834,536	2,429,602	2,024,669	1,619,735	1,214,801	809,867
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS							
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	3,395,843	2,834,536	2,429,602	2,024,669	1,619,735	1,214,801	809,867
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(6,626,240)	(3,395,843)	(3,395,843)	(3,395,843)	(3,395,843)	(3,395,843)	(3,395,843)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(3,230,397)	(561,307)	(966,241)	(1,371,174)	(1,776,108)	(2,181,042)	(2,585,976)
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	N/A	N/A	N/A	N/A

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

	BASE DOLLARS		VALUATION FACTOR	2008 ACTUAL POOL #1	2009	2009	2009	2009	2009	2009
JANUARY 1, 1984 - BASE INVENTORY	942,675	X	0.32934	310,461	310,461	310,461	310,461	310,461	310,461	266,722
CAL YEAR 1997 INCREMENT (NET)	620,570	X	0.43440	269,576	269,576	269,576	269,576	269,576	118,212	-
CAL YEAR 1999 INCREMENT (NET)	1,066,511	X	0.49855	531,709	531,709	431,922	230,043	28,163	-	-
CAL YEAR 2003 INCREMENT (NET)	446,904	X	0.69803	311,952	142,943	-	-	-	-	-
CAL YEAR 2005 INCREMENT (NET)	319,183	X	1.00000	319,183	-	-	-	-	-	-
	3,395,843									

	2008 ACTUAL POOL #1	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%	2009 PROJECTED AT 1.50%
ENDING INVENTORY AT LIFO VALUATION, TOTAL PER ABOVE	1,742,881	1,254,689	1,011,959	810,080	608,200	428,673	266,722
LESS: ENDING INVENTORY AT END OF YEAR - ACTUAL COST (LINE B)	4,131,111	3,500,000	3,000,000	2,500,000	2,000,000	1,500,000	1,000,000
LIFO RESERVE AT END OF CURRENT YEAR	2,388,230	2,245,311	1,988,041	1,689,920	1,391,800	1,071,327	733,278
LESS: LIFO RESERVE AT END OF PREVIOUS YEAR	2,837,627	2,388,230	2,388,230	2,388,230	2,388,230	2,388,230	2,388,230
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	(449,397)	(142,919)	(400,189)	(698,310)	(996,430)	(1,316,903)	(1,654,952)
ADDITIONAL LIFO RESERVE PAYBACK DUE TO ADDITIONAL INVENTORY DROP		142,919	257,270	298,121	298,120	320,473	338,049
PAYBACK / RECAPTURE RATE		23%	51%	60%	60%	64%	68%
		A	*B*	*C*	*D*	*E*	*F*

ANALYSIS OF LIFO RESERVE ... AS OF DEC. 31, 2008 — *SCHEDULE II*

	LIFO Layer History			Contribution of Each Year's Layer to the LIFO Reserve — LIFO Reservé Recapture Potential			
	Base Dollars	Valuation Factor **	LIFO Valuation	Base Dollars	Index Factor		LIFO Reserve by Annual Layer
January 1, 1984 - Base Inventory	942,675	0.32934	310,461	942,675	0.88718	(1.21652 - .32934)	836,322
Cal Year 1997 Increment (Net)	620,570	0.43440	269,576	620,570	0.78212	(1.21652 - .43440)	485,360
Cal Year 1999 Increment (Net)	1,066,511	0.49855	531,709	1,066,511	0.71797	(1.21652 - .49855)	765,723
Cal Year 2003 Increment (Net)	446,904	0.69803	311,952	446,904	0.51849	(1.21652 - .69803)	231,715
Cal Year 2005 Increment (Net)	319,183	1.00000	319,183	319,183	0.21652	(1.21652 - 1.0000)	69,110
	3,395,843			3,395,843			2,388,230 *

Ending Inventory at LIFO Valuation	1,742,881
Less: Ending Inventory at end of year actual cost	4,131,111
LIFO Reserve as of Dec. 31, 2008	2,388,230

** Indexes rebased to 1.0000 as of end of 2005

PROJECTED NET DECREASE IN LIFO RESERVE ... AS OF DEC. 31, 2009

	Ending Inventory @ Actual Cost	LIFO Reserve	Net Decrease In LIFO Reserve	Change in LIFO Reserve Due To: Inflation @ 1.5%	Change in LIFO Reserve Due To: Decrease in Inventory Level
	4,131,111	2,388,230	*		
A	3,500,000	2,245,311	(142,919)	51,730	(194,649)
B	3,000,000	1,988,041	(400,189)	44,340	(444,529)
C	2,500,000	1,689,920	(698,310)	36,950	(735,260)
D	2,000,000	1,391,800	(996,430)	29,560	(1,025,990)
E	1,500,000	1,071,327	(1,316,903)	22,170	(1,339,073)
F	1,000,000	733,278	(1,654,952)	14,780	(1,669,732)

XYZ DEALERSHIP, INC.
PROOFS & RECONCILIATIONS ... ENDING INVENTORIES $3.5 TO $2.5 MILLION
FOR YEAR ENDING DECEMBER 31, 2009 *SCHEDULE III*

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $3,500,000 BASE DOLLARS	FACTOR	AMOUNT	
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322				
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360				
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723				
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 242,124	0.51849	$ 125,539	
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110	
	$ -			$ -			$ 1	
	$ 3,395,843			$ 2,388,230	$ 561,307		194,649	AA

A Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $2,834,536] 51,730
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $561,307 ($3,395,843 - $2,834,536) (194,649)

Projected Net Decrease in LIFO Reserve (142,919)

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $3,000,000 BASE DOLLARS	FACTOR	AMOUNT	
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322				
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360				
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723	$ 200,154	0.71797	$ 143,705	
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 446,904	0.51849	$ 231,715	
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110	
	$ 3,395,843			$ 2,388,230	$ 966,241		444,529	BB

B Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $2,429,602] 44,340
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $966,241 ($3,395,843 - $2,429,602) (444,529)

Projected Net Decrease in LIFO Reserve (400,189)

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $2,500,000 BASE DOLLARS	FACTOR	AMOUNT	
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322				
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360				
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723	$ 605,087	0.71797	$ 434,434	
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 446,904	0.51849	$ 231,715	
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110	
	$ -			$ -			$ 1	
	$ 3,395,843			$ 2,388,230	$ 1,371,174		735,260	CC

C Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $2,024,669] 36,950
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $1,371,174 ($3,395,843 - $2,024,669) (735,260)

Projected Net Decrease in LIFO Reserve (698,310)

XYZ DEALERSHIP, INC.
PROOFS & RECONCILIATIONS ... ENDING INVENTORIES $2.0 TO $1.0 MILLION
FOR YEAR ENDING DECEMBER 31, 2009 *SCHEDULE IV*

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $2,000,000		
					BASE DOLLARS	FACTOR	AMOUNT
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322			
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360			
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723	$ 1,010,021	0.71797	$ 725,165
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 446,904	0.51849	$ 231,715
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110
	$ 3,395,843			$ 2,388,230	$ 1,776,108		1,025,990 DD

D Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $1,619,735] 29,560
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $1,776,108 ($3,395,843 - $1,619,735) (1,025,990)

Projected Net Decrease in LIFO Reserve (996,430)

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $1,500,000		
					BASE DOLLARS	FACTOR	AMOUNT
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322			
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360	$ 348,444	0.78212	$ 272,525
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723	$ 1,066,511	0.71797	$ 765,723
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 446,904	0.51849	$ 231,715
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110
	$ 3,395,843			$ 2,388,230	$ 2,181,042		1,339,073 EE

E Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $1,214,801] 22,170
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $2,181,042 ($3,395,843 - $1,214,801) (1,339,073)

Projected Net Decrease in LIFO Reserve (1,316,903)

Year	Base Dollars	Index Factor		Dec. 31, 2008 LIFO Reserve by Annual Layer	Reserve Recapture Due to 12/31/2009 Decrease in Inventory Level to $1,000,000		
					BASE DOLLARS	FACTOR	AMOUNT
1984	$ 942,675	0.88718	(1.21652 - .32934)	$ 836,322	$ 132,808	0.88718	$ 117,825
1997	$ 620,570	0.78212	(1.21652 - .43440)	$ 485,360	$ 620,570	0.78212	$ 485,360
1999	$ 1,066,511	0.71797	(1.21652 - .49855)	$ 765,723	$ 1,066,511	0.71797	$ 765,723
2003	$ 446,904	0.51849	(1.21652 - .69803)	$ 231,715	$ 446,904	0.51849	$ 231,715
2005	$ 319,183	0.21652	(1.21652 - 1.0000)	$ 69,110	$ 319,183	0.21652	$ 69,110
	$ 3,395,843			$ 2,388,230	$ 2,585,976		1,669,732 FF

F Increase in LIFO Reserve Due to Inflation [(1.23477 - 1.21652 = 0.01825) x $809,867] 14,780
Repayment of LIFO Reserve Due to Decrease in Base Dollars of $2,585,976 ($3,395,843 - $809,867) (1,669,732)

Projected Net Decrease in LIFO Reserve (1,654,952)

Case Study #2 DETERMINING THE "BREAK-EVEN POINT" FOR A LIFO RESERVE

In some situations, or in some years, a dealer may have the opportunity, and the financial capacity, to add units to inventory before year-end ... and the dealer wants to know how much inventory he/she should add in order to be at the "break-even point" for the LIFO reserve.

Typically, what the dealer is asking is the equivalent of ... "What should my inventory level be at year-end in order for my LIFO reserve to stay the same as it was at the beginning of the year?" In other words, the dealer is content to accept no change in the LIFO reserve at the end of the year.

Some dealers ask the question in slightly different way ... and that involves a slightly different analysis. The second variation on a "break-even point" analysis would be one that shows the dealer what the inventory level should be at year-end in order for there to be no reduction in the LIFO reserve attributable to a decrement that is carried back and that produces a recapture of a portion of the LIFO reserve that was there at the beginning of the year.

As discussed elsewhere, there are two factors that affect the net change in the LIFO reserve for a given year. One factor is the rate of inflation (or deflation) reflected in the year-end inventory. The other factor is the amount of increase or decrease in the inventory level, and if there is a decrease in the inventory level, the impact of that decrease as it is carried back against prior years.

In this regard, one other important fact should not be overlooked: Under the Revenue Procedures for the Alternative LIFO Method for New Vehicles and for Used Vehicle, when there is a decrement in the current year for LIFO purposes and that decrement is carried back against an increment in the immediately preceding year, then there will be no repayment of the prior year's LIFO reserve as a result of invading that prior year's increment.

Case study #2 looks at the "break-even" analysis suggested in the first variation of the question (i.e., at what inventory level is there no change in the LIFO reserve for the year?).

The fact pattern for this case study is fairly simple, and it can be read from the information in the 1st column of Schedule I on page 46. In other words, as of Dec. 31, 2008, the LIFO reserve for this dealership was $3,884,508. The ending inventory at actual cost was $19,466,053. The detail of the LIFO layer history is not shown in Schedule I in order to make the presentation of the results more manageable.

Initially, the dealer wanted to know what the change in the LIFO reserve for 2009 would be if the ending inventory ranged anywhere from $10 million up to $18 million. Schedule I shows the comparison of the computations at $2 million intervals from $10 million to $18 million. In order to do the projection, it was estimated that the inflation rate for the year would be 2%. (You can't do a projection without assuming an inflation rate!)

After reviewing the results projected in Schedule I with the dealer, we could see that we could get pretty close to determining a "break-even" inventory level simply by expanding the calculations in the (more narrow) range between $14 and $16 million.

On page 47, Schedule II reflects three more calculations assuming inventory levels of $14.5 - $15 - and $15.5 million (...still keeping the inflation rate at 2%). It can be seen from Schedule II that if the inventory level were $15 million, the LIFO reserve would ***decrease*** by $16,606. On the other hand, if the inventory level were $15.5 million, the LIFO reserve would ***increase*** by $35,193.

It doesn't take a rocket scientist to observe that (at 2% inflation) the inventory level at which there would be no change in the LIFO reserve for 2009 falls between $15 and $15.5 million.

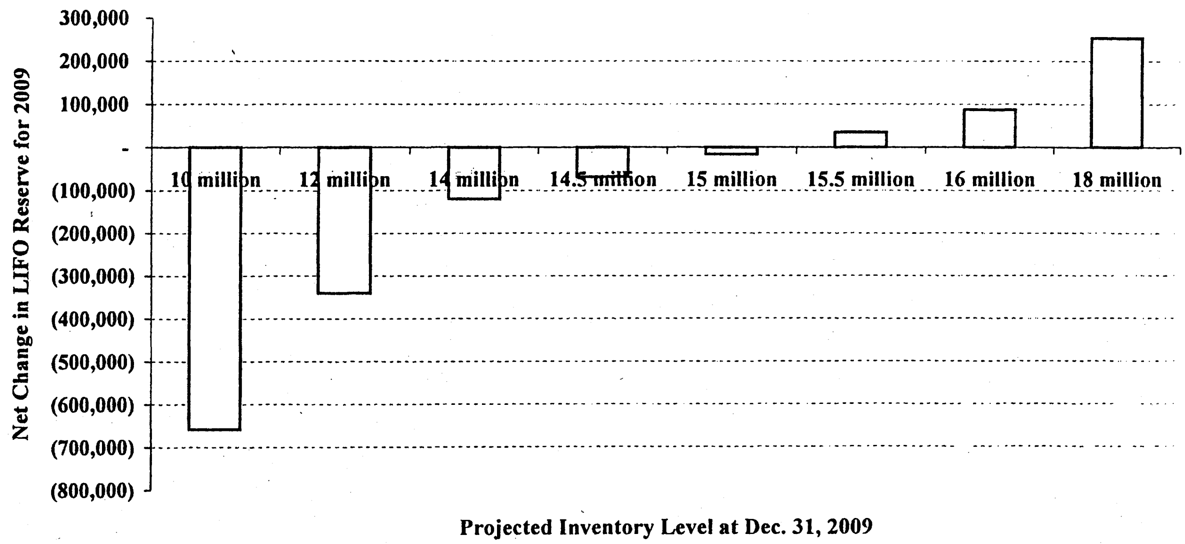
Schedule III and IV are on the facing page.

Schedule III is a summary table prepared from the results in Schedules I and II. This schedule shows the components of the change of the LIFO reserve at the different inventory levels tested. Schedule III also shows that the increase in the LIFO reserve due to the assumed inflation (as the inventory level increases) acts as a cushion against the repayment due to the fact that the assumed ending inventory levels all are smaller than the beginning-of-the-year inventory level, which is roughly $19.5 million.

Schedule IV coveys in a simple graph the results of all the projections plus the answer to the general question about where the "break-even point" lies. "One picture is worth a thousand words," ... and maybe a thousand dollar billing.

ABC DEALERSHIP
SUMMARY OF CHANGES IN LIFO RESERVE
BASED ON PROJECTED INVENTORY LEVELS & 2% INFLATION
FOR THE YEAR ENDING DEC. 31, 2009

Schedule IV



Schedule III

Projected Inventory Level Dec. 31, 2009	Net Change in LIFO Reserve for 2009	Components of Change in LIFO Reserve: Increase Due to 2% Inflation	Components of Change in LIFO Reserve: Repayment of LIFO Reserve Due to Reduced Inventory Level
$ 10,000,000	(657,885)	196,078	(853,963)
$ 12,000,000	(340,012)	235,294	(575,306)
$ 14,000,000	(120,202)	274,510	(394,712)
$ 14,500,000	(68,404)	284,314	(352,718)
$ 15,000,000	(16,606)	294,118	(310,724)
$ 15,500,000	35,193	303,922	(268,729)
$ 16,000,000	86,991	313,725	(226,734)
$ 18,000,000	253,425	352,941	(99,516)

ABC DEALERSHIP

Schedule I

PROJECTION OF NEW VEHICLE LIFO INVENTORY & RESERVE CHANGE
FOR THE YEAR ENDED DECEMBER 31, 2009

	Pool #1 All New Vehicles 12/31/2008 (Actual)	Projected Ending Inventory ... Dec. 31, 2009				
		Pool #1 All New Vehicles $10 Million (Projected)	Pool #1 All New Vehicles $12 Million (Projected)	Pool #1 All New Vehicles $14 Million (Projected)	Pool #1 All New Vehicles $16 Million (Projected)	Pool #1 All New Vehicles $18 Million (Projected)
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	20,472,286	18,390,225	18,390,225	18,390,225	18,390,225	18,390,225
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	19,466,053	10,000,000	12,000,000	14,000,000	16,000,000	18,000,000
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX: RATIO OF: END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.04331	1.02000	1.02000	1.02000	1.02000	1.02000
E. CUMULATIVE LINK-CHAIN INDEX: CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.05850	1.07967	1.07967	1.07967	1.07967	1.07967
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	18,390,225	9,262,089	11,114,507	12,966,925	14,819,343	16,671,761
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS						
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	18,390,225	9,262,089	11,114,507	12,966,925	14,819,343	16,671,761
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(20,472,286)	(18,390,225)	(18,390,225)	(18,390,225)	(18,390,225)	(18,390,225)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(2,082,061)	(9,128,136)	(7,275,718)	(5,423,300)	(3,570,882)	(1,718,464)
x	-	-	-	-	-	-
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	N/A	N/A	N/A

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

	BASE DOLLARS		VALUATION FACTOR	12/31/2008 (Actual)	$10 Million	$12 Million	$14 Million	$16 Million	$18 Million
New Vehicles - Dec. 31, 2008 Actual									
All Layers Combined	18,390,225	x	-	15,581,545					
	18,390,225			15,581,545					
New Vehicles - Dec. 31, 2009 Projected									
All Layers Combined ($10 Million Actual)	9,262,089	x	-		6,773,377				
	9,262,089				6,773,377				
All Layers Combined ($12 Million Actual)	11,114,507	x	-			8,455,504			
	11,114,507					8,455,504			
All Layers Combined ($14 Million Actual)	12,966,925	x	-				10,235,694		
	12,966,925						10,235,694		
All Layers Combined ($16 Million Actual)	14,819,343	x	-					12,028,501	
	14,819,343							12,028,501	
All Layers Combined ($18 Million Actual)	16,671,761	x	-						13,862,067
	16,671,761								13,862,067

	12/31/2008 (Actual)	$10 Million	$12 Million	$14 Million	$16 Million	$18 Million
ENDING INVENTORY AT LIFO VALUATION, PER ABOVE	15,581,545	6,773,377	8,455,504	10,235,694	12,028,501	13,862,067
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	19,466,053	10,000,000	12,000,000	14,000,000	16,000,000	18,000,000
LIFO RESERVE AT END OF CURRENT YEAR	3,884,508	3,226,623	3,544,496	3,764,306	3,971,499	4,137,933
LIFO RESERVE AT END OF PREVIOUS YEAR	3,105,528	3,884,508	3,884,508	3,884,508	3,884,508	3,884,508
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	778,980	(657,885)	(340,012)	(120,202)	86,991	253,425

2009 Projection Detail

	$10 Million	$12 Million	$14 Million	$16 Million	$18 Million
Projected increase due to inflation (at 2%)	196,078	235,294	274,510	313,725	352,941
Projected payback of LIFO reserve due to drop in year-end inventory level	(853,963)	(575,306)	(394,712)	(226,734)	(99,516)
Projected net increase (decrease) in LIFO reserve for 2009	(657,885)	(340,012)	(120,202)	86,991	253,425

ABC DEALERSHIP

Schedule II

PROJECTION OF NEW VEHICLE LIFO INVENTORY & RESERVE CHANGE
FOR THE YEAR ENDED DECEMBER 31, 2009

	Pool #1 All New Vehicles 12/31/2008 (Actual)	Projected Ending Inventory Dec. 31, 2009		
		Pool #1 All New Vehicles $14.5 Million (Projected)	Pool #1 All New Vehicles $15 Million (Projected)	Pool #1 All New Vehicles $15.5 Million (Projected)
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	20,472,286	18,390,225	18,390,225	18,390,225
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	19,466,053	14,500,000	15,000,000	15,500,000
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED	NOT FULLY REPRICED
D. CURRENT YEAR PRICE INDEX: RATIO OF: END OF YEAR INVENTORY PRICED AT END OF YEAR PRICES (DIVIDED BY) END OF YEAR INVENTORY PRICED AT BEGINNING OF YEAR PRICES	1.04331	1.02000	1.02000	1.02000
E. CUMULATIVE LINK-CHAIN INDEX: CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.05850	1.07967	1.07967	1.07967
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	18,390,225	13,430,030	13,893,134	14,356,238
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS				
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	18,390,225	13,430,030	13,893,134	14,356,238
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(20,472,286)	(18,390,225)	(18,390,225)	(18,390,225)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	(2,082,061)	(4,960,195)	(4,497,091)	(4,033,986)
x	-	-	-	-
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	N/A

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

	BASE DOLLARS		VALUATION FACTOR	12/31/2008 (Actual)	$14.5 Million	$15 Million	$15.5 Million
New Vehicles - Dec. 31, 2008 Actual							
All Layers Combined	18,390,225	x	-	15,581,545			
	18,390,225			15,581,545			
New Vehicles - Dec. 31, 2009 Projected							
All Layers Combined ($14.5 Million Actual)	13,430,030	x	-		10,683,896		
	13,430,030				10,683,896		
All Layers Combined ($15 Million Actual)	13,893,134	x	-			11,132,098	
	13,893,134					11,132,098	
All Layers Combined ($15.5 Million Actual)	14,356,238	x	-				11,580,299
	14,356,238						11,580,299

	12/31/2008 (Actual)	$14.5 Million	$15 Million	$15.5 Million
ENDING INVENTORY AT LIFO VALUATION, PER ABOVE	15,581,545	10,683,896	11,132,098	11,580,299
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	19,466,053	14,500,000	15,000,000	15,500,000
LIFO RESERVE AT END OF CURRENT YEAR	3,884,508	3,816,104	3,867,902	3,919,701
LIFO RESERVE AT END OF PREVIOUS YEAR	3,105,528	3,884,508	3,884,508	3,884,508
INCREASE (DECREASE) IN LIFO RESERVE AT END OF CURRENT YEAR	778,980	(68,404)	(16,606)	35,193

2009 Projection Detail

	$14.5 Million	$15 Million	$15.5 Million
Projected increase due to inflation (at 2%)	284,314	294,118	303,922
Projected payback of LIFO reserve due to drop in year-end inventory level	(352,718)	(310,724)	(268,729)
Projected net increase (decrease) in LIFO reserve for 2009	(68,404)	(16,606)	35,193

YEAR-END PROJECTIONS OF LIFO RESERVE CHANGES FOR AUTOMOBILE DEALERSHIPS BASED ON A 'ONE-OF-EACH" MIX ASSUMPTION

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

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

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

Our "one-of-each item category" report compares everything in our *SUPERLIFO* database as of December 3, 2009 ... with intro-2010 model prices, unless the 2010 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2008 is the reference date for the equivalent of the calendar year 2009 beginning of the year date; i.e., December 31, 2008/January 1, 2009.

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

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

Warning & Limitations. If you are going to use this information, please be aware of the following limitation. ... Our database is not entirely complete at this time because not all manufacturers have made their information available as we go to press.

Notwithstanding this limitation, some readers have found our one-of-each inflation indexes to be useful in estimating LIFO reserve changes or in comparing their results with ours. The detailed analyses for each make and model appear on pages 54 to 61.

Two Pools or Single Pool for New Vehicles? We've included information on page 49 for those dealerships that have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method permitted by Revenue Procedure 2009-23.

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

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

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

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

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

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

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

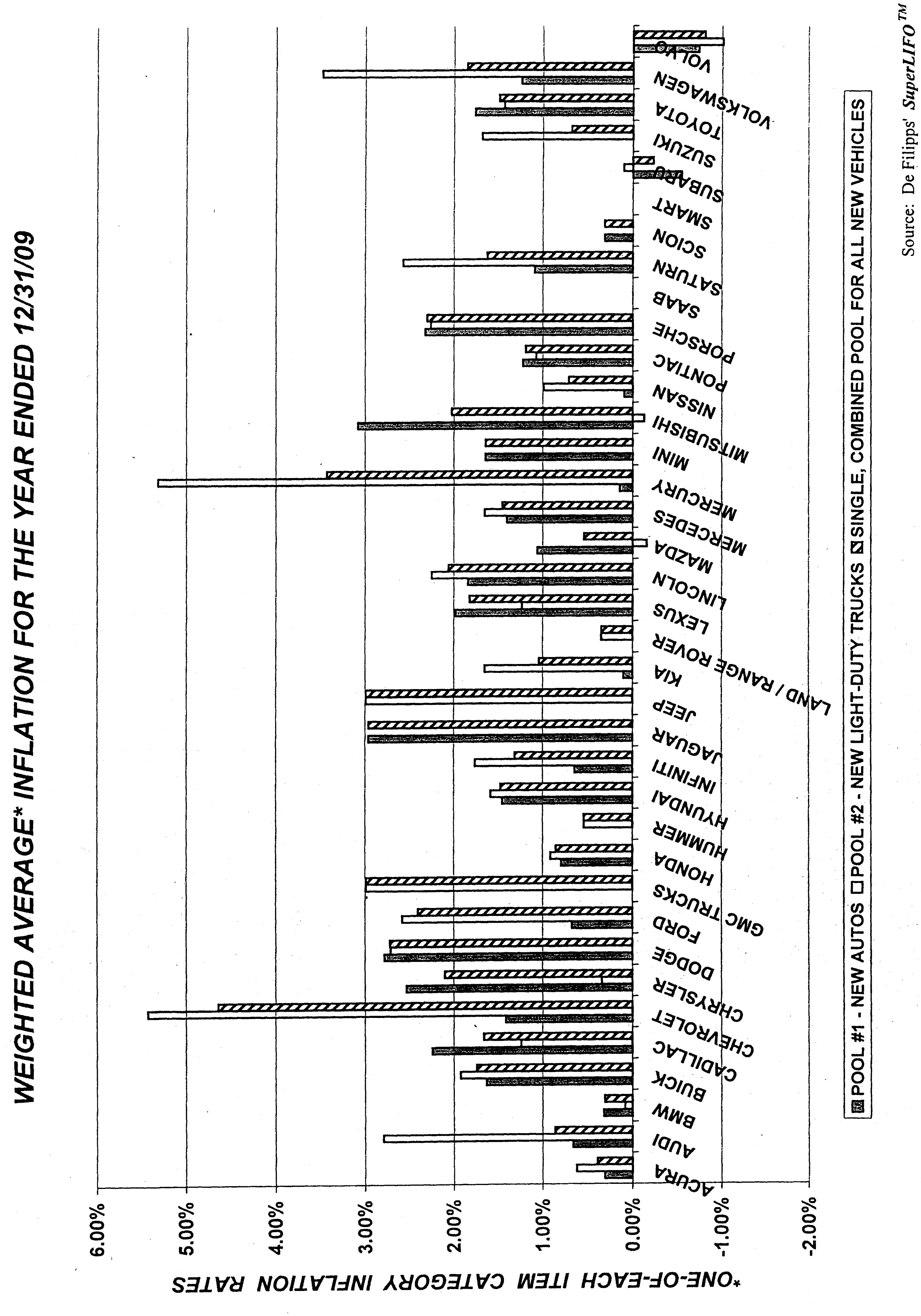
3. Schedule formats and correspondence that we use to summarize LIFO projection information for our clients.

MODEL / ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
DEALER COST FOR THE YEAR ENDED 12/31/09

INFLATION ESTIMATE REPORT BY MAKE
BASED ON INFORMATION AVAILABLE

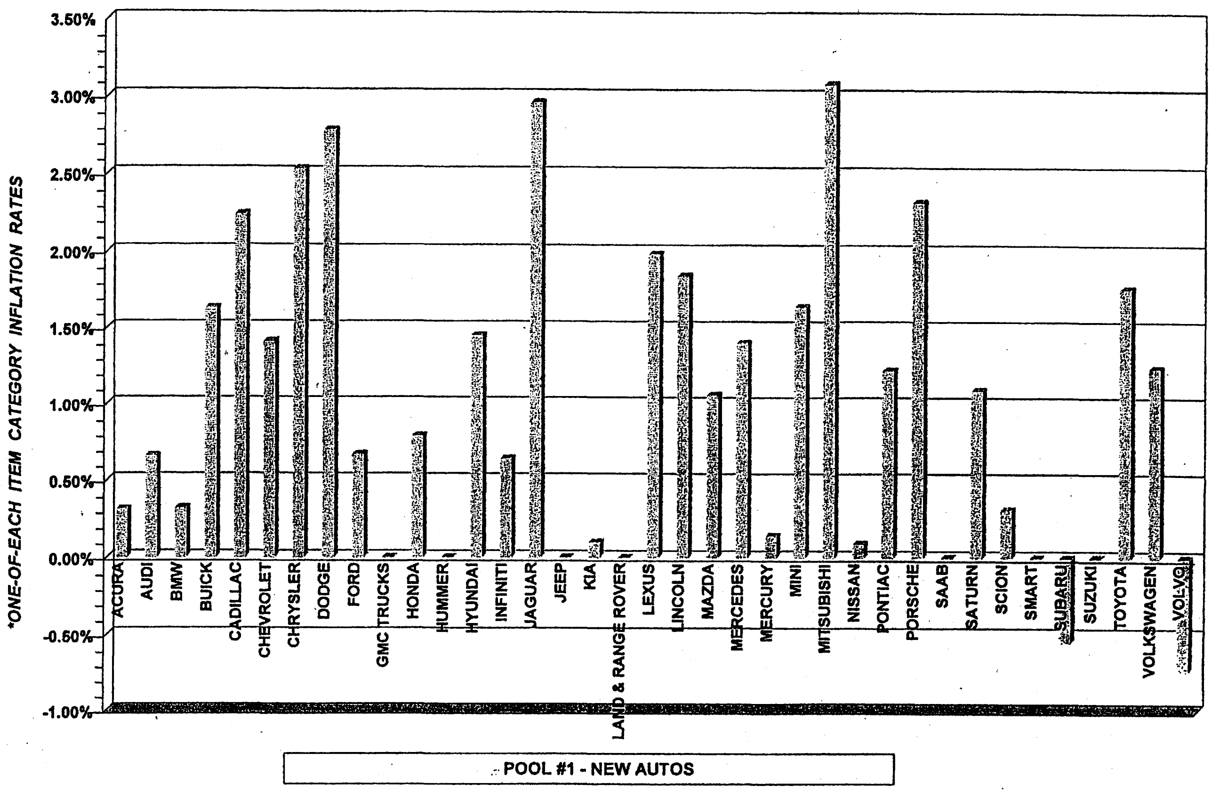
	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS	ALL NEW VEHICLES COMBINED
ACURA	0.31%	0.62%	0.39%
AUDI	0.66%	2.79%	0.86%
BMW	0.32%	0.08%	0.31%
BUICK	1.63%	1.92%	1.74%
CADILLAC	2.24%	1.24%	1.66%
CHEVROLET	1.41%	5.42%	4.64%
CHRYSLER	2.53%	0.34%	2.10%
DODGE	2.78%	2.71%	2.72%
FORD	0.67%	2.58%	2.40%
GMC TRUCKS	0.00%	2.99%	2.99%
HONDA	0.79%	0.91%	0.85%
HUMMER	0.00%	0.54%	0.54%
HYUNDAI	1.45%	1.58%	1.47%
INFINITI	0.64%	1.76%	1.31%
JAGUAR	2.96%	0.00%	2.96%
JEEP	0.00%	2.99%	2.99%
KIA	0.10%	1.65%	1.04%
LAND ROVER/RANGE ROVER	0.00%	0.35%	0.35%
LEXUS	1.98%	1.23%	1.82%
LINCOLN	1.84%	2.25%	2.06%
MAZDA	1.06%	(0.16)%	0.54%
MERCEDES	1.40%	1.65%	1.45%
MERCURY	0.14%	5.31%	3.43%
MINI	1.64%	0.00%	1.64%
MITSUBISHI	3.08%	(0.13)%	2.02%
NISSAN	0.09%	0.99%	0.71%
PONTIAC	1.22%	1.07%	1.19%
PORSCHE	2.32%	2.26%	2.30%
SAAB	0.00%	0.00%	0.00%
SATURN	1.09%	2.57%	1.62%
SCION	0.31%	0.00%	0.31%
SMART	0.00%	0.00%	0.00%
SUBARU	(0.55)%	0.10%	(0.23)%
SUZUKI	0.00%	1.68%	0.68%
TOYOTA	1.76%	1.43%	1.49%
VOLKSWAGEN	1.24%	3.48%	1.85%
VOLVO	(0.74)%	(1.01)%	(0.81)%

Source: De Filipps' ***SuperLIFO™***

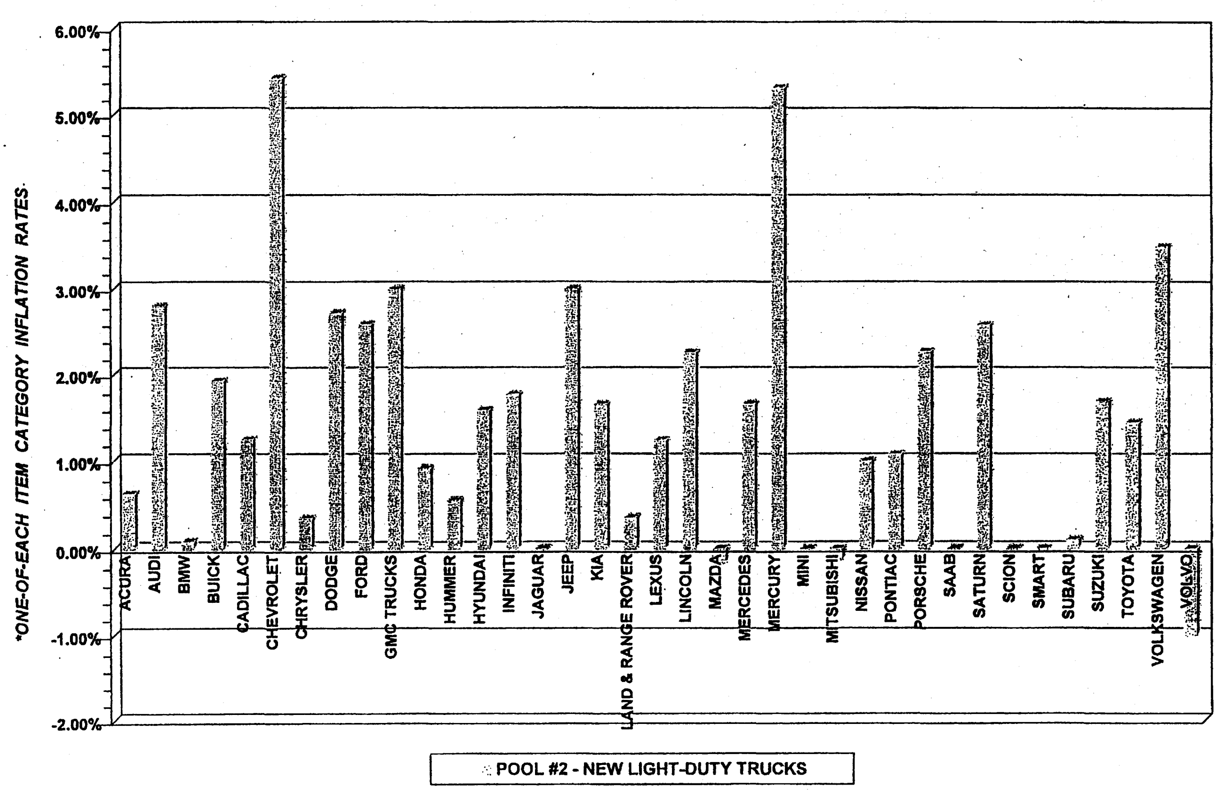


WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/09
*ONE-OF-EACH ITEM CATEGORY INFLATION RATES
6.00%
5.00%
4.00%
3.00%
2.00%
1.00%
0.00%
-1.00%
-2.00%
ACURA
AUDI
BMW
BUICK
CADILLAC
CHEVROLET
CHRYSLER
DODGE
FORD
GMC TRUCKS
HONDA
HUMMER
HYUNDAI
INFINITI
JAGUAR
JEEP
KIA
LAND / RANGE ROVER
LEXUS
LINCOLN
MAZDA
MERCEDES
MERCURY
MINI
MITSUBISHI
NISSAN
PONTIAC
PORSCHE
SAAB
SATURN
SCION
SMART
SUBARU
SUZUKI
TOYOTA
VOLKSWAGEN
VOLVO
POOL #1 - NEW AUTOS
POOL #2 - NEW LIGHT-DUTY TRUCKS
SINGLE, COMBINED POOL FOR ALL NEW VEHICLES
Source: De Filipps' SuperLIFO™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/09

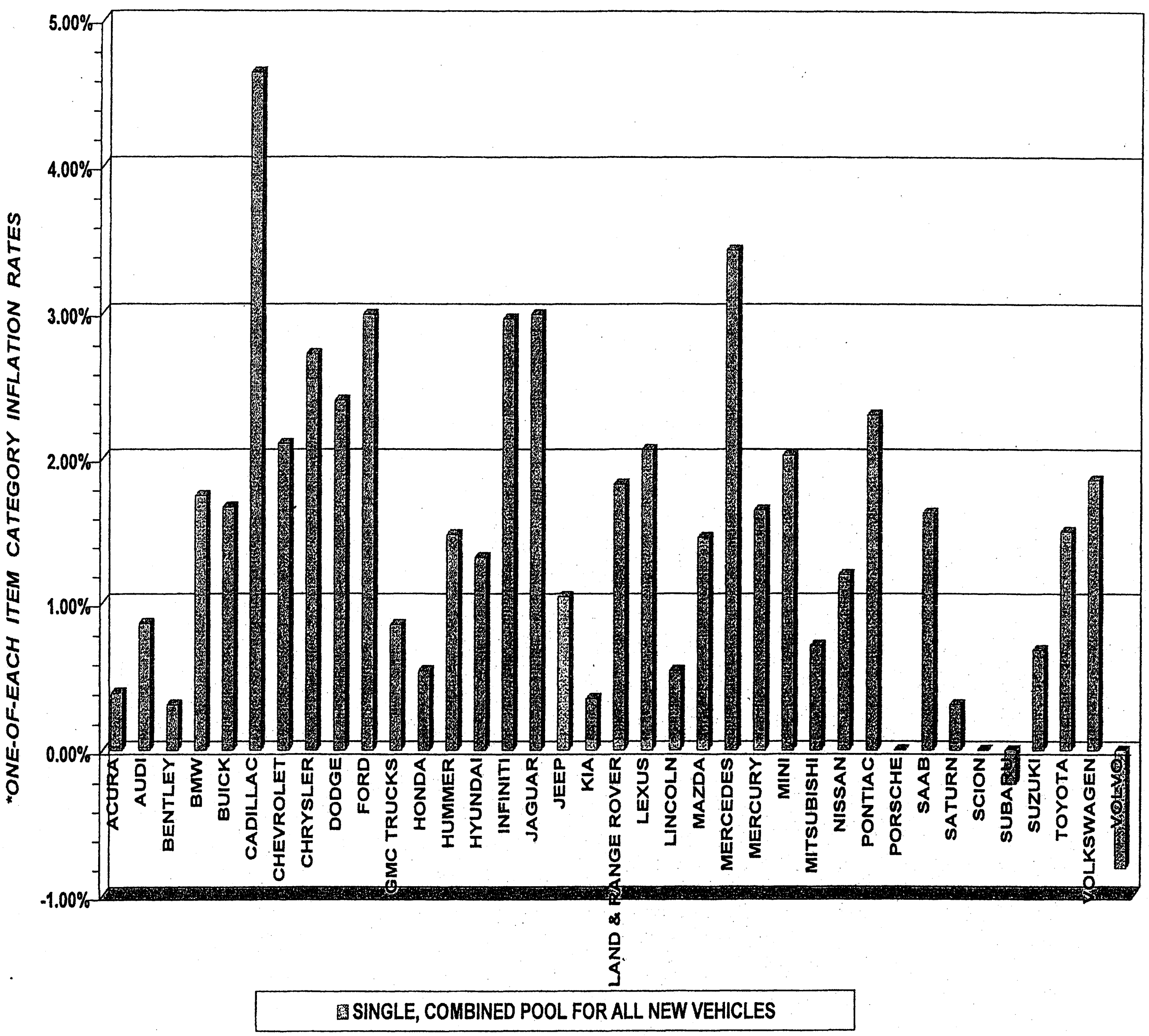


WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/09



Source: De Filipps' *SuperLIFO*™

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/09



Source: De Filipps' *SuperLIFO*™

PROJECTED CHANGE IN LIFO RESERVE(S) FOR 2009

Sample Letter

November ___, 2009

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

Dear __________________:

This will summarize our discussion regarding the projected changes in your new vehicle LIFO reserves at year-end. These projections are based on certain assumptions and estimates. However, the principles underlying this analysis will not change given the estimated year-end inventory levels.

Currently, the dealership maintains separate pools for new autos and for new light-duty trucks. For purposes of our discussion, I used the anticipated inventory levels of roughly $1,600,000 for new automobiles and $1,700,000 for new light-duty trucks. As an estimate of inflation for the year, I used 2%. To the extent that the vehicles in ending inventory will reflect some inflation at year-end, that will work to increase the LIFO reserve for each pool.

Pool #1. In the LIFO pool for new automobiles, the year-end anticipated inventory level ($1,600,000) will be greater than last year's inventory level. Accordingly, this pool will experience an increment for LIFO purposes, but this increment will not increase the amount of the LIFO reserve for 2009. The only increase in the LIFO reserve for this pool at year-end will be due to the inflation factor that is experienced by the mix of vehicles in the ending inventory.

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

Opportunity to use a single LIFO pool for all new vehicles. We have previously discussed the opportunity that the dealership has to elect to use a single, combined pool for all new vehicles for its LIFO calculations. This was a change you decided not to make in previous years.

If this change to a single LIFO pool for all new vehicles were made for 2009, a portion of the overall decrement that will be experienced (in what would have been a separate pool) for new light-duty trucks would be offset against the increment that will be experienced (in what would have been a separate pool) for new automobiles.

The amount of net decrement (in the single LIFO pool that would combine new autos and trucks) would be approximately $xxx,xxx less than if the separate LIFO pool for new light-duty trucks were maintained. This translates into the following conclusion. ***By electing to combine the new vehicle LIFO pools for 2009, the dealership would (1) limit the overall amount of LIFO recapture in that single pool to roughly $yy,yyy and thereby (2) avoid a payback of the LIFO reserve of approximately $zzz,zzz.***

This change in pooling is relatively easy to make and it does not require advance approval from the IRS. It can be made as part of filing the income tax return for the dealership after year-end.

In summary. The anticipated decrease in the year-end inventory levels is significant. This will result in the recapture of some of the LIFO reserves regardless of whether or not the LIFO pools are combined for 2009.

However, a significant portion of this recapture ($zzz,zzz out of $xxx,xxx) can be avoided if the pools are combined.

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

On the other hand, if you want to preserve or retain the highest LIFO reserve possible, then the strategy to accomplish this goal would be to combine the two new vehicle LIFO pools for 2009.

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

PAGE: 1

DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
RL	3	0	3	135,704		136,108	404	0.30%
TL	2	0	2	67,527		67,802	275	0.41%
TSX	1	1	2	26,822	32,039	58,998	137	0.23%
TOTAL NEW AUTOS	6	1	7	230,053	32,039	262,908	816	0.31%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	0	0	0				0	N/A%
RDX	1	2	3	31,164	61,942	93,679	573	0.62%
TOTAL NEW L-D TRUCKS	1	2	3	31,164	61,942	93,679	573	0.62%
TOTAL ACURA	7	3	10	261,217	93,981	356,587	1,389	0.39%
AUDI								
NEW AUTOS - POOL #1								
A3	5	0	5	131,262		132,890	1,628	1.24%
A4	4	0	4	120,668		123,410	2,742	2.27%
A5	1	4	5	39,060	148,150	189,070	1,860	0.99%
A6	3	1	4	152,854	42,036	194,983	93	0.05%
A8	2	0	2	141,316		142,243	927	0.66%
R8	2	2	4	220,875	280,023	500,898	0	0.00%
S4	0	2	2		86,676	86,676	0	0.00%
S5	2	1	3	96,349	54,174	152,754	2,231	1.48%
S6	1	0	1	70,588		70,774	186	0.26%
S8	0	0	0				0	N/A%
TT	2	0	2	71,241		73,098	1,857	2.61%
TTS	0	2	2		88,164	88,164	0	0.00%
TOTAL NEW AUTOS	22	12	34	1,044,213	699,223	1,754,960	11,524	0.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q5	1	0	1	34,596		34,735	139	0.40%
Q7	3	0	3	142,868		147,684	4,816	3.37%
TOTAL NEW L-D TRUCKS	4	0	4	177,464		182,419	4,955	2.79%
TOTAL AUDI	26	12	38	1,221,677	699,223	1,937,379	16,479	0.86%

PAGE: 2

DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
BMW								
NEW AUTOS - POOL #1								
1 SERIES	5	0	5	158,515		159,160	645	0.41%
3 SERIES	17	0	17	610,050		610,235	185	0.03%
5 SERIES	6	0	6	287,410		289,430	2,020	0.70%
6 SERIES	2	0	2	149,500		150,420	920	0.62%
7 SERIES	0	5	5		434,440	434,440	0	0.00%
M3	3	0	3	163,900		164,860	960	0.59%
M5	1	0	1	78,290		78,660	370	0.47%
M6	2	0	2	192,465		193,200	735	0.38%
X6	2	0	2	111,965		113,480	1,515	1.35%
Z4	0	2	2		89,610	89,610	0	0.00%
TOTAL NEW AUTOS	38	7	45	1,752,095	524,050	2,283,495	7,350	0.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	1	0	1	36,250		35,650	(600)	(1.66)%
X5	3	0	3	141,770		142,510	740	0.52%
TOTAL NEW L-D TRUCKS	4	0	4	178,020		178,160	140	0.08%
TOTAL BMW	42	7	49	1,930,115	524,050	2,461,655	7,490	0.31%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	0	4	4		116,702	116,702	0	0.00%
LUCERNE	8	0	8	255,003		261,060	6,057	2.38%
TOTAL NEW AUTOS	8	4	12	255,003	116,702	377,762	6,057	1.63%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENCLAVE	4	2	6	139,220	81,120	224,562	4,222	1.92%
TOTAL NEW L-D TRUCKS	4	2	6	139,220	81,120	224,562	4,222	1.92%
TOTAL BUICK	12	6	18	394,223	197,822	602,324	10,279	1.74%
CADILLAC								
NEW AUTOS - POOL #1								
CTS	4	17	21	160,629	725,812	901,735	15,294	1.73%
DTS	3	1	4	131,058	56,204	200,062	12,800	6.84%
STS	2	3	5	95,669	165,484	262,999	1,846	0.71%
TOTAL NEW AUTOS	9	21	30	387,356	947,500	1,364,796	29,940	2.24%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	11	12	23	732,379	830,953	1,586,125	22,793	1.46%
SRX	0	7	7		271,617	271,617	0	0.00%
TOTAL NEW L-D TRUCKS	11	19	30	732,379	1,102,570	1,857,742	22,793	1.24%
TOTAL CADILLAC	20	40	60	1,119,735	2,050,070	3,222,538	52,733	1.66%

DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	6	0	6	78,304		79,544	1,240	1.58%
CAMARO	5	2	7	128,880	58,195	189,516	2,441	1.30%
COBALT	11	0	11	172,333		175,750	3,417	1.98%
CORVETTE	4	7	11	252,913	422,113	682,929	7,903	1.17%
IMPALA	4	0	4	98,068		100,114	2,046	2.09%
MALIBU	6	0	6	135,073		136,943	1,870	1.38%
TOTAL NEW AUTOS	36	9	45	865,571	480,308	1,364,796	18,917	1.41%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	6	0	6	215,684		232,397	16,713	7.75%
COLORADO	10	6	16	198,496	154,023	358,696	6,177	1.75%
COLORADO CHASSIS CAB	2	0	2	38,986		40,143	1,157	2.97%
EQUINOX	0	8	8		195,302	195,302	0	0.00%
EXPRESS CARGO VAN	10	0	10	262,847		270,914	8,067	3.07%
EXPRESS CUTAWAY VAN	3	0	3	72,918		74,777	1,859	2.55%
EXPRESS PASSENGER VAN	5	0	5	142,471		146,108	3,637	2.55%
HHR	5	0	5	98,576		99,605	1,029	1.04%
SILVERADO 1500	31	0	31	831,676		896,374	64,698	7.78%
SILVERADO 2500HD	28	0	28	867,547		924,116	56,569	6.52%
SILVERADO 3500	30	0	30	943,422		1,004,820	61,398	6.51%
SILVERADO 3500HD CHASSIS CAB	8	0	8	218,485		235,814	17,329	7.93%
SUBURBAN	14	0	14	557,714		592,080	34,366	6.16%
TAHOE	10	0	10	400,270		422,828	22,558	5.64%
TRAVERSE	8	4	12	253,675	135,656	396,488	7,157	1.84%
TOTAL NEW L-D TRUCKS	170	18	188	5,102,767	484,981	5,890,462	302,714	5.42%
TOTAL CHEVROLET	206	27	233	5,968,338	965,289	7,255,258	321,631	4.64%
CHRYSLER								
NEW AUTOS - POOL #1								
300	24	0	24	780,275		799,035	18,760	2.40%
SEBRING	13	0	13	338,701		348,306	9,605	2.84%
TOTAL NEW AUTOS	37	0	37	1,118,976		1,147,341	28,365	2.53%
NEW LIGHT-DUTY TRUCKS - POOL #2								
PT CRUISER	1	0	1	19,182		17,818	(1,364)	(7.11)%
TOWN & COUNTRY	9	0	9	255,531		257,840	2,309	0.90%
TOTAL NEW L-D TRUCKS	10	0	10	274,713		275,658	945	0.34%
TOTAL CHRYSLER	47	0	47	1,393,689		1,422,999	29,310	2.10%

DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
DODGE								
NEW AUTOS - POOL #1								
AVENGER	1	1	2	19,880	20,889	40,413	(356)	(0.87)%
CALIBER	16	0	16	295,480		302,417	6,937	2.35%
CHALLENGER	12	0	12	343,551		353,336	9,785	2.85%
CHARGER	28	0	28	798,241		812,200	13,959	1.75%
VIPER	6	0	6	473,088		497,038	23,950	5.06%
TOTAL NEW AUTOS	63	1	64	1,930,240	20,889	2,005,404	54,275	2.78%
NEW LIGHT-DUTY TRUCKS - POOL #2								
DAKOTA	56	0	56	1,400,096		1,457,446	57,350	4.10%
DURANGO	0	0	0				0	N/A%
GRAND CARAVAN	12	0	12	278,253		280,349	2,096	0.75%
JOURNEY	20	0	20	473,461		481,804	8,343	1.76%
NITRO	8	2	10	172,659	46,769	222,794	3,366	1.53%
RAM CHASSIS CAB	0	0	0				0	N/A%
RAM PICKUP	181	11	192	5,976,619	315,063	6,454,932	163,250	2.59%
SPRINTER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	277	13	290	8,301,088	361,832		234,405	2.71%
TOTAL DODGE	340	14	354	10,231,328	382,721	10,902,729	288,680	2.72%
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	4	0	4	105,705		106,541	836	0.79%
FOCUS	6	0	6	93,343		98,024	4,681	5.01%
FUSION	0	7	7		160,375	160,375	0	0.00%
MUSTANG	0	10	10		297,828	297,828	0	0.00%
TAURUS	0	6	6		167,988	167,988	0	0.00%
TOTAL NEW AUTOS	10	23	33	199,048	626,191	830,756	5,517	0.67%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY	11	1	12	255,069	24,106	283,293	4,118	1.48%
E-SERIES	11	0	11	278,971		289,550	10,579	3.79%
EDGE	8	0	8	234,754		237,148	2,394	1.02%
ESCAPE	10	0	10	251,336		252,741	1,405	0.56%
EXPEDITION	10	0	10	363,679		379,705	16,026	4.41%
EXPEDITION EL	10	0	10	387,770		404,557	16,787	4.33%
EXPLORER	8	0	8	236,532		252,550	16,018	6.77%
EXPLORER SPORT TRAC	5	0	5	138,212		149,833	11,621	8.41%
F150 PICKUP	45	6	51	1,320,570	202,234	1,539,104	16,300	1.07%
F250 SUPER DUTY PICKUP	34	2	36	1,076,798	78,540	1,183,325	27,987	2.42%
F350 SUPER DUTY CHASSIS CAB	35	1	36	1,054,761	27,614	1,109,453	27,078	2.50%
F350 SUPER DUTY PICKUP	50	4	54	1,616,006	158,117	1,821,704	47,581	2.68%
FLEX	5	2	7	154,968	72,567	230,375	2,840	1.25%
RANGER	11	0	11	206,023		219,092	13,069	6.34%
TAURUS X	0	0	0				0	N/A%
TRANSIT CONNECT	0	8	8		160,366	160,366	0	0.00%
TOTAL NEW L-D TRUCKS	253	24	277	7,575,449	723,544	8,512,796	213,803	2.58%
TOTAL FORD	263	47	310	7,774,497	1,349,735	9,343,552	219,320	2.40%

PAGE: 5 DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACADIA	8	0	8	277,190		280,154	2,964	1.07%
CANYON	12	0	12	239,780		242,341	2,561	1.07%
CANYON CHASSIS CAB	2	0	2	38,986		39,399	413	1.06%
ENVOY	0	0	0				0	N/A%
ENVOY DENALI	0	0	0				0	N/A%
SAVANA CARGO VAN	10	0	10	262,847		265,721	2,874	1.09%
SAVANA CUTAWAY VAN	3	0	3	72,912		73,709	797	1.09%
SAVANA PASSENGER VAN	5	0	5	142,471		144,027	1,556	1.09%
SIERRA 1500 SERIES PICKUP	41	0	41	1,174,051		1,217,337	43,286	3.69%
SIERRA 2500HD SERIES PICKUP	28	0	28	878,516		917,903	39,387	4.48%
SIERRA 3500 SERIES PICKUP	30	0	30	954,772		987,120	32,348	3.39%
SIERRA 3500HD CHASSIS CAB	12	0	12	341,480		357,974	16,494	4.83%
SIERRA DENALI	2	0	2	76,210		78,524	2,314	3.04%
YUKON	37	0	37	1,529,813		1,563,717	33,904	2.22%
TOTAL NEW L-D TRUCKS	190	0	190	5,989,028		6,167,926	178,898	2.99%
TOTAL GMC TRUCKS	190	0	190	5,989,028		6,167,926	178,898	2.99%
HONDA								
NEW AUTOS - POOL #1								
ACCORD	25	0	25	591,116		597,033	5,917	1.00%
CIVIC	38	2	40	732,960	35,243	773,430	5,227	0.68%
FIT	6	0	6	97,164		98,028	864	0.89%
INSIGHT	0	3	3		60,576	60,576	0	0.00%
TOTAL NEW AUTOS	69	5	74	1,421,240	95,819	1,529,067	12,008	0.79%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACCORD CROSSTOUR	0	5	5		151,508	151,508	0	0.00%
CR-V	8	0	8	187,805		191,422	3,617	1.93%
ELEMENT	10	0	10	216,821		219,325	2,504	1.15%
ODYSSEY	6	1	7	182,244	28,544	212,505	1,717	0.81%
PILOT	11	1	12	344,879	30,658	377,570	2,033	0.54%
RIDGELINE	4	0	4	117,244		118,870	1,626	1.39%
TOTAL NEW L-D TRUCKS	39	7	46	1,048,993	210,710	1,271,200	11,497	0.91%
TOTAL HONDA	108	12	120	2,470,233	306,529	2,800,267	23,505	0.85%

PAGE: 6 DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
HUMMER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
H2	4	0	4	230,140		231,384	1,244	0.54%
H3	3	0	3	109,358		109,950	592	0.54%
H3T	2	0	2	61,758		62,092	334	0.54%
TOTAL NEW L-D TRUCKS	9	0	9	401,256		403,426	2,170	0.54%
TOTAL HUMMER	9	0	9	401,256		403,426	2,170	0.54%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	6	0	6	78,780		84,078	5,298	6.73%
AZERA	2	0	2	50,628		51,177	549	1.08%
ELANTRA	2	5	7	31,780	83,112	116,610	1,718	1.50%
GENESIS	2	11	13	64,764	273,903	341,433	2,766	0.82%
SONATA	6	0	6	128,350		128,350	0	0.00%
TOTAL NEW AUTOS	18	16	34	354,302	357,015	721,648	10,331	1.45%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SANTA FE	0	0	0				0	N/A%
TUCSON	0	0	0				0	N/A%
VERACRUZ	4	0	4	118,308		120,182	1,874	1.58%
TOTAL NEW L-D TRUCKS	4	0	4	118,308		120,182	1,874	1.58%
TOTAL HYUNDAI	22	16	38	472,610	357,015	841,830	12,205	1.47%
INFINITI								
NEW AUTOS - POOL #1								
G37	1	1	2	30,272	40,490	71,217	455	0.64%
M35	0	0	0				0	N/A%
M45	0	0	0				0	N/A%
TOTAL NEW AUTOS	1	1	2	30,272	40,490		455	0.64%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FX35	0	0	0				0	N/A%
FX50	0	0	0				0	N/A%
QX56	2	0	2	104,468		106,311	1,843	1.76%
TOTAL NEW L-D TRUCKS	2	0	2	104,468		106,311	1,843	1.76%
TOTAL INFINITI	3	1	4	134,740	40,490	177,528	2,298	1.31%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
JAGUAR								
NEW AUTOS - POOL #1								
XF	3	1	4	151,606	72,027	230,778	7,145	3.19%
XJ	0	6	6		502,232	502,232	0	0.00%
XK	4	0	4	311,038		334,608	23,570	7.58%
TOTAL NEW AUTOS	7	7	14	462,644	574,259	1,067,618	30,715	2.96%
TOTAL JAGUAR	7	7	14	462,644	574,259	1,067,618	30,715	2.96%
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMMANDER	14	0	14	465,942		484,609	18,667	4.01%
COMPASS	12	0	12	240,389		248,680	8,291	3.45%
GRAND CHEROKEE	15	0	15	507,377		512,917	5,540	1.09%
LIBERTY	12	0	12	283,402		294,824	11,422	4.03%
PATRIOT	12	0	12	231,698		240,170	8,472	3.66%
WRANGLER	27	0	27	660,976		679,931	18,955	2.87%
TOTAL NEW L-D TRUCKS	92	0	92	2,389,784		2,461,131	71,347	2.99%
TOTAL JEEP	92	0	92	2,389,784		2,461,131	71,347	2.99%
KIA								
NEW AUTOS - POOL #1								
AMANTI	1	0	1	23,585		23,760	175	0.74%
FORTE	0	10	10		159,830	159,830	0	0.00%
OPTIMA	0	0	0				0	N/A%
RIO	0	0	0				0	N/A%
TOTAL NEW AUTOS	1	10	11	23,585	159,830		175	0.10%
NEW LIGHT-DUTY TRUCKS - POOL #2								
BORREGO	0	0	0				0	N/A%
RONDO	0	0	0				0	N/A%
SEDONA	3	0	3	66,780		69,025	2,245	3.36%
SORENTO	5	0	5	111,820		114,290	2,470	2.21%
SOUL	0	7	7		106,965	106,965	0	0.00%
SPORTAGE	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	8	7	15	178,600	106,965		4,715	1.65%
TOTAL KIA	9	17	26	202,185	266,795	473,870	4,890	1.04%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER LR2	1	0	1	32,191		32,305	114	0.35%
LAND ROVER LR3	0	0	0				0	N/A%
RANGE ROVER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	1	0	1	32,191			114	0.35%
TOTAL LAND ROVER/RANGE ROVER	1	0	1	32,191		32,305	114	0.35%
LEXUS								
NEW AUTOS - POOL #1								
ES 350	1	0	1	30,431		31,553	1,122	3.69%
GS 350	2	0	2	80,651		82,754	2,103	2.61%
GS 450H	1	0	1	49,632		50,894	1,262	2.54%
GS 460	1	0	1	46,388		47,587	1,199	2.58%
HS 250H	0	2	2		64,764	64,764	0	0.00%
IS 250	3	2	5	86,468	70,331	160,629	3,830	2.44%
IS 350	1	1	2	32,212	39,545	73,108	1,351	1.88%
IS F	1	0	1	49,816		51,982	2,166	4.35%
LS 460	4	0	4	244,960		246,401	1,441	0.59%
LS 600H	1	0	1	92,118		94,370	2,252	2.44%
SC 430	1	0	1	58,120		60,079	1,959	3.37%
TOTAL NEW AUTOS	16	5	21	770,796	174,640	964,121	18,685	1.98%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 470	1	0	1	41,424		42,376	952	2.30%
LX 570	1	0	1	65,863		68,000	2,137	3.24%
RX 350	0	2	2		66,750	66,750	0	0.00%
RX 450H	0	2	2		77,266	77,266	0	0.00%
TOTAL NEW L-D TRUCKS	2	4	6	107,287	144,016	254,392	3,089	1.23%
TOTAL LEXUS	18	9	27	878,083	318,656	1,218,513	21,774	1.82%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LINCOLN								
NEW AUTOS - POOL #1								
MKS	2	1	3	73,073	43,894	120,981	4,014	3.43%
MKZ	0	2	2		64,547	64,547	0	0.00%
TOWN CAR	4	0	4	173,972		176,512	2,540	1.46%
TOTAL NEW AUTOS	6	3	9	247,045	108,441	362,040	6,554	1.84%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MKT	0	3	3		128,531	128,531	0	0.00%
MKX	2	0	2	69,652		72,337	2,685	3.85%
NAVIGATOR	4	0	4	203,264		209,616	6,352	3.13%
TOTAL NEW L-D TRUCKS	6	3	9	272,916	128,531	410,484	9,037	2.25%
TOTAL LINCOLN	12	6	18	519,961	236,972	772,524	15,591	2.06%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA3	0	14	14		258,249	258,249	0	0.00%
MAZDA6	7	2	9	147,801	46,383	190,213	(3,971)	(2.04)%
MIATA MX-5	10	0	10	234,646		245,388	10,742	4.58%
RX-8	5	0	5	136,485		138,426	1,941	1.42%
TOTAL NEW AUTOS	22	16	38	518,932	304,632	832,276	8,712	1.06%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-7	0	6	6		151,628	151,628	0	0.00%
CX-9	6	0	6	180,324		173,862	(6,462)	(3.58)%
MAZDA5	4	0	4	75,585		76,508	923	1.22%
TRIBUTE	9	0	9	203,319		207,870	4,551	2.24%
TRUCK	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	19	6	25	459,228	151,628		(988)	(0.16)%
TOTAL MAZDA	41	22	63	978,160	456,260	1,442,144	7,724	0.54%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	4	0	4	153,162		156,055	2,893	1.89%
CL CLASS	4	0	4	563,736		573,968	10,232	1.82%
CLK CLASS	0	0	0				0	N/A%
CLS CLASS	2	0	2	155,310		158,426	3,116	2.01%
E CLASS	0	7	7		375,022	375,022	0	0.00%
S CLASS	5	1	6	613,290	81,794	705,453	10,369	1.49%
SL CLASS	0	0	0				0	N/A%
SLK CLASS	3	0	3	151,219		153,868	2,649	1.75%
SLR MC CLAREN	0	0	0				0	N/A%
TOTAL NEW AUTOS	18	8	26	1,636,717	456,816		29,259	1.40%
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	0	0	0				0	N/A%
GL CLASS	3	0	3	184,791		189,488	4,697	2.54%
GLK CLASS	0	2	2		66,216	66,216	0	0.00%
ML CLASS	4	1	5	220,968	46,221	271,002	3,813	1.43%
R CLASS	1	1	2	44,315	47,244	93,093	1,534	1.68%
TOTAL NEW L-D TRUCKS	8	4	12	450,074	159,681	619,799	10,044	1.65%
TOTAL MERCEDES	26	12	38	2,086,791	616,497	2,742,591	39,303	1.45%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	1	1	2	27,413	27,365	54,992	214	0.39%
MILAN	0	4	4		93,938	93,938	0	0.00%
SABLE	0	0	0				0	N/A%
TOTAL NEW AUTOS	1	5	6	27,413	121,303		214	0.14%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	6	0	6	148,656		150,294	1,638	1.10%
MOUNTAINEER	4	0	4	110,556		122,684	12,128	10.97%
TOTAL NEW L-D TRUCKS	10	0	10	259,212		272,978	13,766	5.31%
TOTAL MERCURY	11	5	16	286,625	121,303	421,908	13,980	3.43%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MINI								
NEW AUTOS - POOL #1								
COOPER	9	0	9	205,875		209,250	3,375	1.64%
TOTAL NEW AUTOS	9	0	9	205,875		209,250	3,375	1.64%
TOTAL MINI	9	0	9	205,875		209,250	3,375	1.64%
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	6	1	7	139,904	23,357	174,687	11,426	7.00%
GALANT	1	1	2	20,049	22,643	43,022	330	0.77%
LANCER	7	6	13	121,689	170,841	296,149	3,619	1.24%
TOTAL NEW AUTOS	14	8	22	281,642	216,841	513,858	15,375	3.08%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	0	3	3		84,351	84,351	0	0.00%
OUTLANDER	6	1	7	133,615	27,575	160,880	(310)	(0.19)%
RAIDER	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	6	4	10	133,615	111,926		(310)	(0.13)%
TOTAL MITSUBISHI	20	12	32	415,257	328,767	759,089	15,065	2.02%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NISSAN								
NEW AUTOS - POOL #1								
350Z	0	0	0				0	N/A%
370Z	0	8	8		268,277	268,277	0	0.00%
ALTIMA	0	8	8		182,616	182,616	0	0.00%
GT-R	0	2	2		154,182	154,182	0	0.00%
MAXIMA	2	0	2	57,725		58,292	567	0.98%
SENTRA	0	7	7		117,032	117,032	0	0.00%
VERSA	9	0	9	115,991		116,260	269	0.23%
TOTAL NEW AUTOS	11	25	36	173,716	722,107	896,659	836	0.09%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	2	4	6	70,305	171,720	244,571	2,546	1.05%
CUBE	0	5	5		77,557	77,557	0	0.00%
FRONTIER PICKUP	27	0	27	618,852		621,316	2,464	0.40%
MURANO	4	1	5	107,810	33,689	142,862	1,363	0.96%
PATHFINDER	6	1	7	192,283	25,714	221,311	3,314	1.52%
QUEST	0	0	0				0	N/A%
ROGUE	4	0	4	81,481		81,935	454	0.56%
TITAN	14	0	14	403,456		407,576	4,120	1.02%
XTERRA	10	0	10	246,158		251,884	5,726	2.33%
TOTAL NEW L-D TRUCKS	67	11	78	1,720,345	308,680	2,049,012	19,987	0.99%
TOTAL NISSAN	78	36	114	1,894,061	1,030,787	2,945,671	20,823	0.71%
PONTIAC								
NEW AUTOS - POOL #1								
G3	1	0	1	13,547		13,633	86	0.63%
G5	2	0	2	35,211		35,583	372	1.06%
G6	1	0	1	20,001		20,211	210	1.05%
G8	5	0	5	148,704		150,279	1,575	1.06%
SOLSTICE	5	0	5	132,082		133,481	1,399	1.06%
VIBE	4	0	4	69,879		71,335	1,456	2.08%
TOTAL NEW AUTOS	18	0	18	419,424		424,522	5,098	1.22%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TORRENT	4	0	4	105,160		106,284	1,124	1.07%
TOTAL NEW L-D TRUCKS	4	0	4	105,160		106,284	1,124	1.07%
TOTAL PONTIAC	22	0	22	524,584		530,806	6,222	1.19%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
PORSCHE								
NEW AUTOS - POOL #1								
911	10	1	11	811,440	100,800	936,720	24,480	2.68%
BOXSTER	2	0	2	90,990		94,680	3,690	4.06%
CAYMAN	2	0	2	97,290		101,250	3,960	4.07%
PANAMERA	0	3	3		284,040	284,040	0	0.00%
TOTAL NEW AUTOS	14	4	18	999,720	384,840	1,416,690	32,130	2.32%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	7	2	9	461,638	144,270	619,630	13,722	2.26%
TOTAL NEW L-D TRUCKS	7	2	9	461,638	144,270	619,630	13,722	2.26%
TOTAL PORSCHE	21	6	27	1,461,358	529,110	2,036,320	45,852	2.30%
SAAB								
NEW AUTOS - POOL #1								
9-3	0	0	0				0	N/A%
9-5	0	0	0				0	N/A%
TOTAL NEW AUTOS	0	0	0				0	N/A%
NEW LIGHT-DUTY TRUCKS - POOL #2								
9-7X	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	0	0	0				0	N/A%
TOTAL SAAB	0	0	0				0	0.00%
SATURN								
NEW AUTOS - POOL #1								
AURA	3	0	3	72,438		73,342	904	1.25%
SKY	2	2	4	53,239	60,172	114,526	1,115	0.98%
TOTAL NEW AUTOS	5	2	7	125,677	60,172	187,868	2,019	1.09%
NEW LIGHT-DUTY TRUCKS - POOL #2								
OUTLOOK	2	0	2	59,194		60,720	1,526	2.58%
VUE	2	0	2	45,605		46,773	1,168	2.56%
TOTAL NEW L-D TRUCKS	4	0	4	104,799		107,493	2,694	2.57%
TOTAL SATURN	9	2	11	230,476	60,172	295,361	4,713	1.62%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SCION								
NEW AUTOS - POOL #1								
TC	2	0	2	33,060		33,060	0	0.00%
XB	2	0	2	30,827		30,827	0	0.00%
XD	2	0	2	28,594		28,880	286	1.00%
TOTAL NEW AUTOS	6	0	6	92,481		92,767	286	0.31%
TOTAL SCION	6	0	6	92,481		92,767	286	0.31%
SMART								
NEW AUTOS - POOL #1								
FORTWO	0	0	0				0	N/A%
TOTAL NEW AUTOS	0	0	0				0	N/A%
TOTAL SMART	0	0	0				0	0.00%
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	17	0	17	370,307		366,669	(3,638)	(0.98)%
LEGACY	0	13	13		296,510	296,510	0	0.00%
TOTAL NEW AUTOS	17	13	30	370,307	296,510	663,179	(3,638)	(0.55)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FORESTER	4	6	10	91,320	136,031	227,808	457	0.20%
OUTBACK	3	10	13	66,971	250,423	318,496	1,102	0.35%
TRIBECA	1	2	3	31,458	62,246	92,811	(893)	(0.95)%
TOTAL NEW L-D TRUCKS	8	18	26	189,749	448,700	639,115	666	0.10%
TOTAL SUBARU	25	31	56	560,056	745,210	1,302,294	(2,972)	(0.23)%

PAGE: 15 DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SUZUKI								
NEW AUTOS - POOL #1								
KIZASHI	0	11	11		242,965	242,965	0	0.00%
SX4	0	16	16		264,709	264,709	0	0.00%
TOTAL NEW AUTOS	0	27	27		507,674	507,674	0	0.00%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EQUATOR	0	0	0				0	N/A%
GRAND VITARA	10	2	12	219,964	40,318	265,236	4,954	1.90%
XL7	3	0	3	83,078		83,894	816	0.98%
TOTAL NEW L-D TRUCKS	13	2	15	303,042	40,318	349,130	5,770	1.68%
TOTAL SUZUKI	13	29	42	303,042	547,992	856,804	5,770	0.68%
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	3	0	3	84,124		85,343	1,219	1.45%
CAMRY	11	0	11	228,623		234,956	6,333	2.77%
COROLLA	8	0	8	125,946		127,334	1,388	1.10%
MATRIX	7	0	7	122,213		124,663	2,450	2.00%
PRIUS	0	4	4		91,712	91,712	0	0.00%
YARIS	5	1	6	61,329	12,022	74,716	1,365	1.86%
TOTAL NEW AUTOS	34	5	39	622,235	103,734	738,724	12,755	1.76%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	11	0	11	330,952		334,299	3,347	1.01%
FJ CRUISER	3	0	3	66,183		67,901	1,718	2.60%
HIGHLANDER	8	0	8	233,203		235,818	2,615	1.12%
LAND CRUISER	1	0	1	56,659		58,382	1,723	3.04%
RAV4	12	0	12	272,351		272,319	(32)	(0.01)%
SEQUOIA	0	11	11		477,040	477,040	0	0.00%
SIENNA	9	0	9	238,463		241,128	2,665	1.12%
TACOMA PICKUP	18	0	18	361,286		365,234	3,948	1.09%
TUNDRA	35	4	39	937,862	139,306	1,106,162	28,994	2.69%
VENZA	2	2	4	50,774	48,867	100,752	1,111	1.12%
TOTAL NEW L-D TRUCKS	99	17	116	2,547,733	665,213	3,259,035	46,089	1.43%
TOTAL TOYOTA	133	22	155	3,169,968	768,947	3,997,759	58,844	1.49%

PAGE: 16 DECEMBER 3, 2009

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/09
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/08 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
VOLKSWAGEN								
NEW AUTOS - POOL #1								
CC	5	3	8	153,405	84,079	241,087	3,603	1.52%
EOS	3	3	6	91,271	93,761	187,522	2,490	1.35%
GLI	4	0	4	93,910		94,574	664	0.71%
GOLF	0	10	10		192,974	192,974	0	0.00%
GTI	8	0	8	178,088		180,408	2,320	1.30%
JETTA	16	8	24	314,853	166,437	488,702	7,412	1.54%
NEW BEETLE	5	0	5	102,081		104,723	2,642	2.59%
PASSAT	0	6	6		155,259	155,259	0	0.00%
R32	0	0	0				0	N/A%
RABBIT	6	0	6	99,376		101,584	2,208	2.22%
TOTAL NEW AUTOS	47	30	77	1,032,984	692,510	1,746,833	21,339	1.24%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ROUTAN	10	1	11	309,036	31,231	359,265	18,998	5.58%
TIGUAN	8	1	9	209,632	24,540	235,678	1,506	0.64%
TOUAREG	2	0	2	75,612		77,720	2,108	2.79%
TOTAL NEW L-D TRUCKS	20	2	22	594,280	55,771	672,663	22,612	3.48%
TOTAL VOLKSWAGEN	67	32	99	1,627,264	748,281	2,419,496	43,951	1.85%
VOLVO								
NEW AUTOS - POOL #1								
30 SERIES	2	0	2	46,765		47,376	611	1.31%
40 SERIES	3	0	3	89,018		83,378	(5,640)	(6.34)%
50 SERIES	2	0	2	61,382		58,045	(3,337)	(5.44)%
60 SERIES	0	0	0				0	N/A%
70 SERIES	4	1	5	140,483	35,720	180,762	4,559	2.59%
S80	3	0	3	124,972		125,114	142	0.11%
TOTAL NEW AUTOS	14	1	15	462,620	35,720	494,675	(3,665)	(0.74)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	3	0	3	119,082		117,218	(1,864)	(1.57)%
XC60	0	2	2		65,419	65,419	0	0.00%
TOTAL NEW L-D TRUCKS	3	2	5	119,082	65,419	182,637	(1,864)	(1.01)%
TOTAL VOLVO	17	3	20	581,702	101,139	677,312	(5,529)	(0.81)%

ABC DEALERSHIP **EI#** ________

FORM 3115: APPLICATION FOR CHANGE IN ACCOUNTING METHOD

FOR THE YEAR ENDING DECEMBER 31, 2009

NARRATIVE STATEMENTS & OTHER INFORMATION

General Information

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

This change in LIFO pooling method is being made for the calendar year ending Dec. 31, 2009. This Form 3115 is attached to the Taxpayer's timely filed (including extension of time) income tax return for the year of change. A duplicate copy of this Form 3115 has been sent to the IRS National Office in Washington, D.C.

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

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

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

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

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

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

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

Old Pool #2: ***All new light-duty trucks*** (regardless of manufacturer), including demonstrator vehicles.

On March 7, 2008, the IRS issued Revenue Procedure 2008-23 in which it provided an alternative LIFO pooling method, the Vehicle-Pool Method, which automobile dealers may automatically elect to use. Taxpayer has not previously changed to the Vehicle-Pool Method.

Accordingly, effective for the taxable year ending Dec. 31, 2009, Taxpayer will use a single pool for all new vehicles, including demonstrator vehicles, in accordance with the "Vehicle-Pool Method" permitted by Section 4.01 of Revenue Procedure 2008-23. This single or combined vehicle pool will include all new automobiles and all new light-duty trucks (i.e., a truck with a gross vehicle weight that does not exceed 14,000 pounds, commonly referred to as Class 1, Class 2 or Class 3 trucks). This Vehicle Pool will also include all new crossover vehicles, sport utility vehicles (SUVs), vans, minivans and other similar vehicles (i.e., hybrids, etc.) and all demonstrator vehicles.

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

(continued)

Narrative Statement Attachment for Form 3115 ...
Changing to the Vehicle-Pool (Single, Combined LIFO Pool) Method for 2009

ABC Dealership ***EI #*** ________

Form 3115: Application for Change in Accounting Method

for the Calendar Year Ending December 31, 2009

Narrative Statements & Other Information

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

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

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

Instead of using the earliest taxable year for which taxpayer adopted the LIFO method for any items in a pool, taxpayer will use the year of change (i.e., calendar year 2009) as the base year when determining the LIFO value of that pool for the year of change and subsequent taxable years. The cumulative index at the beginning of the year of change (i.e., as of Dec. 31, 2008/Jan. 1, 2009) will be 1.0000.

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

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

Section 263A Inventory Cost Capitalization Matters

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

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

Previously Filed Forms 970 and 3115

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

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

/S/ ____

Dealers Low on New Vehicle Inventory...

(Continued from page 38)

It would appear that an automobile dealer should use the Producer Price index for its inflation computations. Reg. Sec. 1.472-8(e)(3)(iii)(C) states that "Retailers may select indexes from either the CPI Detailed Report or Producer Prices and Price Indexes, ***but if equally appropriate indexes could be selected from either publication***, a retailer using the retail inventory method must select the index from CPI Detailed Report and a retailer not using the retail inventory method must select the index from Producer Prices and Price Indexes."

Since automobile dealers do not qualify to use the "retail inventory method," the Regulation would seem to mandate the use of the PPI indexes. Apparently, some IRS agents believe that the "if equally appropriate" qualification language in the Regulation does not apply since, in their opinions, the Consumer Price Index is "more appropriate" than the PPI. There is a difference between the results under the CPI verses the PPI and clarification on this point should be sought.

The IRS has not officially expressed a position on which of these indexes is appropriate for use by automobile dealers using the IPIC method. One receives different answers when posing this question, depending on who is being asked the question.

Finally, note that if used vehicle inventories are going to be included in the change to the IPIC method, the "writedown issue" discussed above would also have to be considered.

CONCLUSION

In addition to illustrating the importance of projecting LIFO recapture consequences well in advance of the end of the year, this article should be useful to automobile dealers and their advisors in considering alternatives for year-end LIFO planning.

The *De Filipps' LIFO Lookout* newsletter is a periodic publication of LIFO News, Views and Ideas by Willard J. De Filipps, CPA, P.C., 317 West Prospect Avenue, Mt. Prospect, IL 60056. It is intended to provide accurate, general information on LIFO matters and it should not be construed as offering accounting or legal advice or accounting or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only. Readers should consult their certified public accountant, attorney and/or other competent advisors to discuss their own situations and specific LIFO questions. Mechanical or electronic reproduction or photocopying is prohibited without permission of the publisher. Annual subscription and back issues are available ... See www.defilipps.com for details. Not assignable without consent. Any quoted material must be attributed to *De Filipps LIFO Lookout* published by Willard J. De Filipps, CPA, P.C. Editorial comments and article suggestions are welcome and should be directed to Willard J. De Filipps at (847) 577-3977; FAX (847) 577-1073 or by email to cpawjd@aol.com.
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