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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. MOST FREQUENTLY ASKED QUESTIONS ... What's the Status of LIFO? ... How Much Longer Will LIFO Be Around? As I've said before ... No one really knows. My crystal ball is not any clearer than yours.

This is the 21st year that I've been publishing the *LIFO Lookout*... and I've been asked these questions long before I even started writing this publication. Back in the late 1970s and early 1980s - after presenting full-day seminars on LIFO - somebody attending the seminar would usually ask ... "What are ***you*** going to do if LIFO is repealed?" (... as if the repeal of LIFO would extinguish my professional career). In those days, my answer always was ... "Maybe then I'll think about retiring." Some 30 years later, now my off-the-cuff answer to that question is ... "That depends."

As you might expect, there are continuing activities on several fronts that suggest the days of LIFO may be numbered. But, for many reasons, I still remain very optimistic that at least for closely-held businesses, LIFO will be around for many more years. I also believe that this is not a time to think about terminating LIFO in anticipation of what might happen in the future. (But, to strive for a "fair and balanced" discussion, see Update #4 below.)

Right now, my focus is on the belief that it is in a client's best interest to maximize its LIFO reserves until such time as political and legislative forces - all well beyond our control - dictate what is really going to happen.

My own optimism aside, let's review one significant recent development that is again casting a cloud over the future of LIFO.

On June 24, 2011, President Obama's Administration brought up the repeal of LIFO as a tax break to be eliminated as part of the negotiations to reach a deal on the currently stalled debt limit increase (i.e., debt ceiling) negotiations. Apparently, this is a follow-up to the President's proposal at the beginning of this year - as part of his "Greenbook" proposals - when he had included the repeal of LIFO after the year 2012 ... with a 10-year spread period for the recapture of the LIFO reserve into taxable income.

As to the more recent threat, at this time, specifics relating to when LIFO might end and/or any transition period that might accompany the removal of LIFO - if it is included as part of the compromise on the debt limit increase negotiations - have not been made public.

In response to this recent threat, the LIFO Coalition (www.SaveLIFO.org) immediately generated significant counter-activity. The LIFO Coalition represents hundreds of thousands of businesses and business associations, all of whom have been urged to inundate the President and their own Congressional representatives by phone, fax, e-mail and other media with one simple message ... "Don't Kill More Jobs by Killing LIFO!"

Almost immediately, the LIFO Coalition sponsored an advertisement that appeared in two promi-

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nent publications (*Politico* and *The Hill*). The LIFO Coalition's message was that "repealing LIFO will (1) place a massive, unprecedented retroactive tax hike on job creators, (2) increase costs for businesses that will result in less growth, job losses and reduced employee benefits, and (3) force companies to pay taxes on unrecognized 'phantom profits' caused by inflation."

In addition, the ad argued, "This is not the time to unfairly raise taxes on the companies we need the most to create jobs. Repeal of LIFO is an unexpected tax increase on 36% of all American businesses ... companies of every size and in every state will be forced to pay more taxes, destroying jobs in the process. Repealing LIFO will not create jobs. It will destroy them."

To see the entire LIFO Coalition ad, please visit www.SaveLIFO.com or our website (www.defilipps.com).

#2. SOME DEALERSHIPS WITH FISCAL YEAR-ENDS MAY FACE STIFF LIFO RESERVE RECAPTURE BECAUSE OF REDUCED NEW VEHICLE INVENTORY LEVELS. Many dealerships with fiscal years ending June, July, August and possibly even September may face significant LIFO reserve recapture because of the serious problems created by the inability of manufacturers to get parts from Japan and other sources.

This shortage of inventory problem may be particularly acute for Toyota and Honda dealerships because production for these manufacturers was severely affected by the earthquake and tsunami in Japan in March 2011.

The Year-End 2009 Edition of the *LIFO Lookout* contained an extensive discussion of problems and IRS guidance related to dealers who were low on new vehicle inventory at year-end (at that time, referring to December 31, 2009). Most of what I said in that 24-page discussion bears repeating for dealers currently facing similar mid-yearend inventory shortages.

The only slight difference is that references in that 2009 article are to automatic changes in accounting methods and LIFO terminations requiring the filing of Form 3115 under Revenue Procedure 2008-52, which was the Revenue Procedure in effect when that article was written.

Since then (as discussed elsewhere), Revenue Procedure 2008-52 has been replaced by Revenue Procedure 2011-14. However, there were no changes in the substantive provisions, and the internal section cross-references continue to be accurate.

Instead of reprinting the 2009 article in full, only the table of contents of the topics discussed in that article is included on the facing page. If you were not a subscriber to the *LIFO Lookout* in 2009 but would like a complimentary copy of the complete article, please e-mail us with your request.

In the Mid-Year 2010 Edition of the *LIFO Lookout* (Update #4), I followed-up with a report (based on my experience with our auto dealership LIFO clients) on what many dealerships actually did to cope with their 2009 year-end "stiff LIFO recapture" situations. These results are referenced to the step-by-step listing of planning considerations for year-end LIFO inventories that was included as the "Executive Summary" on page 23 of the 2009 *LIFO Lookout* article.

First (Step 6) ... none of our clients changed to the IPIC method in order to try to expand the dollars of inventory in their LIFO pools.

Second (Step 5) ... none of our clients elected LIFO for used vehicles in order to offset some of the payback in their new vehicle LIFO pools ... basically because used vehicles continued to reflect deflation for 2009.

Third (Step 4) ... only a surprisingly small number of our clients terminated their LIFO elections.

Fourth (Step 3) ... the vast majority of our clients requested projections [discussed in Step 1] of the changes in their year-end LIFO inventories to assist them (and us) in making their decisions.

Fifth (Step 2) ... a significant number of our clients who had not changed to the single, combined (Vehicle-Pool) method for either 2007 or 2008, decided to make the change for 2009 in order to minimize the impact of a decrement in their LIFO inventories. But, quite a few dealers still opted not to make the change, even though that change would have increased their LIFO reserves for 2009.

One additional observation... No dealerships of our acquaintance followed through on the possible approach (suggested by the IRS in Situation #3 of ILM 200935024) of splitting the overall new vehicle LIFO pool, followed by the termination of LIFO for one of the resulting new pools, namely the pool related to the terminated franchise. This is discussed more completely beginning on page 31 as part of the article on splitting LIFO pools.

For dealerships with 2011 fiscal year-ends. My expectation is that dealerships with 2011 fiscal year-ends facing similar significant inventory shortages will behave according to that same pattern. In other words, basically, they will "take the hit" but still stay on LIFO.

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

Year-End Planning ... 2009 Article

Table of Contents of Year-End Planning Article in the Year-End 2009 Edition of the *LIFO Lookout*

* Note: Rev. Proc. 2011-14 has superseded Rev. Proc. 2008-52 as of January 2011.

LIFO Update (Continued)

#3. SPLITTING DOLLAR-VALUE LIFO POOLS ... PROCEDURES, TECHNIQUES & REFINEMENTS. This Edition of the *LIFO Lookout* focuses on a problem that LIFO practitioners frequently encounter ... the need, or the requirement by the IRS, to split a dollar-value LIFO pool into two or more pools.

My conclusion, after reviewing what is available, is that there is not a lot of useful guidance on this subject. However, there are three places where some guidance may be found.

The article beginning on page 18 includes a discussion and analysis of the several examples that provide guidance on how a taxpayer should split a dollar-value LIFO pool into two or more (i.e., multiple)

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pools. In addition, I've tried to emphasize the importance of mathematically proving the changes in the amounts of the LIFO reserves before and after the pool is split by analyzing the underlying components of change. This analysis is intended to help readers understand the dynamics when they are dealing with their own practical situations.

The underlying principle, stated in the Regulations, is that in splitting a dollar-value LIFO pool, the separation of the LIFO value of a taxpayer's inventory for the base year and each yearly layer of increment shall be made in accordance with the appropriate method that is shown in the (somewhat limited) example in the Regulations, ***unless the use of a different method is approved by the Commissioner***.

The relevance of this requirement and the insufficiency of the example in the Regulations are discussed on page 31 in the context of ILM 200935024 on the subject of postponing or deferring the recapture of a portion of an automobile dealership's LIFO reserves in franchise termination situations. It would appear that in these situations, different results - some more favorable or less favorable to a dealership - will be produced depending on the procedures followed and/or allowed by the IRS for splitting a single LIFO pool for all new vehicles.

#4. THE CASE FOR TERMINATING A LIFO ELECTION NOW. A recent article in *The CPA Journal* (April 2011) suggested several reasons why a business using LIFO might want to consider terminating its LIFO election at the present time. Several of the reasons advanced have nothing whatsoever to do with tax implications. Others are tax-related.

Admittedly, the focus of the *LIFO Lookout* has been to advocate the benefits of LIFO, as an interest-free loan from the U.S. Treasury, especially for closely-held businesses. Nevertheless, the authors raise several points (summarized on the facing page) that warrant consideration by thoughtful LIFO advisors.

#5. UPDATED PROCEDURES FOR AUTOMATIC CHANGES IN LIFO METHODS ... REV. PROC. 2011-14. Form 3115, *Application for Change in Accounting Method*, is the form that taxpayers must file with the IRS when they are changing most LIFO accounting methods. This Form (8 pages) and the separate Instructions (17 pages) were both updated in Revisions dated December 2009.

As indicated in Update #2, until early this year, Revenue Procedure 2008-52 was the document that contained the procedural rules to be followed when taxpayers are making voluntary, automatic changes in accounting methods - including the termination of their LIFO elections - which require the filing of Form 3115 under the "automatic consent procedures."

In January, the IRS issued Revenue Procedure 2011-14 to update, supersede, modify and clarify the procedures previously spelled out in Revenue Procedure 2008-52.

Rev. Proc. 2011-14 is effective for the filing of Forms 3115 on or after January 10, 2011 (subject to certain, very limited, exceptions).

Basically, there are no substantial changes between "old R.P. 2008-52" and "new R.P. 2011-14." The Sections in "old R.P. 2008-52" have been carried forward pretty much intact. For a detailed discussion of these procedures see: *"Revised Procedures for Securing Automatic Consent from the IRS to Make Changes in LIFO & Other Methods of Accounting,"* in the Year-End Edition of the *Dealer Tax Watch*, on pages 14-44.

Rev. Proc. 2011-14 adds a few automatic changes in method that are unrelated to LIFO matters. Also, it clarifies that a Section 481(a) adjustment must be computed when terminating a LIFO election (i.e., when changing from the LIFO method to a non-LIFO method). It also provides a special rule for calculating Section 481(a) adjustments for changes in accounting methods under Section 471 that would otherwise be implemented on a cut-off basis for (1) parts inventories using replacement cost methods and/or (2) other inventories using a rolling-average method to value inventories.

Revenue Procedure 2011-14 continues to emphasize the need to coordinate (1) changes in accounting methods with respect to the application of the Section 263A inventory cost capitalization rules with (2) the requirements for computing adjustments to taxable income in the year of change under Section 481(a). For more on this, see below.

#6. SEC. 263A CAMs & LIFO SEC. 481(a) ADJUSTMENTS & INVENTORY RESTATEMENTS. Many readers of the *LIFO Lookout* have automobile, truck or other motor vehicle dealership clients using LIFO to value their new vehicle or new goods inventories. There has been a flurry of activity since November 2010 when the IRS announced certain safe harbor provisions that dealerships could elect in connection with their inventory cost capitalization practices under Section 263A.

These safe harbor provisions are found in Revenue Procedure 2010-44. In most cases, these provisions are extremely favorable to dealerships. However, dealerships are required to file Forms 3115

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Article Excerpts

"SWITCHING FROM LIFO ... STRATEGIES FOR CHANGE"

Why Companies Switch from LIFO

- "LIFO is not permitted under IFRS, which means U.S. companies must switch from LIFO to First-In, First-Out (FIFO) or average cost upon adoption of IFRS ... Their primary concern is the tax burden resulting from the release of accumulated LIFO reserves when switching from LIFO to another inventory valuation method.
- "Disclosures often cite the fact that alternative inventory valuation methods (i.e., FIFO and average cost) better reflect the current value of inventory on the balance sheet. This emphasizes the importance of the balance sheet compared to the income statement.
- "Firms that discontinue using LIFO indicate the importance of uniformity in inventory valuation methods across operations.
    - "More than 100 countries have already adopted IFRS, and Canada and Mexico are adopting it effective 2011 and 2012, respectively. Therefore, many companies or subsidiaries are already prohibited from using LIFO.
- "Disclosures also indicate companies' interest in using accounting methods similar to those of their peers to increase comparability for financial statement users.
- "Companies adopting fresh-start accounting, generally used as companies emerge from bankruptcy, also eliminate the use of LIFO.

Financial Statement Effect

- "For financial reporting purposes, a company is required to retrospectively restate prior years' financial statements if the change is material; otherwise, the effect of the change is recorded in the period of the change.
    - "Generally, the balance sheet accounts affected are inventory, deferred taxes (assets and liabilities), and retained earnings, and the income statement accounts affected are Cost of Goods Sold and provision for income taxes.
    - "How much of the effect falls in the current year and each restated year depends on the changes in the LIFO reserve during the restated years.
- "The USG example* not only illustrates the accounting steps needed when making a change from LIFO, but also suggests an opportune time for such a change; if a company is already projecting a loss, then implementing a change from LIFO has the advantage of reducing the loss. *[*Note: This is an excellent exhibit showing the effect of the change over 3 years.]*

LIFO and Inflation

- "Over the past five years, the inflation rate has averaged roughly 3% and was actually negative (-0.4%) in 2009, according to the Bureau of Labor Statistics. Near-zero inflation stabilizes the LIFO reserve and reduces the impact of a switch from LIFO.
- "The advantage for companies switching from LIFO during a period of low inflation is that the ongoing tax advantage of LIFO during this period is minimal.

LIFO and Taxes

- "Although 35% is currently the highest statutory tax rate, a firm's marginal tax rate (the amount of tax that will be paid on the next dollar of income) could be significantly lower depending on level of taxable income, availability of tax credits and net operating loss carryforwards and carrybacks, the effect of alternative minimum tax, and other factors.
- "If a firm's marginal tax rate is lower than the statutory rate, especially if the lower rate is expected to continue for several years, then a conversion from LIFO results in lower current and future tax liabilities than implied by the top statutory rate.
- "These lower estimated marginal tax rates suggest that the tax effect cost of switching from LIFO is also considerably lower than would be estimated using the current top statutory rate of 35%. ... Firms should consider their own tax situation in gauging the real cost of a switch from LIFO.

LIFO and Inventory Management

- "Companies with large inventories are perhaps more concerned with the potential adverse effects of switching from LIFO. Higher inventories imply a higher LIFO reserve, and consequently a higher taxable income adjustment. For companies that have implemented just-in-time (JIT) or other lean manufacturing techniques, switching from LIFO should have more limited effects.
- "Inventory reduction is a goal under lean inventory and manufacturing systems, such as JIT.
- "When inventory is reduced, fixed manufacturing overhead absorbed in beginning inventory is expensed in the period; this increases Cost of Goods Sold and lowers income. The negative effect on income is a recognized concern with initiatives such as JIT implementation. However, the absorption costing effect of lowering income, along with other implementation costs, is opposite to the LIFO liquidation effect of increasing income. A company facing a LIFO reserve liquidation and anticipating implementation of lean principles could coordinate these two initiatives in order to offset their effects.
- "To some extent, firms that have allowed their inventory to run down because of tough economic conditions have already eliminated large portions of the LIFO reserve. A low LIFO reserve minimizes the adverse effects of a switch from LIFO.
- "Because the two strategies both affect inventory accounting, firms may wish to coordinate these initiatives to mitigate their negative effects on financial statements and tax liability.
- "***Timing the Switch...*** Low inflation and low marginal tax rates set up conditions that mitigate the potentially large tax burden imposed on firms when the LIFO reserve is liquidated and when future income differences favor continued use of LIFO. Firms can align their inventory management initiatives with the LIFO switch to manage the related costs and benefits. Individual firms need to assess their own circumstances and determine the best time to make the switch from LIFO."

Source: *"Switching from LIFO ... Strategies for Change," The CPA Journal*, April 29, 2011, pages 26-29.
By Linda Hughen, PhD, CPA; Jane R. Livingstone, PhD, CPA and David Upton, PhD, CA.

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if they want to make these (automatic) changes in method under Section 263A.

The article on page 8 discusses some of the implications for dealerships using LIFO in connection with the requirement that they must compute a Section 481(a) adjustment in order to make these changes.

#7. DEFERRING "GAIN" ON INVOLUNTARY CONVERSIONS OF LIFO INVENTORIES. The IRS recently ruled that, if the fact pattern is right, a taxpayer may be able to defer the recognition of income of the sale/disposition of inventories if the taxpayer is able to qualify under the special, non-recognition of gain rules available to businesses affected by "Federally-declared disasters."

Technical Advice Memorandum 201111004 (dated December 13, 2010 and released March 18, 2011) involved a taxpayer whose operations had been damaged by the 2006 Gulf Coast Hurricanes known as "Katrina." The IRS concluded that the taxpayer's inventory that was involuntarily converted in a "Presidentially-declared disaster" was "property held for productive use in a trade or business" for purposes of Code Section 1033(h)(2).

The taxpayer received insurance and salvage proceeds relating to property that had been involuntarily converted as a result of the hurricanes, and more than half of the insurance and salvage proceeds related to the lost or damaged inventory. The taxpayer realized gain in excess of basis from these recoveries.

The TAM does not state whether the taxpayer's inventories that were destroyed were valued at LIFO or at FIFO. (But, should that make any difference?)

When the taxpayer reinvested the amounts received from insurance and salvage proceeds into new store construction property, the Service concluded that the taxpayer was entitled to receive the benefits of non-recognition of gain because of the timely reinvestment of the proceeds in property that qualified for gain non-recognition.

In other words, in this case, the proceeds from the loss of the inventory, if reinvested in "property held for productive use in trade or business," could protect the business from having to immediately realize the gain on the inventory that was destroyed by the disaster.

In situations where LIFO inventories are involved, the adjusted basis of the inventory (i.e., its LIFO inventory valuation) in most cases will be considerably less than the amount collected from insurance and salvage proceeds. Thus, it would appear as a matter of first impression that the taxpayer simply realized a gain on its destroyed LIFO inventory. This gain would be most obvious if the taxpayer were unable to replace its inventory by the end of the year so that its inventory level at year-end was significantly below the inventory level at the beginning of the year ... thus resulting in a recapture of a (significant) portion of the LIFO reserve for the year in which the disaster occurred.

However, where a Presidentially-declared disaster precipitates these events, it may be possible to avoid the recognition of gain (i.e., the recapture of the LIFO reserve attributable to the destroyed inventory) by reinvesting the proceeds received as a result of the disaster in replacement inventory after the end of the year ... or by reinvesting the proceeds in other non-inventory assets in the same, or in a subsequent, year.

This TAM is discussed on pages 10-13.

#8. WINERIES USING LIFO ... IRS *AUDIT TECHNIQUE GUIDE* REQUIREMENTS FOR ITEM DEFINITION. Previous issues of the *LIFO Lookout* have included several articles relating to wineries using LIFO for valuing their inventories. These articles have discussed questions that the IRS has been raising over how wineries have defined "items" for LIFO inventory computation purposes. These articles have also reported on other audit settlement controversies surrounding wineries using LIFO.

In May 2011, the IRS released an *Audit Technique Guide (ATG)* for the wine industry, and this *ATG* lists the criteria which the IRS wants wineries to use to define their wine items and value their LIFO inventories.

This criteria is essentially based on the IRS position in ILM 201043029 which was discussed in the article *"At Last, a Good Year ... One Wine(ry) Finally Satisfies the IRS' Taste,"* (Year-End 2010 Edition of the *LIFO Lookout*, page 40).

For more on the IRS *Audit Technique Guide* and the recently formulated criteria for winery "items" for LIFO purposes, see pages 14-17.

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

The last comparison, involving manufacturer model years 2009-2010, appeared in the Mid-Year 2010 Edition of the *LIFO Lookout.* In this Edition, we have summarized our current comparison for manufacturer model years 2010-2011 new items with respect to Dec. 31, 2010 year-end inventories for auto dealers. This is based on the new items list that the IRS released in an e-mail dated February 1, 2011.

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

In listing the results of our comparisons, we have continued to use the two separate classifications for automobiles and light-duty trucks. Many dealerships don't care about this distinction any more because they have changed to the single, combined (Vehicle-Pool) method for all new vehicles.

However, a significant number of dealers (at least many of those we are doing LIFO calculations for) have not changed to the Vehicle-Pool Method, for one reason or another. Therefore, this classification distinction is still relevant for them.

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

A glance at the IRS lists (and ours) makes it clear that item category determinations are required to be detailed down to the most precise levels of vehicle description and differentiation. Calculations cannot be based on rough averages of models or on other more generalized groupings.

Our overview, with related statistics, begins on page 41. The full Lists are available upon request.

#10. UPDATED INDEX OF *LOOKOUT* ARTICLES THROUGH DEC. 31, 2010 IS NOW AVAILABLE. We updated our Index of all articles appearing in the *LIFO Lookout* from our first issue, March 1991, through December 2010. This electronically searchable and user-friendly Index is available on our web site (www.defilipps.com) for your reference purposes. As with last year's Index, you can search the Index by keyword(s), and you can also save the 51-page Index on your computer for handy reference and printing.

This Index of Articles is divided into nineteen sections, each of which is further sub-divided by key topic or subject. It also includes (1) a separate list of what I consider the best of our *Practice Guides* over the years, and (2) *Finding Lists* for all tax cases, Revenue Rulings and Procedures, Letter Rulings (including TAMs), and other precedential and/or non-precedential IRS guidance.

The nineteen sections of our Index of Articles are listed on page 48.

De Filipps' LIFO Bulletin Board

Inflation Indexes for 2010 under the Alternative LIFO Method

Based on the auto dealerships for whom we prepare LIFO calculations, for their Dec. 31, 2010 inventories, most dealerships again experienced a slight upward pressure on their LIFO reserves for new vehicles due to inflation reflected in the dealer invoice costs.

The results for year-end 2010 inventories are summarized below ... A similar summary shows year-end 2009 for comparison.

Year-End 2010

- Ford .... 3 %
- Lincoln ...Mercedes ... Jeep Trucks .... 1¾ - 2¼ %
- Lexus ... Nissan ... Toyota ... Mazda ... VW ... Mercury .... 1¼ - 1¾ %
- Chrysler ... Chevrolet ... Dodge Trucks ... Buick ... Honda ... BMW ... Mitsubishi .... ½ - 1 %
- Cadillac ... GMC Trucks ... Volvo .... No inflation or slight deflation

Year-End 2009

- Chrysler (Dodge) Trucks ... GMC .... 4½ - 5½ %
- General Motors ... Chevrolet .... 3½ - 4 %
- Chrysler ... Ford ... Lincoln-Mercury .... 2½ - 3½ %
- Lexus ... Toyota .... 1½ - 2½ %
- Nissan ... Honda ... Mitsubishi ... BMW ... Volvo .... 1 - 1½ %

SECTION 263A CAMS & SECTION 481(a) ADJUSTMENTS FOR LIFO INVENTORY RESTATEMENTS

Recently, all motor vehicle dealerships - regardless of whether or not they are using the LIFO method to value their inventories - were affected by a major development when the IRS issued Revenue Procedure 2010-44 on November 9, 2010.

In Revenue Procedure 2010-44, the IRS permitted motor vehicle dealerships to elect safe harbor methods that are related to the application of the Section 263A inventory cost capitalization rules to the dealerships' operations and activities. 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).

In the Year-End 2010 Edition of the *Dealer Tax Watch*, I analyzed the impact of Rev. Proc. 2010-44 on dealership inventory cost capitalization practices under Section 263A. I have also presented several 3-hour audio seminars on these developments. My article and other presentations emphasize the advisability/need for filing Forms 3115 to make appropriate elections so that dealerships protect themselves under the Section 236A safe harbor rules that the IRS now allows.

One of the ramifications of making the changes to elect the safe harbor methods involves following the procedural rules and requirements (listed in Revenue Procedure 2011-14) for filing Form 3115 to notify the IRS that the changes are being made. Another ramification involves calculating the adjustment under Section 481(a) that is required by dealerships that elect to change to the Section 263A safe harbor methods.

In many situations involving automatic changes in accounting methods where LIFO inventories are concerned, instead of requiring the computation of a Section 481(a) adjustment, the IRS allows the use of the cut-off method. This means that the dealership does not have to go back and compute an adjustment for the year-of-change in order to reflect the effect of using the new method as if that new method had been used in all prior years.

Unfortunately, the (automatic) changes in Section 263A methods of accounting to be made under Rev. Proc. 2010-44 require the taxpayer to compute a Section 481(a) adjustment. Therefore, dealerships filing Form 3115 to elect the Section 263A safe harbor methods must consider how they have previously applied the Section 263A rules to their inventories on LIFO and how that treatment affects their computation of a Section 481(a) adjustment for the year of change.

Reg. Sec. 1.263A-7 contains the specific rules for revaluing LIFO inventories when Section 263A changes in accounting methods are made. An outline of a portion of this Regulation appears on the facing page.

Note: Although Section 263A did not come into the law until 1986, many dealerships started their LIFO elections in the 1970s or early 1980s ... well before the enactment of this Section.

After Section 263A became effective, some dealerships may have embedded the amounts of their Section 263A adjustments in each of the annual LIFO layers that are added to compute the overall LIFO valuation of the inventory.

Other dealerships - instead of embedding the amounts of their Section 263A adjustments in each annual LIFO layer - simply took the Section 263A amounts into income as net adjustments each year in order to reconcile their off-the-books Sec. 263A calculations (i.e., their calculations on spreadsheets) with adjustments to taxable income on Schedule M-1 or M-3 of their income tax returns.

For those dealerships that did not embed their Section 263A adjustments into their LIFO layers, it would appear that their Section 481(a) adjustment (required at this time in electing the Section 263A safe harbors) would simply involve the reversal of the net amounts previously capitalized through their Schedule M-1 or M-3 adjustments.

Accordingly, it would appear that they would not have to deal with the revaluation provisions in Reg. Sec. 1.263A-7. However, the IRS has not provided any specific guidance as to whether this approach would be acceptable.

For those dealerships that actually did embed the results of their Section 263A adjustments in their annual LIFO layers, the effect (of embedding the Sec. 263A costs into their annual LIFO layers) would have to be undone as part of the Section 481(a) adjustment related to electing the Section 263A safe harbor methods effective for 2010 or 2011.

Assuming the Section 481(a) adjustment were a negative amount (i.e., resulting in a reduction of taxable income in the year of the change in method), the annual LIFO layers would have to be restated at

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correspondingly lower amounts to reflect the removal of the Section 263A costs from each layer.

Such a restatement could require a significant amount of time and effort, even if the so-called "short-cut" method were used. The "short-cut" method permits the use of only the 3 most recent years of information, instead of requiring the recalculation of the effect of the change, year-by-year, all the way back to the base year - the first year of the LIFO election. For some dealerships, the base year could be as far back as 35 or 40 years ago.

It is possible that the IRS might issue some guidance on this in the future. Might the IRS take the position that, even though dealerships using LIFO did not do so, they should have embedded the results of their Section 263A adjustments on a year-by-year basis in their annual increment layers which determine the LIFO value of their inventory?

If the IRS were to take this position, could a dealership defend its contrary practice by arguing that it had adopted a method of accounting that did not embed the Section 263A costs in its LIFO layers? Would this position be likely to prevail?

More to the point at the present time... should a dealership disclose in the filing of Form 3115 whether or not it embedded Section 263A costs in its LIFO layers? This could easily be done as part of a narrative statement attachment.

Conclusion: In making the Section 263A safe harbor elections, there could be a significant increase in a dealership's compliance cost for computing a Section 481(a) adjustment for its LIFO inventories ... even though the restatement of the LIFO layers might produce only a few dollars of favorable difference ... unless the IRS is willing to forego some of the possible technical interpretations of its own Regulations.

Summary of Reg. Sec. 1.263A-7
Changing a Method of Accounting Under Section 263A

(a) Introduction
- (1) Purpose
- (2) Taxpayers that adopt a method of accounting under Section 263A
- (3) Taxpayers that change a method of accounting under Section 263A
- (4) Effective date
- (5) Definition of change in method of accounting

(b) Rules applicable to a change in method of accounting
- (1) General rules
- (2) Special rules
  - (i) Ordering rules when multiple changes in method of accounting occur in the year of change
    - (A) In general
    - (B) Exceptions to the general ordering rule
      - (1) Change from the LIFO inventory method
      - (2) Change from the specific goods LIFO inventory method
      - (3) Change in overall method of accounting
      - (4) Change in method of accounting for depreciation
  - (ii) Adjustment required by Section 481(a)
  - (iii) Base year
    - (A) Need for a new base year
      - (1) Facts and circumstances revaluation method used
      - ***(2) 3-year average method used***
        - (i) Simplified method not used
        - (ii) Simplified method used
    - (B) Computing a new base year

(c) Inventory
- (1) Need for adjustments
- (2) Revaluing beginning inventory
  - (i) In general
  - (ii) Methods to revalue inventory
  - (iii) Facts and circumstances revaluation method
    - (A) In general
    - (B) Exception
    - (C) Estimates and procedures allowed
    - (D) Use by dollar-value LIFO taxpayers
    - (E) Examples

(c) Inventory (continued...)
- ***(2) (iv) Weighted average method***
    - (A) In general
    - (B) Weighted average method for FIFO taxpayers
      - (1) In general
      - (2) Example
    - (C) Weighted average method for specific goods LIFO taxpayers
      - (1) In general
      - (2) Example
    - (D) Adjustments to inventory costs from prior years
  - ***(v) 3-year average method***
    - (A) In general
    - (B) Consecutive year requirement
    - (C) Example
    - (D) Short taxable years
    - (E) Adjustments to inventory costs from prior years
      - (1) General rule
      - (2) Examples of costs eligible for restatement adjustment procedure
    - (F) Restatement adjustment procedure
      - (1) In general
      - (2) Examples of restatement adjustment procedure
      - (3) Intercompany items
        - (i) Revaluing intercompany transactions
        - (ii) Example
        - (iii) Availability of revaluation methods
      - (4) Anti-abuse rule
        - (i) In general
        - (ii) Deemed avoidance of this Section
          - (A) Scope
          - (B) General rule
        - (iii) Election to use transferor's LIFO layers
        - (iv) Tax avoidance intent not required
        - (v) Related corporation

(d) Non-inventory property
- (1) Need for adjustments
- (2) Revaluing property

DEFERRING "GAIN" ON INVOLUNTARY CONVERSIONS OF LIFO INVENTORIES

In general, a taxpayer realizes gain to the extent that the sales price received for an asset exceeds the taxpayer's basis in the property. LIFO inventories generally have an adjusted tax basis which is considerably lower than the current cost, not to mention selling price, of the inventory. Depending on how long the inventories have been valued under LIFO, the LIFO reserve (or built-in gain) on that inventory may be extremely large.

In most circumstances, the sale or other depletion of LIFO inventory at year-end will result in the recapture of a significant portion - if not all - of the LIFO reserve.

Technical Advice Memorandum 201111004 (dated December 13, 2010 and released March 18, 2011) suggests that, if the fact pattern is right, a taxpayer may be able to defer the recognition of income of the sale of LIFO inventories if the taxpayer qualifies under special, non-recognition of gain rules available to businesses affected by "Federally-declared disasters."

Section 1033 of the Code deals with "Involuntary Conversions." It provides that gain realized by a taxpayer from an involuntary conversion of property is deferred to the extent that the taxpayer purchases property similar or related in service or use to the converted property within the applicable "replacement period." The taxpayer's basis in the replacement property generally is the cost of such property to the taxpayer, reduced by the amount of gain which is not recognized under Section 1033.

The applicable period for the taxpayer to replace the converted property begins with the date of disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. There are several special rules that extend the replacement period for certain types of business assets damaged by a Federally-declared disaster. For example, the replacement period for replacing converted property is extended from two years to five years in the case of property that is in the Hurricane Katrina disaster area and that is compulsorily or involuntarily converted on or after August 25, 2005, by reason of Hurricane Katrina.

A special rule provides that any tangible property acquired and held for productive use in a business is treated as similar or related in service or use to property that (1) was held for investment or for productive use in a business and (2) was involuntarily converted as a result of a Federally-declared disaster.

TAM 201111004 examined this special rule in some detail and concluded that inventory that is involuntarily converted in a Presidentially-declared disaster is property held for productive use in a trade or business for purposes of Section 1033(h)(2).

Under Section 1033(h)(3), the term "Federally-declared disaster" refers any disaster subsequently determined by the President of the United States to warrant assistance by the Federal Government under the *Robert T. Stafford Disaster Relief and Emergency Assistance Act*. Prior to January 1, 2008, the term used in the application of Section 1033(h)(2) was "***Presidentially***-declared disasters" rather than "***Federally***-declared disasters."

THE FACTS IN TAM 201111004

This TAM involved (1) a group of affiliated corporations that filed consolidated Federal income tax returns and (2) an operating limited partnership which was wholly-owned by members of the group. The nature of the taxpayers' businesses is redacted from the TAM.

The operations of some of the taxpayer's business units were damaged by the 2006 Gulf Coast hurricanes, which were Presidentially (Federally) declared disasters. The taxpayer received insurance and salvage proceeds relating to property involuntarily converted as a result of the hurricanes, and more than half of the insurance and salvage proceeds related to the lost or damaged inventory. The taxpayer realized gain in excess of basis from these recoveries. (Note: the TAM does not state whether this taxpayer used the LIFO method to value its inventories.)

The taxpayer reinvested most of the insurance and salvage proceeds in new store construction property (i.e., the proceeds were invested in assets that were depreciable Section 1245 and Section 1250 property). The taxpayer included statements in its tax returns that identified the replacement property. The taxpayer also reduced the basis of the new property by the amount of the deferred gain.

The TAM stated that the taxpayer expects to reinvest the remaining proceeds within the five-year replacement period for property damaged by Hurricane Katrina. Since the 2006 hurricanes, the taxpayer purchased and sold inventory, but did not

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designate any acquired inventory as replacement property for the inventory destroyed.

See pages 12-13 for the National Office's analysis of the applicable Code and Regulations from which it concluded that the inventory that was involuntarily converted was property held for productive use in a trade or business for purposes of Section 1033(h)(2).

IMPLICATIONS OF THE TAM ... IS THERE A SILVER LINING?

It seems clear that any tangible property of a type "held for productive use in a trade or business" will be treated as property that is "similar or related in service or use" to business property that is located in a disaster area and is compulsorily or involuntarily converted as a result of a Federally-declared disaster. Accordingly, a taxpayer may elect not to recognize gain with respect to involuntarily converted property/inventory if the tangible business or investment property is acquired within the appropriate replacement period ... which is usually two years.

The TAM seems to suggest that in certain circumstances, taxpayers doing businesses in Federally-declared disaster areas might avail themselves of the deferral benefits available under Section 1033 with respect to major repayments of their LIFO reserves related to their LIFO inventories ... if their inventory declines can be made to fit within the general fact pattern presented in the TAM.

The general fact pattern would have to involve (1) a major decrease in the inventory level at year-end attributable to a Federally-declared disaster and (2) the taxpayer's reinvestment of the sales and/or insurance proceeds within the applicable replacement period in property (inventory or other assets) held for productive use in the same trade or business.

Under these circumstances, should a taxpayer realistically expect to be able to rely on the rationale in this TAM to avoid immediate LIFO recapture resulting from a decline/loss of LIFO inventory?

Some would argue, "Why not?" ... because under the dollar-value method for valuing LIFO inventories, the entire dollar amount of investment in the inventory is considered to be a single asset, notwithstanding the individual inventory items and pools which are aggregated in the overall computations.

Furthermore, if the replacement property consists of other depreciable assets, such as equipment or buildings - instead of inventory - can the gain (which would otherwise be recognized as the LIFO reserve recapture) be deferred and offset against the cost basis of these tangible replacement assets?

APPLICABLE REGULATIONS

The rules for recognizing gain and/or permitting the deferral of gain in these situations are included in Reg. Sec. 1.1033(a)-2. This Regulation provides that "All of the details in connection with an involuntary conversion of property at a gain (including those relating to the replacement of the converted property, or a decision not to replace, or the expiration of the period for replacement) shall be reported in the return for the taxable year or years in which any of such gain is realized."

Among other special conditions and rules, the Regulation further provides that "If, after having made an election under Section 1033(a)(2), the converted property is not replaced within the required period of time, or replacement is made at a cost lower than was anticipated at the time of the election, or a decision is made not to replace, the tax liability for the year or years for which the election was made shall be recomputed. Such recomputation should be in the form of an 'amended return.' If a decision is made to make an election under Section 1033(a)(2) after the filing of the return and the payment of the tax for the year or years in which any of the gain on an involuntary conversion is realized and before the expiration of the period within which the converted property must be replaced, a claim for credit or refund for such year or years should be filed."

C corporations and certain partnerships are not entitled to defer gain under Section 1033 if the replacement property is acquired from a related party.

Other special rules that might come into play could allow a taxpayer (1) to obtain an extension of time for making an election to defer the gain under certain circumstances and/or (2) to acquire the replacement property indirectly by purchasing at least 80% of the stock of a corporation which owns such property.

MORE INFORMATION ON DISASTER AREAS

Unfortunately, many Federally-declared disasters have occurred recently all over the country. The fact that this TAM relates to the Katrina disaster several years ago does not lessen its potential application to businesses that are located in the many different currently-designated Federal disaster areas.

For a list of more recent (2011) disaster areas, see the www.irs.gov/newsroom article "Tax Relief in Disaster Situations" (last updated on May 25, 2011). Also, see www.fema.gov for other information on Federally-declared disasters.

Perhaps this TAM may provide distressed businesses with some help from an unexpected source.

Section 1033 Involuntary Conversion Provisions Apply to Inventory

National Tax Office Analysis of Section 1033 & Applicable Regulations

Section 1033(a)(2) of the Code provides, in part, that if property (as a result of its destruction in whole or in part, theft, seizure, or requisition or condemnation or threat or imminence thereof) is compulsorily or involuntarily converted into money and if the taxpayer during the statutory replacement period, for the purpose of replacing the converted property, purchases other property similar or related in service or use to the converted property, then, at the election of the taxpayer, the gain must be recognized only to the extent that the amount realized on the conversion exceeds the cost of the replacement property.

Under Section 1033(a)(2)(B), the replacement period generally ends two years from the close of the first taxable year in which any gain from a conversion is realized.

However, special legislation has extended the replacement period from two years to five years for property in the Hurricane Katrina disaster area that is compulsorily or involuntarily converted on or after August 25, 2005 by reason of Hurricane Katrina, but only if substantially all of the use of the replacement property is in such area. See Section 405 of P.L. 109-73 (*The Katrina Emergency Tax Relief Act of 2005* enacted September 23, 2005).

[Note: Section 1033(h)(1)(B) extends the replacement period from two years to four years for principal residences converted in a Federally declared disaster. This four year replacement period does not apply to trade or business or investment property.]

Section 1033(h)(2) provides that if a taxpayer's property held for productive use in a trade or business or for investment is located in a disaster area and is compulsorily or involuntarily converted as a result of a Federally-declared disaster, then tangible property held for productive use in a trade or business ***is treated as property similar or related in service or use to the converted property***.

Several provisions of the Internal Revenue Code relating to the deferral of gain on an exchange or other disposition of property explicitly disallow the deferral of gain for dispositions of inventory.

For example, under the like-kind exchange provisions in Section 1031(a)(2)(A), the deferral of gain under Section 1031(a) is not permitted for exchanges of "stock in trade or other property held primarily for sale."

Similarly, Section 1033(g)(1) applies to certain conversions of "real property (not including stock in trade or other property held primarily for sale)."

Section 1033(h)(2), however, does not contain any specific language relating to inventory, stock in trade or property held primarily for sale.

In other provisions of the Internal Revenue Code, inventory is treated separately from property used in a trade or business. For example, in Section 1400N(f)(2), which pertains to clean up costs in the Gulf Opportunity Zone, a distinction is made between property which is (A) held by the taxpayer for use in a trade or business or for the production of income and (B) property described in Section 1221(a)(1) (stock in trade, inventory, etc.). Another example is found in Section 1231(b) which distinguishes between property used in a trade or business and inventory.

Obviously, Congress knows how to make clear distinctions between inventory and other forms of business and investment property. Nevertheless, Congress has made no such distinction in Section 1033(h)(2).

In addition, the legislative history of Section 1033(h)(2) does not exclude inventory from the deferral treatment accorded a conversion of the property described in Section 1033(h)(2). (See S. Rep. 104-281 at 14 (1996).)

Although it is arguable that inventory is not property held for productive use in a trade or business or for investment because inventory does not "produce" property or services within the plain meaning of that term, the use of the term "productive" does not necessarily exclude inventory.

National Tax Office Analysis of Section 1033 & Applicable Regulations

In addition, the subsection that precedes Section 1033(h), Section 1033(g), which applies to real property "held for productive use in a trade or business or investment" specifically excludes inventory property from its application. Had Congress intended to exclude inventory from the language "held for productive use in a trade or business or for investment" in Section 1033(h)(2), it would have expressly done so just as it did in the wording of Sections 1033(g) and 1031(a)(2)(A).

Consistency with Notice 2003-18. The position that Section 1033(h)(2) applies to conversions of inventory is also consistent with Notice 2003-18 (2003-1 C.B. 699) which provides guidance on the treatment of World Trade Center (WTC) grant payments to businesses to aid in the recovery from the September 11, 2001, terrorist attacks. Notice 2003-18, Answer 7, provides as follows:

> "[43] ... A business may elect, under Section 1033, to defer the gain on ... payments received to compensate for losses due to damage to, or destruction of, real property or other tangible assets, including equipment, furniture and fixtures, supplies and ***inventory used in a trade of business*** caused by the attack on the WTC. *[emphasis added]*
>
> "[44] ... In addition, because the property for which businesses will receive the ... grant payments was destroyed in a Presidentially-declared disaster, the businesses may use the ... grant payments to purchase any tangible property of a type held for use in a trade or business and still defer recognition of the gain."

Consistency with Congressional intent. The position that Section 1033(h)(2) applies to conversions of inventory is also consistent with Congress's explanation of its purpose for enacting Section 1033(h)(2). The legislative history of Section 1033(h)(2), in explaining the reason for adding paragraph (h)(2), states:

> "The property damage in a Presidentially-declared disaster may be so great that businesses may be forced to suspend operations for a substantial time. During that hiatus, valuable markets and customers may be lost. If this suspension causes the businesses to fail, and the owners of the business wish to reinvest their capital in a new business venture, the involuntary conversion rules will force them to recognize gain when they buy replacement property that is needed for the new business but not similar to that used in the failed business.
>
> "This provision will offer relief to such businesses by allowing them to reinvest their funds in ***any*** tangible business property without being forced to recognized gain. No such deferral of gain is available now, if the taxpayer decides not to reinvest in tangible business property." (See S. Rep. 104-281, at 14.)

Conclusion

Consequently, Section 1033(h)(2) applies to inventory that is involuntarily converted in a Presidentially-declared disaster. This conclusion is valid for three reasons...

- First, the express language of Section 1033(h)(2) ... unlike Section 1031(a)(1)(A) and Section 1033(g) ... does not exclude conversions of inventory from its application.
- Second, there is no indication of Congressional intent to deny inventory businesses the benefit of the special rule in Section 1033(h)(2).
- Third, this position is consistent with Notice 2003-18.

Accordingly, inventory held by the taxpayer that is involuntarily converted in a Presidentially-declared disaster is "property held for productive use in a trade or business" for purposes of Section 1033(h)(2) of the Code.

IRS ATG DISCUSSES ITEM DEFINITION FOR WINERIES USING LIFO

In May 2011, the IRS released an *Audit Technique Guide* for the wine industry.

Previous issues of the *LIFO Lookout* have included several articles relating to wineries using LIFO for valuing their inventories. These articles are listed in the "Selected References" section below.

The current *Audit Technique Guide* (*ATG*) for the wine industry is dated March 2011, and it is an updated version of *The Wine Industry Market Segment Specialization Program* training document that the IRS published in April, 1995. The 1995 MSSP Guide for the wine industry was reviewed in the March 2007 *LIFO Lookout* as part of the article (*Winery's LIFO Calculations Leave a Bitter Taste in IRS' Mouth*) which discussed the IRS' displeasure with one winery's LIFO calculations as set forth in Field Attorney Advice 20064301F.

The current *Audit Technique Guide* for the wine industry states that, "At the time this *ATG* is being written, published guidance is in process and should be issued in 2010." It would appear that this reference to "published guidance in process" is to the document that was issued during the summer of 2010 as Internal Revenue Service Legal Memorandum (ILM) 201043029. In this ILM, the IRS examined the item definitions that a winery under audit was using for its LIFO price index computation purposes, and the IRS concluded that the item definitions used by that winery in its LIFO calculations were acceptable.

ILM 201043029 is analyzed in detail in the article, *"LIFO & Wineries: At Last, a Good Year ... One Wine(ry) Finally Satisfies the IRS' Taste,"* in the Year-End 2010 Edition of the *LIFO Lookout*.

The current (2011) *Audit Technique Guide* for the wine industry has incorporated (almost word-for-word) the acceptable item definitions used by the taxpayer in ILM 201043029 as the "criteria that an agent should consider in determining the item definition for a winery." *[See page 4 of 4.]*

The current *ATG* states that "this material was designed specifically for training purposes only" and "under no circumstances should the contents be used or cited as sustaining a technical position." Accordingly, although one might accept this wording on its face as suggesting that the item definition criteria are not precedential, these criteria clearly seem to be what the IRS will measure any other winery's methodology against.

Also, in the Mid-Year 2010 Edition of the *LIFO Lookout*, we discussed the IRS' apparent push for wineries to accept one of three options in order to settle current disputes over item definitions used by wineries. We indicated that the IRS seems to be pushing for wineries to accept one of three options in order to settle these LIFO disputes ...

(1) Use the inflation indexes under the IPIC method developed by the Bureau of Labor Statistics.

(2) Recompute their LIFO inventories using the narrower item definitions preferred by the IRS for all years on LIFO ***and then change*** to use the IRS preferred item definitions in future years.

(3) Pay an administratively agreed-upon amount which would be 27% of the LIFO reserve with 20% for the last open year and 7% for the current year, ***and then change*** to use the IPIC method or change their definition of items in the future years to the item definitions preferred by the IRS.

At that time, we had speculated that the IRS might issue some form of guidance (such as an ILM or a Chief Counsel Memo) on this in the near future. It appears that the "form of guidance" suggested is now found in the discussion of acceptable item criteria in the 2011 *Audit Technique Guide* for the wine industry.

The material on the following pages is intended to incorporate the essential portions of the current wine industry *Audit Technique Guide* discussions on LIFO and item definitions with additional background material and commentary. As a result, portions of several previous articles in the *Lookout* have been included to the extent that they are now more relevant in understanding the current position of the IRS.

Selected References from the *LIFO Lookout*

2011 *Audit Technique Guide* for the Wine Industry ... At a Glance

INTRODUCTION

The number of wineries has almost doubled from 2,700 in 1999 to over 5,400 by 2007. While almost 90% of the U.S. wine production still occurs in California, the number of vineyards and wineries in many other states has increased dramatically. Another major change has been consolidation and foreign ownership.

There are a number of significant developments in tax law affecting the Industry. ... For example, it was a common practice for a wine producer to hold its related vineyard assets in a separate farming entity. The cash method farmer would sell the grapes to the winery, but not receive payment until the wine was sold, sometimes 3 or 4 years later. This income deferral issue was raised in *Oakcross Vineyards, Ltd. v. Comm.* (T.C. Memo 1996-433) where the Court determined that the cash method of accounting did not clearly reflect income. Subsequently, it has been held that when a farmer operates as a division of a winery entity, the cash method of accounting for the farming operations is permissible. Therefore, many winery entities are now operating their vineyards as a division of the winery entity in order to take advantage of the opportunities therein afforded.

A winery's website has a wealth of information to assist the agent in determining the scope of the audit. The *Audit Technique Guide* now makes reference to these website resources rather than try to incorporate all of the data from these websites into the *Guide* itself. This should enable the examiner to readily access the most current information.

CHAPTER 1 ... *Overview of Winery / Vineyard Operations*

- This chapter emphasizes that the process of making wine is a manufacturing process. The winery takes one product (grapes) and transforms it into another (wine). Since this is a manufacturing process, the wineries must account for their costs as a manufacturer using the Uniform Capitalization (UNICAP) rules under Section 263A.
- As a result, throughout the *Guide*, considerable emphasis is placed on the proper application of Section 263A rules for the uniform capitalization of inventory costs to a winery's stages of production processes and inventories.
- Sec. 263A requires that the aging process be included in the "production period."
- The "production period" generally terminates as of the "release date," i.e., the date when the wine is officially offered in the winery's distribution chain. Prior to the release date, the winery is purposely holding the wine for aging. After the release date, the wine remains unsold only due to sales or marketing restrictions. Often, a winery will have published release dates for its wines. Barring that, the first shipping invoice for general sales may be determinative.

CHAPTER 2 ... *Pre-Audit Information Gathering*

- There are a number of resources available electronically to assist an IRS agent in the initial review of a return. These resources include the winery/vineyard website and various search engines. Larger, publicly-traded companies often have a link to their financial statements. Perusing these sources can give a wealth of information.
- Another factor to be evaluated by the Agent is "Who prepared the (income tax) return? Some CPA firms specialize in the wine industry." In the 1995 *MSSP Training Guide*, the following comments were included ... "There is a handful of local CPA firms that specialize in the wine industry. A possible 'flag' is a return prepared by anyone not specializing in wineries. A significant rate of substantial errors has been found in examinations of those returns." These comments do not appear in the 2011 *ATG*.

CHAPTER 3 ... *Audit Considerations*

- This chapter provides information to be considered in conducting the pre-audit, initial interview and comparative analysis of the balance sheet and income and expense statements.

CHAPTER 4 ... *Capitalization & Tax Accounting*

- UNICAP costs and issues and other operations and entity issues are discussed.
- General LIFO issues and item definition issues are discussed separately and appear on the following pages.

CHAPTER 5 ... *Glossary*

CHAPTER 6 ... *Information Sources ... Government Agencies, Industry Publications, Magazines & Books*

What the *ATG* Says ... LIFO (General Comments)

Many wineries have elected LIFO under Section 472 using the dollar-value method. The dollar-value method determines cost by using base-year cost expressed in terms of total dollars rather than the quantity and price of specific goods as the unit of measurement.

The dollar-value Regulations offer taxpayers three alternative approaches to computing an internal price index under LIFO. These approaches are (1) the double-extension method, (2) the index method and (3) the link-chain method. These methods measure inflation in a taxpayer's inventory by reference to the taxpayer's own cost data. While each of these methods is available to taxpayers, the Regulations prefer the use of the double-extension method and describe the limited circumstances in which either of the other two methods may be employed.

In lieu of the three foregoing alternative methods of constructing a price index using internal information, a taxpayer may elect to use the IPIC method in order to construct a price index based on external pricing information developed through industry surveys by the Commerce Department's Bureau of Labor Statistics ("BLS").

The objective of the dollar-value LIFO method is to enable a taxpayer to price its inventories at the beginning and end of each year in constant dollars in order to ascertain whether there has been an increment or liquidation in the quantity of items within a pool. To accomplish this objective, the dollar-value method undertakes to cost the items within a pool in a taxpayer's ending inventory at current-year cost and base-year cost in order to develop an index of price change. The development of such a price index is essential in order to restate the beginning and ending inventories to a common dollar basis, so that changes in inventory quantities can be measured.

What the *ATG* Says ... Item Definition for LIFO Computation Purposes

The starting point under the dollar-value methods of pricing LIFO inventories is to determine what constitutes an "item" within each LIFO pool. The dollar-value regulations do not define what an inventory item is; however, the Tax Court has established some basic principles.

In order to clearly reflect income, the grouping of like goods and the separation of dissimilar goods must be accomplished. Because the change in the price of an item determines the price index and the 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. A narrower definition of an item within a pool will generally lead to a more accurate measure of inflation (i.e., price index) and thereby lead to a clearer reflection of income. If factors other than inflation enter into the cost of inventory items, a reliable index cannot be computed. (*Amity Leather Products*, 82 T.C. 726.)

The appropriate definition of a wine item of inventory has recently attracted significant attention. Industry practice has been to define items of wine inventory into very few categories. Most commonly, wineries place all of their products into a single pool that includes only two items, for example, bulk wine and bottled wine. Yet wineries produce several different wine varietals and/or varietal-blends, each with varying cost characteristics and production processes. Wineries may produce wines under different "labels" or trade names as a way to reach consumers at multiple market segments. The cost differentials of the various wines are typically traced for financial accounting purposes and can be substantial.

Wine products may be added or eliminated and production levels may be expanded or contracted for various reasons. When a taxpayer changes its mix of product over the years and does not differentiate between low and high cost items, distortions will occur. Since wine generally takes several years to produce, wineries will have several vintages in inventory at any one time, each at different stages of production. Grouping multiple vintages into one item of inventory will cause a distortion if there is a change in the vintage mix from one year to the next.

Field Attorney Advice 20064301F addressed the weaknesses of the wine industry's "two-item" LIFO methodology. In order for inflation to be correctly and consistently measured, the cost differences associated with the various wines must be identified and measured at the item level. The taxpayer produced a significant number of wines with cost differences due to the type of grape, the location where the grapes were grown, the grape grower, the storage containers used, aging requirements of the wine and the bottling materials used. However, it defined inventory items in just two categories: bulk wine and case goods. This broad item definition allowed product mix variations to intermingle with actual inflationary elements, thereby rendering an inaccurate index computation. The FAA held that since the taxpayer had defined its items too broadly, it had not properly determined its LIFO index, and its LIFO method did not clearly reflect income.

IRS ATG DISCUSSES ITEM DEFINITION FOR WINERIES USING LIFO

What the *ATG* Says ... Item Definition for LIFO Computation Purposes *(continued)*

FAA 20064301F concluded that the taxpayer's use of only two items in its LIFO methodology was not sufficient. However, the FAA did not describe a suitable definition of an "item" of wine inventory. The *ATG* states that, at the time this *ATG* is being written, published guidance is in process and should be issued in 2010. *[Comment: The published guidance referred to is probably ILM 201043029 which was issued in the summer of 2010.]*

The determination of how a winery would define an "item" for purposes of its LIFO dollar-value computations is a ***very factually intensive decision***. How one winery defines its items may be very different from how another winery defines its items. ***Wineries should be using the criteria below to define their wine items and to value their LIFO inventories.***

Produced Wines	• The taxpayer will maintain a natural business unit pool for the wines it produces. • The taxpayer will maintain a separate resale pool for the wines, if any, that it purchases for resale.
Bulk Wines	• Type of wine (i.e., varietal, appellation, or blends of two or more varietals), • Source of grapes (i.e., purchased or grown), • Process, recipe, or formula used, or the program followed, to make the wine, and • Length of time the wine has been aging at the end of the tax year, from the time the grapes are harvested (*e.g.*, 3 months; 15 months; 27 months).
Bottled Wines & Cased Goods	• Type of wine (i.e., varietal, appellation, or blends of two or more varietals), • Source of grapes (i.e., purchased or grown), • Process, recipe, or formula used, or the program followed, to make the wine, • Length of time the wine has been aging when bottled, • Type of container, if a significant cost difference exists between cases of containers, and • Length of time the wine has been stored after bottling. • The taxpayer will not divide wines into separate LIFO inventory items based on the type of barrel or container used for fermenting and aging its wine because the taxpayer does not specifically allocate the cost attributable to a particular type of barrel or container to any particular LIFO inventory item for purposes of determining the inventory cost or current-year cost of that item for income tax return purposes or for financial accounting purposes. • The taxpayer will use the specific identification method to determine current-year cost.
Other Considerations in Defining "Items" in a Winery	• ***The terms "process," "recipe," "formula," and "program"*** 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). ◆ If the taxpayer uses a high quality grape to produce a high quality wine and a medium quality grape to produce a medium quality wine of the same varietal, the two wines will 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, the LIFO index computed would be distorted as a result of the artificial inflation created by the two-year bulk wine's additional costs. ◆ Source: This discussion as to length of time is taken from ILM 201043029.

Any change in the definition of an item (either expanding or contracting the scope of an item) constitutes a change in method of accounting that requires the Commissioner's advance consent.

If an item definition change is proposed as part of an IRS audit adjustment, all of the taxpayer's prior LIFO layers must be restated. This can be accomplished through the use of a simplified allocation method.

SPLITTING DOLLAR-VALUE LIFO POOLS ... PROCEDURES, TECHNIQUES & REFINEMENTS

In working with dollar-value LIFO inventories, it will occasionally become necessary to split a dollar-value LIFO pool into two or more pools.

This article discusses and analyzes the rather limited IRS guidance on how to split a dollar-value LIFO pool into two or more (i.e., multiple) pools. In addition, the importance of mathematically proving the changes in the amounts of the LIFO reserves before and after the pool is split is illustrated by analyzing the underlying components of change. This further analysis is intended to be helpful to readers in dealing with their own practical situations.

Finally, this article discusses several of the many practical applications which involve pool-splitting, one of which relates to the guidance provided by the IRS (in ILM 200935024) on how a dealership might try to postpone or minimize the recapture of a portion of its LIFO reserves in franchise termination situations.

OVERVIEW OF THE DOLLAR-VALUE METHOD

The dollar-value method measures increases or decreases in inventory quantities in terms of total dollars, rather than in terms of physical units. Under the dollar-value method, to determine whether there has been an increase or decrease in the inventory during the year, the ending inventory is valued in terms of total dollars that are equivalent in value to the dollars used to value the beginning inventory.

Because it is not predicated upon the matching of specific items, the dollar-value method permits the application of the LIFO principle in those industries that rely upon complex inventories containing a vast number of items. To make this application work for varying types of businesses, inventory is grouped into "pools," and these pools are composed of "items."

At the end of the year, to determine the amount of change (i.e., either an increase or a decrease) in a LIFO inventory pool's value from the prior year, the current-year aggregate cost of the "items" in ending inventory for each pool is valued at "base-year cost."

Base-year cost is the aggregate cost of all items in the pool expressed in terms of what those items actually cost (or would have cost) as of the beginning of the taxable year for which the LIFO method was first adopted.

After converting the current year's ending inventory from current-year cost to base-year cost, the value of the beginning inventory and of the ending inventory - both expressed in terms of base-year cost - is compared to determine whether an increase or a decrease in inventory quantity has occurred. For this purpose, it is necessary to compare the value of the beginning and of the ending inventories of a particular year in dollar amounts expressed in terms of the same dollar equivalent (i.e., their equivalent base-year costs).

As a general principle, where dollar-value LIFO inventories are concerned, it is usually more advantageous for the taxpayer using LIFO to include its inventories in a small number of LIFO pools ... with a single pool providing the best of all possible results.

The reason for preferring a lesser number of pools, rather than a greater number of pools, is because to the extent that there are changes in the mix of items in the inventory, decreases in the dollar volume of inventory in one group will be offset by increases in the dollar volume of inventory in other groups of items - all of those offsets occurring within the same LIFO pool.

CRITERIA FOR DETERMINING POOLS & ITEMS

By way of further background, pooling relates to the grouping or combining of substantially similar or like inventory items for LIFO computation purposes. Each pool is entirely independent of all other pools for purposes of dollar-value LIFO computations.

The IRS' position is usually that the taxpayer should have more and smaller pools because more pools typically will result in a more accurate measurement of income ... and the "clear reflection of income" is the standard by which the accuracy of LIFO computations is to be judged.

Taxpayers elect LIFO by filing Form 970. In completing Form 970, the taxpayer identifies the pooling arrangement it will use by attaching a statement (to Form 970) that describes the method of pooling for the goods to be covered by the LIFO election. If the taxpayer will use more than one dollar-value pool, the taxpayer is required to list and describe the contents of each pool. (See Form 970, Page 2, Part IV, Item 15.)

An inventory "item" is the basic unit in dollar-value LIFO calculations. Only like items should be placed in the same LIFO pool for which an inflation index can be computed. In this regard, the key concept that has been developed out of several court cases is that the narrower the definition of an item, the more accurate will be the measurement (i.e., the clear reflection) of income.

see **SPLITTING DOLLAR-VALUE LIFO POOLS...**, page 20

Splitting LIFO Pools

Splitting (Separating) Dollar-Value LIFO Pools
Procedures, Techniques & Refinements

Executive Summary

- In simple situations, when a dollar-value LIFO pool is being split, the LIFO reserve as of the beginning of the year of change for the large pool that is being split should be the same amount as the sum of the LIFO reserves for the two or more pools resulting from the splitting of the larger pool. This is clearly evident in the example in the Regulations and in the example in LTR 8137143.
- Where a link-chain method is used to value a dollar-value LIFO pool, the LIFO indexes for the two or more pools resulting from the splitting of a larger LIFO pool will be restated (i.e., rebased) to 1.000 as of the beginning of the year-of-change.
- General "principles" for mathematically reconciling the contribution of each annual layer of increment to the LIFO reserve can readily be applied to the "before" and "after" compositions of the LIFO pools.
- If a LIFO pool is being split in order to settle an IRS audit, there usually will be a Section 481(a) adjustment. However, in many situations, both the IRS and the taxpayer may agree that the taxpayer will make prospective changes in its pool and/or item determination methodologies in exchange for the IRS not requiring the taxpayer to make a Section 481(a) adjustment.
- Where there have been significant fluctuations in the mix and the rates of inflation or deflation experienced by different items in the dollar-value LIFO pool that is being split, the methods of allocation provided for in the Regulations and/or other IRS guidance may provide results that arguably do not represent the underlying composition of the components (i.e., newer pools) into which the single pool is being split.
- In some situations where a pool is being split, a more favorable result may be obtained by the taxpayer if it follows/uses a procedure other than the procedures in examples in the Regulations and in LTR 8137143. However, the Regulations provide that different procedures cannot be used ***unless the use of a different method is approved by the Commissioner.***
- It is important to understand the difference between (1) splitting a dollar-value LIFO pool (for which there are technical rules and principles) and (2) allocating the amount of a LIFO reserve for a single pool at year-end among different franchises or Q-Subs for purposes of reporting on year-end financial statements to the manufacturer or to others (for which several different approximation methods may be considered).

(Continued from page 18)

"Substantial similarity." To recap, in applying the dollar-value method to LIFO inventories, pooling involves the grouping of ***substantially similar*** items of physical inventory. The Regulations provide that the determination of whether similarity exists depends on all the facts and circumstances and that the formulation of detailed rules for the selection of pools applicable to all taxpayers is not feasible. (Reg. Sec. 1.472-8(b)(3)(i)(a)).

Establishing an appropriate number of LIFO pools can be a difficult ... and often debatable, undertaking. Clearly, there is an administrative disadvantage associated with having numerous, narrowly-defined pools because a separate index and dollar-value calculation is required for each pool established by the taxpayer. Therefore, from a taxpayer's standpoint, limiting the number of pools can greatly reduce the administrative effort and cost of computing dollar-value LIFO pools.

In *Amity Leather Products Co.*, the Tax Court recognized the competing objectives of accuracy and administrative feasibility involved in the pooling decision. The Court observed that ...

> *"The nature of 'items' in a pool must be similar enough to allow a comparison between ending inventory and base-year inventory. Because the change in the price of an item determines the price index and that index affects the computation of ... the LIFO inventory, the definition and scope of an item are extremely important to the clear reflection of income ...*
>
> *"A narrower definition of an item within a pool will generally lead to a more accurate measure of inflation (that is, price index) and, thereby, lead to a clearer reflection of income. ...*
>
> *"At the same time, the method of inventory accounting must be administratively feasible and not unduly burdensome from the standpoint of each of the parties."*

Principles for pooling. The principles for establishing pools are found in Reg. Sec. 1.472-8(b) and (c).

Manufacturers and processors may adopt either the natural business unit or multiple pooling methods.

On the other hand, wholesalers, retailers, jobbers and distributors generally must use the multiple pooling method which requires that their inventory be pooled by "major lines, types or classes of goods." These taxpayers cannot elect to pool by using the natural business unit concept unless they first apply to the Commissioner for permission to use this method of pooling.

There are two notable exceptions where taxpayers other than manufacturers could have a single pool. For a limited number of years - from 1981 until 1986 - certain eligible small businesses were permitted to elect a single pool method under Section 474.

More significantly, beginning in 2007, in Revenue Procedure 2008-23, the IRS permitted automobile dealerships (under the Alternative LIFO method - Revenue Procedure 97-36) to combine all new vehicles - i.e., all new automobiles and all new light-duty trucks regardless of manufacturer - into a single dollar-value LIFO pool. A similar single pool for all used vehicles, regardless of manufacturer, is also permitted under Rev. Proc. 2008-23.

LIMITED IRS GUIDANCE ON SPLITTING A POOL

Where the double-extension method is used. The only official guidance on splitting a dollar-value LIFO pool is found in Reg. Sec. 1.472-8(g)(ii). This guidance consists of the statement of several general principles and one example illustrating the splitting of a pool where the taxpayer is using the dollar-value, double-extension method.

Under the double-extension method, the quantity of each item in the pool at the close of the taxable year is extended at both base-year and current-year unit costs. Notice that under this method, ***every*** item in the pool must be repriced ... in other words, sampling techniques are not permitted.

This example from the Regulations is analyzed on pages 22-25. Unfortunately, it contains an over-simplified fact pattern that is not generally useful if the LIFO pool to be split is one for which cost information for all items in all prior years is not available. Also, the example from the Regulations provides no guidance for splitting a pool if the taxpayer uses a link-chain method for valuing the pool to be split.

Where a link-chain method is used. In the real world, many taxpayers using the dollar-value LIFO method also elect to use a so-called "link-chain" method (instead of using the double-extension method) to value their LIFO inventories. All dealerships using the Alternative LIFO Method are using a link-chain method. All taxpayers using the BLS/IPIC Method are using a link-chain method. The list goes on....

In instances where a link-chain method is used, the IRS has permitted taxpayers to make various apportionments to reflect the fact that "base-year costs" are not known under the link-chain method. Usually, this is done by using the ratio of the various newer pools' current-year costs at the end of the year

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preceding the year-of-change (i.e., as of the beginning of the year in which the LIFO pool is being split) for reconstituting the base year and related layers of increment.

In these situations (i.e., where a link-chain method is used), a key element in understanding the process is to recognize that the beginning of the year-of-change (i.e., the year when the pool is being split) becomes the new base year with the indexes for the resulting pools all being restated/rebased to 1.000 as of that date. The rebasing of indexes to 1.000 is a concept that is applied in many LIFO adjustment situations.

The only guidance for splitting LIFO pools for taxpayers using a link-chain method appears in Letter Ruling 8137143. This LTR involved a taxpayer that was required to split a single pool into nine separate pools. The dollar-value LIFO method employed by the taxpayer was based on a link-chain method.

In this heavily redacted Letter Ruling, the taxpayer proposed to split its pool by separating the base-year cost and the layers of increments into the new pools based on the relationship of the cost of the pools in the ending inventory for the taxable year immediately preceding the year of conversion.

The IRS accepted this approach, and because illustrating the taxpayer's procedure would be complicated by the fact that nine new pools were to be created, the IRS instead substituted an example of its own to illustrate the procedure.

Interestingly, the example that the IRS used in LTR 8137143 contains the identical fact pattern found in the Regulation example. The example in the Letter Ruling is analyzed on pages 26-30.

IMPORTANCE OF MIX OF ITEMS IN THE POOL

As indicated previously, taxpayers - in their LIFO calculations - usually want to use the smallest possible number of pools. This is because the smaller the number of LIFO pools, the greater the likelihood that decreases in the dollar volume of inventory or other mix changes in one group will be offset by increases in the dollar volume or mix changes of inventory in other groups of items within the pool.

An example in an IRS LIFO Training Manual illustrates the differences in LIFO reserves that can be created when a LIFO pool is split or divided into multiple pools. These changes in LIFO reserves result from the differences in the mix of the cost characteristics of the items that are reconfigured into the newer, smaller number of pools.

This example, again involving the familiar ABCD pattern of items, is analyzed on pages 34-39. What is important to note in connection with this example is that the splitting of the pool results in the reduction in the total amount of LIFO reserve after the pool is split. The amount of this reduction would be a Section 481(a) adjustment increasing taxable income for the year in which the new pool arrangement is required. The discussion of this example includes an analysis of the underlying factors causing the loss of a portion of the LIFO reserves.

APPLICATIONS ... IRS AUDITS REQUIRING POOLS TO BE SPLIT

In many instances when the IRS audits a taxpayer's LIFO computations, one basic line of inquiry by the examining agent usually relates to whether there would be a clearer reflection of income if the taxpayer were using more pools or different item definitions than the taxpayer is actually using. Often, the IRS will prevail in requiring the splitting of a LIFO pool (or a few pools) into a greater number of LIFO pools.

As indicated in the previous discussion of the importance of the mix of cost characteristics of the items in a pool, the splitting of a pool will often result in a Section 481(a) adjustment that increases taxable income in the year when the pool is split.

Case in point ... No pun intended. Consider the discussion in another article in this Edition of the *Lookout* relating to the criteria which the IRS has established in connection with its audits of wineries using the LIFO method to value their inventories. In many instances, the wineries have used either a single pool (consisting of all wines) or only two pools (consisting of one pool for bulk wine and one pool for bottled wine).

As a result of the IRS disagreeing with these item definitions - which are tantamount to pooling arrangements - the criteria established in the *Audit Technique Guide* released in May 2011 likely would result in the winery being required to split either its single pool or its two pools into multiple pools. How many pools? That would depend on how the criteria used to define wine items (discussed on page 17) would be applied to the winery's facts, circumstances, methods of production and/or methods of marketing.

Presumably in these situations, the principles illustrated in the examples would be applied to split the pools ... unless some other approach were agreed to by the parties.

In many LIFO audit situations that I have been involved with, the IRS required the taxpayer to split a single pool (or two pools) into multiple pools. But, usually the settlement agreement stipulated that (1) there either would be no Section 481(a) adjustment or

see **SPLITTING DOLLAR-VALUE LIFO POOLS...**, page 31

Reg. Sec. 1.472-8(g)(2)(ii)	***Procedures for Separating (Splitting) a Dollar-Value LIFO Pool Where the Double-Extension Method Is Used*** **Page 1 of 4**
General Principles	• A taxpayer who has been using the dollar-value LIFO method and who is permitted or required to change his method of pooling, shall combine or separate the LIFO value of his inventory for the base year and each yearly layer of increment in order to conform to the new pool or pools. • Each yearly layer of increment in the new pool or pools must be separately accounted for and a record thereof maintained. ◆ Any liquidation occurring in the new pool or pools subsequent to the formation thereof shall be treated in the same manner as if the new pool or pools had existed from the date the taxpayer first adopted the LIFO inventory method. • The … separation of the LIFO value of a taxpayer's inventory for the base year and each yearly layer of increment shall be made in accordance with the method set forth below, ***unless the use of a different method is approved by the Commissioner***. • Where the taxpayer changes from one method of pooling to another method of pooling, the ending LIFO inventory for the taxable year preceding the year of change shall be restated under the new method of pooling. • Where the taxpayer is permitted or required to separate a pool into more than one pool, the separation shall be made in the following manner: ◆ First, each item in the former pool shall be placed in an appropriate new pool. ◆ Every item in each new pool is then extended at its base-year unit cost and the extensions are totaled. ▪ Each total is the amount of inventory for each new pool expressed in terms of base-year cost. ◆ Then a ratio of the total base-year cost of each new pool to the base-year cost of the former pool is computed. ◆ The resulting ratio is applied to the amount of inventory for the base year and each yearly layer of increment of the former pool to obtain an allocation to each new pool of the base-year inventory of the former pool and subsequent layers of increment thereof. • ***The double-extension method*** requires that each item of inventory (100% … i.e., all items, with no exceptions) is priced at its base-year unit cost as well as its current-year unit cost. The sum of all extended base-year costs is divided into the sum of all extended current-year costs to obtain a dollar-value index. The dollar value index is used to value the increments.
Example From Regulations Showing How to Split or Separate a Dollar-Value LIFO Pool	
Regulation Example	• The Regulations contain only one example showing how to split a dollar-value LIFO pool. Unfortunately, the example contains an oversimplified fact pattern that is not generally useful if the LIFO pool to be split is one for which information for all prior years is not available and/or if the link-chain methodology is being used. • The example from the Regulations consists of five parts and is analyzed on the following pages. ◆ Part (a) … *Base-Year Costs & LIFO Valuation* ◆ Part (b) … *Extension of Items in Pool at Base-Year Costs* ◆ Part (c) … *Separation of Pool ABCD into Pool #1 (AB) and Pool #2 (CD) & Computation of Allocation Ratios to Be Used* ◆ Part (d) … *Allocation of Base-Year Costs to the Respective Pools* ◆ Part (e) … *LIFO Values of New Pools AB & CD* • ***Comments:*** The additional information regarding the composition of the LIFO reserve(s) before and after the pool is split is intended to show the accuracy of the underlying computations, and their consistency with the principle that the LIFO reserve to be recaptured in any subsequent year should be the same amount (proportionately) as if the pool had not been split. ◆ If the base costs of the items in Pool ABCD and the LIFO valuations of the layers have been allocated in the ratio of 35% (to new Pool AB) and 65% (to new Pool CD), the corresponding allocation of the composition of the LIFO reserve to each pool should also be in the same ratio. This is reflected in the computations below.

Reg. Sec. 1.472-8(g)(2)(ii)	***Procedures for Separating (Splitting) a Dollar-Value LIFO Pool Where the Double-Extension Method Is Used***

Example, Part (a) ... Base-Year Costs & LIFO Valuation

- Items A, B, C and D are all grouped together in one pool prior to December 31, 1960.
- The LIFO inventory value at Dec. 31, 1960 is $22,100, as computed below.
- This LIFO pool is being split as of Dec. 31, 1960.
- Therefore, the taxable year 1961 is the year for which the change in pooling is effective.

	Dec. 31, 1960 Inventory at Jan. 1, 1956 Base-Year Cost	Pool ABCD Ratio of Total Current-Year Cost to Total Base-Year Cost %	Dec. 31, 1960 Inventory at LIFO Value
Jan. 1, 1956 - Base Cost	$ 10,000	100%	$ 10,000
Dec. 31, 1956 Increment	1,000	110%	1,100
Dec. 31, 1958 Increment	5,000	120%	6,000
Dec. 31, 1960 Increment	4,000	125%	5,000
Total	$ 20,000		
LIFO Valuation of Inventory			$ 22,100

Additional Information ... Composition of LIFO Reserve Before Pool Is Split

Proof of LIFO Reserve as of Dec. 31, 1960 Before Pool ABCD Is Split into Two Pools

- Assuming the inventory cost at Dec. 31, 1960 is $25,000, the LIFO reserve is $2,900 ($25,000 cost - $22,100 LIFO value).
- The cumulative inflation index is 1.25 as of Dec. 31, 1960 ... ($25,000 cost / 20,000 base dollars).
- For purposes of "proving" the composition of the LIFO reserve, 1.25 is the key factor.

As of Dec. 31, 1960 Layers	Base Dollars		Proof Factor (1.25 - Valuation Factor)	Amount Contributed to LIFO Reserve
Jan. 1, 1956 - Base Cost	$ 10,000	x	0.25 = (1.25 - 1.00) =	$ 2,500
Dec. 31, 1956 Increment	1,000	x	0.15 = (1.25 - 1.10) =	150
Dec. 31, 1958 Increment	5,000	x	0.05 = (1.25 - 1.20) =	250
Dec. 31, 1960 Increment	4,000	x	- = (1.25 - 1.25) =	-
	$ 20,000			$ 2,900
	Total Base Dollars			Total LIFO Reserve

Example, Part (b) ... Extension of Items in Pool at Base-Year Costs

- There are 8,000 items in the Pool ABCD as of Dec. 31, 1960.
- The extension of the quantity of items A, B, C and D at their respective base-year unit costs is...

Item	Quantity	Base-Year Unit Cost*	Amount	
A	2,000	$ 2	$ 4,000	**
B	1,000	3	3,000	**
C	1,000	5	5,000	***
D	4,000	2	8,000	***
Total Number of Units	8,000			
Total Base Dollars in Pool as of Dec. 31, 1960			$ 20,000	

* i.e., base date cost as of January 1, 1956

PROCEDURES FOR SEPARATING (SPLITTING) A DOLLAR-VALUE LIFO POOL WHERE THE DOUBLE-EXTENSION METHOD IS USED

Example, Part (c) ...

Separation of Pool ABCD into Pool #1 (AB) & Pool #2 (CD)

Computation of Base-Year Cost Ratios

- The former Pool ABCD is separated into two pools - Pool AB and Pool CD, based on the computation of the ratio of the total base-year cost for each of the new pools to the base-year cost of the former pool ...

Item	Total Base-Year Cost		Ratio	Ratios to Be Used %
Pool AB:				
A	$ 4,000 **		-	
B	3,000 **		-	
Total	7,000	7,000	7,000 / 20,000	35%
Pool CD:				
C	$ 5,000 ***		-	
D	8,000 ***		-	
Total	13,000	13,000	13,000 / 20,000	65%
Total Base-Year Cost for Pool ABCD		$ 20,000	-	100%

Example, Part (d) ...

Allocation of Base-Year Costs to Pool #1 (AB) & Pool #2 (CD)

- The ratio of the base-year cost of new Pools AB and CD to the base-year cost of former Pool ABCD is 7,000/20,000 (i.e., 35%) and 13,000/20,000 (i.e., 65%), respectively.
- The allocation of the January 1, 1956 base cost and subsequent yearly layers of increment of former Pool ABCD to new Pools AB and CD is as follows:

Layer	Base-Year Cost to Be Allocated	Pool AB	Pool CD
Jan. 1, 1956 - Base Cost	$ 10,000	$ 3,500	$ 6,500
Dec. 31, 1956 Increment	1,000	350	650
Dec. 31, 1958 Increment	5,000	1,750	3,250
Dec. 31, 1960 Increment	4,000	1,400	2,600
Total	$ 20,000	$ 7,000	$ 13,000
	100%	35%	65%

Reg. Sec. 1.472-8(g)(2)(ii)

PROCEDURES FOR SEPARATING (SPLITTING) A DOLLAR-VALUE LIFO POOL WHERE THE DOUBLE-EXTENSION METHOD IS USED

Example, Part (e) ...

LIFO Valuations of New Pools AB & CD

- The LIFO value of new Pools AB and CD at Dec. 31, 1960, as allocated, is as follows:

	Dec. 31, 1960 Inventory at Jan. 1, 1956 Base-Year Cost		Ratio of Total Current-Year Cost to Total Base-year Cost %	Dec. 31, 1960 Inventory at LIFO Value	
Pool AB					
Jan. 1, 1956 - Base Cost	$	3,500	100%	$	3,500
Dec. 31, 1956 Increment		350	110%		385
Dec. 31, 1958 Increment		1,750	120%		2,100
Dec. 31, 1960 Increment		1,400	125%		1,750
Total	$	7,000		$	7,735
Pool CD					
Jan. 1, 1956 - Base Cost	$	6,500	100%	$	6,500
Dec. 31, 1956 Increment		650	110%		715
Dec. 31, 1958 Increment		3,250	120%		3,900
Dec. 31, 1960 Increment		2,600	125%		3,250
Total	$	13,000		$	14,365
Combined Totals	***$***	***20,000***		***$***	***22,100***

Additional Information ... Composition of LIFO Reserves After Pool ABCD Is Split

Proof of LIFO Reserves of Separate Pools as of Dec. 31, 1960

After Pool ABCD Is Split into Two Pools

- If the base costs of the items in Pool ABCD and the LIFO valuations of the layers have been allocated in the ratio of 35% (to new Pool AB) and 65% (to new Pool CD), the corresponding allocation of the composition of the LIFO reserve to each pool should also be in the same ratio. This is reflected in the computations below.

Pool AB As of Dec. 31, 1960 Layers	Base Dollars			Proof Factor (1.25 - Valuation Factor)	Amount Contributed to LIFO Reserve	
Jan. 1, 1956 - Base Cost	$	3,500	x	0.25 = (1.25 - 1.00) =	$	875.00
Dec. 31, 1956 Increment		350	x	0.15 = (1.25 - 1.10) =		52.50
Dec. 31, 1958 Increment		1,750	x	0.05 = (1.25 - 1.20) =		87.50
Dec. 31, 1960 Increment		1,400	x	- = (1.25 - 1.25) =		-
	$	7,000			$	1,015.00

Pool CD As of Dec. 31, 1960 Layers	Base Dollars			Proof Factor (1.25 - Valuation Factor)	Amount Contributed to LIFO Reserve	
Jan. 1, 1956 - Base Cost	$	6,500	x	0.25 = (1.25 - 1.00) =	$	1,625.00
Dec. 31, 1956 Increment		650	x	0.15 = (1.25 - 1.10) =		97.50
Dec. 31, 1958 Increment		3,250	x	0.05 = (1.25 - 1.20) =		162.50
Dec. 31, 1960 Increment		2,600	x	- = (1.25 - 1.25) =		-
	$	13,000			$	1,885.00
Combined Totals - Both Pools	$	20,000			$	2,900

LTR 8137143

PROCEDURES FOR SEPARATING (SPLITTING) A DOLLAR-VALUE LIFO POOL WHERE A LINK-CHAIN METHOD IS USED TO VALUE THE POOL

Background

- Reg. Sec. 1.472-8(g)(2)(i) provides that the combination or separation of the LIFO value of a taxpayer's inventory for the base year and each yearly layer of increment shall be made in accordance with the example in the Regulations, ***unless the use of a different method is approved by the Commissioner.***
- The example in the Regulation under the Section is based upon a taxpayer using the double-extension method for valuing its LIFO inventory pool. Under the double-extension method, the taxpayer is presumed to know or have information to determine the base date cost (i.e., the cost of each item as of the beginning of the first year on LIFO) so that every item in inventory at the end of any subsequent year can be "double-extended" or repriced back to the base date.
- The example, because of its oversimplified fact pattern, is not generally useful if the dollar-value LIFO pool to be split is one for which information for all prior years is not available and/or the link-chain index methodology is being used.

Letter Ruling 8137143

- In Letter Ruling 8137143, the taxpayer used a link-chain method (not the double-extension method), and it was required to split its single LIFO pool into nine separate pools.
  - ***The link-chain index method*** is a cumulative index which (1) considers all annual indexes dating back to the year of the LIFO election and (2) must be computed every year to keep the cumulative index current. Each year, a taxpayer computes a new cumulative index and uses that index to determine the base-year cost of the ending inventory in a pool and to value the increment for the year, if any.
- Under this circumstance, the Regulations do not provide any guidance on how to split a single LIFO pool into multiple pools. Accordingly, it was necessary for the Commissioner to approve a ***different method*** from that in the Regulation example.
- In the LTR, the IRS allowed the corporation to split its pool by separating the base-year cost and the layers of increments into the new pools based on the relationship of the cost of the pools in the ending inventory for the taxable year immediately preceding the year of conversion (i.e., based on the FIFO value of the pools in the beginning inventory of the taxable year of change).
- The taxpayer had outlined the steps in the procedure it would follow, and the IRS reinforced that method by providing a simplified example.
- The IRS noted that a similar methodology had been used in the proposed amendments of Reg. Sec. 1.472-8(e). [See Proposed Treas. Reg. Sec. 1.472-8, 46 Fed. Reg. 3912 (1981).]

Description of Procedure Used by Taxpayer to Split Its Pool ...

Single Pool Split Based on FIFO Costs as of Beginning of Year of Change

- The taxpayer proposed to separate the single pool's original base-year cost and layers of increment into the newly required nine pools based on the First-In, First-Out (FIFO) value of the pools in the beginning inventory for the taxable year of change.
  - The LIFO inventory value of the existing single dollar-value pool will reflect the LIFO base and yearly layers immediately prior to the separation.
  - The current FIFO cost of each of the nine new pools making up the original single pool will be computed as of the beginning of the year of change.
  - The next computations involve the determination of (1) the relationships between total current FIFO cost and total old base-year costs and (2) the relationship of current FIFO cost and current LIFO for the base year and increments from the results of the first two steps above.
    - The determinations create the ratio needed to translate old base costs to equivalent current base costs comprising the new base year (current FIFO costs).
  - The single pool is then separated into the nine pools by taking the current FIFO cost as of the beginning of the year of change of the original base year and each layer and allocating it among the nine pools.
    - This allocation is based upon the relationship of the current FIFO cost of each of the nine component groupings to the total current FIFO cost computed in the second step above.
  - The LIFO value of each of the nine pools would then be computed on a pool-by-pool basis for the original base-year and each yearly layer.
    - This computation is made by applying the LIFO to current FIFO cost relationship from the third step above to the beginning of the year of change inventory at new base-year costs determined in the fourth step above.
  - Finally, after the separation has been made, all subsequent LIFO calculations will be made on the basis of the beginning of the year of change costs being the new base-year costs.

PROCEDURES FOR SEPARATING (SPLITTING) A DOLLAR-VALUE LIFO POOL WHERE A LINK-CHAIN METHOD IS USED TO VALUE THE POOL

IRS Adds a Simplified Example

- Illustrating the taxpayer's procedure would be quite complex since one pool was being divided into nine pools. Accordingly, the IRS instead included a simplified example to illustrate this procedure.
  - The IRS' example uses the same ABCD pool fact pattern found in the Regulation example for the double-extension method situation.
  - This example consists of five parts and is analyzed below:
    - Part A ... *Base-Year Costs & LIFO Valuation*
    - Part B ... *FIFO Costs of Separate Departments as of the Beginning of Year of Change*
    - Part C ... *Rebasing of Pool ABCD to 1.000 as of the Beginning of the Year of Change*
    - Part D ... *Allocation of Current FIFO Cost (New Base Cost) to the Respective Pools*
    - Part E ... *LIFO Values of the Two New Pools AB & CD*
- To make references in the example easier to follow, it should be noted that ***1981 is the year of change*** (i.e., the year for which the single LIFO pool will be split into two pools).
  - Accordingly, the LIFO layer history as of Dec. 31, 1980 (i.e., the end of the last year for the single pool) is identical to the LIFO layer history as of Jan. 1, 1981 (i.e., the beginning of the first year reflecting the split of the single pool into multiple pools).

The Big Difference ... Rebasing Indexes To 1.000 Before Splitting the Pool

- ***Note that in this case, where the dollar-value pool being split uses a link-chain method, the indexes for the pools resulting from the split of the larger pool are rebased to 1.000 as of the beginning of the year of change.***
- ***LIFO computations after the pool has been split.*** Once the separation of the original LIFO pool into the new pools has been completed, subsequent years' LIFO calculations will be made as if the year of separation were the initial LIFO year.
  - Increases in new base cost amounts will result in increments and will be costed reflecting inflation from a base-year LIFO inventory as of the year of separation.
  - Decreases in new base cost amounts will result in decrements and will be removed from the LIFO inventory layers in reverse chronological order at the LIFO to current FIFO cost relationship applicable to the year the inventory was initially recorded (i.e., 0.96 if the 1979 increment layer is being reduced and 0.88 if the 1977 increment is being reduced, and 0.80 if the Jan. 1, 1974 base cost is being reduced).

Reconciliation of LIFO Reserves ... Before & After

- The additional information reconciling the composition of the LIFO reserve(s) before and after the pool is split does not appear in LTR 8137143.
- These reconciliations are intended to assure the accuracy of the underlying computations, and their consistency with the principle that the LIFO reserve to be recaptured in any subsequent year should be the same amount (proportionately) as if the pool had not been split.

Example, Part A ... Base-Year Costs & LIFO Valuation

- Departments A, B, C and D are all grouped together in one pool prior to December 31, 1980.
- The LIFO inventory value at Dec. 31, 1980/Jan. 1, 1981 is $22,100, as computed below.
- This LIFO pool is being split as of Dec. 31, 1980/Jan. 1, 1981.
- Therefore, the taxable year 1981 is the year for which the change in pooling is effective.

Pool ABCD	Dec. 31, 1980 Inventory at Jan. 1, 1974 Base-Year Cost	Ratio of Total Current-Year Cost to Total Base-Year Cost %	Dec. 31, 1980 Inventory at LIFO Value
Jan. 1, 1974 - Base Cost	$ 10,000	100%	$ 10,000
1977 Increment	1,000	110%	1,100
1979 Increment	5,000	120%	6,000
1980 Increment	4,000	125%	5,000
Total	$ 20,000		
LIFO Valuation of Inventory			$ 22,100

- The above composition of the LIFO value of the original pool reflects the LIFO base and layers immediately preceding the separation of the original LIFO pool into the expanded new pools.
- For purposes of brevity, this example uses only three layers of increment. However, in an actual computation layers may exist for each taxable year.

Example, Part B ...

Breakdown of Departments A, B, C & D at Current-Year FIFO Costs

Department	Amount	AB	CD
A	5,000	5,000	
B	3,000	3,000	
C	7,000		7,000
D	10,000		10,000
Totals*	25,000	8,000	17,000
	100%	32%	68%

*Total FIFO Cost as of Dec. 31, 1980/Jan. 1, 1981

- This step presents the FIFO cost of each affected department, in the original LIFO pool.
- Individual departmental FIFO costs need only be determined for those departments directly affected by the new pooling configuration (i.e., only those departments being removed from the original LIFO pool need have their FIFO costs determined).

Example, Part C ...

Rebasing of Indexes in Pool ABCD to 1.000 as of the Beginning of the Year of Change

- The computation of the allocation of current FIFO cost, by base-year and layer, between the two pools is made on the basis of the ratio of total current FIFO cost to total old base-year costs and the relationship of LIFO cost to current FIFO cost (new base-year costs) as of the beginning of the year of change is as follows ...

Pool ABCD	Dec. 31, 1980 Inventory at Jan. 1, 1974 Base-Year Cost	Ratio of Total Current-Year Cost to Total Base-Year Cost %	Ratios Rebased to 1.000 as of Dec. 31, 1980**	Dec. 31, 1980 Inventory at Current Cost*	Dec. 31, 1980 Inventory at LIFO Value
1974 - Base Cost	$ 10,000	100%	0.80	$ 12,500	$ 10,000
1977 Increment	1,000	110%	0.88	1,250	1,100
1979 Increment	5,000	120%	0.96	6,250	6,000
1980 Increment	4,000	125%	1.00	5,000	5,000
Totals	$ 20,000			$ 25,000	$ 22,100

* The new base-year cost for each of the layers in Pool ABCD is the respective Jan. 1, 1974 base-year cost multiplied by 1.25 (i.e., $25,000 / 20,000 = 1.25).

** The new index reflecting the rebasing to 1.000 for each of the layers in Pool ABCD is determined by dividing the LIFO valuation for each layer by the new base-year cost (i.e., the current-cost as of Dec. 31, 1980) for each layer (i.e., for 1979, $6,000 divided by 6,250 = 0.96 and for 1977, $1,100 divided by 1,250 = 0.88, etc.)

- The determination of the relationships between current FIFO cost and old-base costs and LIFO costs creates the ratio needed to translate old-base costs to equivalent current base costs comprising the new base-year (current FIFO cost).
- Subsequently, a comparison of this division of the new base-year to the LIFO value results in a LIFO to current FIFO cost relationship.
- This relationship would be used whenever a decrease in the LIFO inventory occurred that resulted in the penetration of layer or base-year inventories accumulated prior to the pool separation.
  - In such event, the reductions of LIFO inventory value and current FIFO cost would bear this relationship (i.e., in a penetration of the 1979 increment, LIFO value would decrease by 96% of current FIFO cost.

Example, Part D ...

Allocation of Current FIFO Cost (i.e., New Base Cost) to Pool #1 (AB) & Pool #2 (CD)

- The ratio of the new base-year cost of new pools, AB and CD, to the base-year cost of former pool, ABCD, is 8,000/25,000 (i.e., 32%) and 17,000/25,000 (i.e., 68%), respectively (see (B) above).
- The allocation of the beginning of the year of change current FIFO cost (new base cost) of former pool, ABCD, to the two new pools, AB and CD, is as follows ...

Layer	New Base-Year Cost to Be Allocated*	Pool: AB - 32% ($8,000/25,000)	Pool: CD - 68% ($17,000/25,000)
Jan 1, 1974 - Base Cost	$ 12,500	$ 4,000	$ 8,500
1977 Increment	1,250	400	850
1979 Increment	6,250	2,000	4,250
1980 Increment	5,000	1,600	3,400
Total	$ 25,000	$ 8,000	$ 17,000

* The new base-year cost amount to be allocated ($25,000) is the same amount as the current FIFO cost as of the beginning of the year of change (i.e., $8,000 for Pool AB and $17,000 for Pool CD) because the indexes for the layers have been rebased to 1.000 as of the beginning of the year of change (i.e., Dec. 31, 1980 / Jan. 1, 1981).

- This step divides the components of the current FIFO cost of the original LIFO pool into the separated components of the new pools.
- The overall relationship between the old pool and the two pools (32% - 68%, respectively) is used to allocate the current FIFO cost among the base-year and layers, by pool.

Example, Part E ...

LIFO Valuations of the Two New Pools AB & CD

- The LIFO values of the new Pools AB and CD at the beginning of the year of change are below.
- This step completes the separation of the LIFO valuation of the original (ABCD) LIFO pool into the two new pools - AB and CD.
  - This is done by using the LIFO to current FIFO cost relationship developed above (Step C) to reduce the current FIFO cost amounts to their appropriate LIFO values, by base-year and by subsequent layers.

	New Base-Year Cost*	Indexes as Rebased to 1.000	Dec. 31, 1980 Inventory at LIFO Value
Pool AB			
Jan 1, 1974 - Base Cost	$ 4,000	0.80	$ 3,200
1977 Increment	400	0.88	352
1979 Increment	2,000	0.96	1,920
1980 Increment	1,600	1.00	1,600
Total	$ 8,000		$ 7,072
Pool CD			
Jan 1, 1974 - Base Cost	$ 8,500	0.80	$ 6,800
1977 Increment	850	0.88	748
1979 Increment	4,250	0.96	4,080
1980 Increment	3,400	1.00	3,400
Total	$ 17,000		$ 15,028
Combined Totals	***$ 25,000***		***$ 22,100***

* The new base-year cost amounts for each of the new pools are the same amounts as the current FIFO costs as of the beginning of the year of change (because the indexes for the layers have been rebased to 1.000 as of Dec. 31, 1980 / Jan. 1, 1981).

Procedures for Separating (Splitting) a Dollar-Value LIFO Pool Where a Link-Chain Method Is Used to Value the Pool

Additional Information
Proof of Composition of LIFO Reserve(s) as of Dec. 31, 1980
Before & After Pool ABCD Is Split into Multiple Pools (AB & CD)

Before Pool ABCD Is Split into Multiple Pools & Indexes Have Not Been Rebased to 1.000

- The total inventory cost of the separate departments at current cost (i.e., at FIFO) as of Dec. 31, 1980/Jan. 1, 1981 is $25,000.
- Therefore, the LIFO reserve is $2,900 ($25,000 cost - $22,100 LIFO value).
- The cumulative inflation index (before the pool is split) as of Dec. 31, 1980/Jan. 1, 1981 is 1.25... ($25,000 cost / 20,000 base dollars).
- For purposes of "proving" the composition of the LIFO reserve, 1.25 is the key factor.

As of Dec. 31, 1980 Layers	"Old" Base Dollars		Proof Factor (1.25 - Valuation Factor)		Amount Contributed to LIFO Reserve
Jan. 1, 1974 - Base Cost	$ 10,000	x	0.25	=(1.25 - 1.00) =	$ 2,500
1977 Increment	1,000	x	0.15	=(1.25 - 1.10) =	150
1979 Increment	5,000	x	0.05	=(1.25 - 1.20) =	250
1980 Increment	4,000	x	-	=(1.25 - 1.25) =	-
	$ 20,000				$ 2,900
	Total Base Dollars				Total LIFO Reserve

After Pool ABCD Is Split into Two Pools & Indexes Are Rebased to 1.000

- If the base costs of the departments in Pool ABCD and the LIFO valuations of the layers have been allocated in the ratio of 32% (to new Pool AB) and 68% (to new Pool CD), the corresponding allocation of the composition of the LIFO reserve to each pool should also be in the same ratio. This is reflected in the computations below.
- Note that after the pool has been split, the proof factor becomes 1.000 (not 1.25) because the pools have been rebased to 1.000 as of Dec. 31, 1980.

Pool AB As of Dec. 31, 1980 Layers	"New" Base Dollars		Proof Factor (1.00 - Valuation Factor)		Amount Contributed to LIFO Reserve
Jan 1, 1974 - Base Cost	$ 4,000	x	0.20	=(1.00 - 0.80) =	$ 800
1977 Increment	400	x	0.12	=(1.00 - 0.88) =	48
1979 Increment	2,000	x	0.04	=(1.00 - 0.96) =	80
1980 Increment	1,600	x	-	=(1.00 - 1.00) =	-
	$ 8,000				$ 928

Pool CD As of Dec. 31, 1980 Layers	"New" Base Dollars		Proof Factor (1.00 - Valuation Factor)		Amount Contributed to LIFO Reserve
Jan 1, 1974 - Base Cost	$ 8,500	x	0.20	=(1.00 - 0.80) =	$ 1,700
1977 Increment	850	x	0.12	=(1.00 - 0.88) =	102
1979 Increment	4,250	x	0.04	=(1.00 - 0.96) =	170
1980 Increment	3,400	x	-	=(1.00 - 1.00) =	-
	$ 17,000				$ 1,972
Combined Totals - Both Pools	$ 25,000				$ 2,900

the amount of the Section 481(a) adjustment was a negotiated/compromise amount, and (2) the pooling change or split would be made as of the beginning of the year after the last year under audit. In other words, in regard to the latter, the taxpayer would effect the splitting of the pool(s) by filing a Form 3115 prospectively.

APPLICATIONS ... DEPARTMENT STORES USING THE IPIC RETAIL METHOD

Other circumstances that may require, or result in, the need to split up a LIFO pool arise when the Bureau of Labor Statistics (BLS) expands its indexes and users of the Inventory Price Index Computation (IPIC) LIFO method under Reg. Sec. 1.472-8(e)(3) are required to increase the number of LIFO pools that they are using.

These situations basically apply to department stores using the retail method of valuing inventories in connection with their LIFO elections who must split existing pools when the BLS expands its list of groups of pools.

Revenue Procedure 86-47 addressed this situation. In this Revenue Procedure, the same fact pattern and the same process for splitting a dollar-value LIFO pool described in LTR 8137143 were followed in providing guidance to an IPIC user using the retail method. In essence, this taxpayer was using a link-chain (rather than a double-extension) method for valuing its inventories. The only difference between the IRS' example in Revenue Procedure 86-47 and the example in LTR 8137143 is that later years are indicated for the annual layers of increment.

APPLICATIONS ... MANUFACTURERS MAKING CERTAIN AUTOMATIC CHANGES UNDER REV. PROC. 2011-14

Manufacturers are given permission to change the number of their dollar-value LIFO pools without first securing permission from the IRS in certain circumstances.

These changes/circumstances apply to a manufacturer that purchases goods for resale and, thus, must reassign resale goods from the pool(s) it maintains for the goods it manufacturers to one or more resale pools.

These changes/circumstances also apply to manufacturers who want to change from using multiple pools to using natural business unit pools (or vice versa), and/or who want to reassign items in natural business unit pools to the same number or to a greater number of natural business unit pools.

Collectively, these are all covered as automatic accounting method change No. 141, and they are described in Section 22.10 of the *Appendix* to Revenue Procedure 2011-14.

In making these changes, manufacturers are required to separate (or combine) pools as required by Reg. Sec. 1.472-8(g), and a Section 481(a) adjustment is neither permitted nor required. In other words, these changes are made on a cut-off basis, and they are applied only to the computation of ending inventories after the beginning of the year-of-change.

If a manufacturer splits a pool into two or more permissible pools under this automatic change and uses the cut-off method, it may want to terminate the LIFO election for one (or more) of the newly created pools. In this case, the manufacturer may then file a separate Form 3115 to change from the LIFO inventory method for one or more of the resulting pools. The termination of the election with respect to such pool or pools will require a Section 481(a) adjustment that will recapture the LIFO reserve attributable to such pool or pools.

It should be noted that in these situations which are applicable ***only*** to manufacturers, the automatic changes in method to split a pool (automatic change No. 141) and to terminate the LIFO election for one or more of the newly-formed pools (automatic change No. 56) are both permitted to be made by the filing of Forms 3115 ***after*** ... not before ... the end of the year. This is extremely beneficial because it permits the taxpayer to use hindsight, after the year-of-change is over, in evaluating whether or not to initiate such a change.

APPLICATIONS ... AUTO DEALERSHIPS HAVING THEIR FRANCHISES TERMINATED

A more recent practical example involves situations when automobile dealerships know that they are going to lose one or more manufacturer's franchises. These dealerships may consider terminating a portion of their LIFO elections for new vehicle inventories as an alternative measure to try to reduce their anticipated LIFO reserve recapture at the end of the year.

This was a significant issue in 2009 and 2010 because many dealerships lost - or were told they were going to lose - a franchise due to manufacturer bankruptcies and/or other unilateral actions taken by various manufacturers.

In ILM 200935024, the IRS issued some guidance on LIFO terminations in situations where dealerships were losing their franchises. This guidance basically concluded that the Section 481(a) adjustment recapturing the LIFO reserve on the termination of a LIFO election was not required to be

see **SPLITTING DOLLAR-VALUE LIFO POOLS...**, page 32

(Continued from page 31)

accelerated where the dealership continued operating other activities of its trade or business (i.e., selling used vehicles, selling vehicle parts and accessories, and servicing and repairing vehicles).

In other words, the 4-year spread period for recapturing the LIFO reserve that is generally required when a LIFO election is terminated would not be shortened to a 1-year spread period as long as the dealership continued other operating activities which are part of its overall trade or business.

The IRS guidance in ILM 200935024 takes the form of answers to three questions arising out of different LIFO termination scenarios which relate to the 4-year spread period for the recapture of the LIFO reserves.

Two of the three scenarios of less general application involve dealerships that were not using the Alternative LIFO Method. However, the third scenario contains the discussion of what might be a good planning opportunity for a dealership under certain circumstances.

It also raises the question of how the LIFO reserve for a single pool consisting of all new vehicles would or should be divided or apportioned to the vehicles related to different franchises where the dealership wants to split that single pool in order to follow the splitting of the pool with the termination of the LIFO election for the pool related to the inventory of the lost franchise.

Facts in ILM Situation 3. In 1990, an automobile dealer ("Taxpayer") obtained a franchise to sell new Pontiac-brand vehicles ("Pontiacs"). The dealership also sold used vehicles and new automotive parts and accessories, and its service department provided vehicle maintenance and repair service for customers as well as for used vehicles acquired for resale.

The dealership treated all these activities as a single trade or business since it obtained its Pontiac franchise in 1990.

Between 1991 and 1992, Taxpayer expanded its single trade or business as it obtained franchises to sell new (1) Fords, (2) Chevrolets, (3) Toyotas and (4) Hondas.

Taxpayer lost its Pontiac franchise on July 7, 2009, and it quickly liquidated its inventories of new Pontiacs. Taxpayer did not have any new Pontiacs in ending inventory on December 31, 2009.

Despite the loss of its Pontiac franchise in mid-2009, the dealership continued to sell new Fords, Chevrolets, Toyotas, and Hondas and to operate the other activities of its trade or business (i.e., selling used vehicles, selling vehicle parts and accessories, and servicing and repairing vehicles).

Effective for the taxable year ending December 31, 2007, the dealership had elected to use the Vehicle-Pool Method for all new vehicles. (Rev. Proc. 2008-23.) As a result, Taxpayer was using a single dollar-value LIFO pool which included all inventory of new automobiles and new light-duty trucks, regardless of manufacturer. As of January 1, 2009, the dealership's LIFO reserve attributable to the single pool was $40x.

The ILM states, "If Taxpayer used its LIFO method for the taxable year ending December 31, 2009, the LIFO reserve would be reduced by $8x as a result of having no Pontiac vehicles in ending inventory."

The question posed in this situation was ... If the dealership maintains one pool for all new vehicles, may it change from the LIFO method for only the vehicles sold under the lost franchise?

The IRS answer and analysis was in three parts. First, the dealership may not change from the LIFO method for ***some*** of the goods that are currently properly includible in the scope of its single dollar-value pool.

Second, the IRS said that the dealership may change from the LIFO method for the ***entire*** dollar-value pool (under Revenue Procedure 2011-14, formerly Revenue Procedure 2008-52).

In other words, the dealership could certainly choose to terminate its entire LIFO election for all new vehicles, thus losing the LIFO reserve attributable to all of the retained franchises in the process.

Third, and alternatively, the IRS said that the dealership could consider first splitting its single pool for all new vehicles and franchises (that would be change #1) and then terminating the LIFO election for the pool related to the Pontiac franchise that was lost (that would be change #2). In other words, there would be a pool split, followed by a partial LIFO termination.

The IRS said that the dealership may change (#1) its pooling method to a method of pooling based on the vehicles sold under each ***franchise***. This request for change would have to be filed under the advance consent procedures in Rev. Proc. 97-27. This request would require the filing of Form 3115 ***before the end of its taxable year***.

Then, following change #1 to split the pool, the dealership would change from the LIFO method (i.e., terminate its LIFO election) for the dollar-value pool that includes vehicles sold under the Pontiac franchise (i.e., make change #2). This separate change would be made by filing a Form 3115 pursuant to Rev. Proc. 2011-14 (formerly Rev. Proc. 2008-52). How- →

ever, this change could be made as an automatic change in method by filing Form 3115 ***after the end of its taxable year***.

Note that to do this, two different Forms 3115 must be filed in two (consecutive) different years. The two changes suggested above cannot both be made as automatic changes which do not require advance consent from the IRS. Only one of them can. The change to split the overall pool into multiple pools based on the vehicles sold under each *franchise* is **not** an automatic change. It would have to be made pursuant to Rev. Proc. 97-27 ... by filing a Form 3115 with the IRS *before the end of the dealership's taxable year of change*.

However, if a dealership learned of this possibility after the end of the year and wished to pursue it, perhaps it might request the IRS to grant it an extension of time to file the Form 3115 to split the pool. Unfortunately, requesting such an extension of time may involve considerable additional time and expense.

The IRS guidance in this situation might help a dealership remain on LIFO for some of its new vehicle inventories, while losing only the benefit of the LIFO reserve attributable to the lost franchise. In other words, adopting the procedure suggested in the third situation/fact pattern in the ILM might result in keeping "half-a-loaf" (i.e., staying on LIFO for the new vehicle inventory of the continuing franchise(s)). This might be better than "none" (i.e., repaying all of the LIFO reserve for all of the new vehicle inventory, including the LIFO reserve related to the new vehicles in the continuing franchise(s)).

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

In the ILM Situation 3, the dealer had 5 franchises: one franchise was lost and four remained. If the dealership took the action described by the IRS and terminated its LIFO election for Pontiacs, it would end up with 4 separate LIFO pools ... Fords, Chevrolets, Toyotas and Hondas ... one pool for the vehicles sold under each remaining franchise. In future years, dollar increases in one franchise inventory would not be able to offset dollar decreases in the pool for another franchise. This could pose a greater risk to overall LIFO reserve recapture in later years as inventory levels fluctuated. But, that disadvantage might be worth the "price to pay" in a future year in order to be able to remain on LIFO for the new vehicles sold under the remaining/retained franchises.

Is there another possible variation for dealing with fact patterns other than the one presented in Situation 3? What if the dealer follows the two-step approach, but it asks the IRS for permission to split its pool into multiple pools based on "all new vehicles manufactured by the same *manufacturer*," instead of "all new vehicles manufactured under the same *franchise*?" In many cases, the resulting pooling by "manufacturer" would be far broader than a more narrow pooling by "franchise." *(Note: if allowed by the IRS, this suggested pooling arrangement might not help the dealer in Situation 3 because it would have to include both Pontiacs and Chevrolets in the same pool because they are both produced by the same manufacturer - General Motors.)*

If General Motors is trying to develop a dealer network which basically consists of three stand-alone facilities ... Cadillac, Chevrolet and Buick-GMC ... then pooling new vehicles by manufacturer (GM) might be more beneficial than pooling new vehicles by specific franchises. The same could be said for Ford, Lincoln and Mercury and for Chrysler and Jeep.

However, it is uncertain whether the IRS would consent to splitting the single vehicle pool under any arrangement other than by franchise.

Finally, if the dealer in ILM Situation 3 thought it might be possible to obtain another franchise from the same manufacturer or from a different manufacturer, or even if that were not possible, would it be better for the dealer to stay on LIFO and try to get more other new vehicles in inventory before year-end? ... or try to get another franchise (with vehicles) before year-end? That would depend on the facts and circumstances which vary from dealership to dealership and what assumptions the dealer is willing to make about the future.

DETERMINATION OF LIFO RESERVE ALLOCABLE TO A TERMINATED FRANCHISE

The ILM raises some issues in connection with the splitting of the new vehicle pool.

The ILM facts included the following ... "On January 1, 2009, the LIFO reserve attributable to all of the vehicles in the single pool was $40x." No problem here ... just look at the amount of the LIFO reserve as of December 31, 2008.

The second fact ... "If Taxpayer used its LIFO method for the taxable year ending December 31, 2009, then the LIFO reserve would be reduced by $8x

see **SPLITTING DOLLAR-VALUE LIFO POOLS...**, page 40

Importance of Mix of Items	***EFFECT OF SPLITTING A LIFO POOL ON LIFO RESERVES & TAXABLE INCOME FOR THE YEAR OF CHANGE*** **Page 1 of 6**
Background	• The examples showing how to split a dollar-value LIFO pool in the Regulations (where the taxpayer uses the double-extension method) and in LTR 8137143 (where the taxpayer uses a link-chain method) are both "clean" in the sense that they reflect no changes in the amount of the LIFO reserves for the pools before and after the pools are split. ◆ In other words, in these cases, if the IRS were auditing and challenging the taxpayer's LIFO calculations, the IRS might require that the LIFO pool be split, but there would be no change in the amount of taxable income as a result of splitting the pools according to the IRS procedures. This often happens as a mutual concession between the IRS and the taxpayer. • However, in some LIFO audit situations, it is not unusual for the IRS to require that a pool be split in order to break apart dissimilar items that the taxpayer was including in a single pool. ◆ In these instances, one should expect that there will be a change in the overall amount of the LIFO reserves before and after the pool is split. ◆ Generally, in these situations, if there is a change in the amount of LIFO reserve as a result of splitting a pool (into multiple pools), that adjustment is a Section 481(a) adjustment. • An IRS LIFO Training Guide states that whether "an examination adjustment increasing the number of pools elected by the taxpayer will produce additional income" will depend on the mixture of inventory items in the pool. "By creating new pools, different indexes and incremental/ decremental patterns can result. In some cases, an adjustment (i.e., an increase or decrease in taxable income) will be caused by the additional pools; in other cases, the LIFO inventory values are unaffected."
Example Showing How Mix of Price Changes and/or Quantities Affects Splitting a Pool	
IRS Example	• The example on the following pages is taken from an IRS LIFO Training Guide (cited below). It presents a situation where a single pool originally consisting of Items A, B, C and D is required to be split into one of two new pool configurations ... either ... ◆ Option #1 ... Pool AB & CD, or ◆ Option #2 ... Pool AC & BD. • Under Option #1 for splitting the pool into separate Pools AB & CD... ◆ The mixture of items had little effect on the overall LIFO inventory valuation. ◆ The effect on taxable income was nil ($4 less LIFO reserve after the split). • Under Option #2 for splitting the pool into separate Pools AC & BD... ◆ The inventory mixture in the new pools produced different overall LIFO inventory valuations. ◆ The effect on taxable income was considerable ($786 less LIFO reserve after the split). • In concluding, the example states, "In the long run, fewer pools can benefit taxpayers. In general, fewer liquidations of lower indexed tiers (i.e. earlier years' LIFO layers) occur when there are fewer pools because reductions in quantities of some items in the pool can be offset by increases in other items."
Comments	• In a real IRS audit situation, these amounts would be Section 481(a) adjustments as of the beginning of the year of change (i.e., as of the beginning of the year in which the single LIFO pool was split into two or more pools). ◆ Usually, the year of change would be the earliest year under audit by the IRS. • A third Option, splitting the single pool into pools for AD & BC is not presented. The computations can readily be made following the formats used for the two other Options. ◆ Still other Options for splitting the pool could involve placing 3 of the items in one pool and leaving the other item in a pool by itself (i.e., one pool for ABC and a separate pool for D, etc.). • The additional information and discussion concerning the reconciliation of the composition of the LIFO reserve(s) before and after the pool is split does not appear in the Training Guide example.
Source	*LIFO Method of Inventory Valuation: A Self-Instructional Program - Student Guide* **Internal Revenue Service ... Training 3127-01 (Rev. 12-87),** ***TPDS 86702***

EFFECT OF SPLITTING A LIFO POOL ON LIFO RESERVES & TAXABLE INCOME FOR THE YEAR OF CHANGE

Facts for Single Pool ABCD to Be Split into Two Pools

Price & Quantity Information

Beginning of the Year ... January 1, 1986

Item	Unit Price	Quantity	Extension
A	$ 10	300	$ 3,000
B	5	400	2,000
C	30	500	15,000
D	20	700	14,000
Total Base-Date Cost			$ 34,000

End of the Year ... December 31, 1986

Item	Unit Price	Quantity	Extension	Rate of Inflation
A	$ 12	400	$ 4,800	1.20000
B	6	300	1,800	1.20000
C	35	700	24,500	1.16667
D	23	500	11,500	1.15000
Total Cost - End of the Year			$ 42,600	

LIFO Inventory as Filed - Single Pool

Single Pool

ABCD

Repricing (Double-Extension) of Ending Inventory to Determine Current-Year Inflation

	Base-Year (Base-Date) Cost					Current-Year (End-of-Year) Cost				
Item	Cost		Current-Year Quantity		Extension	Cost		Current-Year Quantity		Extension
A	$ 10	x	400	=	$ 4,000	$ 12	x	400	=	$ 4,800
B	5	x	300	=	1,500	6	x	300	=	1,800
C	30	x	700	=	21,000	35	x	700	=	24,500
D	20	x	500	=	10,000	23	x	500	=	11,500
Totals					$ 36,500					$ 42,600

- ***Inflation index is 1.167123 ... ($42,600 divided by $36,500)***

	Base-Year Cost	Inflation Index	Dec. 31, 1986 Inventory at LIFO Value
Jan. 1, 1986 - Base Cost	$ 34,000	1.00000	$ 34,000
Dec. 31, 1986 Increment	2,500	1.16712	2,918
Total	$ 36,500		
LIFO Valuation of Inventory			$ 36,918

Ending Inventory at Cost	$ 42,600
Ending Inventory at LIFO Valuation	(36,918)
LIFO Reserve - Dec. 31, 1986	$ 5,682

Composition of LIFO Reserve

LIFO Reserve consists of Jan. 1, 1986 base inventory of $34,000 x 0.167123 = $5,682.

EFFECT OF SPLITTING A LIFO POOL ON LIFO RESERVES & TAXABLE INCOME FOR THE YEAR OF CHANGE

Option #1 ... Splitting Pool ABCD into Pools for AB & CD
Repricing (Double-Extension) of Ending Inventory to Determine Current-Year Inflation

Pool #1 AB

Item	Base-Year (Base-Date) Cost: Cost		Current-Year Quantity		Extension	Current-Year (End-of-Year) Cost: Cost		Current-Year Quantity		Extension
A	$ 10	x	400	=	$ 4,000	$ 12	x	400	=	$ 4,800
B	5	x	300	=	1,500	6	x	300	=	1,800
Totals					$ 5,500					$ 6,600

- ***Inflation index is 1.20000 ... ($6,600 divided by $5,500)***

	Base-Year Cost	Inflation Index	Yr. End Inventory at LIFO Value
Base A	$ 3,000		
Base B	2,000		
	5,000	1.00000	5,000
Dec. 31, 1986 Increment	500	1.20000	600
Total	$ 5,500		
LIFO Valuation of Inventory			$ 5,600

Pool #2 CD

Item	Base-Year (Base-Date) Cost: Cost		Current-Year Quantity		Extension	Current-Year (End-of-Year) Cost: Cost		Current-Year Quantity		Extension
C	30	x	700	=	21,000	35	x	700	=	24,500
D	20	x	500	=	10,000	23	x	500	=	11,500
Totals					$ 31,000					$ 36,000

- ***Inflation index is 1.16129 ... ($36,000 divided by $31,000)***

	Base-Year Cost	Inflation Index	Yr. End Inventory at LIFO Value
Base C	$ 15,000		
Base D	14,000		
	29,000	1.00000	29,000
Dec. 31, 1986 Increment	2,000	1.16129	2,322
Total	$ 31,000		
LIFO Valuation of Inventory			$ 31,322

Comparison of Results for Pools AB & CD

Pool #1 - AB ... Ending Inventory at LIFO Valuation	$ 5,600
Pool #2 - CD ... Ending Inventory at LIFO Valuation	31,322
Total LIFO Valuation - Both Pools: AB + CD	36,922
Total LIFO Valuation - Single Pool ABCD	36,918
Increase in LIFO Valuation (i.e., Decrease in LIFO Reserve) resulting from splitting single pool	$ 4

Option #1 Pools AB & CD	***EFFECT OF SPLITTING A LIFO POOL ON LIFO RESERVES & TAXABLE INCOME FOR THE YEAR OF CHANGE***

Option #1 ... Splitting Pool ABCD into Pools for AB & CD
Analysis of Change in Total & Composition of LIFO Reserves for Separate Pools AB & CD

Computation of LIFO Reserves

	AB	CD	Total
Ending Inventory - Current Cost	$ 6,600	$ 36,000	$ 42,600
LIFO Valuation	(5,600)	(31,322)	(36,922)
LIFO Reserve	$ 1,000	$ 4,678	$ 5,678
Composition of LIFO Reserve			
Base Dollars	5,000	29,000	
Factor (Cumulative Index - 1.00000)	0.20000	0.16129	
LIFO Reserve (as above)	$ 1,000	$ 4,678	$ 5,678

<u>Comments</u>

LIFO Reserve Decreases

- In this case, the net ***increase*** in the sum of the LIFO valuations of the pools AB + CD (i.e., $36,918 before the split vs. $36,922 after the split) results in a net ***decrease*** in the amount of the LIFO reserve of ...$4 (i.e., $5,682 LIFO Reserve before the split vs. 5,678 after Pool ABCD was split into Pools AB & CD).
- Although this amount is small, it is not explained as a rounding difference due to lengthy decimals ... except for the $1 rounding difference shown in the "Math" below.*
- Rather, the difference can be identified as consisting of two discreet elements ... namely, (1) the change factor(s) which occurred in recasting Pool AB and (2) the change factor(s) which occurred in recasting Pool CD.
- The bottom line is that splitting the ABCD Pool results in additional taxable income.

Change Factor in Pool AB

- Portion of Pool AB inventory cost consisting of base dollars ($5,000) which is contributing to the LIFO reserve at a 0.20000 factor which is ***greater than*** the weighted average inflation rate (0.16712) which is contributing to the LIFO reserve for the single pool ABCD.

Change Factor in Pool CD

- Portion of Pool CD inventory cost consisting of base dollars ($29,000) which is contributing to the LIFO reserve at ***a lower inflation rate*** (0.16129) than the weighted average inflation rate (0.16712) which is contributing to the LIFO reserve for the single pool ABCD.

The Math

Pool	Base Dollars		Proof Factor	Impact on Amount Contributed to LIFO Reserve
AB	$ 5,000	x	0.03288 = (1.20000 - 1.16712) =	$ 164
CD	29,000	x	(0.00583) = (1.16129 - 1.16712) =	(169)
	$ 34,000		*	$ (5)
	Total Base Dollars		(* $1 = Rounding difference)	Total Decrease in LIFO Reserve

EFFECT OF SPLITTING A LIFO POOL ON LIFO RESERVES & TAXABLE INCOME FOR THE YEAR OF CHANGE

Option #2 ... Splitting Pool ABCD into Pools for AC & BD
Repricing (Double-Extension) of Ending Inventory to Determine Current-Year Inflation

Pool #1

AC

	Base-Year (Base-Date) Cost			Current-Year (End-of-Year) Cost		
Item	Cost	Current-Year Quantity	Extension	Cost	Current-Year Quantity	Extension
A	$ 10 x	400 =	$ 4,000	$ 12 x	400 =	$ 4,800
C	30 x	700 =	21,000	35 x	700 =	24,500
Totals			$ 25,000			$ 29,300

- ***Inflation index is 1.17200 ... ($29,300 divided by $25,000)***

	Base-Year Cost	Inflation Index	Yr. End Inventory at LIFO Value
Base A	$ 3,000		
Base C	15,000		
	18,000	1.00000	18,000
Dec. 31, 1986 Increment	7,000	1.17200	8,204
Total	$ 25,000		
LIFO Valuation of Inventory			$ 26,204

Pool #2

BD

	Base-Year (Base-Date) Cost			Current-Year (End-of-Year) Cost		
Item	Cost	Current-Year Quantity	Extension	Cost	Current-Year Quantity	Extension
B	5 x	300 =	1,500	6 x	300 =	1,800
D	20 x	500 =	10,000	23 x	500 =	11,500
Totals			$ 11,500			$ 13,300

- ***Inflation index is 1.15652 ... ($13,300 divided by $11,500)***

	Base-Year Cost	Inflation Index	Yr. End Inventory at LIFO Value
Base B	$ 2,000		
Base D	14,000		
	16,000	1.00000	16,000
Dec. 31, 1986 Decrement	(4,500)	1.00000	(4,500)
Total	$ 11,500		
LIFO Valuation of Inventory			$ 11,500

Comparison of Results for Pools AC & BD

- In Option #2 for splitting Pool ABCD into Pools AC & BD, the inventory mixture in the new pools produced different LIFO inventory values and a decrease in the amount of LIFO reserve by $786.

Pool #1 - AC ... Ending Inventory at LIFO Valuation	$ 26,204
Pool #2 - BD ... Ending Inventory at LIFO Valuation	11,500
Total LIFO Valuation - Both Pools: AC + BD	37,704
Total LIFO Valuation - Single Pool ABCD	36,918
Increase in LIFO Valuation caused by splitting Pool ABCD into Pools AC & BD (i.e., = Decrease in LIFO Reserve)	$ 786

IRS Discussion of Option #2 Results

- This result can be attributed to offsetting incremental and decremental values shown below.

	Base-Year Cost	Inflation Index	Amount
Increment in Pool AC	$ 7,000	1.17200	$ 8,204
Decrement in Pool BD	(4,500)	1.00000	(4,500)
Net			3,704
Less: Increment in Pool ABCD eliminated by splitting pool	$ 2,500	1.16712	(2,918)
Net Increase in LIFO Valuation of Inventory			$ 786

Option #2 ... Splitting Pool ABCD into Pools for AC & BD
Analysis of Change in Total & Composition of LIFO Reserves for Separate Pools AC & BD

Computation of LIFO Reserves

		AC		BD		Total
Ending Inventory - Current Cost	$	29,300	$	13,300	$	42,600
LIFO Valuation		(26,204)		(11,500)		(37,704)
LIFO Reserve	$	3,096	$	1,800	$	4,896
Composition of LIFO Reserve						
Base Dollars		18,000		11,500		
Factor (Cumulative Index - 1.00000)		0.17200		0.15652		
LIFO Reserve (as above)	$	3,096	$	1,800	$	4,896

Comments — *LIFO Reserve Increases*

- In this case, again, the net ***increase*** in the sum of the LIFO valuations of the pools AC + BD (i.e., $36,918 before the split vs. $37,704 after the split) results in a net ***decrease*** in the amount of the LIFO reserve of ...$786 (i.e., $5,682 LIFO Reserve before the split vs. 4,896 after Pool ABCD was split into Pools AC & BD).
- This net amount can be identified as consisting of three separate elements ... namely, the two change factors which occurred in recasting Pool AC and the single change factor which occurred in recasting Pool BD.
  - The analysis, however, requires additional consideration because a decrement occurred in Pool BD which was carried back against the amount of the beginning-of-the-year (i.e., the base) inventory.
- In other words, splitting the pool again results in additional taxable income.

Change Factors in Pool AC

- Amount/Portion of base cost ($7,000) in original Pool ABCD which is converted to "Dec. 31, 1986 increment" status in Pool AC when Pool ABCD is split. This portion of base cost loses its contribution to the LIFO reserve (at the weighted average inflation rate index of 0.167123) for the single pool ABCD.
- In addition, this amount ($7,000) is valued at 1.17200 in Pool AC, and this rate is greater than the weighted average inflation rate index of 1.167123 at which the increment was valued in Pool ABCD.

Change Factor in Pool BD

- As a result of splitting Pool ABCD, a decrement was computed for 1986 for the new Pool BD. In the comparison of differences, this decrement resulted in the elimination of the $2,500 increment for 1986 that was computed in the single Pool ABCD. This $2,500 increment was not contributing to the LIFO reserve in Pool ABCD at the rate of 0.167123.
- The elimination of this factor which was not contributing to the LIFO reserve in Pool ABCD offsets the factors in Pool AC.

The Math

Pool	Base Dollars		Proof Factor						Impact on Amount Contributed to LIFO Reserve
AC	$ 7,000	x	(0.16712)	= (	1.00000	-	1.16712	) =	$ (1,170)
AC	7,000	x	(0.00488)	= (	1.16712	-	1.17200	) =	(34)
									(1,204)
BD	2,500	x	0.16712	= (	1.16712	-	1.00000	) =	418
Net Decrease in LIFO Reserve caused by splitting Pool ABCD into AC & BD									$ (786)

as a result of having no Pontiac vehicles in ending inventory." This raises a few practical computational questions to consider.

The ILM is silent on how, or by what process, the amount of $8x was determined.

This does not appear to be the same as saying that if the single pool for all new vehicles were split as of January 1, 2009 (i.e., as of the beginning of the year-of-change), then the LIFO reserve allocable to the Pontiac pool would have been $xx__. All of the IRS guidance on how dollar-value LIFO pools should be split involves splitting the pool as of the first day of the year of change.

In this situation, is the IRS ignoring its own Regulation or other guidance on pool splitting? Or, is it employing some new method appropriate to this unusual set of facts and circumstances?

It would seem that the correct result - if one were to follow the alternative procedure suggested in the ILM - would be to split the new vehicle pool as of January 1, 2009 (i.e., the beginning of the year-of-change), and if the LIFO reserve for the Pontiac pool as of that date were $xx__ (i.e., some amount other than $8x), then that amount (and not $8x) should be the Section 481(a) adjustment for 2009 if the LIFO election for that Pontiac pool is terminated.

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

The Regulation clearly indicates that the separation of the LIFO value of a dollar-value pool for the base year and each yearly layer of increment shall be made in accordance with the appropriate method set forth in the Regulations, ***unless the use of a different method is approved by the Commissioner***.

With respect to auto dealership LIFO pools being split, in some instances, one might attempt to persuade the IRS that some method other than FIFO or specific identification should be used in order to more clearly reflect income. The use of the beginning-of-the-year current-cost approach emphasizes the more recent mix in level of the inventory and that more recent mix in level of the inventory might be significantly different from what has occurred over a longer period of time.

In other words, if the LIFO election were made many years before the split in the LIFO pool is to occur, there may be a more appropriate method for allocating the pool contents among the newly-created multiple pools. For example, what if in the year immediately before the LIFO pool was to be split, the dealership added two new franchises, each with $10 million worth of new vehicle inventory to its LIFO pool? Wouldn't an allocation based on beginning-of-the-year costs be unrealistic? Similarly, if there has been a significant difference in the mix or in the rates of inflation, another method may be more suitable than prorations based on beginning-of-the-year current costs.

SPLITTING A POOL VS. ALLOCATING A LIFO RESERVE

At this point, it is necessary to make one very important distinction. The matter of properly splitting (or dividing) a dollar-value LIFO pool where required for income tax purposes should not be confused with the matter of allocating a LIFO reserve among various divisions or other entities that are combined for financial statement purposes.

An allocation of a single pool LIFO reserve is often required of multi-franchise automobile dealerships who are required to report to different manufacturers, or the same manufacturer for different vehicle franchises or makes, for purposes of their year-end financial statements.

The distinction should be recognized between (1) splitting a dollar-value LIFO pool (for which there are technical rules and principles) and (2) allocating the amount of a LIFO reserve for a single pool at year-end among different franchises or Q-Subs for purposes of reporting on year-end financial statements to the manufacturer or to others (for which several different approximation methods may be considered).

For a discussion of these "allocation" matters and alternatives, see *"Allocating the Change in a LIFO Reserve Among Several Group Members"* in the Year-End 2010 Edition of the *LIFO Lookout* (pages 30-39).

CONCLUSION

In all cases, the splitting of a dollar-value LIFO pool involves a change in accounting method for which Form 3115 is required to be filed.

Where the change to split a LIFO pool is voluntarily being requested, Form 3115 may be required to be filed before the end of the year (if advance consent from the IRS to make the change is required) or after the end of the year (if the change can be made under the automatic change procedures).

If the change to split a dollar-value LIFO pool is initiated as a result of an IRS audit, a Section 481(a) adjustment will be required to be computed and taken into income. However, in many situations, both the IRS and the taxpayer may agree that the taxpayer will make prospective changes in its pool and/or item determination methodologies in exchange for the IRS not requiring the taxpayer to make a Section 481(a) adjustment.

COMPARISON OF *SuperLIFO*™ & IRS NEW ITEM DETERMINATIONS FOR NEW VEHICLES IN YEAR-END 2010 INVENTORIES

We are pleased to present our *SuperLIFO™* 2011 New Items Lists in a Report comparing our determinations of new items with those previously made available by the office of the IRS Motor Vehicle Technical Advisor (MVTA) in Grand Rapids, Michigan.

The IRS lists were distributed as an attachment to an e-mail dated February 1, 2011. In the attachment, the IRS Motor Vehicle Technical Advisor stated the following ... "This list is similar to the guidance I provide to examiners who audit automobile dealers' tax returns."

"The list is not an 'Official List;' it does not reflect 'Service Position' and examiners are not required to follow it."

Previously, when the MVTA released lists of new items, the Service identified the sources that it used in compiling its new item lists. This time, the MVTA is vague in describing sources that were consulted. Instead of a detailed list, the following statement appears.

"The revenue procedure [i.e., Rev. Proc. 97-36] requires that dealers obtain invoices for each vehicle in ending inventory, group the invoices into item categories and compute an average base cost for each category. ***Because the Motor Vehicle Technical Advisor program does not have access to all vehicle invoices, the new items list provided by the program uses the best available public information.*** Dealers, however, must use actual invoices in their computation."

In short, there is no indication of what sources the Office of the MVTA used in compiling its new items list.

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

Our Comparative New Item Report covers 20 pages ... New automobiles on pages 1-8 and new light-duty trucks (including sport utility vehicles, minivans and off-roads) on pages 9-20.

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

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

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

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

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

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

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

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

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

With respect to the December 31, 2010 year-end vehicles in inventory, we identified a total of 659 new item categories (264 automobiles and 395 light-duty trucks) whereas the IRS identified a total of only 335 (125 automobiles and 210 light-duty trucks). We both

see **NEW ITEM DETERMINATIONS...**, page 42

 (Continued from page 41)

reached the same conclusion with respect to 162 new item categories.

Previously, when the MVTA released lists of new items, the IRS lists separately grouped new automobiles and new light-duty trucks, disclaiming any inference that placing a vehicle in one group or another suggested the proper pool for that vehicle. In this year's list of new items, the IRS provided only one list in which it combined all new vehicles. This was explained in the MVTA's transmittal cover letter as follows.

"As you will see, the format of the lists has changed. Although the list was never intended for pooling purposes, for years prior to 2010, separate lists were provided for cars and trucks. ***Starting with the 2010 lists, we will provide one combined list of all vehicles.*** *In Revenue Procedure 2008-23, the IRS acknowledged that the line between cars and trucks had become blurred and provided a safe harbor pooling method that allowed dealers that properly change their method of accounting to combine new cars and new trucks into one pool. Taxpayers that did not adopt the single pool method should carefully consider the placement of individual vehicles into the proper pool."*

We have continued to use the two separate classifications for automobiles and light-duty trucks. As indicated above, now many dealerships don't care about this distinction any more because they have changed to the single, combined (Vehicle-Pool) method for all new vehicles. However, a significant number of dealers (at least many of those we are doing LIFO calculations for) have not changed to the Vehicle-Pool Method, for one reason or another. Therefore, this classification distinction for LIFO pooling purposes is still relevant for them.

This year, there are several significant differences between our determinations of new items and the IRS' ... and vice versa. We identified 497 item categories as new, but the IRS determined them to be continuing. The IRS identified 173 items as new, but we concluded that they should be treated as continuing items.

A table summarizing the details of these differences in treatment appears on page 45.

WHY OUR LISTS DIFFER ... IN GENERAL

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

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

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

WHY OUR LISTS DIFFER ... MAJOR SPECIFICS

In several instances, we concluded that certain item categories should be treated as new items, but the IRS reached the opposite conclusion (i.e., that these were continuing items). Accounting for this difference was the fact that in some instances, there was no change in the manufacturer's code, but there was a change in the platform (or wheelbase) of the vehicle. For example ... Chevrolet: the *Silverado 2500HD* (28 truck item categories), and the *Silverado 3500 HD* (48 truck item categories) ... for a total of 74 item categories/units. Similarly, in connection with GMC: the *Sierra 2500 HD* (28 truck item categories), and the *Sierra 3500 HD* (42 truck item categories) ...for a total of 70 item categories/units.

In other cases, we concluded that certain item categories should be treated as continuing items, but the IRS reached the opposite conclusion (i.e., the IRS concluded that these should be treated as new items). Accounting for this difference was the fact that in these cases, although the vehicle did have an engine change - which is a significant change in its own right, but not per se a reason for new item classification - the vehicle did not undergo a change in its platform (or wheelbase), and there was no change in the manufacturer's code. For example ... Ford: the *F-250 SD* (32 truck item categories), and the *F-350 SD* (48 truck item categories) ... for a total of 80 item categories/units.

→

The Ford *F-450 SD* is yet another example of the difference between our list and that of the IRS. Although this truck has been around for a few years, we never included this vehicle in our *SuperLIFO™* database because it had a gross vehicle weight rating (GVWR) in excess of 14,000 lbs. Therefore, according to the Revenue Procedure, the vehicle was too heavy to be included under the Alternative LIFO method.

For 2011, however, the GVWR for this vehicle was reduced to 13,300 lbs. (It was 14,500 lbs. for 2010 models.) Accordingly, for 2011, this vehicle would be included under the Alternative LIFO Method. In previous years, the IRS listed this vehicle in its database, but for 2011, it did not list it as a new item.

DEFINITION OF A "NEW" ITEM

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

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

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

NEW ITEM: WHAT DIFFERENCE DOES IT MAKE?

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

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

However, if there is overall inflation for the year in the dollar-value LIFO pool in which the new item is included, the inclusion of the same dollar amount for that new item in both the numerator and the denominator of the fraction will reduce the overall weighted index result (i.e., it will cause the index computed for the pool to be lower than it would be if the new item(s) were not included in the repricings).

The opposite result will occur in a year where there is overall deflation in the dollar-value pool. New item treatment (at 1.000) will raise or increase the overall weighted index result if there would otherwise be overall deflation for the year in the pool.

FOLLOW-UP AFTER REVIEWING IRS' NEW ITEM DETERMINATIONS

As indicated above, there were several instances where the IRS would appear to permit a vehicle to be treated as a continuing item, even though our analysis suggested otherwise.

For our LIFO clients, we reviewed all of the LIFO Reports for calculations that could be significantly affected by this differing treatment for certain Chevrolet *Silverados*, GMC *Sierras*, etc. As a follow-up we sent letters to a number of clients telling them that we would be pleased to re-run their 2010 Reports to reclassify vehicles affected from "new item" to "continuing item" status.

In each case, we were able to tell the dealer what the exact dollar amount of the increase in the LIFO reserve would be if the IRS' classification of certain vehicles as continuing items were followed. We were able to easily provide this exact information because, as part of our LIFO computation services, we prepare a separate Report which identifies all vehicles in ending inventory (by name, quantity and dollar amount) that were treated as new items for LIFO computation purposes.

Some dealerships opted for us to recalculate their LIFO change for the year using the IRS' determination for these items.

DETAIL LISTINGS

We have included the first page of the New Automobiles Report (Page 1 of 20) on page 46 and the first page of the New Light-Duty Truck Report (Page 9 of 20) on page 47. If you would like to receive a copy of the entire Report, please write or e-mail us with your request.

SUPERLIFO™ vs. IRS 2011 NEW ITEMS LISTS

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

NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
INVOLVING MANUFACTURER MODEL YEARS 2010 & 2011

SUPERLIFO™ - NEW ITEMS LIST FOR CALENDAR YEAR 2010 DEALERS & IRS MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM (DECEMBER, 2010 CALENDAR YEAR)

LEGEND / COMMENT CODE

E = DIFFERENCE IN ENGINE / MOST DETAILED DESCRIPTION

OPTION = OPTION PACKAGES / MOST DETAILED DESCRIPTION

REGION = DIFFERENT PRODUCT REQUIREMENTS OR OPTION PACKAGES WHICH VARY DEPENDING ON REGIONAL CONSIDERATIONS

TIMING = TIMING DIFFERENCE: IRS RECEIVED INFO EARLIER OR LATER

DIFSC = DIFFERENT INFORMATION SOURCES AVAILABLE TO IRS AND / OR TO *SUPERLIFO™*

NUMBER OF NEW ITEMS

	SUPERLIFO™ CATEGORY	IRS CATEGORY
AUTOMOBILES	264	125
LIGHT-DUTY TRUCKS	395	210
TOTAL NEW ITEM CATEGORIES	659	335

COMPARISON OF "UNOFFICIAL" NEW ITEM CATEGORY LISTS

SUPERLIFO™ AND IRS / MOTOR VEHICLE TECHNICAL ADVISOR PROGRAM
NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
FOR CALENDAR YEAR DEALERS - DECEMBER 31, 2010

	LEFT-HAND COLUMN *SUPERLIFO* SAID NEW (A)	IRS SAID NEW (B)	*SUPERLIFO* & IRS BOTH AGREE (A - C)	*SUPERLIFO* & IRS BOTH AGREE (B - D)	*SUPERLIFO* SAID NEW, IRS SAID CONTINUING (C)	RIGHT-HAND COLUMN IRS SAID NEW, *SUPERLIFO* SAID CONTINUING (D)
AUTOS						
Page 1	25	19	8	8	17	11
Page 2	40	14	12	12	28	2
Page 3	42	25	22	22	20	3
Page 4	31	25	15	15	16	10
Page 5	21	23	2	2	19	21
Page 6	37	7	3	3	34	4
Page 7	48	4	4	4	44	0
Page 8	20	8	8	8	12	0
TOTAL AUTOS	264	125	74	74	190	51
TRUCKS						
Page 9	24	19	6	6	18	13
Page 10	44	2	2	2	42	0
Page 11	38	8	6	6	32	2
Page 12	39	25	20	20	19	5
Page 13	5	42	2	2	3	40
Page 14	6	42	2	2	4	40
Page 15	47	12	12	12	35	0
Page 16	49	0	0	0	49	0
Page 17	36	20	15	15	21	5
Page 18	41	17	12	12	29	5
Page 19	36	9	2	2	34	7
Page 20	30	14	9	9	21	5
TOTAL TRUCKS	395	210	88	88	307	122
TOTAL AUTOS & TRUCKS	659	335	162	162	497	173

Out of the differences in Columns C & D, 11 cars and 19 truck differences were not "interpretive" differences. Rather, these 30 differences were solely due to timing in the sense that S/L and the IRS obtained the vehicle data in different time periods and therefore the vehicles did (or did not) appear on one list, but not on the other. In other words, these 30 "timing" differences would not exist if the comparison of lists were made over a 2 year period.

TIMING DIFFERENCES

IRS RECEIVED INFO EARLIER OR LATER				SUPERLIFO RECEIVED INFO EARLIER OR LATER			
CARS - EARLIER	0	TRUCKS - EARL IER	5	CARS - EARLIER	11	TRUCKS - EARLIER	14
CARS - LATER	11	TRUCKS - LATER	14	CARS - LATER	0	TRUCKS - LATER	5

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

NEW AUTOMOBILES AND LIGHT-DUTY TRUCKS
FOR CALENDAR YEAR DEALERS - DECEMBER 31, 2010

		SUPERLIFO™ - NEW ITEMS LIST FOR CALENDAR YEAR 2010 DEALERS		IRS MOTOR VEHICLE INDUSTRY (DECEMBER, 2010 CALENDAR YEAR)				PAGE 1 OF 20
MAKE	MODEL	BODY STYLE	MODEL CODE	YES	NO	BODY STYLE	COMMENT CODE	COMMENTS
		NEW AUTOMOBILES				NEW AUTOMOBILES		
ACURA	TSX	5-DR SPORT WAGON L4 2.4 AUTO W/TECH	CW2H6		X		DIFSC	11 MODEL WJD INTRO 12/15/10
		5-DR WAGON L4 2.4 AUTO	CW2H5		X		DIFSC	11 MODEL WJD INTRO 12/15/10
AUDI	A4		8K256A	X		2.0T PREMIUM 4D SDN TIP QUATTRO	DIFSC	11 MODEL IRS INTRO 4TH Q 2010
			8K556A	X		2.0T PREMIUM AVANT 4D WGN TIP QUATTRO	DIFSC	11 MODEL IRS INTRO 4TH Q 2010
			8K256A	X		2.0T PREMIUM PLUS 4D SDN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
			8K556A	X		2.0T PREMIUM PLUS 4D WGN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
			8K256A	X		2.0T PRESTIGE 4D SDN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
			8K556A	X		2.0T PRESTIGE AVANT 4D WGN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
			8K256A	X		2.0T PRESTIGE S-LINE 4D SDN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
			8K556A	X		2.0T PRESTIGE S-LINE AVANT 4D WGN TIP QUATTRO	OPTION	11 MODEL IRS INTRO 4TH Q 2010
	A8	4-DR AWD QUATTRO SEDAN V8 4.2 TIP AUTO	4H25AA	X				11 MODEL
		4-DR AWD QUATTRO SEDAN L V8 4.2 TIP AUTO	4H85AA	X				11 MODEL
	R8	2-DR AWD CPE SPYDER V10 5.2 6-SP QUATTRO	42952T	X				11 MODEL
		2-DR AWD CPE SPYDER V10 5.2 AUTO RT QUATTRO	42952B	X				11 MODEL
		2-DR AWD CPE SPYDER V8 4.2 6-SP QUATTRO	4295NT	X				11 MODEL
		2-DR AWD CPE SPYDER V8 4.2 AUTO RT QUATTRO	4295NB	X				11 MODEL
	TT	2-DR CPE 4CYL 2.0 PREM STRONIC AUTO	8J35VL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
		2-DR ROADSTER 4CYL 2.0 PREM QUATTRO S AUTO	8J95VL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
BENTLEY	MULSANNE	4-DR SEDAN V8 6.8 AUTO	3Y212A		X		DIFSC	11 MODEL IRS DOES NOT LIST MFR
BMW	3 SERIES	335I 4-DR SEDAN 6CYL TT 3.0 SA	80		X		DIFSC	11 MODEL WJD INTRO 4/5/10
		335IS 2-DR CONVERTIBLE 6CYL TT 3.0	84		X		DIFSC	11 MODEL WJD INTRO 4/5/10
		335IS 2-DR COUPE 6CYL TT 3.0	83		X		DIFSC	11 MODEL WJD INTRO 4/5/10
	5 SERIES	528I 4-DR SEDAN 6CYL 3.0 6-SP	56		X		DIFSC	11 MODEL WJD INTRO 4/6/10
		535I 4-DR SEDAN GT 6CYL TT 3.0 AUTO	86		X		DIFSC	11 MODEL WJD INTRO 8/3/10
		535I 4-DR SEDAN XDRIVE 6CYL TT 3.0 6-SP	50		X		DIFSC	11 MODEL WJD INTRO 4/16/10
		535I 4-DR XDRIVE SEDAN 6CYL TT 3.0 AUTO	55	X				11 MODEL
		535I 4-DR XDRIVE SEDAN GT 6CYL TT 3.0 AUTO	87		X		DIFSC	11 MODEL WJD INTRO 8/3/10
		550I 4-DR RWD SEDAN V8 TT 4.4 AUTO	53		X		DIFSC	11 MODEL WJD INTRO 4/6/10
		550I 4-DR SEDAN GT V8 TT 4.4 AUTO	58		X		DIFSC	11 MODEL WJD INTRO 8/3/10
		550I 4-DR XDRIVE SEDAN GT V8 TT 4.4 AUTO	59		X		DIFSC	11 MODEL WJD INTRO 8/3/10
		550I 4-DR XDRIVE SEDAN V8 TT 4.4 AUTO	85	X				11 MODEL
	GRAN TURISIMO		535I	X		4D SPORTS ACTIVITY CPE 535I	DIFSC	10 MODEL IRS INTRO 3RD Q 2010
			550XI	X		4D SPORTS ACTIVITY CPE 550XI	DIFSC	10 MODEL IRS INTRO 3RD Q 2010
			1090	X		4D SPORTS ACTIVITY CPE 550I	DIFSC	10 MODEL IRS INTRO 3RD Q 2010
	7 SERIES	740I 4-DR SEDAN 6CYL TT 3.0 AUTO	71		X		DIFSC	11 MODEL WJD INTRO 3/1/10
		740LI 4-DR SEDAN 6CYL TT 3.0 AUTO	72		X		DIFSC	11 MODEL WJD INTRO 3/1/10

		SUPERLIFO™ - NEW ITEMS LIST FOR CALENDAR YEAR 2010 DEALERS		IRS MOTOR VEHICLE INDUSTRY (DECEMBER, 2010 CALENDAR YEAR)				PAGE 9 OF 20
MAKE	MODEL	BODY STYLE	MODEL CODE	YES	NO	BODY STYLE	COMMENT CODE	COMMENTS
		LIGHT-DUTY TRUCKS				LIGHT-DUTY TRUCKS		
ACURA	MDX	4-DR SUV V6 3.7 AUTO W/TECH/ADVANCE	YD2H5	X				10 MODEL
			YD2H7AKNW	X		ADVANCE 4D UTILITY W/RES	TIMING	10 MODEL WJD INTRO 12/11/09
	ZDX		YB1H2A	X		4D SPORTS ACTIVITY CPE	TIMING	10 MODEL WJD INTRO 12/1/09
			YB1H4A	X		4D SAC W/TECH PKG	TIMING	10 MODEL WJD INTRO 12/1/09
			YB1H6A	X		4D SAC W/ADVANCE PKG	TIMING	10 MODEL WJD INTRO 12/1/09
AUDI	Q5	4-DR SUV 4CYL 2.0T QUATTRO TIP PREM AUTO	8RB56A	X				11 MODEL
			8RB56A	X		4D UTILITY 2.0T PREMIUM PLUS	OPTION	11 MODEL IRS INTRO 3RD Q 2010
	Q7	4-DR AWD SUV PREM V6 3.0 TDI AUTO	4LB5RA		X		DIFSC	11 MODEL WJD INTRO 6/24/10
		4-DR AWD SUV PREM V6 3.0T QUATTRO AUTO	4LB5ZA		X		DIFSC	11 MODEL WJD INTRIO 6/24/10
		4-DR AWD SUV PRESTIGE V6 3.0T AUTO	4LB5XA		X		DIFSC	11 MODEL WJD INTRIO 6/24/10
BMW	X3	28i 4-DR XDRIVE SAV 6CYL 3.0 AUTO	95	X				11 MODEL
		35i 4-DR XDRIVE SAV 6CYL 3.0 AUTO	65	X				11 MODEL
	X5	35i 4-DR XDRIVE SAV SPORT 6CYL T 3.0 AUTO	97		X		DIFSC	11 MODEL WJD INTRO 4/16/10
		35i 4-DR XDRIVE SAV 6CYL T 3.0 AUTO	96	X				11 MODEL
		35i 4-DR XDRIVE SAV PREM 6CYL T 3.0 AUTO	64		X		DIFSC	11 MODEL WJD INTRO 4/16/10
		50i 4-DR XDRIVE SAV V8 TT 4.4 AUTO	62	X				11 MODEL
BUICK	ENCLAVE	4-DR AWD UTILITY V6 3.6 1CX W/AH5	4V14526 1CXAH5		X		OPTION	11 MODEL
		4-DR FWD UTILITY V6 3.6 1CX W/AH5	4R14526 1CXAH5		X		OPTION	11 MODEL
CADILLAC	ESCALADE		6K10936	X		LUXURY 4D UTILITY AWD EXT	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6C10906	X		ESV LUXURY 4D UTILITY 2WS	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6K10906	X		ESV LUXURY 4D UTILITY AWD	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6C10706	X		PREMIUM 4D UTILITY 2WD	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6K10706	X		PREMIUM 4D UTILITY AWD	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6K10936	X		PREMIUM 4D UTILITY AWD EXT	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6C10906	X		ESV PREMIUM 4D UTILITY 2WD	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
			6K10906	X		ESV PREMIUM 4D UTILITY AWD	DIFSC	11 MODEL IRS INTRO 3RD Q 2010
CHEVROLET	EXPRESS	2500 CARGO VAN V8 6.6 DIESEL 1SD	CG23405 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	CARGO VAN	2500 EXT WB CARGO VAN V8 6.6 DIESEL 1SD	CG23705 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
		3500 CARGO VAN V8 6.6 DIESEL 1SD	CG33405 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
		3500 EXT WB CARGO VAN V8 6.6 DIESEL 1SD	CG33705 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	EXPRESS	3500 CUTAWAY VAN 139WB DIESEL	CG33503 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	CUTAWAY VAN	3500 CUTAWAY VAN 159WB DIESEL	CG33803 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
		3500 CUTAWAY VAN 177WB DIESEL	CG33903 DIESEL		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	EXPRESS	3500 EXT WB PASSENGER VAN V8 6.6 2LS	CG33406 2LS		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	PASSENGER VAN	3500 EXT WB PASSENGER VAN V8 6.6 2LS	CG33706 2LS		X		DIFSC	11 MODEL WJD INTRO 6/21/10
	SILVERADO 2500HD	2500 2WD CRE CAB LONG BOX 1LT	CC20943 1LT		X		DIFSC	11 MODEL WJD INTRO 4/23/10
		2500 2WD CREW CAB LONG BOX 1WT	CC20943 1WT		X		DIFSC	11 MODEL WJD INTRO 4/23/10

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A Periodic Update of LIFO - News, Views and Ideas

LIFO LOOKOUT

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