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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. LIFO IS STILL ON THE HORIZON FOR THE <u>FORESEEABLE FUTURE</u>. That is still my opinion and answer to the two questions that I am asked most frequently these days ... What about LIFO? ... How much longer will it be around?

The short answer: I still believe that LIFO will be with us for quite some time. I've exhausted your eyes with lengthy articles explaining the reasons for my belief. See especially the Mid-Year 2010 Edition material in the article, *"Status of LIFO ... What's New?"*

There's really nothing more to add at this time, other than that I continue to see articles on the inexorable advance of IFRS upon our shores ... to which my reply (as far as LIFO for most closely-held businesses goes) would be ... "So what?"

#2. WHAT'S GOING TO HAPPEN TO DEALERS' <u>LIFO RESERVES AT THE END OF THIS YEAR</u>? Again, I need to paraphrase much of what I said in Update #2 of last year's Year-End Edition. For some dealers, this year, the news will be especially good (if they are Ford dealers).

For other dealers who may have lost franchises (think: Mercury, Saturn, Hummer) and other dealers whose franchises were finally terminated through GM or Chrysler bankruptcy proceedings, the news may not be too good.

Last year, I wrote an extensive article explaining that *"Dealers Low on New Vehicle Inventory at Year-End May Face Stiff LIFO Reserve Recapture ... Planning May Lessen the Blow."* I'm not going to repeat all of that here again, but I do suggest that you (quickly) review that material because it all remains equally relevant at the end of this year for your dealership clients.

#3. LIFO CONFORMITY: WATCH THOSE YEAR-END FINANCIAL STATEMENTS ... AGAIN, <u>OUR USUAL LIFO CONFORMITY REMINDER</u>. For several years, my tradition has been to include a lengthy article reminding readers of the LIFO financial statement conformity issues. That's one tradition that I don't want to break.

LOOKOUT LOOKS INTO

Evidence of the importance that LIFO users should place on adhering to these strict financial statement disclosure requirements is readily found in mid-year IRS Letter Ruling 201034004 (dated August 27, 2010). In this Letter Ruling, the IRS reviewed and approved the disclosures that the parent corporation of a subsidiary using LIFO was planning to include in its consolidated financial statements.

Consider this Letter Ruling, discussed in some detail beginning on page 20, as a supplement to the overall article and materials beginning on page 5. It's not easy reading and that's because the requirements are not intended (by the IRS) to be easily circumvented.

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To summarize what's been said before, properly electing LIFO by filling out Form 970 is just one of four LIFO eligibility requirements. The other three requirements are that (1) the inventory must be valued at cost, (2) adequate books and records must be maintained to support all aspects of the LIFO calculations and (3) the use of LIFO must be reflected in year-end financial statements (subject to a several technical qualifications that permit non-LIFO disclosures only in supplementary information).

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.

#4. IRS CHECKLIST FOR YEAR-END ... LIFO ... INVENTORIES. Included on page 21 is a checklist for your consideration in reviewing how you are handling computations and issues for clients using LIFO. This checklist is directly from the IRS *Internal Revenue Manual.* IRS agents are supposed to consult and use this list in connection with reviewing or auditing taxpayers who have inventories on LIFO.

#5. ADEQUATE "BOOKS & RECORDS" FOR LIFO COMPUTATIONS. Don't be in hurry to throw away the inventory records for dealerships that are still on LIFO or that have recently terminated their LIFO elections.

Many readers of this publication have several automobile and/or truck dealerships on LIFO as clients, and one or two of these dealerships may have terminated their LIFO elections recently. Other readers are interested in LIFO applications for businesses other than dealerships. Cutting across all types of businesses using LIFO, and equally affecting all of them, is the requirement that they maintain ***"adequate books and records"***... whatever that means.

A silent reminder in the background is a 30-year old Revenue Procedure (79-23) which states that a taxpayer's LIFO election ***may*** be terminated (at the discretion of the IRS) if the taxpayer fails to "maintain adequate books and records with respect to its LIFO inventory and ***all*** computations incident thereto." Don't overlook the word "all." And, be assured that the IRS has - on more than one occasion - threatened to terminate a taxpayer's LIFO election because it did not have "adequate books and records."

The important reminder at this time is that dealerships should not be in a hurry to discard any (not to mention, all) of their LIFO calculations and information for prior years ... even if they are no longer on LIFO. The Code and Regulations require the retention of all LIFO-related records by the corporation/entity for as long as those calculations might be relevant. In short, these calculations and supporting documentation should be retained by the entity ***indefinitely*** as permanent tax records.

The LIFO Regulations contain vague, general language in connection with discussing the requirement that LIFO taxpayers are required to maintain adequate books and records.

Basically, the requirement is that adequate records must be maintained that will enable the IRS to ***readily verify*** the taxpayer's inventory computations. And, these records should be maintained for one additional year beyond the normal 3-year statute of limitations. But, the safest and best advice is ... Don't ever throw anything away.

Just exactly what records and information must be retained in order for the IRS to "readily" verify the computations? For more on this, see page 24.

#6. SECTION 263A INVENTORY COST CAPITALIZATION RULES & LIFO INVENTORIES. Many readers of the *Lookout* have automobile and/or truck dealership clients on LIFO. Recently, all dealerships - whether they use LIFO or not to value their inventories - were affected by a major development when the IRS issued Revenue Procedure 2010-44 on November 9.

In the Year-End 2010 Edition of the *Dealer Tax Watch,* I analyzed the impact of this Revenue Procedure on dealership inventory cost capitalization rules under Section 263A. My article called attention to the need for filing Forms 3115 to make appropriate elections so that dealerships could protect themselves under the Section 236A safe harbor rules that the IRS introduced.

One of the ramifications of filing Form 3115 involves calculating the adjustment under Section 481(a) that is required by dealerships that elect to change to the Section 263A safe harbor methods. These safe harbors include (1) the "retail sales facility" safe harbor, (2) the "reseller without production activities" safe harbor and (3) the "simplified resale" method under Reg. Sec. 1.236A-3(d).

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In many situations involving changes in accounting methods where LIFO inventories are concerned, the IRS permits the use of the cut-off method. This means that the dealership does not have to go back and compute a current-year adjustment to reflect the effect of using the new method as if it had been used in prior years.

Unfortunately, the Section 263A method changes to be made under Rev. Proc. 2010-44 require the taxpayer to compute a Section 481(a) adjustment. Therefore, it becomes necessary to take into account how the dealership previously applied the Section 263A rules to its inventories on LIFO and how this affects the computation of a Section 481(a) adjustment for the year of change.

This subject will be considered in more detail in the next Edition of the *LIFO Lookout*.

#7. ALLOCATING THE CHANGE IN A LIFO RESERVE AMONG SEVERAL GROUP MEMBERS ... A CASE STUDY. In many situations, LIFO calculations are made for different dealerships with different franchises which for tax purposes are treated as disregarded entities, or Qualified S Corporation Subsidiaries (QSSSs) or some other form of series limited liability entities (Corporations/LLCs or Partnerships/LLPs). The new vehicles for these entities in many cases may be combined into a single, overall pool for LIFO inventory valuation purposes.

In these instances, the result of the LIFO calculation for the pool is that there is a single amount which represents the net change in the LIFO reserve at the end of the year.

Invariably, the dealerships want to know what amount of the net change in the LIFO reserve should be allocated among each of the individual dealerships, entities, etc., for purposes of year-end reporting to the manufacturer, as well as for other year-end financial statement reporting purposes to creditors, shareholders, etc.

The case study (beginning on page 30) discusses the different ways to approach this allocation question. This may be helpful as a starting point for you if you are facing a similar need to come up with some numbers for your dealership clients.

What needs to be emphasized is that the allocation method that is selected for the first year should be continued to be used in allocating annual increases or decreases in the LIFO reserve in succeeding years.

I've taken a rather comprehensive situation in order to explore some of the lengths to which you might go. The case study includes (1) detailed background information, (2) a technical memorandum that discusses several approaches that might be taken and (3) detail supporting schedules.

All of the computation variations discussed in the case study could be made because the *SuperLIFO™* software that was used in making the LIFO computations is detailed enough to easily permit the data to be analyzed to the degree indicated.

Incidentally, there is an interesting variation on this theme.

In Internal Revenue Service Legal Memorandum (ILM) 200935024, IRS Chief Counsel provided advice or guidance on the acceleration of a Section 481(a) adjustment in three situations where an automobile dealership was considering the termination of its LIFO election.

Basically, the questions addressed in the ILM involved whether or not there would be an acceleration of the recapture or recovery of the Section 481(a) adjustment dependent upon further activities or operations of the dealership. See pages 33-35 of the Year-End 2009 Edition of the *LIFO Lookout* for an analysis of the ILM.

As part of the discussion of Situation 3, the ILM states as a fact that "if the taxpayer used the 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." Query: how did the IRS compute or otherwise arrive at this $8x amount? My comment in this regard was that the computation of the amount of the LIFO reserve attributable to the lost (Pontiac) franchise could be problematic.

If a dealership's fact pattern parallels Situation 3 discussed in the ILM, the computational approach(es) discussed in the case study will produce varying results, some of which might be either more favorable or less favorable to the dealership ... depending on what end result the dealer or dealership might prefer.

#8. LIFO FOR VINTNERS & WINERIES: A GOOD YEAR ... AT LAST, ONE WINE(RY) FINALLY SATISFIES THE IRS' TASTE. In our last Edition of the *Lookout*, one of the *Bulletin Board* items commented on the extensive audit activities of wineries in Northern California by the IRS.

Recently, at least one of these wineries caught a break when the IRS reviewed the detailed procedures the winery was following in defining its *"items"* for LIFO computation purposes. Because the item definitions used by the winery for its LIFO calculations were significantly "narrow" - rather than "broad" - the

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IRS accepted the item definitions used by the taxpayer.

Internal Revenue Service Legal Memorandum (ILM) 201043029 confirms (1) the importance of having appropriate *"item"* definitions for LIFO purposes and (2) the fact that the IRS continues to refer to several landmark cases (i.e., *Amity Leather Products, Hamilton Industries* and *Wendle Ford Sales*) whenever the issue of *"item"* definition arises.

If you've been a subscriber to the *Lookout* for many years, you'll know that I've previously discussed these landmark cases in great detail. If you're a more recent subscriber, you can readily find articles where these cases have been analyzed in the Index of Articles on our website (www.defilipps.com).

For more on this ILM, see page 40.

#9. SAMPLING & LIFO INVENTORIES. For those applying LIFO to automobile dealerships, if you are using the Alternative LIFO Method for new or for used vehicles, you know that the IRS does not allow the use of any sampling in connection with these methods. In other words, every vehicle must be repriced in determining the inflation price indexes.

However, in many other LIFO inventory situations, especially where there may be thousands of SKUs or items, taxpayers often rely upon statistical sampling to minimize a great deal of detail work.

The last articles in the *Lookout* discussing sampling appeared over 15 years ago when the IRS released a proposed Coordinated Issue Paper on the use of sampling in connection with LIFO inventories. (See *"Sampling & LIFO Inventories ... ISP Paper ... June 1995," LIFO Lookout*, September 1995, page 20, and also March 1995 and September 1994 issues of the *Lookout*.)

A year ago in November, the IRS Director of Field Specialists issued *"Field Directive on the Use of Estimates from Probability Samples"* (LMSB Control No. LMSB-4-0809-032). If you're interested in this Memorandum, you can obtain a copy of it at www.irs.gov/pub/irs-utl/statsamplingidd.pdf.

This Directive supersedes a previous Directive on this subject that was issued in March of 2002.

In reviewing this recent Directive, I found that although there were a few general comments regarding probability sampling and LIFO inventories, those references basically conveyed the message that LIFO applications were more specialized than the general guidance in the Directive contemplated ... and that IRS agents should seek further assistance from other IRS Specialists if they encountered sampling in connection with the use of the LIFO method.

If you are applying sampling in connection with your LIFO inventories, you will want to review this Directive. The two Revenue Procedures mentioned in the Directive (Rev. Proc. 2007-35 and Rev. Proc. 2004-29) address specific applications of statistical principles to areas other than LIFO inventories. Rev. Proc. 2007-35 deals with the domestic production activities deduction under Section 199. Rev. Proc. 2004-29 deals with the meals and entertainment expenses deduction and substantiation rules under Section 274.

Attachment A to the Directive discusses "Probability Sample Documentation Standards" (sampling plan and sample execution documentation). The Technical Appendix contains (breathtaking) formulas for "unstratified" and "stratified" mean estimators and a glossary of terms and symbols.

For those desiring further information, a helpful interpretation may be found in the article entitled *"The Service's Field Directive on Sampling"* on pages 127-128 of the August 2010 *Journal of Taxation.* Borrowing from this article, the bottom line appears to be ... "These changes are indicative of the Service's greater level of comfort with statistical sampling and a desire to promote its use."

#10. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX ASSUMPTION. 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 for this year-end are on pages 45-48 and the detail lists are on pages 50-56.

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.

#11. THANK YOU. This Edition of the *Lookout* completes 20 years of writing about LIFO in this publication. Some of you have been subscribers from the very beginning. Unfortunately, as a result of our changing computer systems over the years and some of you changing firms during that time, I can't readily determine who has been with me from the very beginning. But, if you have been, please let me know, as I have a special thank you that I'd like to send to you.

Thank you for your continued interest in the *LIFO Lookout* and the *Dealer Tax Watch*. We're looking forward to 2011 and we are planning to expand our outreach to you through the medium of audio seminars to supplement our regular, periodic written updates.

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

YEAR END ALERT

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

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

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

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SPECIAL YEAR-END CHALLENGES FOR LIFO USERS

CONFORMITY REPORTING REQUIREMENTS

YEAR-END PROJECTIONS FOR PLANNING PURPOSES

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

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

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

TERMINATION SITUATIONS

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

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

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

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

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

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

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

FORM 970 QUESTIONS REGARDING CONFORMITY

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

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

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

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CONFORMITY REQUIREMENTS... THERE ARE MANY

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

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

TWO SETS OF REQUIREMENTS

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

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

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

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

***EVERY YEAR,* ALL OF THE CONFORMITY REQUIREMENTS MUST BE MET**

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

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

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

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

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

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

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

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

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

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

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

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

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

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

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

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

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

IRS TESTS

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

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

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

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

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

WARNING

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

HOW SOME BUSINESSES GET AROUND THE LIFO CONFORMITY LIMITATIONS

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

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

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

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

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

INTERIM REPORTS

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

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

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

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

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

"CONFORMITY" ... WHERE FOREIGN CORPORATIONS ARE INVOLVED

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

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

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

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

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

In this Ruling, the Service held that ...

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

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Rev. Rul. 78-246

Foreign Corporations & Foreign Operations
Financial Statement Conformity Requirements & the 30% Test or Threshold

Background

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

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

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

30% or More Threshold

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

Facts & Circumstances

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

LTR 200540005 ... Dated June 20, 2005

LTR Summary

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

LTR Facts

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

LTR Discussion

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

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

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

CONCLUDING CONFORMITY WARNINGS

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

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

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

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

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

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

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

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

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

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

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

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

PROJECTION MECHANICS, STEP-BY-STEP

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

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

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

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

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

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

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

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

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

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

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

PROJECTIONS STEP-BY-STEP

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 17

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

(Continued from page 15)

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

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

ALTERNATIVES

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

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

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

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

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

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

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

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

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

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

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

see **CONFORMITY REPORTING REQUIREMENTS**, page 18

(Continued from page 17)

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

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

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

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

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

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

SOMETIMES THE IRS REVERSES YEAR-END LIQUIDATION AVOIDANCE MEASURES

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

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

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

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

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

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

PLANNING CHECKLIST

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

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

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

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

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

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

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

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

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

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

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

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

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

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

LTR 201034004	IRS LTR APPROVES NON-LIFO DISCLOSURES AS SUPPLEMENTARY INFORMATION IN YEAR-END FINANCIAL STATEMENTS Page 1 of 2
Overview	• In IRS Letter Ruling 201034004 (dated August 27, 2010), the IRS reviewed and approved the disclosures that the parent corporation of a subsidiary using the LIFO method was planning to include in its reviewed (i.e., unaudited) year-end consolidated financial statements that it would issue to its shareholders and creditors, including a foreign parent. • This LTR addressed potential conformity requirement violations under Section 472(c), (e) and (g). • This Ruling illustrates the finer points of the analysis that must be made in attempting to comply with the financial statement conformity requirement, especially where there are several layers of subsidiaries involved.
Fact Pattern ... Four Layers of Ownership	• ***Taxpayer***, a newly-formed limited liability company, treated as a U.S. corporation for U.S. Federal tax purposes, is the common parent of an affiliated group of corporations that file a consolidated Federal income tax return on a calendar year basis. • Taxpayer is wholly owned by ***Company***, a foreign corporation, which is a lower-tier subsidiary of ***Foreign Parent***. • ***Subsidiary***, also a U.S. corporation, is a wholly-owned subsidiary of Taxpayer and is a member of Taxpayer's consolidated group. • Subsidiary uses the LIFO method to account for its inventory for U.S. Federal income tax purposes. • Foreign Parent is a corporation organized under the laws of Foreign Country. • IRS Comment: Under Section 472(g), Taxpayer and Subsidiary are treated as a single taxpayer for purposes of the LIFO conformity requirements. Since the Subsidiary's inventory is accounted for using the LIFO method for U.S. Federal income tax purposes, Taxpayer is subject to the LIFO conformity requirements.
Income Statement Disclosures	• On the ***Income Statement*** the gross margin, earnings before interest and taxes, earnings before taxes, and net income of the Subsidiary will be reported on a LIFO basis. • IRS Comment: Taxpayer's proposed income statement reporting Subsidiary's income, profit, or loss on a LIFO basis is in accordance with Reg. Sec. 1.472-2(e)(1) and does not violate the LIFO conformity requirements.
Balance Sheet ... Inventory Disclosure	• On the Balance Sheet, ***inventory*** will be reported on a non-LIFO basis. • IRS Comment: Taxpayer's proposed Balance Sheet reporting the value of Subsidiary's inventories as assets on a non-LIFO basis is allowed under Reg. Sec. 1.472-2(e)(1)(ii) and does not violate the conformity requirement.
Balance Sheet... Equity Section Disclosures	• On the Balance Sheet, ***in the equity section***, total equity will be reported on a non-LIFO basis; however, retained earnings will be reported on a LIFO basis and other comprehensive income will include a LIFO offset. • Other comprehensive income will be reported as a single line item. • A breakdown of other comprehensive income will not appear on the face of the balance sheet, but will appear in a footnote to the financial statements labeled as "Supplemental Information - Detail of Changes in Equity." • All footnotes to the financial statements will be presented together and will accompany the income statement in a single report. • IRS Comment: Under Reg. Sec. 1.472-2(e)(4), the disclosure of net worth on a non-LIFO basis "may be at variance with the [conformity] requirement if the disclosure of net worth is made in a manner that also discloses income, profit, or loss for a taxable year." ◆ However, Reg. Sec. 1.472-2(e)(4) also provides that "a disclosure of income, profit, or loss using an inventory method other than LIFO is not considered at variance with the [conformity] requirement if the disclosure is made in the form of either a footnote to the Balance Sheet or a parenthetical disclosure on the face of the Balance Sheet." ◆ Taxpayer's proposed reporting is allowed under Reg. Sec. 1.472-2(e)(4) and does not violate the conformity requirement.

LTR 201034004	**IRS LTR *APPROVES* NON-LIFO *DISCLOSURES*** ***AS SUPPLEMENTARY INFORMATION IN YEAR-END FINANCIAL STATEMENTS*** **Page 2 of 2**
Statement of Changes in Equity	• On the ***Statement of Changes in Equity***, total equity will be reported on a non-LIFO basis. • Retained earnings and net income will be reported on a LIFO basis. • The change in other comprehensive income, which includes the LIFO offset, will be reported as a single line item in the calculation of total equity instead of presenting the components of other comprehensive income as separate line items. • IRS Comment: As with Taxpayer's proposed reporting of net equity on the balance sheet, this proposed reporting is allowed under Reg. Sec. 1.472-2(e)(4) and does not violate the conformity requirement.
IRS Conclusion	• Taxpayer's proposed financial statements and supplemental information, as described in this ruling letter, which contain disclosures of Subsidiary's income on a LIFO and non-LIFO basis, to Taxpayer's creditors and shareholders, including Foreign Parent, are not a LIFO conformity violation under Sections 472(c), (e), (g), and the Regulations thereunder.
Qualifications	• Whether or not the LIFO method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer's income tax returns. • This Letter should not be construed as a ruling as to whether Taxpayer's or Subsidiary's use of the LIFO inventory method and relevant computations are in accordance with Section 472 and Regulations thereunder. • A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, taxpayers filing their returns electronically may satisfy this requirement by attaching a statement to their return that provides the date and control number of the Letter Ruling.

IRS Manual

IRS AGENTS' CHECKLIST

For Taxpayers Using the LIFO (Last-In, First-Out) Method for Valuing Inventories

- Verify that the taxpayer made a proper LIFO election (Form 970) and that it has been consistently applied.
  - Also verify there have been no unauthorized changes from the LIFO election.
- Verify that LIFO index calculations are based on actual costs and that any writedowns to market value have been restored pursuant to Reg. Sec. 1.472-2(c).
- Verify that LIFO inventory valuation method is used on all financial reports issued to shareholders, partners, and creditors, etc.

  [Comment: Note that Agents are told to look at "all" financial reports. This does not distinguish between reports for periods of less than a full year (i.e., monthly, quarterly, etc.) to which the LIFO financial statement conformity requirements do not apply.]
- Verify the reasonableness of the taxpayer's cumulative index by comparing the price increases per Table 6 of the *Producer Price Index* published by the U.S. Bureau of Labor Statistics.
  - Investigate any material differences.

    *[Comment: Some IRS training materials for LIFO refer to this comparison as a **"Sanity Check."**]*
- Verify that the taxpayer has established an appropriate number of LIFO pools and that only substantially similar items are included in a particular pool.
- If the taxpayer is using sampling techniques to calculate a current-year index, verify that no segment of the inventory has been excluded from the sample population and that the index sample is based on valid statistical sampling principles.
- Review the ending inventory for "new items."
  - Verify that the base year cost is the current-year cost of that item, unless the taxpayer is able to reconstruct or otherwise establish a different cost.
  - If the taxpayer establishes a cost different from the current-year cost, review the calculations and supporting documentation for propriety.

Source: *Internal Revenue Manual* - Section 4.10.3.8.4.3 Inventories (03-01-2003)

Conformity Requirements	***Code & Regulations re: Non-LIFO Disclosures as Supplementary Information in Year-End Financial Statements*** **Page 1 of 2**
Code Section 472(c)	• A taxpayer that elects to use the LIFO inventory method for Federal income tax purposes must establish to the satisfaction of the Commissioner that it has used no method other than LIFO in inventorying goods specified in its LIFO election to ascertain income, profit, or loss ***for the first taxable year*** for which the method is to be used, for the purpose of a report or statement covering such taxable year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.
Code Section 472(e)	• If a taxpayer uses the LIFO method for any taxable year, then such method ***shall be used in all subsequent taxable years*** unless ... (1) With the approval of the Secretary a change to a different method is authorized; or, (2) The Secretary determines that the taxpayer has used for any such subsequent taxable year some procedure other than LIFO in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (A) to shareholders, partners, or other proprietors, or beneficiaries, or (B) for credit purposes; and requires a change to a method different from that prescribed in Sec. 472(b) beginning with such subsequent taxable year or any taxable year thereafter. • If (1) or (2) above applies, the change to - and the use of - the different method shall be in accordance with such Regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.
Code Section 472(g)	• All members of the same group of financially related corporations are treated as a single taxpayer for purposes of the LIFO conformity requirements of Sections 472(c) and (e)(2). • 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 it appears, and any other group of corporations that consolidate or combine for purposes of financial statements.
Reg. Sec. 472-2(e)(1)	• The taxpayer must establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining the income, profit, or loss for the taxable year for which the LIFO inventory method is first used, or for any subsequent taxable year, for credit purposes or for purposes of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than the LIFO method or at variance with the requirement referred to in Reg. Sec. 1.472-2(c). [Requiring the use of average cost.] • The taxpayer's "use of an inventory method other than LIFO for purposes of ascertaining information reported ***as a supplement to or explanation of the taxpayer's primary presentation of the taxpayer's income, profit, or loss*** for a taxable year in credit statements or financial reports" is not considered at variance with the requirements of Reg. Sec. 1.472-2(e)(1). • The "use of an inventory method other than LIFO to ascertain the value of the taxpayer's inventory of goods on hand for purposes of ***reporting the value of such inventories as assets***" is not considered at variance with the requirements of Reg. Sec. 1.472-2(e)(1).
Reg. Sec. 1.472-2(e)(4)	• Under Reg. Sec. 1.472-2(e)(1)(ii), the use of an inventory method other than LIFO to ascertain the value of the taxpayer's inventories for purposes of ***reporting the value of the inventories as assets is not considered the ascertainment of income, profit, or loss***, and therefore, is not considered at variance with the [conformity] requirement. • Therefore, a taxpayer may disclose the value of inventories on a ***Balance Sheet*** (i.e., a statement of asset values) using a method other than LIFO to identify the inventories, and such a disclosure will not be considered at variance with the [conformity] requirement. • However, ***the disclosure of income, profit, or loss for a taxable year on a Balance Sheet*** issued to creditors, shareholders, partners, other proprietors, or beneficiaries ***is considered at variance with the [conformity] requirement if such income information is ascertained using an inventory method other than LIFO and such income information is for a taxable year for which the LIFO method is used for Federal income tax purposes.*** • Therefore, a ***Balance Sheet*** that discloses the net worth of a taxpayer, determined as if income had been ascertained using an inventory method other than LIFO, may be at variance with the [conformity] requirement if the disclosure of net worth is made in a manner that also discloses income, profit, or loss for a taxable year.

CODE & REGULATIONS RE: NON-LIFO DISCLOSURES AS SUPPLEMENTARY INFORMATION IN YEAR-END FINANCIAL STATEMENTS

Reg. Sec. 1.472-2(e)(4)	• ***Footnote or parenthetical disclosures.*** A disclosure of income, profit, or loss using an inventory method other than LIFO is not considered at variance with the [conformity] requirement if the disclosure is made in the form of either a footnote to the balance sheet or a parenthetical disclosure on the face of the balance sheet. • In addition, an income disclosure is not considered at variance with the [conformity] requirement if the disclosure is made on the face of a supplemental Balance Sheet labeled as a supplement to the taxpayer's primary presentation of financial position, ***but only if,*** consistent with the rules discussed below (i.e., Reg. Sec. 1.472-2(e)(3)), ***such a disclosure is clearly identified as a supplement to or explanation of the taxpayer's primary presentation of financial income as reported on the face of the taxpayer's Income Statement.***
Reg. Sec. 1.472-2(e)(3) ***Supplemental & Explanatory Information***	• ***Face of the Income Statement (i).*** Information reported on the face of a taxpayer's financial ***Income Statement*** for a taxable year is not considered a supplement to or explanation of the taxpayer's primary presentation of the taxpayer's income, profit, or loss for the taxable year in credit statements or financial reports. ◆ For this purpose, the face of an income statement does not include notes to the ***Income Statement*** presented on the same page as the income statement, ***but only if*** all notes to the financial income statement are presented together. • ***Notes to the Income Statement (ii).*** Information reported in notes to a taxpayer's financial ***Income Statement*** is considered a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss for the period covered by the ***Income Statement*** if (1) all notes to the financial ***Income Statement*** are presented together and (2) if they accompany the ***Income Statement*** in a single report. • ***Appendices & supplements to the Income Statement (iii).*** Information reported in an appendix or supplement to a taxpayer's financial ***Income Statement*** is considered a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss for the period covered by the ***Income Statement*** but, only if ◆ (1) The appendix or supplement accompanies the income statement in a single report ***and*** ◆ (2) The information reported in the appendix or supplement is clearly identified as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement*** . . . • Information is considered to be clearly identified as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement*** if the information either ... (1) Is reported in an appendix or supplement that contains a general statement identifying all such supplemental or explanatory information, (2) Is identified specifically as supplemental or explanatory by a statement immediately preceding or following the disclosure of the information, (3) Is disclosed in the context of making a comparison to corresponding information disclosed both on the face of the taxpayer's ***Income Statement*** and in the supplement or appendix, ***or*** (4) Is a disclosure of the effect on an item reported on the face of the taxpayer's ***Income Statement*** of having used the LIFO method. • For example, a restatement of cost of goods sold based on an inventory method other than LIFO is considered to be clearly identified as supplemental or explanatory information if the supplement or appendix containing the restatement contains a general statement that all information based on such inventory method is reported in the appendix or supplement as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement.***

ADEQUATE BOOKS & RECORDS AND RECORD RETENTION REQUIREMENTS FOR LIFO INVENTORIES

Overview	• Revenue Procedure 79-23 states that a taxpayer's LIFO election ***may*** be terminated (at the discretion of the IRS) if the taxpayer fails to "maintain adequate books and records with respect to its LIFO inventory and all computations incident thereto." [Section 3.01(d)] • As a matter of caselaw, a most serious threat was posed to one taxpayer, Mountain State Ford Truck Sales, when the Tax Court held that the taxpayer's use of replacement cost for valuing its parts inventories could not be employed as a substitute for actual cost in connection with its LIFO inventories. Fortunately, the taxpayer in this case did not lose its LIFO election because it did not have adequate records to document cost. That's probably because the IRS was trying to establish a more significant precedent, namely that replacement cost could not be used as a substitute for actual cost. • There are several provisions within the LIFO Regulations that set forth the requirement that adequate books and records must be maintained. • What can be most problematic in this regard is that the requirements add the condition that the IRS must be able to "readily verify" the taxpayer's LIFO computations, and no one can be sure just what it takes to allow the IRS to "readily" execute its review. ◆ The pertinent LIFO Regulations are included below. • The IRS has not issued specific guidance to LIFO taxpayers concerning exactly what records should be retained. Accordingly, one should err on the side of keeping more adequate records and keeping them for a longer period of time.
Electronic Recordkeeping Requirements (Rev. Proc. 98-25)	• Revenue Procedure 98-25 provides special requirements that taxpayers must comply with if their records are maintained "within an automatic data processing system." ◆ In three places, Rev. Proc. 98-25 recognizes the special attention that LIFO records and calculations must be given in terms of either maintaining more detailed information or retaining that information for longer periods of time. ◆ ***Warning...*** Although Rev. Proc. 98-25 generally applies to taxpayers with $10 million or more in assets, this $10 million cut-off limitation is specifically inapplicable to taxpayers using the LIFO inventory valuation method. (See Section 3.02 of Rev. Proc. 98-25.) **See accompanying analysis of relevant Sections of Rev. Proc. 98-25.**
Recordkeeping Requirements in the LIFO Regulations	• ***Adoption of LIFO ...*** "The records and accounts employed by the taxpayer in keeping his books shall be maintained in conformity with the inventory method referred to in Reg. Sec. 1.472-1; and such supplemental and detailed inventory records shall be maintained as will enable the District Director ***readily to verify*** the taxpayer's inventory computations as well as his compliance with the requirements of Section 472 and Reg. Secs. 1.472-1 through 1.472-7." [Reg. Sec. 1.472-2(h)] • ***Dollar-Value LIFO method ...*** "Adequate records must be maintained to support the base-year unit cost as well as the current-year unit cost for ***all items*** priced on the dollar-value LIFO inventory method, regardless of the method authorized by Reg. Sec. 1.472-8(e) which is used in computing the LIFO value of the dollar-value pool." [Reg. Sec. 1.472-8(d)] • ***Various (different) methods of computing the LIFO value of a dollar-value pool ...*** "Adequate records must be maintained by the taxpayer to support the appropriateness, accuracy, and reliability of an index or link-chain method." [Reg. Sec. 1.472-8(e)] ◆ ***Double-extension method ...*** "Under the double-extension method, the quantity of each item in the inventory pool at the close of the taxable year is extended at both base-year unit cost and current-year unit cost. The respective extensions at the two costs are then each totaled. The first total gives the amount of the current inventory in terms of base-year cost and the second total gives the amount of such inventory in terms of current-year cost." [Reg. Sec. 1.472-8(e)(2)] ◆ "Taxpayers must maintain adequate books and records of the use and computation of the inventory price index method in order to satisfy the requirements of Reg. Sec. 1.472-2(h)." [Reg. Sec. 1.472-8(e)(3)(v)]

ADEQUATE BOOKS & RECORDS AND RECORD RETENTION REQUIREMENTS FOR LIFO INVENTORIES

General Recordkeeping Requirements

- Any person subject to tax under Subtitle A of the Code, or any person required to file a return of information with respect to income, "shall keep such permanent books of account or records, ***including inventories***, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information." [Reg. Sec. 1.6001-1(a)]
- ***Retention of records.*** The books or records required by this Section shall be kept at all times available for inspection by authorized Internal Revenue Officers or employees, and ***shall be retained so long as the contents thereof may become material in the administration of any Internal Revenue Law***. [Reg. Sec. 1.6001-1(e)]
- ***Records in general ... Form of records.*** The records required by the Regulations in this part shall be kept accurately, but no particular form is required for keeping the records. Such forms and systems of accounting shall be used as will enable the District Director to ascertain whether liability for tax is incurred and, if so, the amount thereof. [Reg. Sec. 31.6001-1(a)]
- ***Place for keeping records.*** All records required by the Regulations in this part shall be kept, by the person required to keep them, at one or more convenient and safe locations accessible to Internal Revenue Officers, and shall at all times be available for inspection by such officers. [Reg. Sec. 31.6001-1(e)(1)]
- ***Period for keeping records.*** Except as otherwise provided in the following sentence, every person required by the Regulations in this part to keep records in respect of a tax (whether or not such person incurs liability for such tax) shall ***maintain such records for at least four years after the due date of such tax for the return period to which the records relate, or the date such tax is paid, whichever is the later.*** The records of claimants required by paragraph (c) of this Section shall be maintained for a period of at least four years after the date the claim is filed. [Reg. Sec. 31.6001-1(e)(2)]

IRS "Unofficial" Comments

- "As part of the LIFO election, the taxpayer agrees to maintain detailed inventory records that will enable the District Director to readily verify the taxpayer's inventory computations as well as the taxpayer's compliance with the requirements of Code Section 472 and the Regulations thereunder.
- "The recordkeeping requirements are an ***absolute necessity because the LIFO inventory computations rely on records dating back to the year of the LIFO election***.
- "The records must be detailed enough to enable you [the IRS agent] to go back and determine if the taxpayer has properly carried forward prior years' costs in computing the current inventory value."
- Source: *LIFO Method of Inventory Valuation: Student Guide - Self-Instructional Program*, Training 3127-01 (Rev. 12-87), TPDS 86702.

Limited Discussion in ATG

- There are no specific comments regarding LIFO recordkeeping in Chapter 2 - Re: Electronic Recordkeeping Requirements for Software.
- ***From Chapter 5 ... "What are the recordkeeping requirements?***
  - A taxpayer electing LIFO agrees to maintain adequate records to comply with the Regulations. Reg. Sec. 1.472-2(h) requires a taxpayer electing LIFO to maintain records supporting the LIFO computations and compliance with the LIFO Regulations.
  - Reg. Sec. 1.472-2(h) places a ***substantial*** responsibility on the taxpayer since, under the LIFO reverse order principle, the costs in ending inventories relate to years all the way back to the year of the initial LIFO election.
  - A taxpayer may have the LIFO election terminated for non-compliance. (See *H.E. Boecking v. Comm.*, T.C. Memo. 1993-497 and also Reg. Sec. 1.472-8(e)(1).)
- ***From Chapter 6 ... Changing to the Used Vehicle Alternative LIFO Method.***
  - Electing dealerships must maintain complete books and records of the computations under the method.
  - Records must include the used vehicle guides used in the index computation.
  - LIFO inventory cost increments and the values of the increments must be retained.
  - The year of change to the new method becomes the new base year.
- Source: *IRS New Vehicle Dealership Audit Technique Guide (ATG)*, Training 3147-120 (01-2005).

ADEQUATE BOOKS & RECORDS AND RECORD RETENTION REQUIREMENTS FOR LIFO INVENTORIES

Information to Be Retained

- ***Year-end financial statements.*** Copies of all year-end financial statements issued to shareholders, creditors, the manufacturer(s) for all years LIFO election is in effect. This will enable IRS to review compliance with financial statement conformity requirements.
- ***First year of LIFO election ... base-year inventory.*** Records to allow the IRS to verify the base-year cost of the inventory. ***This would include inventory cost information for the year immediately preceding the first year of the LIFO election.*** Information to be retained would include (1) quantity information ... including vehicle invoices for auto dealerships and other data supporting additions to cost ... and (2) cost information, including invoices to support the accumulated costs.
- ***Form 970 ... making the initial election to use LIFO.*** Obviously, a copy of Form 970 in which the initial LIFO election was made should be retained. Usually, a copy of Form 970 can be found as part of the income tax return filed for the year in which LIFO was elected.
- ***All subsequent years on LIFO ... i.e., for every year on LIFO.*** Listing of each item in ending inventory, in some instances including stockkeeping units if that is the means by which inventory data is accumulated.
  - For each item listed in the ending inventory, information regarding the unit cost of each item, including invoices to support the determination of cost.
- *New items.* Listing of new items included in ending inventory each year, including information regarding how the taxpayer reconstructed the base-year cost of the new item in the current year for double-extension LIFO (or the beginning-of-the-year cost for the new item for link-chain, index LIFO computations).
  - Although not in the context of discussing the LIFO recordkeeping requirements, the *ATG* (in Chapter 5) states that the Regulations place the burden of reconstruction [of the base-year cost of a new item] on the taxpayer by creating a presumption that base-year cost equals current-year cost for new items unless the taxpayer can demonstrate otherwise. Accordingly, retaining cost and other information relating to new items is very important for LIFO applications where the link-chain method is used.
- ***Sampling procedures.*** If (probability) sampling procedures were employed as part of the overall LIFO computation process, information concerning the sampling procedures employed and justification for the use of these procedures should be retained.
- ***Forms 3115 & changes in LIFO methods.*** After the first year on LIFO, if any changes have been made to the original LIFO methodology elected on Form 970, changes would be made by filing Form 3115.
  - Copies of any Forms 3115 which have been filed during the course of the LIFO election should be retained.
  - In addition, taxpayers should retain copies of computations showing (1) the rebasing of LIFO inventories to 1.000 as of the beginning of the year of change, (2) any Section 481(a) adjustments and (3) any and all documentation and/or substantiation for any representations of fact that were made in the application for permission to change the LIFO method.
- ***Dual index - earliest acquisitions applications.*** If the LIFO methodology includes the determination of current cost with reference to "earliest acquisitions," additional documentation must be retained to establish the quantities and costs (including the retention of invoices to establish cost).
- ***IPIC method users.*** If the IPIC method selected requires the computation of cost compliments, documentation must be retained to establish the quantities and costs (including the retention of invoices to establish cost).

ADEQUATE BOOKS & RECORDS AND RECORD RETENTION REQUIREMENTS FOR LIFO INVENTORIES

Terminations of LIFO Elections… Voluntary or Required by the IRS	• Businesses should not be in a hurry to discard all of their LIFO records if their LIFO elections have been terminated (regardless of whether the termination was voluntarily made by the taxpayer or it was required as a result of an IRS audit). • ***The general rule would seem to be that these records should be maintained for at least 4 years after the last year on LIFO.*** [Reg. Sec. 31.6100-1(e)(2)] • However, if the business incurs a net operating loss in a later year and plans to carry back that loss to a preceding year in which the LIFO election was in effect, the IRS could require the taxpayer to demonstrate the correctness of its LIFO calculations in that carryback year, and if there is some problem with the LIFO calculations, the IRS could recompute the taxable income for the carryback year in order to decrease the taxpayer's NOL refund claim to that year.
Another LIFO Lookout Article	• Discussion of several Letter Rulings (8851001 and 9343001) and a 1993 Tax Court Memo Decision (*Boecking v. Comm.*) and *Mountain State Ford Truck Sales v. Comm.* appear in the September 1999 *LIFO Lookout* article, *"When Are Books Records (In)Adequate to Support LIFO Calculations?"* on page 10.
Electronic Recordkeeping Requirements for Dealer Software	• Automobile dealerships utilize computer software specifically designed for a particular dealership or from the manufacturer for use at the dealership. Revenue Procedure 98-25 sets guidelines for the requirement of a dealership to retain electronic records. • With regard to a dealership's information system: ◆ The manufacturers and distributors mandate the specifications of dealership accounting systems. ◆ Dealerships have a limited number of hardware and software vendors from which to choose. ◆ The transfer of data from one vendor's product to another is difficult or impossible. ◆ Information systems are typically relatively small and do not store information from prior cycles. ◆ Back up tapes might be made, but typically they are not retained for an extended period. ◆ If back up information is available; it generally cannot be loaded back onto the dealer's system without removal of the current activity. ◆ Information systems contain proprietary software that usually cannot be accessed by a Computer Audit Specialist. **Source:** *New Vehicle Dealership Audit Technique Guide*, 2004 - Ch. 2 - Books and Records (12-2004)
Certain Events in a Dealership's History Could Jeopardize Its Maintenance of Adequate LIFO Records	• Rev. Proc. 98-25 (in Section 8) provides that taxpayers are required to notify the IRS if certain events occur that impair its ability to produce prior records. (See accompanying material on Rev. Proc. 98-25.) • Previous dealership events could affect a dealership's compliance with Rev. Proc. 98-25. ◆ ***Computer/System crashes.*** Any time a dealer's computer system crashes and all, or much, of the accounting data is lost or compromised, compliance with these notification requirements must be considered. ▪ If data has been lost, appropriate and reasonable steps are required to be taken to comply. ◆ ***Hurricanes, tornadoes and other disasters.*** Any dealership that has been affected by hurricanes, tornadoes or any other natural disasters must consider the impact of these notification requirements. ▪ In these circumstances, might the IRS provide the affected taxpayer any significant relief? ◆ ***Vendor changes.*** Whenever a dealer changes computer vendors and/or systems, continuity of the records and journals and continuing compliance with Rev. Proc. 98-25 and with Rev. Proc. 97-22 must be maintained. ◆ ***Employee dishonesty and/or major defalcations.*** It is not uncommon for key employees in dealerships to commit fraud on their employers, and in the course of doing so, to significantly corrupt financial records that might otherwise make detection of their crimes easier. ▪ If data has been lost, destroyed or corrupted, notification requirements should be considered.

LIFO Inventory Records	***Revenue Procedure 98-25*** ***Electronic Recordkeeping Requirements***

Summary

- This Revenue Procedure specifies the basic requirements that the IRS considers to be essential in cases where a taxpayer's records are maintained within an Automatic Data Processing (ADP) system.
- These requirements are applicable to all Internal Revenue Code provisions that have unique or specific recordkeeping requirements.
- Citation: 1998-1 C.B. 689. Rev. Proc. 98-25 supersedes Rev. Proc. 91-59 (its predecessor).

Section 2.

Background

...

Sec. 6001 Requirements

- Every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and Regulations as the Secretary may from time to time prescribe.
- Whenever necessary, the Secretary may require any person, by notice served upon that person or by regulations, to make such returns, render such statements, or keep such records, as the Secretary deems sufficient to show whether or not that person is liable for tax.
- Persons subject to income tax, or required to file a return of information with respect to income, must keep such books or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown in any return of such tax or information.
- These books or records required by Section 6001 must be kept available at all times for inspection by authorized IRS employees.
- These books and records must be retained so long as the contents thereof may become material in the administration of any internal revenue law.
- All machine-sensible data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's ADP system are "records" and are required to be retained so long as the contents may become material in the administration of any Internal Revenue law. (Rev. Rul. 71-20, 1971-1 C.B. 392)

Section 3.02

Scope

...

Taxpayers Affected

- ***Taxpayers with $10 million or more in assets.*** A taxpayer with assets of $10 million or more at the end of its taxable year must comply with the record retention requirements of Rev. Rul. 71-20 and the provisions of this Revenue Procedure.
  - A controlled group of corporations, as defined in Section 1563, is considered to be one corporation and all assets of all members of the group are aggregated.
- ***Taxpayers with under $10 million in assets must also comply if any of the following conditions exist.***
  - All or part of the information required by Section 6001 is ***not*** in the taxpayer's hardcopy books and records, but is available in machine-sensible records,
  - *Machine-sensible records were used for computations that cannot be reasonably verified or recomputed without using a computer (e.g., Last-In, First-Out (LIFO) inventories), or*
  - The taxpayer is notified by the IRS that machine-sensible records must be retained.
- ***Use of service bureaus. A taxpayer's use of a third-party*** (such as a service bureau, time-sharing service, value-added network, or other third-party service) ***to provide services*** (e.g., custodial or management services) in respect of machine-sensible records ***does not relieve the taxpayer of its recordkeeping obligations and responsibilities under Section 6001 and this Revenue Procedure.***

Section 4.

Definitions

- An ***"ADP system"*** consists of an accounting and/or financial system (and subsystems) that processes all or part of a taxpayer's transactions, records, or data by other than manual methods.
  - An ADP system includes, but is not limited to,
    - A mainframe computer system,
    - Stand-alone or networked microcomputer system,
    - Data Base Management System (DBMS), and
    - A system that uses or incorporates Electronic Data Interchange (EDI) technology or an electronic storage system.
- ***"Capable of being processed"*** means the ability to retrieve, manipulate, print on paper (hardcopy), and produce output on electronic media.
  - *This term does not encompass any requirement that the program or system that created the computer data be available to process the data unless that program or system is necessary to...*
    - *A tax-related computation (e.g., LIFO inventories ...), or*
    - The retrieval of data (e.g., some data base systems processes where the taxpayer chooses not to create a sequential extract).
- This Section also provides definitions of other terms (i.e., *"DBMS," "EDI technology," "electronic storage system,"* and *"machine-sensible record"*) which are not reproduced here.

LIFO Inventory Records

Revenue Procedure 98-25
Electronic Recordkeeping Requirements

- The taxpayer must retain machine-sensible records so long as their contents may become material to the administration of the internal revenue laws.
  - At a minimum, this materiality continues until the expiration of the period of limitation for assessment, including extensions, for each tax year.
- *In certain situations, records should be kept for a longer period of time.*
  - *For example, records that pertain to fixed assets, losses and LIFO inventories should be kept for longer periods of time.*

Section 5. Retaining Machine-Sensible Records ... General

- The taxpayer's machine-sensible records must provide sufficient information to support and verify entries made on the taxpayer's return and to determine the correct tax liability.
- The taxpayer's machine-sensible records will meet this requirement only if they reconcile with the taxpayer's books and the taxpayer's return.
- A taxpayer establishes this reconciliation by demonstrating the relationship (i.e., audit trail):
  - Between the total of the amounts in the taxpayer's machine-sensible records by account and the account totals in the taxpayer's books, and
  - Between the total of the amounts in the taxpayer's machine-sensible records by account and the taxpayer's return.
- ***The taxpayer must ensure that its machine-sensible records contain sufficient transaction-level detail so that the information and the source documents underlying the machine-sensible records can be identified.***
- All machine-sensible records required to be retained by this Revenue Procedure must be made available to the Service upon request and must be capable of being processed.
- A taxpayer is not required to create any machine-sensible record other than that created either in the ordinary course of its business or to establish entries on its tax returns.
  - ***Example.*** A taxpayer who does not create, in the ordinary course of its business, the electronic equivalent of a traditional paper document (such as an invoice) is not required by this Revenue Procedure to construct such a record. (However, for requirements relating to hardcopy records, see Section 11 of this Revenue Procedure.)
- Exceptions are discussed with respect to DBMS and EDI technology.
- A taxpayer's disposition of a subsidiary company does not relieve the taxpayer of its responsibilities under this Revenue Procedure to retain all appropriate books and records.
  - The files and documentation retained for the Service by, or for, a disposed subsidiary must be retained as otherwise required by this Revenue Procedure.

Section 8. Notification ... In General

- ***General situations requiring the taxpayer to notify the IRS.*** The ***taxpayer must promptly notify*** the IRS/District Director ***if any machine-sensible records are***
  - Lost, stolen, destroyed, damaged, or otherwise ***no longer "capable of being processed,"*** or
  - Found to be incomplete or materially inaccurate (affected records).
  - A limited exception is made for "partial" loss of data.
- ***Contents of Notice.*** The taxpayer's notice to the IRS must ...
  - Identify the affected records and
  - Include a plan that describes how, and in what timeframe, the taxpayer proposes to replace or restore the affected records in a way that assures that they will be capable of being processed.
  - The plan must demonstrate that all of the ERR requirements will continue to be met with respect to the affected records.
- The IRS will notify the taxpayer of any objection(s) to the taxpayer's plan.
- ***Possible limited relief.*** A IRS may consider, whenever warranted by the facts and circumstances, the possibility of requiring less than a total restoration of missing data.
- This Section also includes one example of a situation where the taxpayer is not required to notify the IRS and a second example of situations where the taxpayer is required to notify the IRS.

Source

- This summary of the more relevant Sections of Rev. Proc. 98-25 is taken from *"IRS Electronic Recordkeeping Requirements ... Revenue Procedure 98-25,"* which includes a more complete analysis of R. P. 98-25. See the March 2007 issue of *Dealer Tax Watch*, pages 8-37.

Allocating the Change in a LIFO Reserve Among Several Group Members

Background

Overview. There are many situations in which the new vehicle inventories of several automobile dealerships are combined into a single LIFO pool for Federal income tax purposes. The most common situations where several dealerships' inventories are combined involve disregarded entities, or Qualified S Corporation Subsidiaries (QSSSs) or some other form of series limited liability entities (Corporations/LLCs or Partnerships/LLPs).

This case study examines several different approaches that can be considered when it is necessary to allocate the change in the LIFO reserve for the large, single pool among its several group members whose new vehicle inventories have been combined. In this case study, the analysis has been made for a group of four QSSSs, all of which are operated as independent (except for ownership) automobile dealerships. All dealerships are using the LIFO method for their new vehicle inventories, and all vehicles are combined into one new vehicle LIFO pool.

In this case study, the year ended December 31, 2008 was the first year that these entities were combined, and the increase in the LIFO reserve for the combined inventories LIFO pool for the year was $481,745.

The question for consideration: How should this increase of $481,745 be allocated among the four QSSSs on the financial statements that they would be submitting to their respective manufacturers?

Background information. As of December 31, 2008, ***ABC Consolidated Dealerships, Inc.*** includes four dealerships ... ***(1) ABC Ford-Lincoln-Mercury, (2) ABC Toyota, (3) ABC Ford-Mercury and (4) ABC Highline Cars*** ... all of which are Qualified Subchapter S Subsidiaries (QSSSs). Each of these dealerships previously elected to use the Alternative LIFO Inventory Method for New Vehicles.

As of January 1, 2000, three of the dealerships (***ABC Toyota, ABC Ford-Mercury and ABC Highline Cars***) had elected to be taxed as S Corporations. Accordingly, for each of these dealerships, a special collapsed layer was computed in accordance with Section 1363(d) and Rev. Proc. 94-61 to reflect the recapture of their respective LIFO reserves for new vehicles as of December 31, 1999.

In 2003, the dealerships changed their methods for determining inventory cost to eliminate trade discounts and advertising fees and expenses from inventory costs. In accordance with this change, the respective LIFO layer histories for the dealership pools were rebased to 1.000 as of Dec. 31, 2002.

ABC Ford-Lincoln-Mercury elected to be taxed as an S Corporation as of January 1, 2008. Accordingly, special collapsed layers were computed in accordance with Rev. Proc. 94-61 to reflect the recapture of LIFO reserves in the amount of $394,199 for New Automobiles and $1,006,452 for New Light-Duty Trucks as of December 31, 2007. Thus, the LIFO reserves for ***ABC Ford-Lincoln-Mercury*** were $0 as of Dec. 31, 2007 (i.e., Jan. 1, 2008) since the LIFO reserves were required to be repaid as of the end of the last year in which the dealership operated as a C Corporation for tax purposes.

Change to the Vehicle-Pool Method in 2008. For years prior to 2008, each dealership had two LIFO pools for its new vehicle inventories: one LIFO pool for new automobiles and a separate pool for new light-duty trucks. Effective January 1, 2008, pursuant to Revenue Procedure 2008-23, ***ABC Consolidated Dealerships, Inc.*** filed Form 3115 to (1) combine of all of the new vehicle pools for all four of the QSSSs operating collectively as ***ABC Consolidated Dealerships, Inc.*** and (2) further combine each dealership's pools for new automobiles and for new light-duty trucks into a single, combined LIFO pool for all new vehicles.

Rebasing LIFO Indexes to 1.000 as of Dec. 31, 2007. In connection with combining the LIFO pools for the QSSSs and combining the pools for New Automobiles and for New Light-Duty Trucks to use the Vehicle-Pool Method in Rev. Proc. 2008-23, the LIFO indexes at the beginning of the year-of-change (i.e., as of January 1, 2008 / December 31, 2007 ... the last day of the year ***before*** the year of change) were required to be rebased to 1.000.

This required a recomputation of the prior years' LIFO indexes so that the first year reflecting the combination of the inventories (i.e., the calendar year ending December 31, 2008) reflected its opening inventory indexes rebased to 1.000 ***for LIFO computation purposes only***. Accordingly, in the LIFO computations for the single pool for all new vehicles for ***ABC Consolidated Dealerships, Inc.*** for calendar year 2008, the current-year inflation index computed for 2008 (i.e., 1.02353 or 2.353%) is the same amount as the cumulative inflation index at the end of 2008 (1.02353 x 1.0000 = 1.02353).

ALLOCATING THE CHANGE IN A LIFO RESERVE AMONG SEVERAL GROUP MEMBERS

This memorandum discusses the matter of how to allocate the net increase of $481,745 in the single, combined LIFO pool for all new vehicles among the four (4) dealerships which are combined into the ***ABC Consolidated Dealerships, Inc.*** reporting entity.

For LIFO purposes, the single pool consisting of all new vehicles experienced an increment of $1,150,275 (expressed in "base" dollars) and, as a result, the increase in the LIFO reserve for this pool was $481,745. All of the increase in the LIFO reserve for 2008 was attributable to the amount of the beginning inventory (expressed in "base" dollars) of $20,473,652. See ***Schedule #1*** for details.

These four dealerships had a total ending inventory cost, net of trade discounts and advertising fees, of $22,132,738 and an inflation rate of 2.353% was computed for the LIFO pool for 2008. See ***Schedule #2*** for details.

Because of the changes that were made to combine the dealerships and to combine all separate LIFO pools, the amount of the beginning inventory expressed in base dollars is exactly the same amount as the Dec. 31, 2007 ending inventory at cost. (This is due to the procedures that are required to be followed in combining pools when electing to use the single pool method.) As shown in ***Schedule #1***, the increase in the LIFO reserve for 2008 for the single pool is an amount exactly equal to this amount of base dollars multiplied by the inflation rate for 2008 ($20,473,652 x 0.02353 = $481,745).

There are several different ways to approach the allocation question. It is most important to recognize that whatever method is selected to use for the first time in 2008 should be the method that will be followed in allocating annual increases or decreases in the LIFO reserve (among group members) in future years. In other words, the method selected should be consistently applied in the future.

The differences in allocation results may or may not be significant (or material) in any given year. However, the method of allocating the LIFO reserve will follow through to reporting to the different manufacturers on different financial statements for the individual dealerships and could affect the computation of various liquidity and other operating or financial ratios and/or compliance with loan covenant requirements.

Different Allocation Methods

As a general observation, the method more commonly used for allocating the LIFO reserve change among dealerships in a group involves taking the most simple approach. This approach is to allocate the increase in the LIFO reserve for the year among the dealerships on the basis of the ratio of the ending inventory cost for a dealership in the group to the total of all of the ending inventory costs for all of the dealerships that make up the group.

However, there are several other approaches. These include the following:

1. Allocation based on the ratios of the average of the beginning-of-the-year (i.e., Dec. 31, 2007) and end-of-the-year (i.e., Dec. 31, 2008) inventory costs for each dealership to the total, combined average inventory costs.
2. Allocation based on the ratio of the LIFO reserves at the ***beginning of the year*** (i.e., as of Dec. 31, 2007) for each of the dealerships comprising the group.
3. Allocation based on estimated (or calculated) different inflation rates for different makes of vehicles comprising the pool.
4. Allocation based on making ***separate LIFO calculations for the vehicles in the ending inventory of each member entity*** and using the results of the separate calculations to allocate the net change in the LIFO reserve (computed for the single, combined pool). Variations in this approach include determining ratios for allocation based on either (1) the sum(s) of the individually computed increases or decreases in the LIFO reserves or (2) the sum(s) of the individually computed increments and/or decrements (expressed in base dollars).

Allocations Based on Ending Inventory Levels

Schedule #3 shows the information which could be used to determine the allocation percentage for each dealership under three different scenarios (1) using Dec. 31, 2007 or beginning-of-the-year inventory levels, (2) using Dec. 31, 2008 or end-of-the-year inventory levels, or (3) determining a simple mathematical average by obtaining the sum of the beginning and ending inventory levels and then dividing by two to produce a "simple average."

It should be noted that the calculations in ***Schedule #3*** reflect the ending inventory cost ***before*** reducing that cost by trade discounts and certain advertising fees and expenses. This data was used because it was more readily identifiable. However, a more detailed analysis could certainly break down the inventory data to show the net of discount amounts.

Using the "simple average" approach described above, the allocation of the increase in the LIFO reserve for the single pool for 2008 is shown below. The calculation of the ending inventory allocation ratios is shown in ***Schedule #3***.

	Average % (Rounded)	Allocation Based on Simple Average (BOY+EOY)/2 Costs
ABC Ford-Lincoln-Mercury	30%	$ 144,524
ABC Toyota	27%	130,071
ABC Ford-Mercury	19%	91,532
ABC Highline Cars	24%	115,619
	100%	$ 481,745

It could be argued that this satisfies what many would consider a test of reasonableness of the end result. Under the Alternative LIFO Method for New Vehicles, a single index approach is used. In other words, the same inflation index that is used to deflate the ending inventory at cost in order to express that amount in base dollars is also used to inflate any increment (expressed in base dollars) in the pool in order to state the increment in the pool at its LIFO valuation.

As a result, a basic principle of LIFO in this application context is that the increase in the LIFO reserve for the year is measured by the amount of inventory (expressed in base dollars) that has remained constant (or in tact) throughout the year. This is determined simply by looking at the lower of the beginning inventory amount (expressed in base dollars) or the ending inventory amount (also expressed in base dollars) and then multiplying that lower amount by the inflation rate for the year.

Accordingly, if this principle were applied as the basis for a test of "reasonableness," the results do not seem to vary significantly from the result actually computed.

	Lower of ...			Actual			
	Beginning Inventory	Ending Inventory		Inflation Rate		Hypothetical Allocation	Allocation Based on EOY Costs
ABC Ford-Lincoln-Mercury	-	6,557,473	x	0.02353	=	154,297	$ 144,524
ABC Toyota	5,644,903	-	x	0.02353	=	132,825	130,071
ABC Ford-Mercury	3,958,488	-	x	0.02353	=	93,143	91,532
ABC Highline Cars	4,937,962	-	x	0.02353	=	116,190	115,619
						496,455	$ 481,745

Technically, the above table should reflect the amounts expressed in base dollars, rather than the actual/current costs shown in ***Schedule #3***. However, substituting base dollar amounts would not significantly alter the end results.

If we compare the hypothetical allocation result (i.e., an increase in the LIFO reserve for the single pool of $496,455) to the allocation result computed for the pool using the "simple average" ratios of 30%-27%-19%- and 24%, the difference is only approximately 3% of the amount of the ***actual change*** in the LIFO reserve. [$496,455 - $481,745 = $14,710 (or 3% of $481,745)]

The allocation of the 2008 net increase in the LIFO reserve might seem to be a relatively simple matter. However, this allocation must be considered in view of the fact that the overall pool had a net increment for the year and three of the four dealerships comprising ***ABC Consolidated Dealerships, Inc.*** had ending inventories that were greater than their respective beginning-of-the-year inventories.

Different Current-Year Rates of Inflation for Vehicles in Ending Inventory

An alternative approach for allocating the increase (or decrease, if there had been one) in the LIFO reserve for the year would be to look at the presence or absence of significantly greater or lesser amounts of inflation attributable to various vehicles/makes in the ending inventory.

When one takes into consideration the different inflation rates, a different result clearly emerges. Schedule #2 summarizes the inflation indexes by make (based on Report #3 in our SuperLIFO Inventory Report for ***ABC Consolidated Dealerships, Inc.***). From this data, it can be seen that the 2008 inflation indexes for new vehicles are as follows:

1. ***ABC Highline Cars*** (BMW, Subaru & Volkswagen)............. 1.316%
2. ***ABC Toyota*** (Toyota & Scion) 2.724%
3. ***ABC Ford*** (including Lincoln & Mercury).. 2.699%
4. Overall weighted index for all vehicles.................................. 2.353%

In general, approximately 50% of the inventory at cost for Ford (including Lincoln and Mercury) reflected a weighted index of 2.699 or 2.7% ... and this is not significantly different from the overall weighted index for the entire pool which was 2.35%.

The Toyota inventory, comprising roughly 25% of the total inventories for the pool, had a somewhat greater inflation index of 2.72% - and this is greater than the overall weighted index for the entire pool which was 2.35%.

More importantly, the ***ABC Highline Cars*** new vehicle inventory (BMW, Subaru, Volkswagen), which comprised approximately 25% of the total dollars in ending inventory, reflects a current-year inflation index of 1.316% ... compared to an average for all of the other vehicles that was slightly more than double that inflation rate. In other words, the inflation index for ***ABC Highline Cars*** was slightly less than one-half of the average inflation rate for all of the other vehicles.

The question is... "Is this difference in inflation rates a ***significant difference***? And if so, how should that be factored into allocating the net increase in the LIFO reserve for the pool among the dealerships?" Does "logic" or "common sense" suggest that a more simple allocation approach (based on the average of the ending inventory levels) would be deficient or inappropriate in this case, given these facts? If so, how should this approach be modified to reflect this significant difference?

Consider the following with respect to ***ABC Highline Cars*** if we apply the 1.3% inflation rate to the lower of its own beginning or ending inventory amounts... Applying the general principle above, the result would be that the increase in the LIFO reserve attributable to the ***ABC Highline Cars*** inventory based on its own inflation rate of 1.3% would be only $65,000 ($4,937,962 x 0.01316 = $64,985). Accordingly, this is a difference of almost $50,000 compared to $115,619 which is the result of an allocation to ***ABC Highline Cars*** under the simple average approach ($115,619 - $64,984 = $50,635).

This disparity, if deemed "material" or "significant" in any one of several different contexts, might suggest that a method of allocation more suitable under the circumstances would be to reflect the more reasonable result of applying a given fact (i.e., a significantly lower rate of inflation for the ***ABC Highline Cars*** inventory) before making a more general allocation based on average inventory costs applicable to the remainder of the increase in the LIFO reserve for the year.

This "two-step" approach can be computed in a variety of ways. For example, ***Step #1*** would be to determine or quantify the impact of the unusual factor (i.e., the significantly lower inflation rate for the year) and apply that result to the dealership that has that specific attribute (in this case, ***ABC Highline Cars***). ***Step #2*** would be to allocate the remainder of the net change (i.e., increase in this case) in the LIFO reserve to all of the other dealerships that are members of the group (that do not reflect this attribute) in the ratio of their respective average ending inventories.

This computation is set forth below and in ***Schedule #4*** which also shows the calculation of the ending inventory allocation ratios.

Net Increase in LIFO Reserve for 2008		$ 481,745	
Less: Specific allocation to ABC Highline Cars		(65,000)	65,000
Balance to be allocated (based on ending inventory "simple average")		416,745	
ABC Ford-Lincoln-Mercury	39.5%	164,614	164,614
ABC Toyota	35.5%	147,944	147,944
ABC Ford-Mercury	25.0%	104,187	104,187
	100%	416,745	
Increase in LIFO Reserve for 2008			481,745

Again, technically, the allocation to ***ABC Highline Cars*** should reflect the beginning-of-the-year amount expressed in base dollars, rather than the actual/current cost shown in ***Schedule #3***. However, substituting the base dollar amount would not significantly change the end result.

The schedule below shows the LIFO reserve balances as of December 31, 2008 for the four dealerships, comparing the results under the two different approaches (i.e., with and without a special allocation based on inflation for ***ABC Highline Cars***).

		2008 Increase in LIFO Reserve		LIFO Reserve at 12/31/08		
	LIFO Reserve At 12/31/07	Allocation Based on Simple Average (BOY+EOY)/2 Costs	Two-Step Special Allocation Per Above	Without Two-Step Special Allocation	Reflecting Two-Step Special Allocation	Difference
ABC Ford-Lincoln-Mercury	-	144,524	164,614	144,524	164,614	(20,091)
ABC Toyota	187,017	130,071	147,944	317,088	334,961	(17,873)
ABC Ford-Mercury	343,089	91,532	104,187	434,621	447,276	(12,655)
ABC Highline Cars	285,946	115,619	65,000	401,565	350,946	50,619
	816,052	481,745	481,745	1,297,797	1,297,797	-

There can be no right or wrong answer to the question(s) ... Which of the two approaches is more (1) accurate, (2) reasonable, or (3) closer to a desired result in terms to reporting to the manufacturer?

The fact pattern for 2008 simply highlights how the results might vary. One other caution is that one should not expect that every year will present such an easily recognizable degree of variation in the fact pattern.

Allocation Based on LIFO Reserve Balances as of the Beginning-of-the-Year (i.e., as of Jan. 1, 2008)

An alternative approach for allocating the LIFO reserve increase for the current year would be to make the allocation based on the ratios of the LIFO reserves at the beginning of the year. Unfortunately, this would be problematic because, for tax purposes, ***ABC Ford-Lincoln-Mercury*** does not have a LIFO reserve at the beginning of 2008 (because it was required to recapture its LIFO reserve as of Dec. 31, 2007 when it elected to be treated as an S Corporation effective Jan. 1, 2008).

However, that does not mean that for *"allocation purposes,"* one would have to ignore that zero balance. In other words, one might consider that LIFO balance at Dec. 31, 2007 (i.e., before it was recaptured) in a "side computation." However, this may be an impractical approach for a number of reasons which are not discussed any further in this Memorandum.

Allocation Based on Continuing to Make Separate LIFO Computations for Each Dealership

Yet another approach would be to make separate LIFO calculations for each dealership and then, based on those results, come up with an allocation approach for the single, combined pool using the ratios of changes in the LIFO reserves based on the individual dealership's LIFO computations. Needless to say, this approach would be considerably more expensive to work through because it would require four additional separate, hypothetical LIFO calculations.

We have not expended any effort at this time to make separate LIFO computations for the different dealership members, and we will not do so unless that is an allocation approach that we are requested to pursue further. (See Note 3 on ***Schedule #3***.)

Final Recommendation

After considering all of the foregoing, it is our recommendation that ***ABC Consolidated Dealerships, Inc.*** consider allocating the net increase in the LIFO reserve for 2008 (or the net increase or decrease in the LIFO reserve in a future year) on the basis of the ratios of the "simple average" of the beginning and the ending inventory amounts at cost (unadjusted by reductions for trade discounts and/or certain advertising fees and expenses).

This is the result shown on page 2 of 5 of this Memorandum and in more detail on ***Schedule #3***.

	Average % (Rounded)	Allocation Based on Simple Average (BOY+EOY)/2 Costs	"Two-Step" Allocation	Difference
ABC Ford-Lincoln-Mercury	30%	$ 144,524	$ 164,614	$ (20,091)
ABC Toyota	27%	130,071	147,944	(17,873)
ABC Ford-Mercury	19%	91,532	104,187	(12,655)
ABC Highline Cars	24%	115,619	65,000	50,619
	100%	$ 481,745	$ 481,745	$ -

The major reason for this recommendation and preference for using this "simple average" approach is that it is practical, easily quantifiable and will not require critical analysis of results from year-to-year. Over the years, some combinations of inventory level fluctuations and/or inflation or deflation rate variations may present more complex fact patterns (i.e., variations among the dealerships) than others. This could lead to the need for more subjective estimates and/or interpretations.

It can be, or should be, expected that the level of analysis in determining the allocation of a given year's increase or decrease in the LIFO reserve for ***ABC Consolidated Dealerships, Inc.'s*** single pool will become considerably more complex and subjective if the ending inventories decrease significantly for some members, but not for all members or in different proportions. This would raise the question of how deeply would you want to go into the computation of "what if" or "as if" carrybacks of decrements and the determination of effective rates of recapture in computing the impact of the LIFO reserve change with respect to a member(s) that experienced decreases in its ending inventory? It should be expected that this would just become more complicated over time. Hence, the better argument seems to be for greater simplicity, rather than potentially more complexity, in future years.

Finally, the recommended approach would be more flexible in future years in anticipation of either (1) the addition of more QSSS members to the ***ABC Consolidated Dealerships, Inc.*** group or (2) the disposition of a member or members from the group.

ABC Consolidated Dealerships, Inc.
Computation of New Vehicle LIFO Inventory & Reserve Change
For the Year Ended December 31, 2008

Schedule #1

	Pool #1 All New Vehicles
A. BEGINNING OF YEAR INVENTORY AT BASE DATE COST	20,473,652
B. END OF YEAR INVENTORY AT END OF YEAR (CURRENT) PRICES	22,132,738
C. END OF YEAR INVENTORY AT BEGINNING OF YEAR (BASE) PRICES	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	1.02353
E. CUMULATIVE LINK-CHAIN INDEX: CURRENT YEAR PRICE INDEX (LINE D) MULTIPLIED BY (X) PRIOR YEAR'S CUMULATIVE INDEX (LINE E OF PRIOR YEAR)	1.02353
F. END OF YEAR INVENTORY AT BASE DATE COST (LINE B DIVIDED BY LINE E)	21,623,927
G. CURRENT YEAR INVENTORY INCREASE (DECREASE) - EXPRESSED IN BASE DOLLARS	
1. END OF YEAR INVENTORY AT BASE DATE COST (LINE F)	21,623,927
2. BEGINNING OF YEAR INVENTORY AT BASE DATE COST (LINE A)	(20,473,652)
3. CURRENT YEAR INCREMENT (G(1) EXCEEDS G(2)) OR DECREASE (IF G(2) EXCEEDS G(1))	1,150,275
	x 1.023530
4. LIFO VALUATION OF CURRENT YEAR INCREMENT (IF G(1) EXCEEDS G(2), MULTIPLY LINE G(3) BY LINE E)	1,177,341

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

	BASE DOLLARS		VALUATION FACTOR	
Year 2000, Base Inventory	8,310,943	x	0.918360	7,632,438
Calendar Year 2000 Increment	199,594	x	0.953760	190,365
Calendar Year 2002 Increment	1,733,454	x	0.959510	1,663,266
Calendar Year 2003 Increment	97,402	x	0.963290	93,826
Calendar Year 2004 Increment	467,242	x	0.995960	465,354
Calendar Year 2005 Increment	1,622,694	x	0.993080	1,611,465
Calendar Year 2006 Increment	1,031,478	x	0.994500	1,025,805
Calendar Year 2007 Increment	7,010,845	x	0.994900	6,975,090
Rebased Dec. 31, 2007	-	x	1.000000	-
Calendar Year 2008 Increment	1,150,275	x	1.023530	1,177,341
	21,623,927			20,834,950

ENDING INVENTORY AT LIFO VALUATION, PER ABOVE	20,834,950
LESS: ENDING INVENTORY AT END OF YEAR PRICES (LINE B)	22,132,738
LIFO RESERVE AS OF DEC. 31, 2008	1,297,788
LESS: LIFO RESERVE AS OF DEC. 31, 2007	816,043
INCREASE IN LIFO RESERVE AS OF DEC. 31, 2008	481,745

Proof of Increase in LIFO Reserve for Calendar Year 2008

Amount of Base Dollars that Remained Intact Throughout Year Ended Dec. 31, 2008	20,473,652
(x) Multiplied by Current-Year Inflation Factor (1.02353 - 1.00000)	0.02353
Increase in LIFO Reserve Due to Inflation Factor	481,745

Note: Due to change to single pool for all new vehicles, LIFO pools were combined and rebased to 1.0000 as of Dec. 31, 2007.

ABC Consolidated Dealerships, Inc.
Summary of Makes and Inflation Indexes by Makes for the Year 2008
For the Year Ended December 31, 2008

Schedule #2

Make	Total Units	Inventory Cost	BOY Cost	EOY Cost	Inflation Index
ABC Highline Cars					
BMW	62	3,264,924	2,681,715	2,710,370	1.01069
Subaru	40	1,025,272	956,338	969,921	1.01420
Volkswagen	64	1,576,918	1,416,974	1,441,235	1.01712
Subtotal - ABC Highline Cars	166	5,867,115	5,055,027	5,121,526	1.01316
ABC Toyota					
Toyota	266	6,131,712	5,272,902	5,419,614	1.02782
Scion	8	145,310	126,444	126,824	1.00301
Subtotal - ABC Toyota	274	6,277,022	5,399,346	5,546,438	1.02724
Ford Lincoln Mercury (ABC Ford-Lincoln-Mercury and ABC Ford-Mercury combined)					
Ford	354	10,132,573	8,602,083	8,844,832	1.02822
Lincoln	16	636,362	567,602	573,790	1.01090
Mercury	8	211,917	189,340	193,008	1.01937
Subtotal - ABC Toyota	378	10,980,853	9,359,025	9,611,630	1.02699
	818	23,124,989	19,813,398	20,279,594	1.02353
Less: Trade Discounts & Advertising Fees		(992,251)			
Inventory at Cost		22,132,738			

December 31, 2008 LIFO Reserve Consists of...

Schedule #2

	Base Dollars		Index Factor			Composition of LIFO Reserve
Year 2000, Base Inventory	8,310,943	x	0.10517	=	(1.02353 - 0.91836) =	874,062
Calendar Year 2000 Increment	199,594	x	0.06977	=	(1.02353 - 0.95376) =	13,926
Calendar Year 2002 Increment	1,733,454	x	0.06402	=	(1.02353 - 0.95951) =	110,976
Calendar Year 2003 Increment	97,402	x	0.06024	=	(1.02353 - 0.96329) =	5,867
Calendar Year 2004 Increment	467,242	x	0.02757	=	(1.02353 - 0.99596) =	12,882
Calendar Year 2005 Increment	1,622,694	x	0.03045	=	(1.02353 - 0.99308) =	49,411
Calendar Year 2006 Increment	1,031,478	x	0.02903	=	(1.02353 - 0.99450) =	29,944
Calendar Year 2007 Increment	7,010,845	x	0.02863	=	(1.02353 - 0.99490) =	200,720
Calendar Year 2008 Increment	1,150,275	x	-	=	(1.02353 - 1.02353) =	-
	21,623,927					
						1,297,788

Schedule #3

ABC Consolidated Dealerships, Inc.
Data Re: Allocation of Increase in LIFO Reserve for Pool #1 (All New Vehicles) Among QSSS Members
For the Year Ended December 31, 2008

	Number of Units	Number of Makes Accessed in Database	Estimated Weighted Inflation Average for 2008	Ending Inventory at Cost (Before Subtracting Trade Discounts & Ad Fees): Dec. 31, 2007 Amount	Dec. 31, 2007 Percentage	Dec. 31, 2008 Amount	Dec. 31, 2008 Percentage	Simple Average of BOY + EOY Amount	Simple Average of BOY + EOY Percentage	Average % (Rounded)
ABC Ford-Lincoln-Mercury	221	3	1.02699	6,681,928	31.5%	6,557,473	28.4%	6,619,701	29.9%	30%
ABC Toyota	274	2	1.02724	5,644,903	26.6%	6,277,021	27.1%	5,960,962	26.9%	27%
ABC Ford-Mercury	157	1	1.02699	3,958,488	18.7%	4,423,380	19.1%	4,190,934	18.9%	19%
ABC Highline Cars	166	3	1.01316	4,937,962	23.3%	5,867,115	25.4%	5,402,539	24.4%	24%
Totals	818	9	-	21,223,281	100.0%	23,124,989	100.0%	22,174,135	100.0%	100%
Overall Weighted Inflation Rate			1.02353							

	A-1 Allocation Based on Simple Avg. (BOY+EOY)/2 Costs	B-1 Separate LIFO Calculations for Each Dealership	C-1 Allocation Based on Sum of Separate L/R Changes	D-1 Allocation Based on Sum of Net Increments / Decrements	LIFO Reserve Balances at Dec. 31, 2007 Before Recapture of ABC Ford-Lincoln-Mercury L/R: Amount	Percentage	LIFO Reserve Balances at Dec. 31, 2007 Reflecting Recapture of ABC Ford-Lincoln-Mercury LIFO Reserve (See Note 2): Amount	Percentage	LIFO Reserve Balances Dec. 31 2008
ABC Ford-Lincoln-Mercury	144,524	-	-	-	1,400,651	63.2%	-	0.0%	144,524
ABC Toyota	130,071	-	-	-	187,017	8.4%	187,017	22.9%	317,088
ABC Ford-Mercury	91,532	-	-	-	343,089	15.5%	343,089	42.0%	434,621
ABC Highline Cars	115,619	-	-	-	285,946	12.9%	285,946	35.0%	401,565
Totals	481,745	See Note 3	See Note 3	See Note 3	2,216,703	100.0%	816,052	100.0%	1,297,797
	(Page 2 of Memo)								(9)
									1,297,788

Notes:

1. As of January 1, 2008, the New Vehicle LIFO inventories of the four dealerships listed above comprising ABC Consolidated Dealerships, Inc., were combined into a single LIFO pool for all New Vehicles.
2. On Jan. 1, 2008, ABC Ford-Lincoln-Mercury elected to be treated as an S Corporation. As a result, its LIFO reserves as of Dec. 31, 2007 were fully recaptured.
3. Other allocation approaches in addition to those in Schedules 3 and 4 are discussed on pages 1 and 4 of the Memorandum. Detailed computations for these other alternative approaches are not included as attached schedules (because, as a practical matter, the choice came down to only one of the two shown in Schedules 3 and 4).

ABC Consolidated Dealerships, Inc.
Allocation of Increase in LIFO Reserve for Pool #1 (All New Vehicles) Among QSSS Members
For the Year Ended December 31, 2008

Schedule #4

Two-Step Allocation Based on Significantly Lower Inflation Rate for Vehicles in ABC Highline Cars

		**Allocation (See Below)		
	Net increase in LIFO Reserve for 2008 for combined overall new vehicle pool		481,745	
Step #1	Less: Specific allocation to ABC Highline Cars - based on 1.316% inflation rate		(65,000)	65,000 *
	Balance to be Allocated Among Remaining 3 Dealerships		416,745	
Step #2	Remainder allocated - based on ratio of ending inventory "simple average"	39.5%	164,614	164,614
	ABC Ford-Lincoln-Mercury	35.5%	147,944	147,944
	ABC Toyota	25.0%	104,187	104,187
	ABC Ford-Mercury	100%	416,745	-
	Increase in LIFO Reserve for 2008			481,745

* Beginning-of-the-year inventory at cost multiplied by inflation rate per Schedule #2.
($4,937,962 x 0.01316 = $64,985, rounded to $65,000)

	Ending Inventory at Cost (Before Subtracting Trade Discounts & Ad Fees)							
	Dec. 31, 2007		Dec. 31, 2008		Simple Average of BOY + EOY			
	Amount	Percentage	Amount	Percentage	Amount	Percentage	All 4 Dealerships	3 Dealerships (Excluding ABC Highline Cars)**
ABC Ford-Lincoln-Mercury	6,681,928	31.5%	6,557,473	28.4%	6,619,701	29.9%	30%	39.5%
ABC Toyota	5,644,903	26.6%	6,277,021	27.1%	5,960,962	26.9%	27%	35.5%
ABC Ford-Mercury	3,958,488	18.7%	4,423,380	19.1%	4,190,934	18.9%	19%	25.0%
ABC Highline Cars	4,937,962	23.3%	5,867,115	25.4%	5,402,539	24.4%	24%	-
Totals	21,223,281	100.0%	23,124,989	100.0%	22,174,135	100.0%	100%	100.0%
					(5,402,539)			
					16,771,597			

LIFO & WINERIES: AT LAST, A GOOD YEAR ... ONE WINE(RY) FINALLY SATISFIES THE IRS' TASTE

In the last Edition of the *LIFO Lookout*, we mentioned the recent activity of the IRS auditing the LIFO computations of several wineries in Northern California and what seemed to be a big push by the IRS to settle audits that were still open.

1992 FIELD SERVICE ADVICE

Almost 20 years ago, in a Field Service Advice (FSA) released September 1992, the IRS suggested that a winery should have considered the following in its item definitions for LIFO purposes ... (1) grapes differing in **price**, (2) the **location** in which certain grapes are grown, (3) **when** different grapes are used in production and (4) **how** different grapes are used in production.

The wine maker in this case used the dollar-value, double-extension method, and it divided its grape juice inventory into two items: (1) grape juice used to produce ***sweet*** wine, and (2) grape juice used to produce ***dry*** wine. The IRS felt that two items were not enough.

The IRS determined that there were (numerous) varieties of grapes that went into the juices in the LIFO pool and that due to substitutions of new types of grapes for old types, the taxpayer's use of certain prices for juice did not accurately reflect the base-year cost of the current years' inventories.

This FSA involved technical issues other than LIFO, so the item definition aspect of the winery's LIFO calculations was not discussed further.

2006 FIELD ATTORNEY ADVICE

In a comparatively more recent (and much more intensive) analysis of the LIFO calculations for a winery, the IRS in Field Attorney Advice (FAA) 20064301F found that the producer of bottled wines did not properly establish "item" definitions for "goods" in its LIFO calculations.

Here again, the basic issue in the FAA was whether the winery's LIFO computations "clearly reflect income." The critical element in the determination had to do with whether the winery's definition of "items" was too broad (it was) and should have been more narrow (it should have been).

Unfortunately, neither the Code (Section 472) nor the Regulations thereunder set forth a definition of the words "goods" and "items." However, several landmark cases have been decided in the Courts from which a fairly reliable, and now commonly accepted, interpretation of the term "item" has emerged.

The IRS Chief Counsel's Office's conclusions in the FAA were a disaster for the winery ... (1) with its overly broad definition of "items" for LIFO purposes, the winery failed to determine properly its LIFO indexes, and (2) the winery's LIFO indexes did not accurately measure inflation. As a result, the taxpayer's LIFO method did not clearly reflect income.

In the IRS audit which gave rise to the FAA, the IRS asked many questions about the LIFO calculations which the taxpayer could not answer because it had not retained sufficient books, records and other accounting information. Note here the importance of the requirement (in Rev. Proc. 79-23) that a taxpayer's LIFO election *may* be terminated (at the discretion of the IRS) if the taxpayer fails to "maintain adequate books and records with respect to its LIFO inventory and ***all*** computations incident thereto."

In FAA 20064301F, although the IRS concluded that the winery's LIFO inflation indexes did not "clearly reflect income," the IRS left unanswered the question of whether the deficiencies in the taxpayer's LIFO calculations were so severe that its LIFO election should be terminated.

The FAA advised the IRS Examining Agent that (1) his/her next step should be to consider whether the IRS should seek to terminate the winery's LIFO method and that (2) the winery's books and records should be further examined to confirm that placing the taxpayer on an alternative method for valuing inventory, ***such as FIFO***, would clearly reflect the winery's income.

This FAA is analyzed in detail in the March 2007 issue of the *LIFO Lookout* (in *"Winery's LIFO Calculations Leave a Bitter Taste in IRS' Mouth,"* pages 10-19). That discussion of the FAA includes considerable supplementary discussions on the importance of item definition and a few landmark LIFO cases on this subject (*Amity Leather Products, Co.*, *Wendle Ford Sales, Inc.* and *Hamilton Industries, Inc.*) which have significant precedential value in countless other LIFO contexts.

ILM 201043029

During the summer of 2010, in Internal Revenue Service Legal Memorandum (ILM) 201043029, IRS Chief Counsel Advice examined the item definitions that another winery was using for its LIFO price index computation purposes. In this case, the IRS concluded that the item definitions used by the winery in its LIFO calculations were acceptable.

ILM 201043029 is analyzed in detail on the following pages.

Item Definition	***LIFO Landmark Cases Establishing the Narrow "Item" Definition Concept for Dollar-Value LIFO Purposes***
Importance of Defining Items Properly	• In 1984, the Tax Court (in *Amity Leather Products Co. v. Comm.*) established a basic principle for the term "item" in the context of Section 472 ... "[a] narrow definition of an item within a pool will generally led to a more accurate measure of inflation (i.e., price index) and thereby lead to a clearer reflection of income." • Thus, whether referencing "goods" or an "item," the goods or item placed in the inventory pool must provide an accurate measure of inflation. • The cost of inventory items plays a significant role in defining an item. ◆ In *Amity Leather*, the Tax Court agreed with the taxpayer that billfolds manufactured in Puerto Rico should be treated for inventory purposes as different items from otherwise identical billfolds produced in the United States. The billfolds produced in Puerto Rico were substantially cheaper. • Proper item definition is the foundation on which an accurate, reliable, and suitable LIFO index must be built. • The LIFO index is generally defined as the ratio of the current cost of the goods in inventory to the base cost of those same goods. Since a LIFO reserve measures cumulative inflation in the ending inventory, it is imperative that the LIFO index accurately measure inflation.
Amity Leather Products, Co.	• Distortions can occur when the taxpayer does not properly define its items. • Because the change in the price of an item determines the price index and that index affects the computation of increments or decrements in the LIFO inventory, the definition and scope of an item are extremely important to the clear reflection of income. • If factors other than inflation enter into the cost of inventory items, a reliable index cannot be computed. ◆ For example, if a taxpayer's inventory experiences mix changes that result in the substitution of less expensive goods for more expensive goods, the treatment of those goods as a single item increases taxable income. ◆ Conversely, if changes in mix of the inventory result in the substitution of more expensive goods for less expensive goods, the treatment of those goods as a single item decreases taxable income because the increase in inventory costs is eliminated from the LIFO cost of the goods as if such cost increase represented inflation.
Hamilton Industries, Inc.	• The taxpayer in *Hamilton* had elected the LIFO method and tried to include inventory purchased in two acquisitions in the same inventory pool as inventory manufactured after the acquisition. • The Tax Court determined that the purchased inventory could be placed in the same pool as the later manufactured inventory but, despite the taxpayer's arguments, could not be treated as the same item for LIFO purposes because the values of the purchased inventory were too disparate from the costs of the manufactured inventory. ◆ Furthermore, the taxpayer could identify the inventory in question and track it at the time of purchase. *[Another example of the problems raised then the taxpayer has not maintained adequate books and records.]* • The proper grouping of goods into pools and items is central to the operation of the dollar-value method. (Citing *Wendle Ford Sales, Inc. v. Comm.*) • In order to produce a clear reflection of income, the goods contained in a taxpayer's pool and item categories must have similar characteristics, as determined under the standards applicable to each. • A system which groups like goods together and separates dissimilar goods permits cost increases attributable to inflation to be isolated and accurately measured. • The more homogenous that each category can be made, the better it will screen out cost increases caused by non-inflationary factors, thus producing a clearer reflection of income than would be possible with categories containing heterogeneous agglomerations of goods.

ILM 201043029	IRS APPROVES NARROW ITEM DEFINITIONS USED BY A WINERY FOR VALUING ITS LIFO INVENTORIES Page 1 of 2
Facts	• The taxpayer is a winery that owns and operates two vineyards in a particular Region from which it produces several types of wine. Significant detail concerning the growing and production activities of the winery has been omitted from this summary. • The taxpayer uses the dollar-value, link chain, LIFO method to value its bulk and bottled wine inventory. It determines current-year cost using the latest acquisitions method, and it maintains one natural business unit pool.
In General	• If the inflation in the taxpayer's LIFO inventory is to be correctly and consistently measured, the taxpayer must properly define each item of wine in its inventory and the change in cost of its various wines must be identified and measured at the item level. • The manner in which a winery should define "items" for LIFO purposes so that this goal is met is factually dependent, and the resulting item definitions may vary depending on the particular facts and circumstances of each winery.
Item Criteria for Bulk Wines	• Type of wine (e.g., varietal, appellation, or blend), • Source of grapes (e.g., purchased or grown), • Process, recipe, or formula used, or the program followed, to make the wine, and • Length of time the wine has been in production or aging at the end of the tax year, from the time the grapes are harvested (*e.g.*, 3 months; 15 months; 27 months).
Item Criteria for Bottled Wines & Cased Goods	• Type of wine (e.g., varietal, appellation, or blend), • Source of grapes (e g., purchased or grown), • Process, recipe, or formula used, or the program followed, to make the wine, • If the wine if aged in the bottle, the length of time the bottled wine has been aging when bottled, • Type and size of container, if a significant cost difference exists between types or sizes of containers, and • Length of time the wine has been stored after bottling.
Other Considerations for Purposes of Defining "Items" in a Winery	• ***As to type of wine*** ... each varietal, appellation, and blend should be defined as a separate item. For this purpose, a blend generally is a wine made from mixing together two or more wines or varietals. The term appellation refers to a defined viticultural growing region, whereby specific grape varietals are grown, harvested, and made into wine. • ***Regarding source of grapes*** ... wines made with purchased grapes and wines made with estate-grown grapes should generally be treated as separate items due to their cost differences. ◆ However, where a taxpayer purchases grapes if, and only to the extent, there is a shortfall in the yield from its vineyard due to weather, insects, diseases,. or other similar causes, the taxpayer need not under such circumstances separate wines into separate items on the basis that some of the grapes used to make wine, otherwise made with estate grapes, were purchased. • ***The terms "process," "recipe," "formula," and "program"*** (for purposes of defining an item of wine) mean a set of directions, techniques, or procedures regularly followed, as well as a set of ingredients regularly used, to produce a distinct product (i.e., wine with specific taste, quality or grade, cost, and price point). ◆ For example, if the taxpayer uses different quality grapes of the same varietal to produce a high quality wine and a medium quality wine, the two wines should be treated as separate items. ◆ On the other hand, if the taxpayer uses the same quality grapes and some of the resulting wine has a higher quality than, or will be marketed as a different wine from, the remainder of the wine produced using these grapes, the taxpayer will not treat this wine as two items based solely on the process, recipe, formula, or program criteria. • ***As to length of time wine has been aging or in production*** ... wines with different ages or at different stages of production (such as the current year's production, one-year bulk wine, and two-year bulk wine, etc.) should be separate items. ◆ This is because treating wines that are at different stages of production as the same item would not create an accurate measure of inflation or result in a correct LIFO index. ◆ For example, two-year bulk wine would have more production and storage costs applied to it than the current year's production, or than one-year bulk wine. If two-year bulk wine and one-year bulk wine were treated as the same item for purposes of computing a LIFO index, the LIFO index would be distorted as a result of the artificial inflation created by the two-year bulk wine's additional costs.

IRS APPROVES NARROW ITEM DEFINITIONS USED BY A WINERY FOR VALUING ITS LIFO INVENTORIES

"Item" Definitions Used by the Winery	• ***Bulk wines.*** The taxpayer defines items in its bulk wine by varietal: Varietal 1, Varietal 2, Varietal 3, and Varietal 4. It further defines bulk wine by length of production, i.e., time, in months, from the month the grapes are harvested (stage of production). Additionally, the taxpayer defines bulk wine by quality. Once bulk wine is determined to be of sufficient quality to be bottled as a "Reserve" (high quality) wine, the taxpayer treats such bulk wine as a separate item from the bulk wine of the same varietal and production period. • ***Bottled wines.*** The taxpayer defines items of bottled wine in a similar manner as bulk wine. It defines bottled wine by varietal, length of time it has been aged and stored, and the quality of the wine (e.g., Estate Varietal 1, Reserve Varietal 1). • The taxpayer further defines items by the size of the bottle used, if the same item is bottled in containers of different sizes. For example, some wines are further defined by 750 mL and 1.5L bottles.
Bulk Wine ***Application of "Item" Definition Criteria to Taxpayer***	• The taxpayer properly defines its bulk wine by varietal. The taxpayer does not need to distinguish its bulk wine by appellation because the taxpayer only uses grapes grown within the same appellation. • The taxpayer properly defines bulk wine by source of grapes. The taxpayer primarily uses estate-grown grapes. ◆ The taxpayer uses purchased grapes only if, and to the extent, there is a shortfall in the yield of grapes from its vineyard due to weather, insects, diseases, or other similar causes. Therefore, the taxpayer does not need to distinguish wine on the basis of the use of purchased grapes versus estate-grown grapes. • The taxpayer properly defines bulk wine by process, recipe, or formula used. The taxpayer also properly defines bulk wine by quality. ◆ Once the taxpayer's Varietal 1 is determined to be of sufficient quality to be bottled as a "Reserve" wine, this higher-quality bulk wine becomes a separate item. • The taxpayer properly defines its bulk wine by the stage of production or length of time the bulk wine has been aging or in production.
Bottled Wine & Cased Goods ***Application of "Item" Definition Criteria to Taxpayer***	• The taxpayer properly defines its bottled wine by varietal. The taxpayer does not need to distinguish its bottled wine by appellation because the taxpayer only uses grapes grown within the same appellation. • The taxpayer properly defines bottled wine by source of grapes. The taxpayer primarily uses estate-grown grapes. ◆ The taxpayer uses purchased grapes only if, and to the extent, there is a shortfall in the yield of grapes from its vineyard due to weather, insects, diseases, or other similar causes. Therefore, the taxpayer does not need to distinguish wine on the basis of the use of purchased grapes versus and estate-grown grapes. • The taxpayer properly defines bottled wine by process, recipe, or formula used. The taxpayer also properly defines bottled wine by quality. ◆ Once the taxpayer's Varietal 1 is determined to be of sufficient quality to be bottled as a "Reserve" wine, this higher-quality bulk wine becomes a separate item. • The taxpayer properly defines bottled wine by length of time it has been aged and stored. • The taxpayer properly defines bottled wine by the type and size of container used. ◆ The taxpayer treats as separate items wine bottled in 750 mL containers and 1.5 L containers.
IRS Accepts the Taxpayer's Item Definitions	
ILM Conclusion	• Based on the facts presented, the taxpayer does not consider goods that do not have similar characteristics as the same item. • The taxpayer defines items of wine in a manner that allows for an accurate measure of inflation. • The taxpayer appropriately subdivides bulk wine and bottled wine into inventory items based on factors such as varietal, quality, length of time of aging, and other criteria noted. • Therefore, the taxpayer properly defines items within its dollar-value LIFO pool for purposes of computing the LIFO price index of the pool.

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 45-48. In general, based on our one-of-each new vehicle item category compilations for this year-end, we are expecting that inflation rates will be fairly flat in comparison with last year except for Ford.

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 16, 2010 ... with intro-2011 model prices, unless the 2011 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2009 is the reference date for the equivalent of the calendar year 2010 beginning of the year date; i.e., December 31, 2009/January 1, 2010.

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 50-56.

Two Pools or Single Pool for New Vehicles? We've included information on page 45 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 45-56 in connection with many of our year-end LIFO reserve projection activities. In the December 2004 *LIFO Lookout*, we included an extensive look at how we do year-end projections including ***Practice Guides*** and sample formats showing ...

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

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

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

DECEMBER 17, 2010

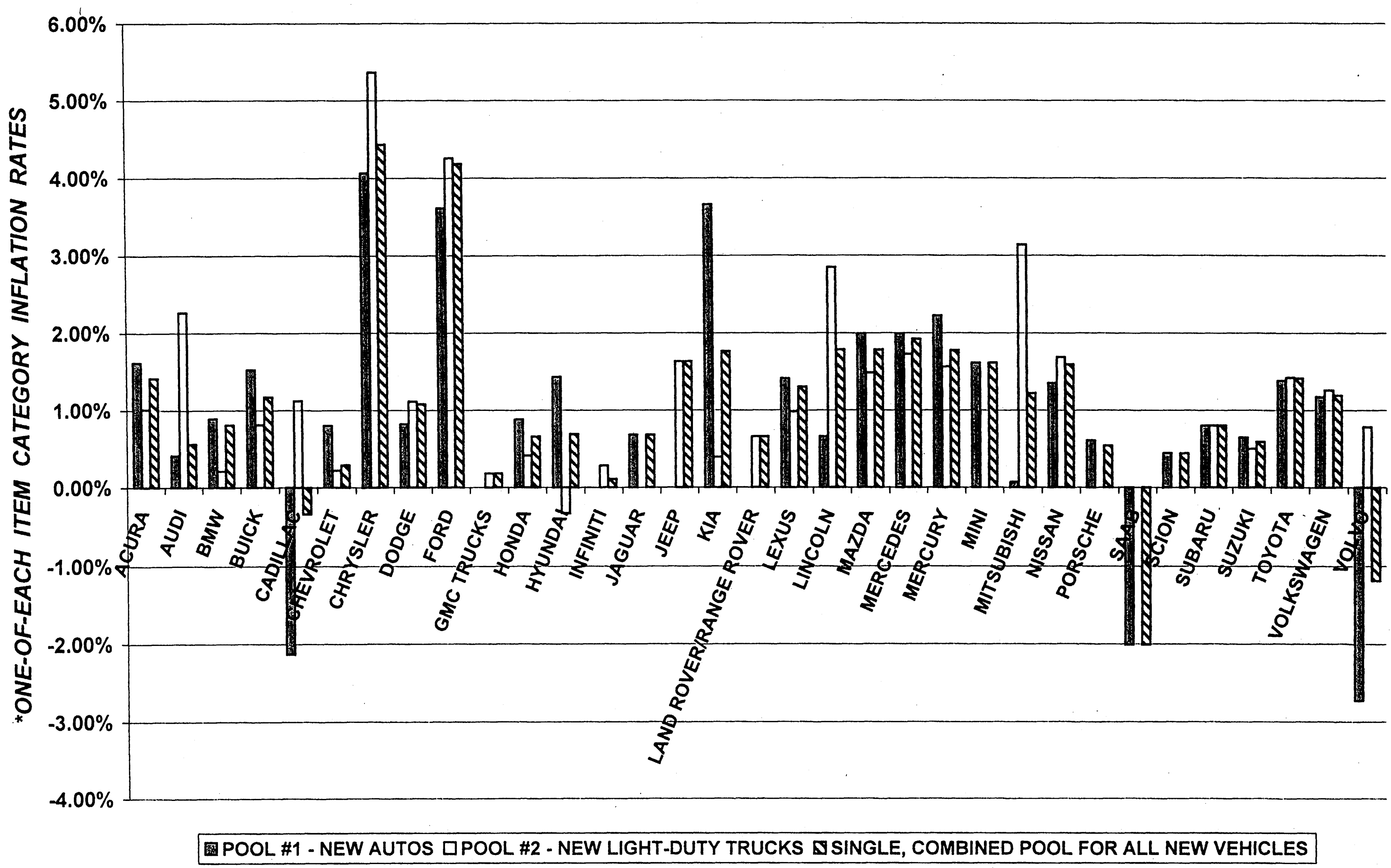
MODEL/ITEM CATEGORY INFLATION SURVEY
FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES
DEALER COST FOR THE YEAR ENDED 12/31/10

INFLATION ESTIMATE REPORT BY MAKE
BASED ON INFORMATION AVAILABLE

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS	ALL NEW VEHICLES COMBINED
ACURA	1.61%	1.01%	1.41%
AUDI	0.41%	2.26%	0.56%
BMW	0.89%	0.21%	0.81%
BUICK	1.52%	0.81%	1.17%
CADILLAC	(2.13)%	1.12%	(0.34)%
CHEVROLET	0.80%	0.22%	0.29%
CHRYSLER	4.06%	5.36%	4.43%
DODGE	0.82%	1.11%	1.08%
FORD	3.61%	4.25%	4.18%
GMC TRUCKS	0,00%	0.18%	0.18%
HONDA	0.88%	0.41%	0.66%
HYUNDAI	1.43%	(0.33)%	0.69%
INFINITI	0.00%	0.28%	0.11%
JAGUAR	0.68%	0.00%	0.68%
JEEP	0.00%	1.63%	1.63%
KIA	3.66%	0.39%	1.76%
LAND ROVER/RANGE ROVER	0.00%	0.66%	0.66%
LEXUS	1.41%	0.98%	1.30%
LINCOLN	0.66%	2.85%	1.78%
MAZDA	1.99%	1.48%	1.78%
MERCEDES	1.99%	1.72%	1.92%
MERCURY	2.22%	1.56%	1.77%
MINI	1.61%	0.00%	1.61%
MITSUBISHI	0.07%	3.14%	1.22%
NISSAN	1.35%	1.68%	1.59%
PORSCHE	0.61%	0.00%	0.54%
SAAB	(2.01)%	0.00%	(2.01)%
SCION	0.44%	0.00%	0.44%
SUBARU	0.80%	0.80%	0.80%
SUZUKI	0.65%	0.50%	0.59%
TOYOTA	1.38%	1.42%	1.41%
VOLKSWAGEN	1.17%	1.26%	1.19%
VOLVO	(2.73)%	0.78%	(1.19)%

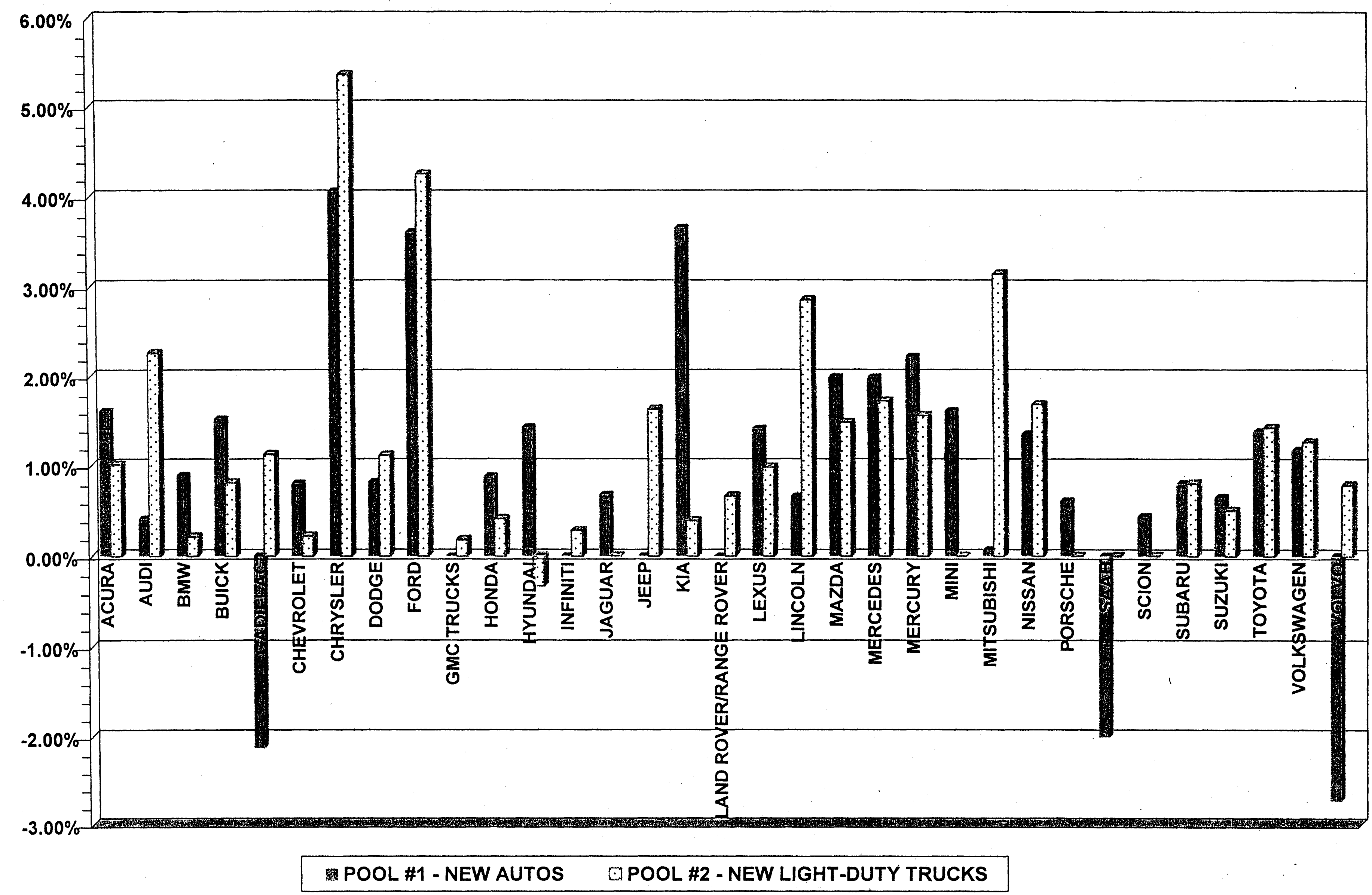
Source: De Filipps' *SuperLIFO™*

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/10



Source: De Filipps' *SuperLIFO*™

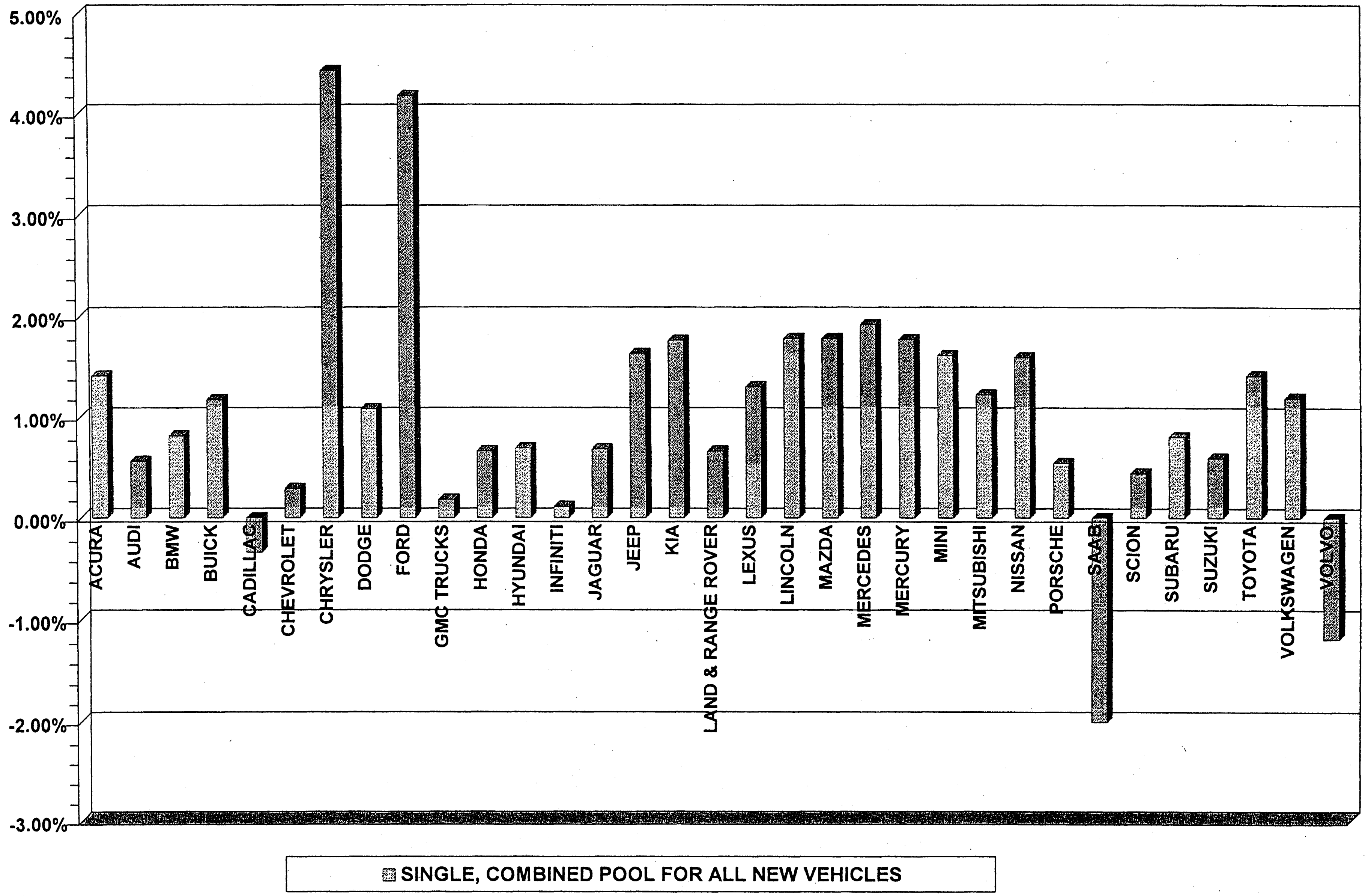
WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/10



Source: De Filipps' ***SuperLIFO***™

*ONE-OF-EACH ITEM CATEGORY INFLATION RATES

WEIGHTED AVERAGE* INFLATION FOR THE YEAR ENDED 12/31/10



*ONE-OF-EACH ITEM CATEGORY INFLATION RATES

Source: De Filipps' ***SuperLIFO***™

Projected Change in LIFO Reserve(s) for 2010

Sample Letter

December ___, 2010

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 2010. 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 2010, 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 2010, 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 2010.

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 2010.

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

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
RL	3	0	3	136,108		137,306	1,198	0.88%
TL	8	0	8	297,737		302,402	4,665	1.57%
TSX	6	0	6	180,443		184,495	4,052	2.25%
TOTAL NEW AUTOS	17	0	17	614,288		624,203	9,915	1.61%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	0	1	1		47,821	47,821	0	0.00%
RDX	4	0	4	128,966		130,932	1,966	1.52%
ZDX	3	0	3	137,658		138,856	1,198	0.87%
TOTAL NEW L-D TRUCKS	7	1	8	266,624	47,821	317,609	3,164	1.01%
TOTAL ACURA	24	1	25	880,912	47,821	941,812	13,079	1.41%
AUDI								
NEW AUTOS - POOL #1								
A3	6	0	6	160,743		161,024	281	0.17%
A4	4	0	4	123,410		125,437	2,027	1.64%
A5	4	0	4	148,150		149,247	1,097	0.74%
A6	4	0	4	194,983		193,310	(1,673)	(0.86)%
A8	0	2	2		150,707	150,707	0	0.00%
R8	4	4	8	500,898	553,908	1,057,596	2,790	0.26%
S4	2	0	2	86,676		87,978	1,302	1.50%
S5	3	0	3	152,754		154,242	1,488	0.97%
S6	1	0	1	70,774		70,774	0	0.00%
TT	0	2	2		74,028	74,028	0	0.00%
TTS	2	0	2	88,164		90,210	2,046	2.32%
TOTAL NEW AUTOS	30	8	38	1,526,552	778,643	2,314,553	9,358	0.41%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q5	1	1	2	34,735	32,736	72,262	4,791	7.10%
Q7	0	3	3		144,616	144,616	0	0.00%
TOTAL NEW L-D TRUCKS	1	4	5	34,735	177,352	216,878	4,791	2.26%
TOTAL AUDI	31	12	43	1,561,287	955,995	2,531,431	14,149	0.56%
BMW								
NEW AUTOS - POOL #1								
1 SERIES	6	0	6	186,210		188,235	2,025	1.09%
3 SERIES	20	3	23	711,430	137,795	862,445	13,220	1.56%
5 SERIES	0	9	9		471,180	471,180	0	0.00%
7 SERIES	5	6	11	434,440	553,935	996,275	7,900	0.80%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
M3	3	0	3	164,860		166,385	1,525	0.93%
X6	4	0	4	277,060		278,395	1,335	0.48%
Z4	2	1	3	89,610	56,625	147,615	1,380	0.94%
TOTAL NEW AUTOS	40	19	59	1,863,610	1,219,535	3,110,530	27,385	0.89%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X3	0	2	2		71,575	71,575	0	0.00%
X5	2	4	6	125,675	194,945	321,445	825	0.26%
TOTAL NEW L-D TRUCKS	2	6	8	125,675	266,520	393,020	825	0.21%
TOTAL BMW	42	25	67	1,989,285	1,486,055	3,503,550	28,210	0.81%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	3	1	4	90,700	25,915	118,449	1,834	1.57%
LUCERNE	4	0	4	134,496		137,276	2,780	2.07%
REGAL	0	2	2		52,790	52,790	0	0.00%
TOTAL NEW AUTOS	7	3	10	225,196	78,705	308,515	4,614	1.52%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENCLAVE	6	2	8	224,562	69,378	296,314	2,374	0.81%
TOTAL NEW L-D TRUCKS	6	2	8	224,562	69,378	296,314	2,374	0.81%
TOTAL BUICK	13	5	18	449,758	148,083	604,829	6,988	1.17%
CADILLAC								
NEW AUTOS - POOL #1								
CTS	21	7	28	901,735	305,015	1,169,628	(37,122)	(3.08)%
DTS	5	0	5	244,269		246,159	1,890	0.77%
STS	3	0	3	144,751		145,984	1,233	0.85%
TOTAL NEW AUTOS	29	7	36	1,290,755	305,015	1,561,771	(33,999)	(2.13)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	23	0	23	1,586,125		1,598,929	12,804	0.81%
SRX	9	0	9	366,282		375,259	8,977	2.45%
TOTAL NEW L-D TRUCKS	32	0	32	1,952,407		1,974,188	21,781	1.12%
TOTAL CADILLAC	61	7	68	3,243,162	305,015	3,535,959	(12,218)	(0.34)%

PAGE: 3 DECEMBER 17, 2010

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
CHEVROLET								
NEW AUTOS - POOL #1								
AVEO	6	0	6	79,544		79,832	288	0.36%
CAMARO	5	0	5	131,321		133,464	2,143	1.63%
CORVETTE	5	0	5	314,124		316,928	2,804	0.89%
CRUZE	0	6	6		108,624	108,624	0	0.00%
IMPALA	4	2	6	100,114	47,016	148,546	1,416	0.96%
MALIBU	5	0	5	112,314		113,149	835	0.74%
VOLT	0	1	1		38,669	38,669	0	0.00%
TOTAL NEW AUTOS	25	9	34	737,417	194,309	939,212	7,486	0.80%
NEW LIGHT-DUTY TRUCKS - POOL #2								
AVALANCHE	6	0	6	232,397		234,420	2,023	0.87%
COLORADO	16	0	16	358,696		359,609	913	0.25%
COLORADO CHASSIS CAB	2	0	2	40,143		40,257	114	0.28%
EQUINOX	8	0	8	195,302		198,447	3,145	1.61%
EXPRESS CARGO VAN	10	4	14	270,914	149,995	423,089	2,180	0.52%
EXPRESS CUTAWAY VAN	3	3	6	74,777	108,243	183,020	0	0.00%
EXPRESS PASSENGER VAN	5	2	7	146,108	84,519	230,607	(20)	(0.01)%
HHR	3	0	3	55,171		55,171	0	0.00%
SILVERADO 1500	35	0	35	1,057,216		1,057,216	0	0.00%
SILVERADO 2500HD	0	28	28		938,351	938,351	0	0.00%
SILVERADO 3500HD	0	38	38		1,316,537	1,316,537	0	0.00%
SILVERADO 3500HD CHASSIS CAB	0	12	12		370,780	370,780	0	0.00%
SUBURBAN	13	0	13	550,337		554,082	3,745	0.68%
TAHOE	9	0	9	388,158		390,314	2,156	0.56%
TRAVERSE	8	0	8	260,832		261,268	436	0.17%
TOTAL NEW L-D TRUCKS	118	87	205	3,630,051	2,968,425	6,613,168	14,692	0.22%
TOTAL CHEVROLET	143	96	239	4,367,468	3,162,734	7,552,380	22,178	0.29%
CHRYSLER								
NEW AUTOS - POOL #1								
200	0	3	3		62,165	62,165	0	0.00%
300	3	2	5	100,571	68,230	178,188	9,387	5.56%
SEBRING	0	0	0				0	N/A%
TOTAL NEW AUTOS	3	5	8	100,571	130,395		9,387	4.06%
NEW LIGHT-DUTY TRUCKS - POOL #2								
TOWN & COUNTRY	2	1	3	60,102	30,431	95,388	4,855	5.36%
TOTAL NEW L-D TRUCKS	2	1	3	60,102	30,431	95,388	4,855	5.36%
TOTAL CHRYSLER	5	6	11	160,673	160,826	335,741	14,242	4.43%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
DODGE								
NEW AUTOS - POOL #1								
AVENGER	0	3	3		61,967	61,967	0	0.00%
CALIBER	1	4	5	16,986	73,016	90,764	762	0.85%
CHALLENGER	3	0	3	90,914		92,820	1,906	2.10%
CHARGER	0	3	3		84,083	84,083	0	0.00%
TOTAL NEW AUTOS	4	10	14	107,900	219,066	329,634	2,668	0.82%
NEW LIGHT-DUTY TRUCKS - POOL #2								
DAKOTA	11	0	11	289,346		292,896	3,550	1.23%
GRAND CARAVAN	2	1	3	43,138	27,218	72,511	2,155	3.06%
JOURNEY	1	8	9	19,861	224,676	246,561	2,024	0.83%
NITRO	0	6	6		151,656	151,656	0	0.00%
RAM CHASSIS CAB	0	0	0				0	N/A%
RAM PICKUP	60	7	67	2,017,200	235,960	2,278,743	25,583	1.14%
TOTAL NEW L-D TRUCKS	74	22	96	2,369,545	639,510	3,042,367	33,312	1.11%
TOTAL DODGE	78	32	110	2,477,445	858,576	3,372,001	35,980	1.08%
FORD								
NEW AUTOS - POOL #1								
CROWN VICTORIA	0	0	0				0	N/A%
FIESTA	0	5	5		73,454	73,454	0	0.00%
FOCUS	4	0	4	65,136		67,757	2,621	4.02%
FUSION	7	0	7	160,375		163,567	3,192	1.99%
MUSTANG	10	0	10	297,823		317,734	19,911	6.69%
TAURUS	6	0	6	168,708		170,598	1,890	1.12%
TOTAL NEW AUTOS	27	5	32	692,042	73,454	793,110	27,614	3.61%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CUTAWAY	0	0	0				0	N/A%
E-SERIES	17	0	17	463,078		471,632	8,554	1.85%
EDGE	8	0	8	237,148		246,162	9,014	3.80%
ESCAPE	10	0	10	252,741		256,273	3,532	1.40%
EXPEDITION	4	2	6	168,586	74,173	249,109	6,350	2.62%
EXPEDITION EL	4	2	6	178,230	79,105	263,689	6,354	2.47%
EXPLORER	0	6	6		185,572	185,572	0	0.00%
F150 PICKUP	51	3	54	1,539,104	127,936	1,745,180	78,140	4.69%
F250 SUPER DUTY PICKUP	36	0	36	1,186,432		1,244,509	58,077	4.90%
F350 SUPER DUTY CHASSIS CAB	0	0	0				0	N/A%
F350 SUPER DUTY PICKUP	53	0	53	1,786,785		1,901,034	114,249	6.39%
FLEX	7	3	10	230,302	118,651	353,592	4,639	1.33%
RANGER	10	0	10	197,163		201,947	4,784	2.43%
TRANSIT CONNECT	8	1	9	160,366	21,612	185,894	3,916	2.15%
TOTAL NEW L-D TRUCKS	208	17	225	6,399,935	607,049	7,304,593	297,809	4.25%
TOTAL FORD	235	22	257	7,091,977	680,503	8,097,703	325,223	4.18%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACADIA	8	2	10	282,768	84,018	364,462	(2,324)	(0.63)%
CANYON	14	0	14	311,101		311,900	799	0.26%
CANYON CHASSIS CAB	2	0	2	40,143		40,257	114	0.28%
SAVANA CARGO VAN	10	4	14	270,914	149,995	425,772	4,863	1.16%
SAVANA CUTAWAY VAN	3	3	6	74,777	108,243	183,020	0	0.00%
SAVANA PASSENGER VAN	5	1	6	146,108	43,129	189,217	(20)	(0.01)%
SIERRA 1500 SERIES PICKUP	37	0	37	1,149,783		1,150,173	390	0.03%
SIERRA 2500HD SERIES PICKUP	0	30	30		1,028,305	1,028,305	0	0.00%
SIERRA 3500HD CHASSIS CAB	0	12	12		373,059	373,059	0	0.00%
SIERRA 3500HD SERIES PICKUP	0	38	38		1,326,618	1,326,618	0	0.00%
TERRAIN	8	0	8	209,572		211,472	1,900	0.91%
YUKON	20	0	20	920,866		926,590	5,724	0.62%
TOTAL NEW L-D TRUCKS	107	90	197	3,406,032	3,113,367	6,530,845	11,446	0.18%
TOTAL GMC TRUCKS	107	90	197	3,406,032	3,113,367	6,530,845	11,446	0.18%
HONDA								
NEW AUTOS - POOL #1								
ACCORD	20	1	21	478,937	21,518	506,823	6,368	1.27%
CIVIC	32	1	33	608,064	24,022	636,488	4,402	0.70%
CR-Z	0	6	6		119,827	119,827	0	0.00%
FIT	0	5	5		83,210	83,210	0	0.00%
INSIGHT	3	1	4	60,576	17,188	79,405	1,641	2.11%
TOTAL NEW AUTOS	55	14	69	1,147,577	265,765	1,425,753	12,411	0.88%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACCORD CROSSTOUR	5	0	5	151,508		152,250	742	0.49%
CR-V	8	2	10	191,422	42,847	235,382	1,113	0.48%
ELEMENT	4	0	4	82,673		83,784	1,111	1.34%
ODYSSEY	0	7	7		226,165	226,165	0	0.00%
PILOT	10	2	12	309,024	66,648	377,028	1,356	0.36%
RIDGELINE	4	0	4	118,870		119,412	542	0.46%
TOTAL NEW L-D TRUCKS	31	11	42	853,497	335,660	1,194,021	4,864	0.41%
TOTAL HONDA	86	25	111	2,001,074	601,425	2,619,774	17,275	0.66%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	7	0	7	93,950		93,773	(177)	(0.19)%
AZERA	2	0	2	51,177		52,154	977	1.91%
ELANTRA	4	0	4	69,354		70,298	944	1.36%
GENESIS	9	0	9	245,061		251,789	6,728	2.75%
SONATA	0	6	6		131,041	131,041	0	0.00%
TOTAL NEW AUTOS	22	6	28	459,542	131,041	599,055	8,472	1.43%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
SANTA FE	8	0	8	198,125		199,241	1,116	0.56%
TUCSON	4	1	5	91,483	19,008	107,975	(2,516)	(2.28)%
VERACRUZ	4	0	4	120,182		120,182	0	0.00%
TOTAL NEW L-D TRUCKS	16	1	17	409,790	19,008	427,398	(1,400)	(0.33)%
TOTAL HYUNDAI	38	7	45	869,332	150,049	1,026,453	7,072	0.69%
INFINITI								
NEW AUTOS - POOL #1								
G37	0	0	0				0	N/A%
M35	0	0	0				0	N/A%
M37	0	2	2		87,383	87,383	0	0.00%
M45	1	0	1	50,439		50,439	0	0.00%
M56	0	2	2		108,520	108,520	0	0.00%
TOTAL NEW AUTOS	1	4	5	50,439	195,903	246,342	0	0.00%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EX35	0	0	0				0	N/A%
FX35	1	0	1	39,155		39,569	414	1.06%
FX50	0	0	0				0	N/A%
QX56	0	2	2		107,508	107,508	0	0.00%
TOTAL NEW L-D TRUCKS	1	2	3	39,155	107,508	147,077	414	0.28%
TOTAL INFINITI	2	6	8	89,594	303,411	393,419	414	0.11%
JAGUAR								
NEW AUTOS - POOL #1								
XF	4	0	4	230,778		234,232	3,454	1.50%
XJ	6	0	6	502,232		504,068	1,836	0.37%
XK	4	1	5	334,608	94,763	432,035	2,664	0.62%
TOTAL NEW AUTOS	14	1	15	1,067,618	94,763	1,170,335	7,954	0.68%
TOTAL JAGUAR	14	1	15	1,067,618	94,763	1,170,335	7,954	0.68%
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMPASS	3	1	4	63,451	18,962	87,941	5,528	6.71%
GRAND CHEROKEE	0	6	6		206,500	206,500	0	0.00%
LIBERTY	4	1	5	100,362	26,348	126,564	(146)	(0.12)%
PATRIOT	3	1	4	62,334	15,850	78,252	68	0.09%
WRANGLER	7	0	7	180,942		186,467	5,525	3.05%
TOTAL NEW L-D TRUCKS	17	9	26	407,089	267,660	685,724	10,975	1.63%
TOTAL JEEP	17	9	26	407,089	267,660	685,724	10,975	1.63%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
KIA								
NEW AUTOS - POOL #1								
FORTE	8	3	11	128,600	50,650	186,230	6,980	3.89%
OPTIMA	3	2	5	55,610	47,180	106,410	3,620	3.52%
RIO	5	0	5	69,900		72,165	2,265	3.24%
TOTAL NEW AUTOS	16	5	21	254,110	97,830	364,805	12,865	3.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SEDONA	2	0	2	50,310		51,145	835	1.66%
SORENTO	0	10	10		254,720	254,720	0	0.00%
SOUL	5	0	5	77,780		78,860	1,080	1.39%
SPORTAGE	0	5	5		103,750	103,750	0	0.00%
TOTAL NEW L-D TRUCKS	7	15	22	128,090	358,470	488,475	1,915	0.39%
TOTAL KIA	23	20	43	382,200	456,300	853,280	14,780	1.76%
LAND ROVER/RANGE ROVER								
NEW LIGHT-DUTY TRUCKS - POOL #2								
LAND ROVER LR2	1	0	1	32,305		32,487	182	0.56%
LAND ROVER LR4	1	0	1	42,998		43,362	364	0.85%
RANGE ROVER	4	0	4	278,178		279,953	1,775	0.64%
TOTAL NEW L-D TRUCKS	6	0	6	353,481		355,802	2,321	0.66%
TOTAL LAND ROVER/RANGE ROVER	6	0	6	353,481		355,802	2,321	0.66%
LEXUS								
NEW AUTOS - POOL #1								
ES 350	1	0	1	31,553		32,209	656	2.08%
GS 350	2	0	2	82,754		84,554	1,800	2.18%
GS 450H	1	0	1	50,894		52,154	1,260	2.48%
GS 460	1	0	1	47,587		48,477	890	1.87%
HS 250H	2	0	2	64,764		66,402	1,638	2.53%
IS 250	5	0	5	161,441		163,959	2,518	1.56%
IS 350	2	1	3	73,512	36,925	112,442	2,005	1.82%
IS F	1	0	1	51,982		53,108	1,126	2.17%
LS 460	4	0	4	246,401		246,719	318	0.13%
LS 600H	1	0	1	96,832		97,900	1,068	1.10%
TOTAL NEW AUTOS	20	1	21	907,720	36,925	957,924	13,279	1.41%
NEW LIGHT-DUTY TRUCKS - POOL #2								

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX 460	2	0	2	96,771		97,438	667	0.69%
LX 570	1	0	1	68,445		69,201	756	1.10%
RX 350	2	0	2	69,335		69,999	664	0.96%
RX 450H	2	0	2	79,130		80,132	1,002	1.27%
TOTAL NEW L-D TRUCKS	7	0	7	313,681		316,770	3,089	0.98%
TOTAL LEXUS	27	1	28	1,221,401	36,925	1,274,694	16,368	1.30%
LINCOLN								
NEW AUTOS - POOL #1								
MKS	3	0	3	120,981		122,106	1,125	0.93%
MKZ	2	1	3	64,547	31,622	96,567	398	0.41%
TOWN CAR	4	0	4	176,512		177,606	1,094	0.62%
TOTAL NEW AUTOS	9	1	10	362,040	31,622	396,279	2,617	0.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MKT	3	0	3	128,531		128,576	45	0.04%
MKX	2	0	2	72,337		73,887	1,550	2.14%
NAVIGATOR	4	0	4	209,616		219,714	10,098	4.82%
TOTAL NEW L-D TRUCKS	9	0	9	410,484		422,177	11,693	2.85%
TOTAL LINCOLN	18	1	19	772,524	31,622	818,456	14,310	1.78%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA2	0	4	4		60,423	60,423	0	0.00%
MAZDA3	15	0	15	277,011		285,034	8,023	2.90%
MAZDA6	7	0	7	153,380		158,131	4,751	3.10%
MIATA MX-5	10	0	10	245,388		248,527	3,139	1.28%
RX-8	5	0	5	138,426		139,946	1,520	1.10%
TOTAL NEW AUTOS	37	4	41	814,205	60,423	892,061	17,433	1.99%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-7	6	1	7	151,628	25,104	179,296	2,564	1.45%
CX-9	6	0	6	173,862		176,740	2,878	1.66%
MAZDA5	0	4	4		79,095	79,095	0	0.00%
TRIBUTE	9	0	9	207,870		211,860	3,990	1.92%
TOTAL NEW L-D TRUCKS	21	5	26	533,360	104,199	646,991	9,432	1.48%
TOTAL MAZDA	58	9	67	1,347,565	164,622	1,539,052	26,865	1.78%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	6	0	6	223,087		226,428	3,341	1.50%
CL CLASS	4	0	4	573,968		585,621	11,653	2.03%
CLS CLASS	2	0	2	158,426		160,936	2,510	1.58%
E CLASS	7	4	11	375,022	212,777	593,983	6,184	1.05%
S CLASS	6	0	6	705,453		729,826	24,373	3.45%
SL CLASS	0	0	0				0	N/A%
SLK CLASS	2	0	2	91,884		93,883	1,999	2.18%
SLS CLASS	0	1	1		170,190	170,190	0	0.00%
TOTAL NEW AUTOS	27	5	32	2,127,840	382,967	2,560,867	50,060	1.99%
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	2	0	2	210,831		214,086	3,255	1.54%
GL CLASS	3	0	3	189,488		192,836	3,348	1.77%
GLK CLASS	2	0	2	66,216		67,890	1,674	2.53%
ML CLASS	6	0	6	322,152		327,306	5,154	1.60%
R CLASS	2	0	2	93,093		94,841	1,748	1.88%
TOTAL NEW L-D TRUCKS	15	0	15	881,780		896,959	15,179	1.72%
TOTAL MERCEDES	42	5	47	3,009,620	382,967	3,457,826	65,239	1.92%
MERCURY								
NEW AUTOS - POOL #1								
GRAND MARQUIS	1	0	1	27,627		28,200	573	2.07%
MILAN	4	0	4	93,938		96,062	2,124	2.26%
TOTAL NEW AUTOS	5	0	5	121,565		124,262	2,697	2.22%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MARINER	6	0	6	150,294		152,730	2,436	1.62%
MOUNTAINEER	4	0	4	122,684		124,520	1,836	1.50%
TOTAL NEW L-D TRUCKS	10	0	10	272,978		277,250	4,272	1.56%
TOTAL MERCURY	15	0	15	394,543		401,512	6,969	1.77%
MINI								
NEW AUTOS - POOL #1								
COOPER	9	3	12	207,720	66,465	278,595	4,410	1.61%
TOTAL NEW AUTOS	9	3	12	207,720	66,465	278,595	4,410	1.61%
TOTAL MINI	9	3	12	207,720	66,465	278,595	4,410	1.61%

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INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
MITSUBISHI								
NEW AUTOS - POOL #1								
ECLIPSE	6	0	6	148,125		145,893	(2,232)	(1.51)%
GALANT	2	0	2	43,022		43,673	651	1.51%
LANCER	11	2	13	242,568	33,033	277,502	1,901	0.69%
TOTAL NEW AUTOS	19	2	21	433,715	33,033	467,068	320	0.07%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENDEAVOR	3	0	3	84,351		90,030	5,679	6.73%
OUTLANDER	5	0	5	114,809		117,878	3,069	2.67%
OUTLANDER SPORT	0	4	4		79,190	79,190	0	0.00%
TOTAL NEW L-D TRUCKS	8	4	12	199,160	79,190	287,098	8,748	3.14%
TOTAL MITSUBISHI	27	6	33	632,875	112,223	754,166	9,068	1.22%
NISSAN								
NEW AUTOS - POOL #1								
370Z	9	0	9	305,682		310,471	4,789	1.57%
ALTIMA	8	0	8	182,616		184,885	2,269	1.24%
GT-R	1	0	1	78,149		79,109	960	1.23%
LEAF	0	2	2		63,687	63,687	0	0.00%
MAXIMA	2	0	2	58,292		58,931	639	1.10%
SENTRA	7	0	7	117,032		118,035	1,003	0.86%
VERSA	9	0	9	116,260		119,069	2,809	2.42%
TOTAL NEW AUTOS	36	2	38	858,031	63,687	934,187	12,469	1.35%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	6	0	6	244,571		248,389	3,818	1.56%
CUBE	4	0	4	65,746		66,976	1,230	1.87%
FRONTIER PICKUP	22	6	28	501,362	142,189	661,598	18,047	2.80%
JUKE	0	8	8		164,076	164,076	0	0.00%
MURANO	2	6	8	53,161	197,646	251,634	827	0.33%
PATHFINDER	7	2	9	221,311	67,594	292,171	3,266	1.13%
ROGUE	6	0	6	128,556		132,884	4,328	3.37%
TITAN	14	0	14	407,576		413,903	6,327	1.55%
XTERRA	4	3	7	96,134	80,855	178,920	1,931	1.09%
TOTAL NEW L-D TRUCKS	65	25	90	1,718,417	652,360	2,410,551	39,774	1.68%
TOTAL NISSAN	101	27	128	2,578,448	716,047	3,344,738	52,243	1.59%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
PORSCHE								
NEW AUTOS - POOL #1								
911	11	5	16	936,720	674,640	1,622,160	10,800	0.67%
BOXSTER	2	1	3	94,680	54,900	149,580	0	0.00%
CAYMAN	2	0	2	101,250		101,250	0	0.00%
PANAMERA	3	2	5	284,040	137,610	424,890	3,240	0.77%
TOTAL NEW AUTOS	18	8	26	1,416,690	867,150	2,297,880	14,040	0.61%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	0	5	5		295,740	295,740	0	0.00%
TOTAL NEW L-D TRUCKS	0	5	5		295,740	295,740	0	0.00%
TOTAL PORSCHE	18	13	31	1,416,690	1,162,890	2,593,620	14,040	0.54%
SAAB								
NEW AUTOS - POOL #1								
9-3	3	6	9	106,350	215,338	311,774	(9,914)	(3.08)%
9-5	0	4	4		170,975	170,975	0	0.00%
TOTAL NEW AUTOS	3	10	13	106,350	386,313	482,749	(9,914)	(2.01)%
TOTAL SAAB	3	10	13	106,350	386,313	482,749	(9,914)	(2.01)%
SCION								
NEW AUTOS - POOL #1								
TC	0	2	2		35,672	35,672	0	0.00%
XB	4	0	4	66,715		67,172	457	0.69%
XD	2	2	4	29,070	32,878	62,222	274	0.44%
TOTAL NEW AUTOS	6	4	10	95,785	68,550	165,066	731	0.44%
TOTAL SCION	6	4	10	95,785	68,550	165,066	731	0.44%
SUBARU								
NEW AUTOS - POOL #1								
IMPREZA	12	2	14	276,014	67,454	345,782	2,314	0.67%
LEGACY	7	0	7	164,563		166,312	1,749	1.06%
TOTAL NEW AUTOS	19	2	21	440,577	67,454	512,094	4,063	0.80%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
FORESTER	3	2	5	70,713	52,372	124,371	1,286	1.04%
OUTBACK	6	0	6	153,287		154,941	1,654	1.08%
TRIBECA	3	0	3	92,811		92,811	0	0.00%
TOTAL NEW L-D TRUCKS	12	2	14	316,811	52,372	372,123	2,940	0.80%
TOTAL SUBARU	31	4	35	757,388	119,826	884,217	7,003	0.80%
SUZUKI								
NEW AUTOS - POOL #1								
KIZASHI	5	6	11	101,275	143,806	246,569	1,488	0.61%
SX4	12	1	13	194,782	16,319	212,557	1,456	0.69%
TOTAL NEW AUTOS	17	7	24	296,057	160,125	459,126	2,944	0.65%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EQUATOR	6	0	6	140,631		141,988	1,357	0.96%
GRAND VITARA	5	1	6	106,267	21,887	128,154	0	0.00%
TOTAL NEW L-D TRUCKS	11	1	12	246,898	21,887	270,142	1,357	0.50%
TOTAL SUZUKI	28	8	36	542,955	182,012	729,268	4,301	0.59%
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	0	2	2		60,631	60,631	0	0.00%
CAMRY	11	0	11	234,956		238,288	3,332	1.42%
COROLLA	0	0	0				0	N/A%
MATRIX	7	0	7	124,663		125,634	971	0.78%
PRIUS	5	0	5	113,317		115,979	2,662	2.35%
YARIS	6	0	6	76,142		77,566	1,424	1.87%
TOTAL NEW AUTOS	29	2	31	549,078	60,631	618,098	8,389	1.38%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	5	0	5	157,750		158,271	521	0.33%
FJ CRUISER	3	0	3	69,281		72,343	3,062	4.42%
HIGHLANDER	9	1	10	264,451	28,899	302,458	9,108	3.10%
LAND CRUISER	1	0	1	58,382		59,621	1,239	2.12%
RAV4	12	0	12	277,263		280,048	2,785	1.00%
SEQUOIA	11	0	11	477,040		487,439	10,399	2.18%
SIENNA	0	12	12		354,241	354,241	0	0.00%
TACOMA PICKUP	15	5	20	314,242	103,065	423,147	5,840	1.40%
TUNDRA	27	0	27	767,302		775,895	8,593	1.12%
VENZA	4	0	4	100,752		101,444	692	0.69%
TOTAL NEW L-D TRUCKS	87	18	105	2,486,463	486,205	3,014,907	42,239	1.42%
TOTAL TOYOTA	116	20	136	3,035,541	546,836	3,633,005	50,628	1.41%

INFLATION ESTIMATE REPORT BY MAKE/MODEL/POOL
DEALER COST FOR THE YEAR ENDED 12/31/10
NEW ITEMS AT CURRENT COST - I.E., NO INFLATION

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/09 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
VOLKSWAGEN								
NEW AUTOS - POOL #1								
CC	6	9	15	166,158	286,329	456,411	3,924	0.87%
EOS	3	0	3	93,761		98,955	5,194	5.54%
GOLF	10	0	10	192,974		199,794	6,820	3.53%
GTI	8	24	32	180,408	644,124	832,592	8,060	0.98%
JETTA	8	32	40	166,437	647,740	819,554	5,377	0.66%
NEW BEETLE	6	3	9	122,328	64,848	188,154	978	0.52%
PASSAT	6	0	6	155,259		156,819	1,560	1.00%
TOTAL NEW AUTOS	47	68	115	1,077,325	1,643,041	2,752,279	31,913	1.17%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ROUTAN	0	7	7		237,122	237,122	0	0.00%
TIGUAN	7	4	11	180,801	127,913	319,960	11,246	3.64%
TOUAREG	0	7	7		346,703	346,703	0	0.00%
TOTAL NEW L-D TRUCKS	7	18	25	180,801	711,738	903,785	11,246	1.26%
TOTAL VOLKSWAGEN	54	86	140	1,258,126	2,354,779	3,656,064	43,159	1.19%
VOLVO								
NEW AUTOS - POOL #1								
30 SERIES	2	0	2	47,376		48,457	1,081	2.28%
40 SERIES	1	1	2	29,281	26,085	55,366	0	0.00%
50 SERIES	0	2	2		58,139	58,139	0	0.00%
70 SERIES	3	1	4	113,505	30,080	135,313	(8,272)	(5.76)%
S60	0	1	1		35,438	35,438	0	0.00%
S80	2	0	2	77,221		73,021	(4,200)	(5.44)%
TOTAL NEW AUTOS	8	5	13	267,383	149,742	405,734	(11,391)	(2.73)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
90 SERIES	3	0	3	117,218		118,628	1,410	1.20%
XC60	3	3	6	104,476	105,750	211,359	1,133	0.54%
TOTAL NEW L-D TRUCKS	6	3	9	221,694	105,750	329,987	2,543	0.78%
TOTAL VOLVO	14	8	22	489,077	255,492	735,721	(8,848)	(1.19)%

De Filipps' LIFO LOOKOUT
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