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A Periodic Update of LIFO - News, Views and Ideas

LIFO LOOKOUT

Volume 22, Number 2 | Publisher: Willard J. De Filipps, C.P.A. | Year-End 2012

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. AS FAR AS LIFO MATTERS GO, IT'S BEEN A <u>RATHER QUIET YEAR</u>. This year, there hasn't been much new in the way of IRS guidance on LIFO matters, nor were there any exciting (or even rather dull) court case involving LIFO to report.

Timelines. What little activity there was is reflected in the Timeline for 2012 included on page 4. A similar Timeline for 2011 is included on page 5 for comparison.

#2. 2012 SHOULD BE A PRETTY GOOD YEAR <u>FOR DEALERSHIPS ON LIFO</u>. Inflation for auto dealers' inventories for 2012 LIFO computations should be a bit higher than it was last year, and year-end 2012 inventories are - in many cases - at least 30 or 40% greater than last year.

The result should be reflected in greater increases in LIFO reserves for 2012 than last year due to slightly more inflation and the lesser impact, if any, of repayments of some of the LIFO reserve because of lower inventory levels.

In general, based on our one-of-each new vehicle item category compilations for this year-end, we are expecting that inflation rates will be closer to 4% for Lexus and Mazda ... closer to 3% for Buick, Nissan and Volvo ... and closer to 2% for Chevrolet, Ford, GMC trucks, Hyundai, Infiniti and Suzuki.

I'm still recommending that new dealers elect LIFO for 2012 even though, as discussed below, some feel uncertain about the future of LIFO.

#3. <u>"REVISED" FORM 970</u>. If you are making elections to use the LIFO method for 2012, be aware that the IRS recently "revised" the form (Form 970) that is required for making initial LIFO elections. The new revision date for the Form and Instructions is November 2012.

The reason for the quotation marks around the word "revised" is because there are no changes of substance on the Form itself (2 pages) except for the inclusion of a third line at the top which states, "Information about Form 970 and its Instructions is at http://www.irs.gov/form970."

The only changes to the Form 970 Instructions (also 2 pages) simply refer to the new IRS web site and update the references to the most current revision of the Revenue Procedure (2011-14) for automatic changes in certain LIFO methods.

#4. <u>WILL LIFO BE AROUND NEXT YEAR</u>? No one really knows exactly what Congress and the President are going to do about "simplifying" the Tax Code and/or fixing the country's deficit spending patterns. Therefore, no one really knows if, whether or how long LIFO will (still) be around.

In February 2012, the Obama Administration included a proposal to eliminate the use of LIFO as part of its 2013 Revenue Proposals. The

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LOOKOUT LOOKS INTO

(Continued from page 1)

Administration's proposal - if it were to come to pass - at least would provide a 2-year stay of execution if broad repeal were to be the fate of LIFO.

In June, a bill was introduced to immediately repeal the use of LIFO by certain major integrated oil companies. There has been no activity on this bill at all.

There has been a lot of speculation over the possibility that the blending of International Financial Reporting Standards (IFRS) and U.S. Generally Accepted Accounting Principles (GAAP) would automatically result in the "effective repeal" of the use of the LIFO method for U.S. businesses.

Many who testified before Congress in favor of repealing the use of the LIFO method have argued that, as a practical matter, the repeal of LIFO was inevitable as soon as U.S. GAAP reporting standards (which permit LIFO) were absorbed and eliminated via "convergence" with global or European-style IFRS.

The "inevitability" of the demise of LIFO based on this assumption continues to be in doubt. And, it is becoming more doubtful with the passing of each month.

This doubt continues to grow because the SEC seems to be interested in evaluating new approaches for the more gradual, and less all-inclusive, integration of U.S. GAAP and IFRS. These new approaches would not, per se, either directly or indirectly prohibit the use of LIFO by U.S. companies reporting to the SEC.

Also, talk of separate IFRS for non-public businesses is getting more attention.

These factors bearing on the retention/repeal status of LIFO have not changed at this time. A more thorough discussion of this appeared in the Mid-Year 2012 Edition of the *LIFO Lookout.*

Repeal of LCM methods ... A related dangerous proposal. We still have to be on the "lookout" for the possibility that along with efforts directed at the repeal of LIFO, there may/will also be efforts directed at the repeal of the use of the lower-of-cost-or-market (LCM) method and the subnormal goods method.

The fate of these important accounting methods still seems to be linked to whether the LIFO method will be permitted to stay in place.

#5. IF LIFO MUST GO ... A PROPOSAL TO EASE THE PAIN. If Congress were to decide to terminate LIFO for the "big boys," there is still room to hope that Congress would allow non-public businesses to continue to use LIFO. Should that hope be extinguished, I have a proposal for transitioning non-publicly-held companies that might ease their financial pain in going from using LIFO to using FIFO (or something else).

If Congress should, indeed, terminate the use of LIFO for all companies, I've included a letter on pages 7-8 that can be filled in with particulars and sent by anyone who wants to ask Congress to show a little more leniency to businesses that are forced to go off of LIFO.

The leniency requested is to ask Congress to allow businesses to repay the tax on their LIFO reserves over a less painful time-frame by using a reverse sum-of-the-years-digits calculation method. The schedule on page 9 shows an example of the calculation.

Interestingly, in the November elections, seven dealers or former dealers who were running for Congress were successful. These individuals, in particular, might be more receptive to written requests from automobile dealers to save LIFO (or to ease the pain if saving is not possible). These Congressmen are: Vern Buchanan (R-Florida), John Campbell (R-California), Mike Kelly (R-Pennsylvania), Jim Renacci (R-Ohio), Scott Rigell (R-Virginia), Bill Shuster (R-Pennsylvania) and Roger Williams (R-Texas).

#6. YEAR-END FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS FOR LIFO INVENTORIES. For over 20 years in writing the *Lookout,* I have always reminded readers of the perils and pitfalls associated with the LIFO financial statement conformity issues. Beginning on page 10, I've expanded previous discussions to include several related developments and consolidate the presentation of these significant requirements.

The so-called LIFO financial statement conformity "requirement" can be troublesome for taxpayers and their advisors because there are actually many such requirements, rather than just one. And, a taxpayer's violation of any one of these conformity requirements would allow the IRS to take the position that the LIFO election must be terminated (although asserting that harsh penalty is - in theory - *discretionary* with the IRS).

All of this is discussed in the article beginning on page 10 and in the supplementary information accompanying the article.

#7. YEAR-END PLANNING & PROJECTIONS FOR LIFO INVENTORIES. Beginning on page 36, another article discusses year-end planning for changes in LIFO inventories. This article walks you through procedures for estimating changes in LIFO reserves for projection purposes.

It also discusses several year-end planning strategies that taxpayers have employed - some successfully, and others, unsuccessfully - to reduce the impact of LIFO reserve repayments when year-end →

inventories were anticipated to fall below desired levels.

For readers with automobile dealership clients, the article also addresses how an auto dealer's loss or termination of a franchise by the manufacturer (which usually would be expected to result in a decrease in ending inventory level) can be "managed" ... if that's the right word ... in some circumstances to limit the amount of LIFO reserve recapture.

It should be noted that the "pool split and partial LIFO termination" strategy suggested for auto dealers (see page 47) perhaps might also be applied in other inventory situations.

#8. HURRICANE SANDY ... HOW WILL IT AFFECT YEAR-END INVENTORY LEVELS FOR DEALERS? What will the consequences be for dealers using LIFO?

In the 2011 Editions of the *LIFO Lookout*, we discussed the resistance of the IRS/Treasury to afford relief under Section 473 to dealerships who experienced lower year-end inventories as a result of disruptions caused by natural disasters (earthquakes and tsunamis, etc.) in early 2011.

Will year-end inventory levels be depressed because new vehicle inventories were damaged and rendered non-salable? Or, will year-end inventory levels be reduced because what new vehicle inventory a dealership had was depleted by increased sales due to the increased customer demand in order to replace their own storm-damaged vehicles?

As you may recall, the impact of these disasters in 2011 on the manufacturers had a marked effect on the year-end inventory levels of many dealerships.

Notwithstanding what NADA and others thought was a strong case for the Treasury to grant some relief to dealers under Code Section 473, the Treasury turned a deaf ear on NADA's pleas. (For the text of NADA's letter to the IRS dated January 13, 2012, see pages 8-9 of the Mid-Year 2012 Edition of the *Lookout*.)

In March 2012, the Treasury responded by saying that Section 473 cannot be used to provide relief in situations that do not involve a "politically motivated" inventory disruption. Furthermore, in its opinion, the inventory disruptions caused by (these) natural disasters did not rise to the level of urgency that would justify granting relief under Section 473.

Despite this adverse attitude of the Treasury, perhaps a similar effort should now be made by NADA on behalf of dealers in the several states that have been declared Federal Disaster Areas as a result of Hurricane Sandy and/or other major weather-caused disruptions.

NADA ... Are you listening?

#9. OTHER RELIEF FOR DEALERSHIPS AFFECTED BY HURRICANE SANDY. Practitioners should not overlook other possibilities for relief for dealers (using LIFO) who are affected by the destruction and disruption brought about by Sandy.

Your attention is called specifically called to Technical Advice Memorandum (TAM) 201111004 (included in the March 2011 *Timeline*) regarding the opportunities for certain deferral treatment for dealerships in disaster areas.

In this TAM, the IRS ruled that - in effect - 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."

The TAM 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.

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.

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?)

In situations where LIFO inventories are involved, the adjusted basis of the inventory (i.e., its LIFO inventory valuation) in most cases will be consider-

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LIFO Lookout Timeline	CALENDAR YEAR 2012 ... YEAR TO DATE
	• In *LTR 201150025* (released Dec. 16, 2011), the IRS granted extensions of time to file Forms 970 to the parent of a consolidated group that went through an extensive restructuring in order to acquire a new business. • This LTR involved interpretations requiring the filing of Forms 970 for transactions involving disregarded and entities and LLCs (i.e., Reg. Sec. 301.7701-3(g)(1)(iv)) and transfers to a controlled corporation (i.e., Section 351(a)).
January	• ***Request for relief from LIFO recapture due to natural disasters in 2011.*** On January 13, 2012, National Automobile Dealers Association (NADA) sent a letter to the Treasury/IRS requesting expedited Section 473 relief for certain franchised auto and truck dealers (Honda, Subaru and Toyota/Scion). • These dealers experienced significant decreases in their new vehicle year-end Dec. 31, 2011 LIFO inventories as a result of the earthquake and tsunami that occurred in Japan in march 2011 and/or the flooding that occurred in Thailand in July 2011. • In March, the Treasury's Office of Tax Policy responded by stating its position that ... ◆ Section 473 cannot be used to provide relief in situations that do not involve a "politically motivated" inventory disruption. ◆ The inventory disruptions caused by (these) natural disasters do not rise to the level of urgency that would justify granting relief under Section 473.
February	• ***Repeal of LIFO and other inventory accounting methods.*** President Obama's Administration again included the repeal of the use of the LIFO method as a tax break to be eliminated as part of the fiscal year 2013 revenue proposals. • The repeal of LIFO would start in the first taxable year beginning after the December 31, 2013. ◆ This, in effect, is a 2-year postponement of the repeal advocated by the Administration in prior years' revenue proposals. ◆ The recapture of the LIFO reserve into taxable income would occur ratably over a 10-year spread period. • The Administration's revenue proposals for 2013 would also prohibit the use of (1) the lower-of-cost-or-market method and (2) the subnormal goods method for valuing inventories. ◆ The repeal of these methods would start in the first taxable year beginning after the Dec. 31, 2013. ◆ The Sec. 481(a) adjustments would be taken into income ratably over a 4-year spread period.
March	• ***Form 3115 Instructions.*** The IRS revised the Instructions for Form 3115 (to be used with the December 2009 revision of Form 3115). This revision supersedes the previous revision of the Instructions dated December 2009. • This revision essentially updates all references relating to automatic changes to refer to Revenue Procedure 2011-14 (which superseded Revenue Procedure 2008-52) as the controlling document. • This revision of the Form 3115 Instructions lists all of the changes in accounting methods that might be made in connection with the new Tangibles Regulations under Sections 162, 167, 168 and 263(a). ◆ These changes in accounting method may be made under Rev. Procs. 2012-19 or 2012-20. • The total of the automatic changes that do not require advance consent from the IRS is 180.
April	• ***OMB defends Administration's proposal to repeal LIFO.*** On April 2, 2012, the Director of the Office of Management and Budget (OMB) defended the proposal to eliminate the LIFO method. • This defense was in response to a letter (dated Jan. 27, 2012) signed by 22 members of Congress that had requested removal of the LIFO repeal provision from the revenue proposals for 2013.
June	• ***LIFO Coalition response activity.*** On June 6, 2012, the LIFO Coalition (www.saveLIFO.org) submitted an extensive rebuttal/ response to the letter written by the Office of Management and Budget in which the OMB defended the proposal to eliminate the LIFO method.
June	• ***Bill introduced to repeal LIFO for integrated oil companies.*** On June 7, 2012, a bill was introduced (H.R. 5906) that would repeal the use of the LIFO inventory method starting in 2012 by integrated oil companies (as defined in Section 167(h)(5)(B)). • The Section 481(a) adjustment to recapture the LIFO reserve into the income would be taken into account ratably over a period not greater than 8 taxable years.
November	• ***Revision of Form 970 & Instructions.*** The IRS revised Form 970, the form on which LIFO is officially elected. This revision supersedes the previous revision dated December 2005. • This revision simply updates all references in the Instructions relating to automatic changes in LIFO accounting methods to refer to Rev. Proc. 2011-14 (which superseded Rev. Proc. 2008-52).

LIFO Lookout Timeline	CALENDAR YEAR 2011 ... THE YEAR IN REVIEW
Jan. 2011	• ***Revenue Procedure 2011-14*** revised and updated the procedures for taxpayers making designated ***automatic*** changes in (LIFO and other) accounting methods and filing Forms 3115. ◆ This Revenue Procedure included the Section 263A safe harbor elections for motor vehicle dealerships that can be made as automatic changes #150 and #151. ◆ This Revenue Procedure supersedes Rev. Procs. 2008-52 and 2009-39. ◆ Effective for the filing of Forms 3115 on or after January 10, 2011.
March 2011	• In ***TAM 201111004***, the IRS held that a taxpayer may defer the gain on an involuntary conversion of inventory if the business is located in a Federally-declared disaster area. • This guidance emphasizes to practitioners that the provisions of Code Section 1033(h)(2) should not be overlooked by dealerships located in disaster areas. • The broader application of this TAM is that Section 1033(h)(2) could allow a dealership (in a Federally-designated disaster area) to defer reporting gain if (or when) it reinvests insurance or salvage proceeds in other assets used in the business.
May 2011	• IRS released its ***Audit Technique Guide (ATG) for Wineries.*** • This *ATG* sets forth the criteria that wineries should use to define their wine items and to value their LIFO inventories. • Essentially, the *ATG* requires that the winery must define items of wine in a way that subdivides bulk wine and bottled wines into inventory items based on factors such as type of wine, source of grapes, process recipe or formula used, length of aging time, type of container, length of time wine has been stored after bottling, etc. • This *Audit Technique Guide* basically follows the IRS holdings in ILM 201043029 (July 2010).
May 2011	• In ***FAA 20114702F***, the IRS concluded that the absence of proper disclosures related to the use of the LIFO method in financial statements prepared using IFRS (International Financial Reporting Standards) resulted in violations of several LIFO conformity requirements. • IFRS standards do not permit the use of LIFO for valuing inventories, and the financial statements did not comply with various exceptions that are available in the Regulations. • What this FAA does suggest is that the LIFO financial statement conformity requirements would not be violated if proper supplementary disclosures accompany financial statements issued under IFRS. • This appears to be the first published IRS guidance involving IFRS-prepared statements.
April - June 2011	• In ***LTRs 201130001*** and ***201136006***, the IRS granted taxpayers extensions of time to file Form 970. ◆ In one instance, the taxpayer failed to file Form 970 after a Section 351(a) exchange. ◆ In the other case, a parent corporation overlooked filing 14 LIFO elections forms for various subsidiaries over a long period of time. • In both cases, the oversight by the taxpayer was called to its attention when a pair of "fresh eyes" reviewed their LIFO situations and caught the omissions.
June 2011	• ***President Obama's Administration*** included the repeal of LIFO as a tax break to be eliminated as part of the negotiations to reach a deal on the debt limit increase impasse. • 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.
August 2011	• In ***Rev. Proc. 2011-42***, the IRS provided general guidance regarding its requirements concerning the use and evaluation of statistical samples and sampling estimates. • There is no specific discussion in the Revenue Procedure that relates to LIFO inventory application situations. • Accordingly, the general principles and guidance in the Rev. Proc. will have to be adapted to LIFO situations on a case-by-case basis, depending on the facts and circumstances.
October 2011	• The Treasury published ***Final Regulations under Section 381*** relating to the carryover / combination of inventory methods, including LIFO inventory methods, in reorganizations or tax-free liquidations. • Under the Final Regulations, the determination of which inventory accounting method will carry over is to be made on the basis of considering ***only the inventories of the trades or businesses that are going to be integrated*** after the (tax-free) transaction/acquisition takes place.

ably 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.

#10. YEAR-END PROJECTIONS FOR AUTO DEALERS BASED ON "ONE-OF-EACH" MIX ASSUMPTION. To assist you in making year-end projections, each year we provide a listing for automobile dealership *new* vehicle LIFO inventories showing weighted average inflation (or deflation) information for each model.

The summaries for this year-end are on pages 50-53, and the detail lists for each make/model are on pages 54-60.

This information shows the weighted One-of-Each-Item-Category inflation (or deflation) indexes for dealerships using the Alternative LIFO Method for New Vehicles. These charts and schedules show the information separately for dealerships that (1) have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method for all new vehicles, and (2) may still be using separate pools for all new automobiles and for all new light-duty trucks.

#11. BY THE WAY ... FYI ... ONE MINOR NOTE REGARDING STATISTICAL SAMPLING. The Year-End 2011 Edition of the *LIFO Lookout* included an analysis of Revenue Procedure 2011-42. This Rev. Proc. "provides taxpayers with guidance regarding the use and evaluation of statistical samples and sampling estimates." The guidance in this Rev. Proc. is basically ***general*** in nature, and as indicated in that analysis, the IRS deliberately omitted any specific discussions of the statistical sampling procedures it would require or find acceptable in connection with LIFO inventory calculations.

Interestingly (?), Rev. Proc. 2011-42 takes on added prominence now as a result of the new Regulations issued by the Treasury in December 2011 for capitalizing vs. expensing repair and improvement expenditures which require many Section 481(a) adjustments when taxpayers change accounting methods to conform to the new rules.

Revenue Procedures 2012-19 and 2012-20 describe the various procedures related to changes in accounting methods that taxpayers will have to - or may elect to - make in order to comply with the new Regulations. These Revenue Procedures specifically require taxpayers to apply only the sampling principles and procedures that are set forth in Rev. Proc. 2011-42 in making all of these changes.

Apparently, the procedures set forth in Rev. Proc. 2011-42 are now - as far as the IRS is concerned - the "gold standard" for statistical sampling procedures ... because no other estimation techniques or approximations are permitted by the IRS in Rev. Procs. 2012-19 and 2012-20. Really, now? It is possible that when the IRS/Treasury "finalizes" the tangibles Regulations sometime in 2013, there may be some lessening of these requirements.

#12. *De Filipps University* AUDIO SEMINARS. During 2012, I presented 9 audio seminars to supplement my publications and various speaking engagements. In 2011, I had presented 12 audio seminars.

Complete information about *De Filipps University* and each 2-hour audio seminar is available on our web site (www.defilipps.com). On Demand Audio Recordings (which include all of the presentation materials for that seminar) can be purchased at www.krm.com/wjd (on the "Recordings" tab).

These audio seminars (through the *De Filipps University* Resource Center) are becoming more and more the primary vehicle for keeping you up-to-date on a more timely basis with in-depth technical discussions of relevant LIFO and dealership tax issues.

#13. UPDATED INDEX OF *LOOKOUT* ARTICLES ... 21 YEARS. We have updated our *Index* of all articles appearing in the *LIFO Lookout* from our first issue, March 1991, through December 2012.

This electronically searchable and user-friendly *Index* is available on our web site (www.defilipps.com) for your reference purposes. You can search the Index by keyword(s); you can also save the *Index* on your computer for handy future reference. And, copies of articles in all prior issues of both publications are now readily available to you.

Urge Congress Not to Repeal LIFO ... A Sample Letter

(To Be Sent Under Your Company's Letterhead & Tailored to Your Specific Situation)

Date__________, 2013

Honorable (___________________)
U.S. Senate or House of Representatives
Address
Washington, DC 20510

Dear Senator ___________:

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

Many years ago, in filing our income tax returns, we made the election to use the Last-In, First-Out (LIFO) inventory method to value our inventories.

We elected to use this method *[X number of years ago ____] [or* starting in *year ____]* because of the inflationary costs of goods, products and materials used in our business. As the cost of replacing the goods we sell [manufacture] has continued to increase, we have been able to use the cash "savings" which resulted from using the LIFO valuation method to defer the payment of tax on inflationary profits, when we had to replace and maintain our inventory levels.

This was just good, basic business sense. And besides, LIFO has been accepted and recognized in the Internal Revenue Code for many years as a legitimate method for valuing inventories. LIFO has also been a Generally Accepted Accounting Principle which enjoys long-standing favor and acceptance in the business and financial communities (notwithstanding some of the comments to the contrary by some academics).

Over the years, we have built up a LIFO reserve of *[$____ indicate amount]* as of the end of *[indicate year-end ____]*. This represents the amount of income we have been able to defer by using the LIFO method. We know that this represents only a timing difference. And, we know that, eventually, it will have to be repaid. However, we believe that now is not a good time to force that repayment by eliminating the use of LIFO.

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

We are under constant intense pressure from the manufacturers to expand and improve our facilities and to carry more inventory. Meeting these demands, as well as many others, will require even more cash and financing if we are to remain competitive. *[Expand further ________________________.]*

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

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

(continued...)

Please Don't Repeal LIFO

URGE CONGRESS NOT TO REPEAL LIFO ... A SAMPLE LETTER

(To Be Sent Under Your Company's Letterhead & Tailored to Your Specific Situation)

We currently have *[____ number]* employees. Undoubtedly, many - if not the majority of them - will have to be terminated as we downsize our business in order to be able to cope with the financial impact of repaying our LIFO reserves.

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

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

As we said, without going out of business, if LIFO is repealed, it would be (almost) impossible for us to raise the money or arrange the financing to pay the Federal (and state) taxes on the recapture of our LIFO reserves. And, that's true even if part of the repeal would allow us to make that repayment over several years. Many banks and other lenders are reluctant to loan money to finance year-end inventories. They will be even more reluctant to loan money to us so that we can pay the tax on LIFO reserves that are being recaptured.

Until we go out of business, funds to pay the tax on LIFO reserves simply will not be available.

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

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

Also, proposals to eliminate LIFO usually include proposals to eliminate two other inventory methods that we apply to our non-LIFO inventories. These inventory methods permit us at year-end to reduce the cost of our inventory goods to a "lower-of-cost-or-market" value or to a "subnormal goods" value *[if appropriate]*. These methods also have been recognized as being in compliance with Generally Accepted Accounting Principles, as well as current Income Tax law.

We would respectfully urge you to resist any legislation that would eliminate the use of ***all*** of these inventory valuation methods.

Finally, should all efforts to resist the repeal of LIFO come to no avail, we would respectfully request that the repayment of the LIFO reserve be permitted over at least a 10-year period with the amount of the LIFO reserve to be recaptured in each year computed under the reverse sum-of-the-year-digits amortization method.

An example of this method of calculation is enclosed. This shows how much more manageable any repayment might be than if were required to be made evenly or pro rata over the same number of years.

Thank you for your consideration of our requests.

Sincerely,

____

/S/ Business Owners

Recapture (Repayment) of a LIFO Reserve as of Dec. 31, 2014 Over a 10-Year Period

Comparison of Recapture Under Straight-Line (Pro-Rata) vs. Reverse Sum-of-the-Years-Digits Amortization Method

ASSUMPTIONS

1. The LIFO Reserve balance at Dec. 31, 2012 is $1,400,000.
2. The LIFO Reserve increases 2.5% per year for 2013 and 2014.
3. The use of the LIFO method is terminated as of Dec. 31, 2014.
4. The LIFO Reserve balance at Dec. 31, 2014 is $1,470,000 (rounded) as computed below.

LIFO Reserve at Dec. 31, 2012	1,400,000
Increase for 2013 (2.5%)	35,000
LIFO Reserve at Dec. 31, 2013	1,435,000
Increase for 2014 (2.5%)	35,875
LIFO Reserve at Dec. 31, 2014	1,470,875
Round to	1,470,000

5. The LIFO Reserve as of Dec. 31, 2014 is to be recaptured over 10 years.

COMPARISON OF RECAPTURE UNDER STRAIGHT-LINE (PRO RATA) VS. REVERSE SUM-OF-THE-YEARS-DIGITS METHOD

	Year #1 2015	Year #2 2016	Year #3 2017	Year #4 2018	Year #5 2019	Year #6 2020	Year #7 2021	Year #8 2022	Year #9 2023	Year #10 2024	Total
Repayment of 12/31/14 LIFO Reserve Balance, computed											
Pro Rata at a Rate of 10% per year	147,000	147,000	147,000	147,000	147,000	147,000	147,000	147,000	147,000	147,000	1,470,000
Under the Reverse Sum-of-the-Years-Digits Method	26,727	53,455	80,182	106,909	133,636	160,364	187,091	213,818	240,545	267,273	1,470,000
Difference in Amount of LIFO Reserve Recapture											
Per Year	120,273	93,545	66,818	40,091	13,364	(13,364)	(40,091)	(66,818)	(93,545)	(120,273)	-
Cumulative	120,273	213,818	280,636	320,727	334,091	320,727	280,636	213,818	120,273	-	
Recapture Percentage (%)											
Per Year	0.01818	0.03636	0.05455	0.07273	0.09091	0.10909	0.12727	0.14545	0.16364	0.18182	
	1/55	2/55	3/55	4/55	5/55	6/55	7/55	8/55	9/55	10/55	
Cumulative	0.01818	0.05455	0.10909	0.18182	0.27273	0.38182	0.50909	0.65455	0.81818	1.00000	
	1.82%	5.45%	10.91%	18.18%	27.27%	38.18%	50.91%	65.45%	81.82%	100.00%	

YEAR-END FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS FOR LIFO INVENTORIES

WILLARD J. DE FILIPPS, CPA ✱ *DECEMBER 2012*

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SUPPLEMENTARY INFORMATION & DISCUSSIONS

YEAR-END FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS FOR LIFO INVENTORIES

Every taxpayer using the Last-In, First-Out (LIFO) method to value its inventories must be sure that all year-end financial statements it issues satisfy all of the LIFO conformity requirements. If they do not, the taxpayer risks the loss of its LIFO election and the repayment of its entire LIFO reserve in a single year. Compliance with the conformity requirements is expected even though the taxpayer may be under great pressure to issue its financial statements as soon as possible after year-end.

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

In many places, this article discusses the special rules and IRS guidance for auto dealerships. Taxpayers who are not in the automobile business and are therefore outside the scope of that guidance should be careful ***not*** to rely on that guidance as if the IRS had generalized or intended it to be applicable in their own different situations or industries.

Similarly, auto dealerships - although benefiting from some clarification by the IRS on certain reporting issues - should be careful ***not*** to rely on that guidance as if the IRS had generalized or intended it to be applicable beyond the carefully worded narrow "scope" sections in the applicable IRS guidance publications (i.e., Revenue Ruling 97-42 or Revenue Procedure 97-44).

BASIC LIFO ELIGIBILITY REQUIREMENTS: "CONFORMITY" IS ONLY ONE

First: The bigger picture, of which the year-end financial statement conformity requirements are only a part.

The IRS can disallow a taxpayer's LIFO election if it finds a violation of any one of four general eligibility requirements. The four eligibility requirements involve cost, conformity, consent, and the maintenance of adequate books and records.

The case of *Mountain State Ford Truck Sales v. Comm.*, in 1999 serves as a warning that whenever the IRS chooses, it can take a very aggressive position, threatening the very existence of a long-standing LIFO election. In that case, the Tax Court agreed with the IRS that the taxpayer's use of replacement cost for valuing parts inventories could not be employed as a substitute for the more precise determination of actual cost in connection with LIFO inventories ... nor for any other non-LIFO inventories.

Fortunately, the IRS subsequently issued Revenue Procedure 2002-17, effectively negating the Tax Court's holding in *Mountain State*. All of the drama relating to *Mountain State* has been fully discussed in previous articles beginning in June 1994 through March 2006 in the *LIFO Lookout*. (See Section IX of the *LIFO Lookout* Index of Articles at www.defilipps.com.)

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

However, if a taxpayer is able to reconstruct the information necessary to calculate the LIFO inventory amount properly, it ***may*** be possible to avoid

see **CONFORMITY**, page 12

Rev. Proc. 79-23	**LIFO ELECTION TERMINATION SITUATIONS**
Cost	• Failure to value LIFO inventory at cost for tax purposes for the year preceding the year of LIFO election, the election year, and in all subsequent years.
Conformity	• Violation of the financial statement reporting conformity requirements for the election year and/or for all subsequent years while the LIFO election is in place.
Consent	• Failure to properly elect LIFO, including the failure to file Form 970.
Books & Records	• Failure to maintain adequate books and records with respect to the LIFO inventory and all computations related to it.

(Continued from page 11)

termination of the LIFO election for a violation of the "books and records" requirement.

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

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

FORM 970 QUESTIONS REGARDING THE CONFORMITY REQUIREMENTS

One might consider Form 970 to be the gateway to the LIFO election because it is the form which is required to be included with the income tax return for the first LIFO year in order to make the election. The current revision of this Form is dated November 2012. Although the Instructions indicate that if a taxpayer prefers, it "can file an election statement that gives the same information requested on Form 970," that alternative is rarely followed.

Section 472 provides that a taxpayer that elects to use the LIFO inventory method for Federal income tax purposes must establish to the satisfaction of the Commissioner that it has used no method other than LIFO in inventorying goods specified in its LIFO →

Form **970**
(Rev. November 2012)
Department of the Treasury
Internal Revenue Service

Application To Use LIFO Inventory Method

▶ Attach to your tax return.
▶ Information about Form 970 and its instructions is at *www.irs.gov/form970.*

OMB No. 1545-0042
Attachment Sequence No. 122

Name of filer (name of parent corporation if a consolidated group) (see instructions) | Filer's identification number (see instructions)

Name of applicant(s) (if different from filer) and identification number(s)

Part I Statement of Election under Section 472 — Yes | No

- *Questions 1 through 5 ... Omitted ... Not related to financial statement conformity.*

Part II LIFO Inventory Requirements — Yes | No

- *Questions 6 & 7 ... Omitted ... Not related to financial statement conformity.*

8a Did the applicant (or any member of the same group of financially related corporations as defined in section 472(g)) issue credit statements or reports to shareholders, partners, other proprietors, or beneficiaries covering the tax year specified on line 1? . . . .

b If "Yes" to line 8a, attach a statement describing the recipient(s), the date(s) of issuance, and the inventory method(s) used to determine income, profit, or loss in those statements.

- *Questions 9 & 10 ... Omitted ... Not related to financial statement conformity.*

Part III Specific Goods (Unit) Method

Part IV Dollar-Value Method

Part V Inventory Price Index Computation (IPIC) Method

Part VI Other Information

- *Questions 11 through 23 (included in Parts III - VI) ... Omitted ... Not related to financial statement conformity.*

election to ascertain income, profit, or loss ***for the first taxable year*** for which the method is to be used, for the purpose of a report or statement covering such taxable year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes. The taxpayer is also required to use the LIFO method in all succeeding years.

Traps. One of the significant traps for the unwary is that Question 8 on Form 970 asks only whether the year-end financial statements *for the election year* have satisfied certain conformity requirements. This Question refers only to the issuance of statements "covering the tax year specified on Line 1" (which would be the year of election).

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

Worse yet, the relatively limited Form 970 Instructions give no hint of the many troublesome interpretations that can arise under the Regulations.

On top of all that, the Instructions may confuse some taxpayers into believing they can safely elect LIFO by filing an amended return. That could only happen in the most limited of circumstances.

The Instructions for Form 970 include a section: "When to File." This section states...

"File Form 970 (or a similar statement) with your tax return for the first tax year you intend to use the LIFO method.

"If you filed your return for the tax year in which you wish to use the LIFO inventory method described in Section 472 without making the election, you can make the election by filing an amended return within 12 months of the date you filed your original return.

see **CONFORMITY**, page 14

Responses to the Conformity Questions on Form 970 for Auto Dealers Electing the Alternative LIFO Method for New Vehicles

- ***Question 8a*** ...Generally, the answer to Question 8a will be "Yes," in almost all situations.
  - Care must be exercised in answering this question, because Question 8a references not only the individual taxpayer/entity, but also includes ***"any member of the same group of financially-related corporations as defined in Section 472(g)."***
  - Essentially, Sec. 472(g) references controlled groups with 50% [not 80%] ownership relationships.
  - Sec. 472(g) also includes "any other group of corporations which consolidate or combine for purposes of financial statements."
- ***Question 8b*** ... Identification of all recipients of year-end financial statements, the dates of issuance and the inventory method(s) used to determine income, profit or loss.
  - Generally, response would identify (1) recipients such as "Manufacturer, credit corp., bank," (2) dates financial statements were issued, and (3) "LIFO for goods in No. 1 above" as the description for the method used.
  - If the required response cannot be squeezed into the space allowed beneath Question 8b, an additional attachment/schedule (suggested form below) should be included as part of the Form 970 filing package.
  - If the dealership has several franchises reporting to different manufacturers or divisions, all manufacturers/divisions and all credit corporations who received year-end statements should be listed.

Form 970 ... Part II, Line 8b
Attachment re: Distribution of Year-End Financial Statements

Name of Recipient	*Date of Issuance*	*Method Used for Valuing Inventories in Statements*
(Manufacturer(s))		LIFO for goods subject to this LIFO election ... for all other classes of inventory not on LIFO, see the attachment describing other valuation methods used.
(Credit Corporations)		
(Banks or Other Lenders)		
(Others)		
(Dealer)		
(Other Shareholders)		

(Continued from page 13)

Attach Form 970 (or similar statement) to the amended return and write 'Filed pursuant to Section 301.9100-2' at the top of Form 970. File the amended return at the same address the original return was filed."

What this "instruction" fails to say is that the LIFO election would not be valid if the taxpayer had issued any year-end financial statements on a non-LIFO basis before the amended return was filed. It seems the only way a taxpayer could have a valid LIFO election considering the "conformity requirements" would be if (1) the IRS exercised its discretion to not terminate the LIFO election because of this conformity violation, or (2) the taxpayer never issued any year-end financial statements to anyone for any purpose. In either case, the answer to Question 8 on a Form 970 attached to an amended return would stand a strong chance of inviting a few questions from the IRS.

WHERE DID THE "CONFORMITY" REQUIREMENTS COME FROM?

There is relatively little history concerning the origins - or the reasons underlying - the conformity requirements. Two cases are instructive in this regard. The first is *Insilco Corporation v. Comm.* (73 T.C. 589), a 1979 Tax Court decision; the other is *The William Powell Company v. USA* (81-1 USTC ¶9449), a 1981 District Court (Southern District of Ohio) case.

The common discussion of the origin/history/purpose of the conformity requirements in both cases is included below. The unique aspect of each case is discussed in separate sections of this article ... *Powell*, relating to the recall of year-end statements issued on a non-LIFO basis and *Insilco*, relating to the origins of Section 472(g) which extended the applicability of the conformity requirements.

Until 1938, LIFO was not acceptable for tax accounting purposes. In that year Congress allowed tanners and producers of non-ferrous metals to use LIFO, expanding this privilege to all taxpayers the following year. The 1939 amendments added a conformity requirement, which was amended in 1942 to its current form.

The discussion by the District Court in *Powell* contains a good summary of the general use of LIFO ... The principle purpose of LIFO is to mitigate inflation and to protect the taxpayer from paying taxes on profits resulting from price inflated inventories. Under the FIFO method, the earliest historical costs are matched against current revenues and, to the extent that current costs exceed such historical costs, gross profit is overstated and distorted. Rather than being available totally for the payment of operating expenses, the repayment of debt, new investment, distribution to owners and the like, a portion of such profit must be used merely to replace the inventory which was sold. It is this distortion of profit which may be substantially mitigated by the use of LIFO. Accordingly, ***the objective of the LIFO method*** is to match relatively current costs against current revenues in order to produce a more realistic gross profit.

The Court in *Powell* noted that there was no support for the taxpayer's position that the conformity requirements were intended by Congress to be a deterrent to taxpayers' use of LIFO and that it could not "presuppose this purpose on the basis of what we [i.e., the District Court] think Congress was contemplating, for such action is speculation, not evidence of legislative intent."

As to the IRS' side of the argument, the Court also noted that, "In essence, the government is asking this Court to add a business purpose requirement to Section 472(c)(1). Strict compliance with Section 472(c)(1) does not require that the electing taxpayer be motivated by a business purpose. We refuse to read such a requirement into the statute."

In the *Insilco* Tax Court case a few year earlier, Judge Tannenwald had already investigated the legislative and judicial background for the conformity requirements.

Judge Tannenwald reported that ... "Section 472(e) had its origin in Section 219 of the Revenue Act of 1939 ... which amended Section 22(d)(5) of the Internal Revenue Code of 1939 to provide for a conformity requirement essentially as it now exists in the 1954 Code.

"The legislative history of that Section is of little help on the issue before us [i.e., the *Insilco* case], merely stating that the underlying intent behind the LIFO conformity requirement was to insure that the use of LIFO for tax purposes conformed as nearly as possible with the ***best accounting practice in the trade or business in order to provide a clear reflection of income***. ...

"The only substantial change in the conformity provision since its original enactment occurred when Section 118 of the Revenue Act of 1942 ... was enacted so as to make clear that only annual and not interim reports or financial statements were to be considered. Here, again, there is nothing of help in the Committee reports, as far as the instant case [i.e., the *Insilco* case] is concerned ....

"The judicial history of Section 472(e) has, for all practical purposes, been equally unrevealing. None of the cases involving LIFO issues have been required to face the application of the conformity requirement...." [Citations omitted; emphasis added.]

→

To this analysis in 1979 by Judge Tannenwald, the District Court two years later in *William Powell*, simply added ... "This intent supports an interpretation that Section 472(c)(1) was designed to require consistency in accounting method in order to insure that the method used by the taxpayer most clearly reflected income." (The "intent" referred to is the intent to insure that the use of LIFO for tax purposes conformed as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income.)

The District Court added, "This consistency requires the taxpayer, at the time he elects LIFO, to be using LIFO for the business reports mentioned in Section 472(c)(1). This consistency is connected neither to guaranteeing the existence of a business purpose nor to deterring the use of LIFO. The conformity requirement, in essence, is designed to establish prima facie evidence that at the time of its election, the taxpayer feels LIFO provides a clear reflection of its income."

Conclusion. It would not be accurate to say that the origin or purpose of the conformity requirements is "shrouded in mystery." It might be closer to the truth to say that the conformity requirements are simply set forth in the statute with very little further elaboration on the reason for their existence.

CONFORMITY REQUIREMENTS ... THERE ARE MANY TO BE MET EVERY YEAR

Despite the conclusions of Judge Tannenwald (in *Insilco*) and the District Court (in *William Powell*), some would still argue that the conformity requirements exist as restrictions on a taxpayer's general desire to pay lower taxes using a LIFO method for valuing inventories, while reporting more income to shareholders or banks and other creditors using a non-LIFO method. To prevent this from happening, the Treasury says that LIFO must be used in all reports covering a full year to insure that the use of LIFO for tax purposes conforms as nearly as possible with the best accounting practice in the trade or business in order to provide a clear reflection of income.

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

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

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

These are discussed on page 26 and in the selected portions of the Regulations on pages 27-28.

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

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

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

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

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

see **CONFORMITY**, page 16

TRADITIONAL FINANCIAL STATEMENTS IN ANNUAL REPORTS ISSUED BY CPAs

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

The LIFO conformity requirement as it relates to reports issued by CPAs requires than in the primary presentation of income (i.e., the Income Statement), the results disclosed must only be in the net-of-LIFO results.

The primary Income Statement *cannot* show results before LIFO, followed by either an addition or subtraction for the net LIFO change, coming down to a final net income or loss after-LIFO figure. This means that during a period of rising prices, a business using LIFO will usually be reporting lower operating results in order to comply with the conformity requirements.

Restrictions eased for non-LIFO disclosures as supplementary financial information. For years prior to 1981, very strict disclosure limitations existed and these provided little or no room for deviation. In 1981, the Regulations were liberalized to allow LIFO taxpayers to disclose non-LIFO operating results in *supplementary financial statements,* as long as those supplementary non-LIFO financial statements satisfy two tests.

First, they must be issued as part of a report which includes the primary presentation of income on a LIFO basis.

Second, each non-LIFO financial statement must contain on its face a warning or statement to the reader that the non-LIFO results are supplementary to the primary presentation of income which is on a LIFO basis.

Accordingly, in CPA-prepared year-end financial statements, a LIFO taxpayer's results on a non-LIFO basis can be fully disclosed as *Supplementary Information* if both of these requirements are met.

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

(Continued from page 15)

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

DEALERSHIP YEAR-END FINANCIAL STATEMENTS SENT TO MANUFACTURERS, SUPPLIERS & CREDITORS

The Regulations contain several year-end LIFO reporting restrictions which apply to the specially formatted financial statements (operating statements) sent by auto dealerships and other businesses immediately after year-end to their manufacturers, suppliers and creditors. Some CPAs who were not aware of these restrictions experienced a rude awakening when their (former) dealer clients - through their attorneys - asked them to reimburse the dealers for their payments of a 4.7% penalty "settlement amount" due under Revenue Procedure 97-44 because the dealerships had violated the conformity requirements on their year-end statements.

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

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

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

Literally interpreted, this wording applies to all franchised auto dealers' 12th statements (i.e., December unadjusted) as well as to their 13th statements. The 12th statement is usually issued on a preliminary basis, before accruals and estimates are refined by detailed adjusting entries. The 13th statement is usually issued several weeks after the 12th statement, and it reflects year-end accrual adjust- →

ments and other computations not otherwise completed within the tight time frame for the issuance of the December or 12th statement (usually by the 10th day of the following month).

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

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

IRS TESTS

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

With respect to the use of the financial statements "for credit purposes," the IRS found that a debtor-creditor relationship did exist between the dealership and the manufacturer and the credit corporation.

The rationale of the IRS was that if the taxpayer's "operations began to deteriorate, it is doubtful that Corp. X (the manufacturer) and Corp. Y (the Credit Corporation) would ignore these reports and continue to extend credit to T (the taxpayer) as though nothing has changed." The IRS noted that the taxpayer was unable to provide any explanation of what purpose other than credit evaluation the credit subsidiary might have for requesting the dealer's financial statements.

In a companion Letter Ruling, LTR 9535009, the IRS "officially" restated its position with respect to a dealer who reported for tax purposes using a fiscal year. The IRS employed the same four-step analysis as above to determine whether the fiscal year dealership had violated the LIFO conformity requirements.

In connection with the second "test" related to whether the dealership's financial statements that were sent to the manufacturer *ascertained* the taxpayer's income for the taxable year, the IRS noted that the year-to-date column information readily provides this computation for the reader. Even without year-to-date accumulations on the face of the monthly Income Statement, any series of months could simply be added together to reflect a complete 12-month period of anyone's choice.

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

WARNING

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

REV. RUL. 97-42: DISCLOSURE GUIDELINES FOR CERTAIN AUTOMOBILE DEALERSHIPS

A few years after the issuance of these "adverse" Letter Rulings in 1995, the IRS published Revenue Ruling 97-42 on September 25, 1997. This Ruling provides special interpretations allowing auto dealers to satisfy the LIFO conformity requirements. However, ***these special interpretations apply only to year-end financial statements that are prepared in a format required by an automobile manufacturer on preprinted forms supplied by the automobile manufacturer.***

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

An analysis of three illustrative situations presented in Revenue Ruling 97-42 is included on page 29.

see **CONFORMITY**, page 18

Conformity

(Continued from page 17)

Revenue Ruling 97-42 allows auto dealerships to reflect the change in the LIFO reserve for the year as an adjustment to ***either*** the *Cost of Goods Sold* account ***or*** to the *Other Income* or the *Other Deductions* accounts. An adjustment to any of these accounts flows directly to the net income line in the Income Statement.

If the dealership makes a projection of the change in the LIFO reserve for the year, and that change is reflected on the 12th statement, then ... after the final computation of the change in the LIFO reserve is made for the year ... the net amount required to adjust from the projected amount of change to the actual amount of change for the year must be reported on the 13th statement ***as a charge against (or as a credit to) income in the Income Statement for that same year.***

In other words, auto dealerships must reflect the projected change and the adjustment to reflect the actual change in the LIFO reserve for the year as a charge against (or as a credit to) income ***in the income statement for that same year.***

Revenue Ruling 97-42 makes it clear that if a LIFO reserve adjustment is posted directly to the retained earnings account and reflected on the dealership's Balance Sheet, that treatment of the LIFO reserve change will ***not*** satisfy the conformity requirement.

Therefore, the change in the LIFO reserve ... or the adjustment of a year-end projected amount to the actual amount of the LIFO reserve change for the year ... should ***not*** be charged directly against retained earnings in the financial statements. Furthermore, and specifically, this adjustment (from the projected change amount to the actual change amount) should ***not*** be included as an adjustment in the monthly statement for January or for February of the following year.

In summary, it is imperative that the LIFO adjustment be properly reflected in the Income Statement prepared for the last month of the year.

Interpreting the Flowcharts. The flowcharts on pages 30 and 31 were originally developed in 1995 (i.e., before the IRS issued Revenue Ruling 97-42) when the IRS was issuing Private Letter Rulings which required the termination of auto dealers' LIFO elections because the dealerships failed to satisfy the financial statement conformity requirements in the year-end reports they were required to send to their manufacturers and to their credit corporations.

In the flowchart for calendar-year dealerships (on page 30), there are three boxes (and in the flowchart for fiscal-year dealerships - on page 31, there are four boxes) where references are made to reflecting the amount of a LIFO adjustment ... "In the *CGS* (*Cost of Goods Sold*) section of the Income Statement."

As a result of the more liberal reporting allowances the IRS permitted in Rev. Rul. 97-42, when interpreting these flowcharts now, all references in the flowcharts to the *CGS* account would be expanded to read ... "In the *CGS* section ***or*** in the *Other Income* ***or*** *Other Deductions* accounts." This is stated in the very small print in the rectangular box near the center of each flowchart.

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

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

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

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

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

The dealer may simply carry through the annual LIFO reserve change effect reflected in the September fiscal year-end Income Statement without modi-

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fication in the December Income Statement. Note that the December Income Statement must reflect the charge against income for the prior fiscal year-end LIFO reserve change and that prior September fiscal year-end LIFO reserve change should ***not*** be reversed so that the December Statement of Income does not reflect any LIFO reserve charge for the twelve month period ending December 31.

Rev. Proc. 97-44 ... One-time-only limited relief for certain automobile dealerships. As a matter of historical interest, Revenue Procedure 97-44 provided "relief" to auto dealers whose year-end Factory statements had "inadvertently" failed to comply with the conformity requirements at any time during a six-year "look-back" period.

These dealers were allowed to keep their LIFO elections if they paid a 4.7% penalty/settlement tax. This tax was computed based on the amount of their LIFO reserves as of the last taxable year ended on or before October 14, 1997 (i.e., as of December 31, 1996 for most calendar-year auto dealers). These dealers were also required to satisfy certain other conditions as terms of the settlement.

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

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

Revenue Procedure 97-44 was analyzed in detail in the September 1997 and December 1997 issues of the *LIFO Lookout*.

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

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

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

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

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

For LIFO taxpayers other than those dealers indicated above, where and how the year-end LIFO adjustment is placed on the Income Statement is still critical and has not been the subject of any subsequent guidance issued by the IRS.

The IRS "only-through-Cost-of-Goods-Sold" interpretation could result in countless LIFO election terminations in situations where the (projected) change in the LIFO reserve at year-end was placed in some other section of the Income Statement, such as in the *Other Income* or *Other Deductions* sections.

Unfortunately, the IRS "guidance" for franchised auto dealers in Revenue Ruling 97-42 and the "relief" for prior conformity violations under Revenue Procedure 97-44 and 98-46 ***do not apply*** to any other types of taxpayers issuing what might be "similar" statements under "similar circumstances" to other manufacturers, suppliers or credit sources.

No one can be sure what these other businesses with LIFO violations should do in light of what is now understood to be the IRS interpretation of these Regulations.

see **CONFORMITY**, page 20

(Continued from page 19)

WARNING

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

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

CONFORMITY VIOLATIONS CANNOT BE CORRECTED ONCE THE YEAR-END FINANCIAL STATEMENTS HAVE BEEN RELEASED ... *William Powell*

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

The position of the IRS is that once a year-end Income Statement has been issued or released on a non-LIFO basis, that statement cannot be recalled and corrected to reflect LIFO by the re-issuance of statements satisfying the conformity requirement.

Furthermore, it then becomes discretionary with the IRS Commissioner as to whether or not the Commissioner chooses to terminate the taxpayer's LIFO election as a penalty for the violation.

The *William Powell Company* decision (81-1 USTC ¶ 9449) illustrates one taxpayer's success (or possibly good fortune) in avoiding termination of its LIFO election when it came down to "all-or-nothing" on this issue.

This case, decided in 1981, involved what would have been the termination of a LIFO election made in 1973 because at the end of the first LIFO year, the taxpayer had issued non-LIFO statements and then later made a LIFO election when it filed its tax return.

In that case, the taxpayer recalled its previous non-LIFO statements and replaced/reissued LIFO statements to all the banks, creditors and shareholders before the income tax return for the first year was filed. All in all, after issuing several sets of financial statements - some in connection with banks for financing purposes and others to corporate officers and members of the Company's Board of Directors - "Ultimately, seventeen of the original thirty-nine reports distributed were returned" to the William Powell Company.

One might speculate that the taxpayer probably would have lost its LIFO election if it had litigated the issue in the Tax Court. Fortunately for the taxpayer, it chose instead to litigate this issue in the District Court in Ohio.

The taxpayer took the position that it had not "used" FIFO within the meaning of Section 472(c). Its position with respect to Section 472(c)(2) was that non-LIFO "worksheets" were not used for "credit purposes," since the credit it was trying to secure already had been extended prior to the delivery of the worksheets.

The District Court accepted the taxpayer's arguments. With respect to Section 472(c)(1), Powell contended that *use* is determined at the time of the LIFO election and that the LIFO election need not be made until the taxpayer files its return. At the time Powell elected LIFO, it was no longer *using* the FIFO statements, inasmuch as they had been recalled prior to the election and LIFO statements had been reissued.

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

HOW SOME BUSINESSES CIRCUMVENT THE LIFO CONFORMITY REQUIREMENTS

Many businesses using LIFO - especially publicly-held companies reporting to the SEC - would like to reduce taxes by reporting lower taxable income/earnings in tax returns while at the same time reporting higher earnings/more income to their shareholders and creditors for financial and market valuation purposes. This can be done easily, thanks to loopholes - i.e., liberal wording - conveniently provided in the Regulations. But one has to know that these exceptions are found in Reg. Sec. 1.472-2(e)(8) which describes 14 different costing methods and accounting methods that are "neither inconsistent ... nor at variance with the requirement of Reg. Sec. 1.472-2(c) and which ... may be used to ascertain income, profit, or loss for credit purposes or for purposes of financial reports regardless of whether such method is also used by the taxpayer for Federal income tax purposes."

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Conformity

(Continued)

The Regulations allow taxpayers to legitimately avoid the intent of the conformity requirement by allowing them to use LIFO methods and sub-elections in their financial statements that are different from those LIFO sub-elections and methods that are used in their income tax return computations. That's right: ***Different LIFO methods may be used for book and for tax purposes.***

It is not necessary for the year-end financial statements to use the same exact LIFO sub-elections that are used in the tax return LIFO calculations. The Regulations simply require that both sets of financial statements (i.e., those included in the financial reports and those used for income tax return purposes) must report using LIFO methods.

This allows some companies to use more pools ... in one case, several hundred more pools ... for financial reporting purposes than for income tax purposes. Others use link-chain or link-chain, index (dollar-value) methods to lower LIFO income for tax purposes, while they use double-extension (dollar-value) LIFO methods for financial reports. Still others reconstruct long distant base prices for new items in their tax return LIFO calculations while they price new items at current cost in their financial statements. These companies enjoy the best of both worlds without violating the fine print of the "conformity" requirements.

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

INTERIM REPORTS

Interim reports covering a period of operations that is less than the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement for tax purposes.

Reg. Sec. 1.472-2(e)(1)(iv) is completely clear and unambiguous on this point. "The taxpayer's use of an inventory method other than LIFO for purposes of issuing reports or credit statements covering a period of operations that is ***less than the whole of a taxable year*** (for which the LIFO method is used for Federal income tax purposes)" is not considered to be at variance with the conformity requirement.

Although Generally Accepted Accounting Principles may present some difficulties in this regard in connection with the issuance of quarterly or semi-annual reports by taxpayers using LIFO, the Income Tax Regulations clearly do not.

AFFILIATED & CONSOLIDATED GROUP REPORTING CONCERNS ... *Insilco* & Sec. 472(g)

For another example of how seriously the Treasury/IRS polices the LIFO conformity requirement, consider the origin of Code Section 472(g). This subsection was added to the Code because the IRS lost when it tried to terminate the taxpayer's LIFO election in *Insilco Corporation v. Comm.* (73 T.C. 589).

This Tax Court case involved a subsidiary that used the LIFO method and reported to its parent corporation using LIFO; however, the parent corporation reported its consolidated earnings (which included those of the LIFO-user subsidiary) to its own shareholders on a non-LIFO basis.

In permitting the taxpayer to keep its LIFO election despite the IRS' objections, the Tax Court in *Insilco* told the IRS that if it didn't like the result, it should get Congress to change the law. And that's exactly what the IRS/Treasury did!

After its loss, the Treasury persuaded Congress to change the law (which it did by adding subsection (g) to Section 472) so that taxpayers in the future couldn't get around the conformity requirement the way Insilco had.

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

In addition to the more traditional consolidation/combination situations, special consideration must be given to FASB Interpretation 46 (Revised Dec. 2003) *Consolidation of Variable Interest Entities* (an interpretation of ARB No. 51). This FASB increased the number of situations where consolidation may be required, particularly if variable interest entities are involved. These are commonly encountered in related-party lease situations.

see **CONFORMITY**, page 22

(Continued from page 21)

FOREIGN CORPORATIONS & OPERATIONS PRESENT SPECIAL CONFORMITY REPORTING ISSUES

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

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

In Letter Ruling 200540005, dated June 20, 2005, the IRS addressed a situation involving the LIFO conformity requirement application to consolidated financial statements and foreign operations and subsidiaries. This LTR involved a very narrow or limited fact pattern.

A summary of Rev. Rul. 78-246 (1978-1 C.B. 146) and more details on LTR 200540005 are included on page 32.

In Letter Ruling 200540005, the Service held that...

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

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

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

A few years later, in Letter Ruling 201034004 (dated August 27, 2010), the IRS reviewed and approved the disclosures that the parent corporation of a subsidiary using the LIFO method was planning to include in its reviewed (i.e., unaudited) year-end consolidated financial statements that it would issue to its shareholders and creditors, including a foreign parent.

This Ruling is discussed further on page 33. It illustrates the finer points of the analysis that must be made in attempting to comply with the financial statement conformity requirement, especially where there are several layers of subsidiaries involved.

IFRS FINANCIAL STATEMENTS & LIFO CONFORMITY REQUIREMENTS

The emergence of IFRS. The emergence of the possibility that may U.S. taxpayers might be required to adopt International Financial Reporting Standards (IFRS) has resulted in a great deal of literature explaining that the use of LIFO, although permissible under Generally Accepted Accounting Principles (GAAP), is incompatible with reporting standards under IFRS.

It is well-known and generally accepted that LIFO cannot be used in financial statements issued under IFRS. Accordingly, if financial statements were issued under IFRS, that would appear to prevent the use of LIFO but for the inclusion in the Regulations of the numerous exceptions to the conformity requirements.

FAA 20114702F. In May 2011, in Field Service Advice 20114702F, the IRS concluded that a taxpayer committed multiple violations of the LIFO financial statement conformity requirements when it submitted year-end statements prepared using International Financial Reporting Standards (IFRS) to a bank.

This FAA appears to be the first published IRS guidance involving how disclosures in financial statements using International Financial Reporting Standards (which prohibit the use of LIFO) must be presented as *Supplementary Information* or in supplementary disclosures in order to comply with the very strict LIFO conformity requirements.

This FAA involves a somewhat complicated ownership structure of affiliated/consolidated group entities consisting of (1) the foreign parent [a foreign entity], (2) ABC - a member of the ABC consolidated group - who owns the sub, (3) the ABC consolidated group [which consists of ABC and other members]

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and (4) the Taxpayer, a subsidiary of ABC [and thus, a second-tier member of the ABC consolidated group].

The IRS held that the taxpayer failed to include or make the necessary, restrictive, and/or appropriate disclosures in its IFRS-prepared financial statements when it submitted these statements to a lending bank in accordance with lending requirements under a letter of credit.

In more terse language, the FAA concluded ... "The provision of financial statements prepared using IFRS to the lending bank violated the conformity requirements." A more detailed analysis of the FAA is included on pages 34-35.

It should be noted this FAA suggests that the LIFO financial statement conformity requirements would not be violated if proper supplementary disclosures were to accompany the financial statements that were issued under International Financial Reporting Standards.

Interestingly, the question most likely to be on a reader's mind after reading the FAA was not answered by the IRS analyst. That question, of course, is whether the IRS would require the taxpayer to discontinue its LIFO election because it violated the conformity requirements.

The Commissioner does have the discretion to allow taxpayers to continue to use the LIFO method even though conformity violations might have occurred. However, one should not be too optimistic about obtaining a happy ending or relief if a conformity violation is discovered by the IRS ... especially if that discovery happens during an audit.

CONCLUDING CAUTIONS

Very often, it is easy for the IRS to find a taxpayer's violation of the conformity reporting requirements in the first year of the LIFO election. This is because, by the time (many months after year-end) the taxpayer "officially" makes its election to use the LIFO method by filing Form 970 with its income tax return, the taxpayer may have already issued financial statements for the year that contain unacceptable, non-LIFO disclosures.

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

The IRS supports its position by reminding taxpayers that they have explicitly consented/agreed to this result by putting an "X" in the "Yes" column on Form 970 for Question/Item #10 ("As a condition of adopting the LIFO inventory method, Reg. Sec. 1.472-4 requires a taxpayer to agree to make any adjustments incident to the change to, the change from, or the use of, the LIFO inventory method that, upon examination of the taxpayer's income tax return, the IRS determines are necessary to clearly reflect income. Does the applicant agree to this condition?")

Historically, the IRS' general behavioral pattern whenever the Service uncovers an financial statement conformity violation is to propose to terminate the taxpayer's LIFO election.

Revenue Procedure 97-44, which allowed certain taxpayers (automobile dealerships) with conformity violations to avoid termination of their LIFO elections by paying a 4.7% penalty amount, should be regarded as an extremely limited exception to this behavior. This special relief for auto dealers only came about because of the significant pressure the National Automobile Dealers Association was able to exert on the Treasury to prevent hundreds of dealers from losing their LIFO elections for inadvertent conformity violations.

Little comfort can be secured from the *William Powell Company* and the *Insilco* decisions which are the only recorded cases where taxpayers successfully contested the IRS' efforts to terminate their LIFO elections in court.

The bottom line is that the IRS takes all of these conformity requirements seriously. On many audits, instead of assuming that the taxpayer has complied, the IRS asks for proof that financial statements at year-end were not in violation of the LIFO conformity requirements. Consequently, LIFO users cannot be too cautious or careful in dealing with conformity matters.

Executive Summary

YEAR-END FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS FOR LIFO INVENTORIES

- ***The conformity requirements must be complied with in every year that the taxpayer is using the LIFO method.***
  - Section 472 provides that a taxpayer that elects to use the LIFO inventory method for Federal income tax purposes must establish to the satisfaction of the Commissioner that it has used no method other than LIFO in inventorying goods specified in its LIFO election to ascertain income, profit, or loss ***for the first taxable year*** for which the method is to be used, for the purpose of a report or statement covering such taxable year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.
  - ***In all succeeding years,*** taxpayers using LIFO are also required to use the LIFO method in their year-end financial statements.

- ***The questions on Form 970 regarding conformity are deceptive.*** In completing Form 970 in order to make the LIFO election for the first year, Form 970 does not call attention to the fact that the financial statement conformity requirements must be met ***in all succeeding years.*** Question #8 refers to the financial statements ***only*** for the year of election and some taxpayers might easily overlook this requirement as to future years. The Instructions to Form 970 are silent on this matter.

- ***Conformity requirements ... There are many to be met every year.***
  - The LIFO conformity requirements provide that any year-end financial statements ***issued in the traditional report form*** by the business to creditors, shareholders, partners or other users must reflect the year-end results on LIFO. This applies to only the primary presentation of income (i.e., in the Income Statement).
  - However, the Regulations allow LIFO taxpayers to disclose non-LIFO operating results in *supplementary financial statements*, as long as those supplementary non-LIFO financial statements satisfy two tests.
    - ***First,*** they must be issued as part of a report which includes the primary presentation of income on a LIFO basis.
    - ***Second,*** each non-LIFO financial statement must contain on its face a warning or statement to the reader that the non-LIFO results are supplementary to the primary presentation of income which is on a LIFO basis.
    - Accordingly, in CPA-prepared year-end financial statements, a LIFO taxpayer's results on a non-LIFO basis can be fully disclosed as *Supplementary Information* if both of these requirements are met.
  - Subject to other similar restrictions and conditions, the Regulations also permit disclosure of non-LIFO results in footnotes and under certain other circumstances.

- ***Special rules for automobile dealerships.***
  - Revenue Ruling 97-42 provides some relief in reporting changes in LIFO reserves in the year-end statements that dealerships are required to send to their manufacturers and/or credit corporations affiliated with their manufacturers.
  - This relief applies only to so-called "Factory statements." These are dealership "income statements that are prepared in a format required by the manufacturer or on pre-printed forms supplied by the manufacturer" which present the dealers' operating results for both the month and the calendar year-to-date.

- ***Non-dealership businesses should proceed with caution.*** Businesses that are not franchised automobile dealerships should not rely on the guidance in Rev. Rul. 97-42 when considering their own responsibilities for complying with the conformity requirements. In other words, these special interpretations have been clarified ***only for auto and truck dealerships.***
  - The placement of the LIFO change in the year-end Statement of Income is critical and has not been the subject of any subsequent guidance issued by the IRS.
  - If the position of the IRS is that the change in the LIFO reserve can only be reflected through the beginning-of-the-year and the end-of-the-year inventory amounts in the *Cost of Goods Sold* section of the Income Statement, this interpretation could result in countless LIFO election terminations in situations where the (projected) change in the LIFO reserve at year-end was placed in some other section of the Income Statement, such as in the *Other Income* or *Other Deductions* sections.

Executive Summary

YEAR-END FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS FOR LIFO INVENTORIES

- ***Interim reports are not subject to the LIFO conformity requirements.***
  - Interim reports covering a period of operations that is less than the whole of a taxable year may be issued on a non-LIFO basis without violating the LIFO conformity requirement for tax purposes.
  - However, a ***series*** of credit statements or financial reports is considered a single statement or report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period.
  - In other words, the "aggregation theory" provides that if a series of interim or partial-year statements can be combined or "aggregated" to disclose the results of operations for a full year, then the last Income Statement must reflect income computed using LIFO to value the inventory.

- ***Conformity violations cannot be corrected once year-end financial statements have been released.***
  - The position of the IRS is that once a year-end Income Statement has been issued or released on a non-LIFO basis, that statement cannot be recalled and corrected to reflect LIFO by the re-issuance of a financial statement that satisfies the conformity requirement. This was the subject of litigation in *William Powell.*

- ***Different LIFO methods may be used for financial statement reporting and for income tax reporting purposes.***
  - The Regulations allow taxpayers to legitimately avoid the intent of the conformity requirement by allowing them to use LIFO methods and sub-elections in their financial statements that are different from those LIFO sub-elections and methods that are used in their income tax return computations.

- ***Special business arrangements introduce further challenges in complying with the conformity requirements.***
  - Affiliated and consolidated groups must deal with the special requirements in Section 472(g).
  - Foreign corporations and operations may find some guidance in Rev. Rul. 78-246 and in Letter Rulings 200540005 and 201034004.
  - Entities issuing financial statements in compliance with International Financial Reporting Standards (IFRS), to date, have only FAA 201147004 for guidance.

- ***LIFO users cannot be too cautious or careful in dealing with conformity matters.***
  - The position of the IRS is that the statute of limitations does not prevent it from inquiring into a taxpayer's compliance with the conformity requirements ... And, it can raise this issue as far back as the year of the initial LIFO election.
  - Historically, the IRS' general behavioral pattern whenever it uncovers an financial statement conformity violation is to propose to terminate the taxpayer's LIFO election.
  - Little comfort can be secured from the *William Powell Company* and the *Insilco* decisions which are the only recorded court cases where taxpayers successfully contested the IRS' efforts to terminate their LIFO elections.
  - On many audits, instead of assuming that the taxpayer has complied, the IRS asks for proof that financial statements at year-end were not in violation of the LIFO conformity requirements ... The burden of proof is on the taxpayer - not on the IRS - in these inquiries.

- ***Remember that the "Conformity" requirement is only one of four basic LIFO eligibility requirements.***
  - The IRS can disallow a taxpayer's LIFO election if it finds a violation of any one of four general eligibility requirements. The four eligibility requirements involve cost, conformity, consent, and the maintenance of adequate books and records.
  - If the IRS finds that a violation of any one of the eligibility requirements has occurred, it has the discretionary power to allow the LIFO election to continue - if it can be persuaded to exercise that power in the taxpayer's favor.

Reg. Sec. 1.472-2(e) Outline

THE LIFO FINANCIAL STATEMENT CONFORMITY REPORTING REQUIREMENTS

(e) LIFO conformity requirement

- ***(1) In general.*** ... See pages 27-28.
  - (i) - (viii) Omitted.
- ***(2) One-year periods other than a taxable year.***
- ***(3) Supplemental and explanatory information*** ... See pages 27-28.
  - (i) Face of the income statement.
  - (ii) Notes to the income statement.
  - (iii) Appendices and supplements to the income statement.
    - (A) - (D) Omitted.
  - (iv) Other reports; in general.
  - (v) Other reports; disclosure of non-LIFO income.
    - "(A) - "(B)" Omitted
  - (vi) Other reports; disclosure of effect on income.
    - "(A) - "(B)" Omitted
- ***(4) Inventory asset value disclosures.*** ... See pages 27-28.
- ***(5) Internal management reports. [Reserved]*** ... There is no text for this section.
- ***(6) Series of interim reports.*** ... A series of credit statements or financial reports is considered a single statement or report covering a period of operations if the statements or reports in the series are prepared using a single inventory method and can be combined to disclose the income, profit, or loss for the period. (This is referred to as the "aggregation" theory.)
- ***(7) Market value.*** ... Generally not applicable (i.e., limited to credit statements or financial reports issued before Jan. 22, 1981).
- ***(8) Use of different methods.***

  The following are examples of costing methods and accounting methods that are neither inconsistent ... nor at variance with the requirement of Reg. Sec. 1.472-2(c) and which ... may be used to ascertain income, profit, or loss for credit purposes or for purposes of financial reports regardless of whether such method is also used by the taxpayer for Federal income tax purposes.
  - (i) Any method relating to the determination of which costs are includible in the computation of the cost of inventory under the full absorption inventory method.
  - (ii) Any method of establishing pools for inventory under the dollar-value LIFO inventory method.
  - (iii) Any method of determining the LIFO value of a dollar-value inventory pool, such as the double-extension method, the index method, and the link chain method.
  - (iv) Any method of determining or selecting a price index to be used with the index or link chain method of valuing inventory pools under the dollar-value LIFO inventory method.
  - (v) Any method permitted under Reg. Sec. 1.472-8 for determining the current-year cost of closing inventory for purposes of using the dollar-value LIFO inventory method.
  - (vi) Any method permitted under Reg. Sec. 1.472-2(d) for determining the cost of goods in excess of goods on hand at the beginning of the year for purposes of using a LIFO method other than the dollar-value LIFO method.
  - (vii) Any method relating to the classification of an item as inventory or a capital asset.
  - (viii) The use of an accounting period other than the period used for Federal income tax purposes.
  - (ix) The use of cost estimates.
  - (x) The use of actual cost of cut timber or the cost determined under Section 631(a).
  - (xi) The use of inventory costs unreduced by any adjustment required by the application of Section 108 and Section 1017, relating to discharge of indebtedness.
  - (xii) The determination of the time when sales or purchases are accrued.
  - (xiii) The use of a method to allocate basis in the case of a business combination other than the method used for Federal income tax purposes.
  - (xiv) The treatment of transfers of inventory between affiliated corporations in a manner different from that required by Reg. Sec. 1.1502-13.
- ***(9) Reconciliation of LIFO inventory values.*** ... A taxpayer may be required to reconcile differences between the value of inventories maintained for credit or financial reporting purposes and for Federal income tax purposes in order to show that the taxpayer has satisfied the (financial statement conformity reporting) requirements.

Conformity Requirements	***CODE & REGULATIONS RE: NON-LIFO DISCLOSURES AS SUPPLEMENTARY INFORMATION IN YEAR-END FINANCIAL STATEMENTS*** Page 1 of 2
Code Section 472(c)	• A taxpayer that elects to use the LIFO inventory method for Federal income tax purposes must establish to the satisfaction of the Commissioner that it has used no method other than LIFO in inventorying goods specified in its LIFO election to ascertain income, profit, or loss ***for the first taxable year*** for which the method is to be used, for the purpose of a report or statement covering such taxable year to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.
Code Section 472(e)	• If a taxpayer uses the LIFO method for any taxable year, then such method ***shall be used in all subsequent taxable years*** unless ... (1) With the approval of the Secretary a change to a different method is authorized; or, (2) The Secretary determines that the taxpayer has used for any such subsequent taxable year some procedure other than LIFO in inventorying the goods specified in the application to ascertain the income, profit, or loss of such subsequent taxable year for the purpose of a report or statement covering such taxable year (A) to shareholders, partners, or other proprietors, or beneficiaries, or (B) for credit purposes; and requires a change to a method different from that prescribed in Sec. 472(b) beginning with such subsequent taxable year or any taxable year thereafter. • If (1) or (2) above applies, the change to - and the use of - the different method shall be in accordance with such Regulations as the Secretary may prescribe as necessary in order that the use of such method may clearly reflect income.
Code Section 472(g)	• All members of the same group of financially related corporations are treated as a single taxpayer for purposes of the LIFO conformity requirements of Sections 472(c) and (e)(2). • The term "group of financially related corporations" means any affiliated group as defined in Section 1504(a), determined by substituting "50%" for 80% each place it appears, and any other group of corporations that consolidate or combine for purposes of financial statements.
Reg. Sec. 472-2(e)(1)	• The taxpayer must establish to the satisfaction of the Commissioner that the taxpayer, in ascertaining the income, profit, or loss for the taxable year for which the LIFO inventory method is first used, or for any subsequent taxable year, for credit purposes or for purposes of reports to shareholders, partners, or other proprietors, or to beneficiaries, has not used any inventory method other than the LIFO method or at variance with the requirement referred to in Reg. Sec. 1.472-2(c). [Requiring the use of average cost.] • The taxpayer's "use of an inventory method other than LIFO for purposes of ascertaining information reported ***as a supplement to or explanation of the taxpayer's primary presentation of the taxpayer's income, profit, or loss*** for a taxable year in credit statements or financial reports" is not considered at variance with the requirements of Reg. Sec. 1.472-2(e)(1). • The "use of an inventory method other than LIFO to ascertain the value of the taxpayer's inventory of goods on hand for purposes of ***reporting the value of such inventories as assets***" is not considered at variance with the requirements of Reg. Sec. 1.472-2(e)(1). • The taxpayer's "use of an inventory method other than LIFO for purposes of ascertaining information reported in internal management reports" is not considered at variance with the requirements Reg. Sec. 1.472-2(e)(1).
Reg. Sec. 1.472-2(e)(4)	• Under Reg. Sec. 1.472-2(e)(1)(ii), the use of an inventory method other than LIFO to ascertain the value of the taxpayer's inventories for purposes of ***reporting the value of the inventories as assets is not considered the ascertainment of income, profit, or loss***, and therefore, is not considered at variance with the [conformity] requirement. • Therefore, a taxpayer may disclose the value of inventories on a ***Balance Sheet*** (i.e., a statement of asset values) using a method other than LIFO to identify the inventories, and such a disclosure will not be considered at variance with the [conformity] requirement. • However, ***the disclosure of income, profit, or loss for a taxable year on a Balance Sheet*** issued to creditors, shareholders, partners, other proprietors, or beneficiaries ***is considered at variance with the [conformity] requirement if such income information is ascertained using an inventory method other than LIFO and such income information is for a taxable year for which the LIFO method is used for Federal income tax purposes.*** • Therefore, a ***Balance Sheet*** that discloses the net worth of a taxpayer, determined as if income had been ascertained using an inventory method other than LIFO, ***may*** be at variance with the [conformity] requirement ***if*** the disclosure of net worth is made in a manner that also discloses income, profit, or loss for a taxable year.

Conformity Requirements	**CODE & REGULATIONS RE: NON-LIFO DISCLOSURES AS SUPPLEMENTARY INFORMATION IN YEAR-END FINANCIAL STATEMENTS**
Reg. Sec. 1.472-2(e)(4)	• ***Footnote or parenthetical disclosures.*** A disclosure of income, profit, or loss using an inventory method other than LIFO is not considered at variance with the [conformity] requirement if the disclosure is made in the form of either a footnote to the balance sheet or a parenthetical disclosure on the face of the balance sheet. • ***In addition***, an income disclosure is not considered at variance with the [conformity] requirement if the disclosure is made on the face of a supplemental Balance Sheet labeled as a supplement to the taxpayer's primary presentation of financial position, ***but only if***, consistent with the rules discussed below (i.e., Reg. Sec. 1.472-2(e)(3)), ***such a disclosure is clearly identified as a supplement to or explanation of the taxpayer's primary presentation of financial income as reported on the face of the taxpayer's Income Statement.***
Reg. Sec. 1.472-2(e)(3) ***Specific Rules Related to the Exceptions to the Conformity Requirements for ...*** ***Supplemental and/or Explanatory Information***	• ***Face of the Income Statement (i).*** Information reported ***on the face*** of a taxpayer's financial ***Income Statement*** for a taxable year is not considered a supplement to or explanation of the taxpayer's primary presentation of the taxpayer's income, profit, or loss for the taxable year in credit statements or financial reports. ◆ For this purpose, the face of an income statement does not include ***notes to the Income Statement*** presented on the same page as the income statement, ***but only if*** all notes to the financial income statement are presented together. • ***Notes to the Income Statement (ii).*** Information reported in notes to a taxpayer's financial ***Income Statement*** is considered a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss for the period covered by the ***Income Statement*** if (1) all notes to the financial ***Income Statement*** are presented together and (2) if they accompany the ***Income Statement*** in a single report. • ***Appendices & supplements to the Income Statement (iii).*** Information reported in an appendix or supplement to a taxpayer's financial ***Income Statement*** is considered a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss for the period covered by the ***Income Statement*** but, ***only if*** (1) The appendix or supplement accompanies the income statement in a single report ***and*** (2) The information reported in the appendix or supplement is clearly identified as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement***... • Information is considered to be clearly identified as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement*** if the information either ... (1) Is reported in an appendix or supplement that contains a general statement identifying all such supplemental or explanatory information, (2) Is identified specifically as supplemental or explanatory by a statement immediately preceding or following the disclosure of the information, (3) Is disclosed in the context of making a comparison to corresponding information disclosed both on the face of the taxpayer's ***Income Statement*** and in the supplement or appendix, ***or*** (4) Is a disclosure of the effect on an item reported on the face of the taxpayer's ***Income Statement*** of having used the LIFO method. • For example, a restatement of cost of goods sold based on an inventory method other than LIFO is considered to be clearly identified as supplemental or explanatory information if the supplement or appendix containing the restatement contains a general statement that all information based on such inventory method is reported in the appendix or supplement as a supplement to or explanation of the taxpayer's primary presentation of income, profit, or loss as reported on the face of the taxpayer's ***Income Statement.***
Internal Management Reports	• Reg. Sec. 1.472-2(e)(5) is supposed to provide specific rules related to exceptions to the conformity requirements for internal management reports. • This Reg. Sec. has been reserved. • No Regulations have been promulgated to date.

Revenue Ruling 97-42

Permissible Auto Dealer LIFO Reporting Variations in Certain Factory-Formatted Statements Issued "for Credit Purposes"

	Situation 1		Situation 2			Situation 3	
	LIFO Reflected in Gross Profit *(CGS)* *		LIFO Reflected in Adj. to Net Income **			LIFO Not Reflected *Anywhere* on the Income Statement	
	Income Statement December 1996		Income Statement December 1996			Income Statement December 1996	
	Month	Year-to-Date	Month	Year-to-Date		Month	Year-to-Date
Sales of Automobiles	300	3,600	300	3,600		300	3,600
Cost of Goods Sold	*(255)*	*(2,400)* *	(195)	(2,340)		(195)	(2,340)
Gross Profit	45	1,200	105	1,260		105	1,260
Variable Expenses	(12)	(144)	(12)	(144)		(12)	(144)
Fixed Expenses	(18)	(216)	(18)	(216)		(18)	(216)
Operating Profit	15	840	75	900		75	900
Other Income & Expenses	0	0	*(60)*	*(60)*	**	0	0
Net Income	15	840	15	840		75	900

Notes

In Situations 1 and 2, A and B did not violate the LIFO conformity requirement in their statements to Y (a financing subsidiary of the Factory/manufacturer) because they used the LIFO method in inventorying goods to ascertain their net income in the Month and Year-to-Date columns of the December income statement.

The results in Situations 1 and 2 ***would be the same if the $60x LIFO adjustment reflected in*** the Month and Year-to-Date columns of the December 1996 ***income had been a reasonable estimate of the change in LIFO reserve for the year.***

Further, if A or B had employed a ***fiscal taxable year,*** the results in *Situations 1 and 2* would be the same if A or B made *either (1)* an adjustment for the change in the LIFO reserve that occurred during the calendar year in the Month and Year-to-Date column of the December income statement or *(2)* an adjustment for the change in the LIFO reserve that occurred during the fiscal year in the Month and Year-to-Date columns of the income statements provided for the last month of the fiscal year.

In Situation 3, C violated the LIFO conformity requirement in its statements to Y because C used a method other than LIFO (i.e., it used the specific identification inventory method) in inventorying goods to ascertain its net income in the Year-to-Date column of the December income statement.

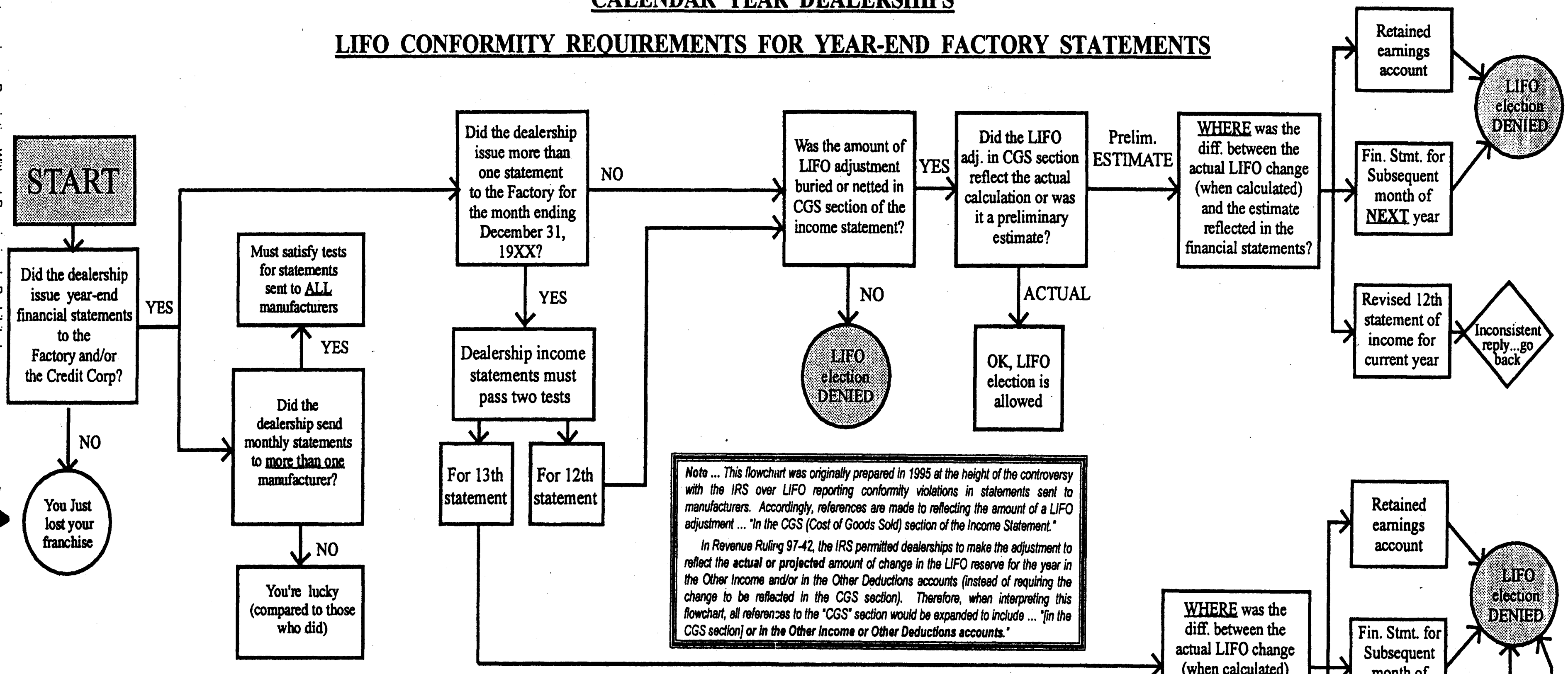
Further, C violated the LIFO conformity requirement because the January through November income statements can be combined with the December income statement to ascertain C's net income for the year using a single inventory method other than LIFO.

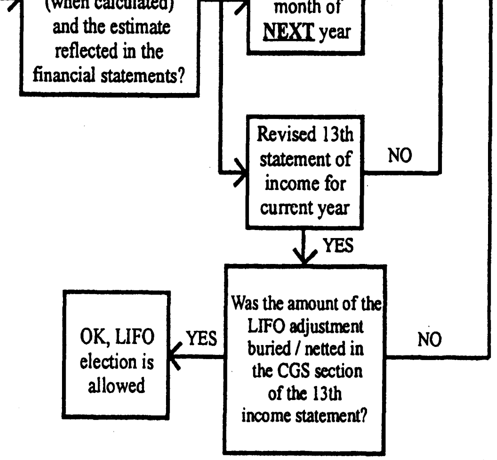
C used the specific identification inventory method to calculate its Cost of Goods Sold, Gross Profit, and Net Income for the year and month without adjusting for a $60x increase in C's LIFO reserve for 1996. ***Thus, the December 1996 income statement does not reflect C's use of the LIFO inventory method.*** The result in *Situation 3* would be the same even if C's December 31, 1996 Balance Sheet had reflected a 1996 adjustment to C's LIFO reserve.

Warning: These examples can only be interpreted in the context of the entire discussions in Revenue Ruling 97-42 and Revenue Procedure 97-44 which relate to franchised automobile dealers who have provided monthly financial (income) statements ***"for credit purposes"*** to the credit subsidiary of the franchisor/automobile manufacturer.

CALENDAR YEAR DEALERSHIPS

LIFO CONFORMITY REQUIREMENTS FOR YEAR-END FACTORY STATEMENTS





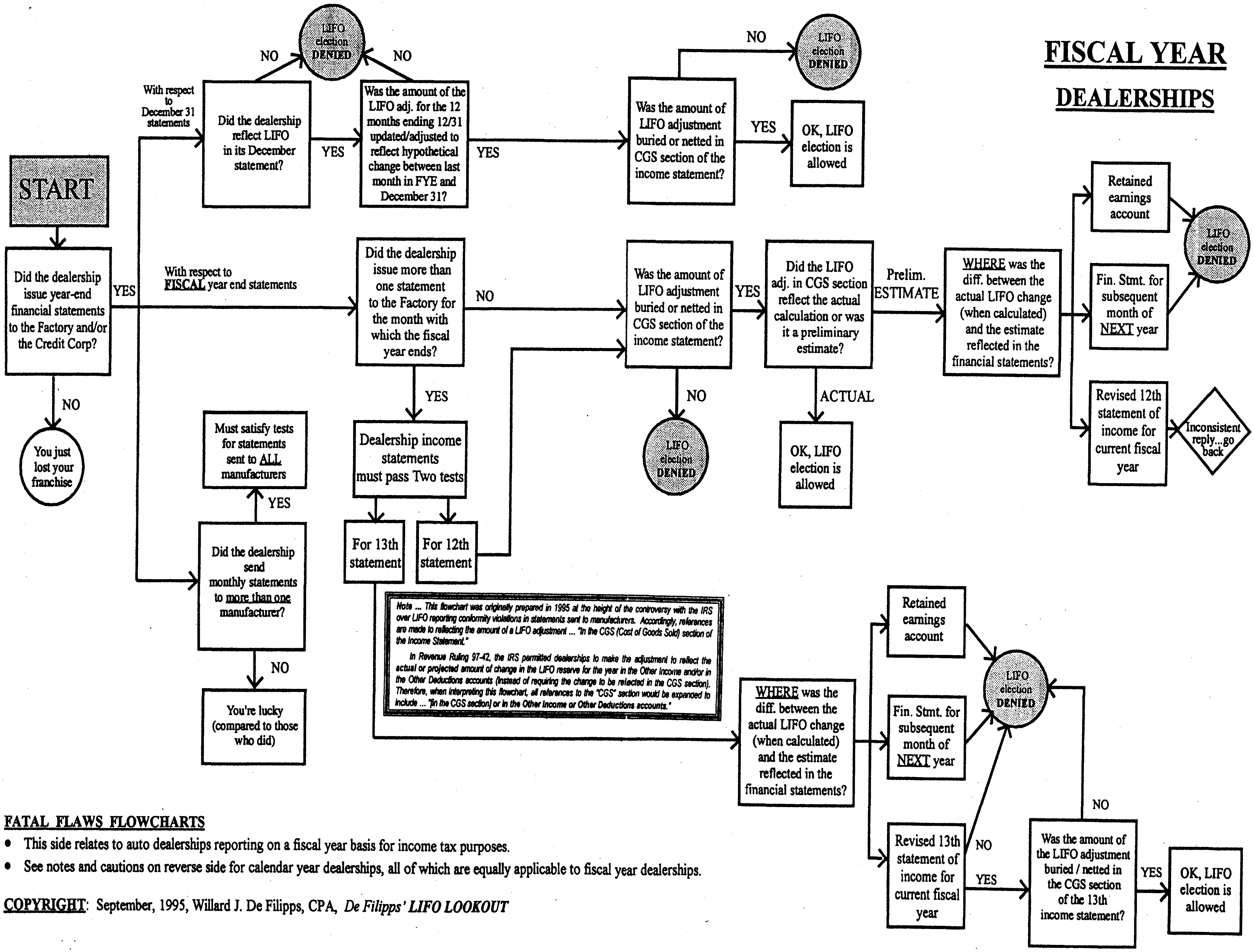
FATAL FLAWS FLOWCHARTS

- **This side relates to calendar year auto dealerships.** See reverse side for fiscal year dealerships.
- **Multi-Franchise Dealers:** LIFO adjustments must be reflected in the year-end income statements submitted to each different manufacturer.
- **New, Used and/or Parts** on LIFO: LIFO adjustments must be computed (or estimated) and properly reflected in the dealership's year-end income statements for each different class of goods subject to a LIFO election.
- **Preliminary or Estimated calculations** should be based on reasonable assumptions, documented and saved for review.
- CAUTION: These flowcharts summarize the LIFO conformity requirements as the IRS appears to interpret them (as of September, 1995) with respect to the financial statements prepared by auto dealerships on Factory-prescribed formats and sent to the manufacturer and/or to the manufacturer's credit corporation affiliates. **IRS interpretations may change without notice at any time.**

  Although these flowcharts are intended to be helpful in determining the consequences of various LIFO reporting conformity situations, they may not be appropriate in all cases. You must have a thorough understanding of the LIFO conformity regulations and of the IRS official and unofficial interpretations of them, and of the dealership's specific reporting practices to the Factory, in order to determine whether the reporting situation is within the scope of either flowchart summary.

FISCAL YEAR

DEALERSHIPS



Note ... This flowchart was originally prepared in 1995 at the height of the controversy with the IRS over LIFO reporting conformity violations in statements sent to manufacturers. Accordingly, references are made to reflecting the amount of a LIFO adjustment ... "In the CGS (Cost of Goods Sold) section of the Income Statement."

In Revenue Ruling 97-42, the IRS permitted dealerships to make the adjustment to reflect the actual or projected amount of change in the LIFO reserve for the year in the Other Income and/or in the Other Deductions accounts (instead of requiring the change to be relected in the CGS section). Therefore, when interpreting this flowchart, all references to the "CGS" section would be expanded to include ... "[in the CGS section] or in the Other Income or Other Deductions accounts."

FATAL FLAWS FLOWCHARTS

- This side relates to auto dealerships reporting on a fiscal year basis for income tax purposes.
- See notes and cautions on reverse side for calendar year dealerships, all of which are equally applicable to fiscal year dealerships.

Rev. Rul. 78-246	**_Foreign Corporations & Foreign Operations_** **_Financial Statement Conformity Requirements & the 30% Test or Threshold_**
Background	• The LIFO financial statement reporting requirements were enacted to ensure that the LIFO method "conforms as nearly as may be to the best accounting practice in the trade or business. ..." (H. Rep. No. 2330, 75th Cong., 3d Sess. 34 (1938)). • The legislative history of Section 472 indicates that the conformance "to the best accounting practice" is to be made on the basis of United States standards of accounting practice. • Congress was concerned solely with domestic accounting practice. Therefore, the conformity requirements of Section 472 should not be extended to determine what is the "best accounting practice" in foreign countries.
Are Operating Assets of "Substantial Value" Used in the Foreign Operations?	• If a foreign parent owns ***operating assets of substantial value which are used in foreign operations,*** the LIFO financial statement conformity requirements ***do not apply*** to the consolidated financial statements. ◆ This applies to ownership by the parent either directly or indirectly through members of its group. • Operating assets are considered to be used in foreign operations if they are owned by, and used in the business of, corporations that ... (1) are members of the consolidated group, (2) are ***foreign*** corporations, (3) ***do not use the LIFO method*** of accounting for Federal income tax purposes, and (4) ***engage in a business outside the United States.*** • For purposes of this test, operating assets are all the assets necessary for the conduct of an active operating company.
30% or More Threshold	• The foreign parent corporation will be considered as owning substantial foreign assets if the total value of such assets constitutes ***30% or more*** of the total operating assets of the consolidated group. • This determination will be made annually. • This determination ***will normally be made on the basis of the asset valuation*** reflected in the consolidated financial statements of the group for the year.
Facts & Circumstances	• ***If the consolidated group does not satisfy the 30% test,*** the IRS may waive the 30% test and make a determination on the basis of all of the ***facts and circumstances*** presented.
LTR 200540005 ... Dated June 20, 2005	
LTR Summary	• In LTR 200540005, the IRS was dealing with a foreign parent corporation that had to issue consolidated financial statements to its shareholders and creditors in which it was reporting its own operations and the operations of subsidiaries acquired by its own wholly-owned U.S. subsidiary. • The taxpayer persuaded the IRS that, although it failed to have operating assets in excess of the 30% threshold, it should be considered to have satisfied the alternative "facts and circumstances" test. • As a result, the parent was permitted to issue consolidated financial statements on a non-LIFO basis without violating the LIFO financial statement conformity requirements ... ***but only for the one year in question.***
LTR Facts	• The parent (a foreign corporation, not reporting under U.S. GAAP) made an agreement whereby the taxpayer (its wholly-owned U.S. subsidiary) would acquire all of the outstanding stock of a group of new subsidiaries. ◆ Prior to the acquisition, the taxpayer also had other wholly-owned U.S. subsidiaries ("old subs"). ◆ Following the acquisition, the activities of the parent, the taxpayer, and the taxpayer's subsidiaries (old subs and new subs) would be reported in the consolidated financial statements of the Parent. • Prior to the acquisition, the new subs used LIFO for valuing their inventories. The parent and the taxpayer used a non-LIFO method for valuing inventory for U.S. and for the parent's foreign country tax purposes.
LTR Discussion	• The taxpayer conceded that it did not meet the more than 30% test for establishing substantial foreign operations under Rev. Rul. 78-246. However, it said that it should be allowed to make certain distinctions in order to qualify under the alternative "facts and circumstances" test. • The taxpayer argued that as a result of the stepped-up basis in the assets involved in the acquisition, financial statement comparisons did not fairly represent its situation. The assets of the new subsidiaries reflected current value because the acquisition was recorded as a purchase pursuant to U.S. GAAP. • Accordingly, the taxpayer argued that it should be allowed to compare the higher ***market values*** (i.e., instead of the lower asset book values) of the foreign operations to its total operations. ◆ In determining the market value of new subsidiaries, the taxpayer proposed to use the purchase price of the new subsidiaries. ◆ For the market value of the remainder of the Group, the taxpayer proposed to use EBITDA (earnings before interest, taxes, depreciation and amortization) as a basis for allocating the Group's market value, prior to the acquisition, between its foreign and domestic operations. • As a result of this alternative analysis, the computed percentage of assets used in foreign operations (to total operations) would only be slightly less than the 30% minimum threshold set forth in Rev. Rul. 78-246.

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

FAA 201147021F
The Facts

IFRS FINANCIAL STATEMENTS VIOLATE THE LIFO CONFORMITY REQUIREMENTS

Background

This Field Service Advice (FAA) appears to be the first published IRS guidance involving the application of the LIFO conformity requirements to financial statements that are issued using the International Financial Reporting Standards (IFRS).

Four entities are involved in this FAA ...

(1) The foreign parent [a foreign entity],

(2) ABC, a member of the ABC consolidated group who owns the sub,

(3) The ABC consolidated group [which consists of ABC and other members] and

(4) The Taxpayer, a subsidiary of ABC [and thus, a second-tier member of the ABC consolidated group].

Three actual dates have been redacted from the text of the FAA. Assumptions regarding the dates and sequence of events have been made in the statement of facts in order to make it easier to follow the fact pattern.

On *[January 1, 2008]*, the Taxpayer became a wholly-owned subsidiary of ABC and a member of the ABC Consolidated Group. The ABC Consolidated Group filed a consolidated federal tax return for Tax Year *[2008]*.

ABC is wholly-owned by Foreign Parent, a foreign entity. Foreign Parent reported its worldwide consolidated financial statements using the International Financial Reporting Standards (IFRS) for Tax Year *[2008]*.

Foreign Parent required the Taxpayer to adopt the IFRS standards to facilitate the process of preparing these worldwide consolidated financial statements. Therefore, the Taxpayer adopted IFRS for the first time for Tax Year *[2008]*. This marked the first year that the Taxpayer issued any IFRS based financial statements. Prior to the adoption of IFRS, the Taxpayer used U.S. Generally Accepted Accounting Principles (GAAP) as its accounting standard.

The Last-In, First-Out (LIFO) inventory method is not an allowable method under IFRS. The Taxpayer has used the LIFO inventory method for accounting for a portion of its inventory since *[2002]* for both tax and financial reporting purposes. The Taxpayer continued to use the LIFO inventory method for Tax Year *[2008]*.

The Taxpayer provided financial statements to its foreign parent based upon IFRS standards for Tax Year *[2008]*. These financial statements included a balance sheet and income statement based upon IFRS standards.

The Taxpayer also provided the IFRS-only balance sheet and income statement to its lending bank.

Along with the IFRS-only balance sheet and income statement, the Taxpayer provided its lending bank with tabulated versions of its balance sheet and income statement whereby each was presented on an IFRS and U.S. GAAP standard.

Specifically, the tabulated financial statements made adjustments (including LIFO adjustments) to the IFRS column to arrive at U.S. GAAP. The IFRS version of the profit/income of the Taxpayer was based on a method that did not include LIFO principles in inventorying goods.

The Taxpayer did not make a distinction between primary or supplemental information within these financial statements related to the change from IFRS to U.S. GAAP reporting standards. Also, the Taxpayer did not include explanatory footnotes regarding the change.

The Taxpayer provided these financial statements to the lending bank in accordance with lending requirements imposed by the bank related to a letter of credit.

IFRS FINANCIAL STATEMENTS VIOLATE THE *LIFO* CONFORMITY REQUIREMENTS

The Taxpayer is subject to the LIFO conformity requirements because it elected to use the LIFO method of accounting for Federal income tax purposes.

With respect to the financial statements provided to its lending bank, the Taxpayer violated the LIFO conformity requirements if ...

(1) It used an inventory method other than LIFO to ascertain its income, profit or loss in the financial statements,

(2) The financial statements were "for credit purposes," ***and***

(3) The financial statements are not within any of the exceptions to the LIFO conformity requirements.

The Taxpayer provided the same IFRS-only balance sheet and income statement provided to the foreign parent to the lending bank. It also provided tabulated versions of these documents that adjusted the IFRS amounts to arrive at U.S. GAAP amounts.

Both the balance sheets and income statements involve the ascertainment of items of income, profit, or loss. The balance sheets do not fall within the exception under Reg. Sec. 1.472-2(e)(1)(ii), (4), which provides valuing inventory as an asset is not an ascertainment of income, profit, or loss, as the Taxpayer also used IFRS to ascertain retained earnings and net income on the balance sheets. The income statements by their nature involve the ascertainment of income, profit, or loss.

There is no question the IFRS-only versions used a method other than LIFO to ascertain income, profit, or loss, as IFRS is a non-LIFO method and was the only method used.

Arguably, the tabulated versions of the financial statements provided to the lending bank comply with the LIFO conformity requirements as they used U.S. GAAP to determine income, profit, and loss. However, they also used IFRS.

The LIFO conformity requirements do not merely require the use of a LIFO inventory method; ***they require that no method other than LIFO be used.***

The financial statements were issued to the Taxpayer's lending bank in accordance with lending requirements related to a letter of credit. Thus, there was a debtor-creditor relationship between the Taxpayer and the lending bank and the financial statements were provided pursuant to this debtor-creditor relationship. The Taxpayer's continued receipt of credit was dependent upon the provision of such financial statements. Therefore, the financial statements were "for credit purposes."

It could be argued that the use of IFRS was for purposes of supplementing or explaining the Taxpayer's primary U.S. Generally Accepted Accounting Principles (GAAP) position and, thus, the tabulated financial statements meet the exception for supplemental or explanatory information. However, the provision of information using IFRS was not presented as either supplemental or explanatory.

With respect to the tabulated balance sheet, the disclosure of income, profit, and loss using IFRS was not made in the form of a footnote to the balance sheet or a parenthetical disclosure on the face of the balance sheet. Even if the disclosure qualified as a parenthetical, despite the lack of parentheses, or other punctuation or formatting to indicate the IFRS information is an aside, there is still the problem of the tabulated income statement. Reg. Sec. 1.472-2(e)(3)(i) clearly provides that "[i]nformation reported on the face of a taxpayer's financial income statement for a taxable year is not considered a supplement to or explanation of the taxpayer's primary presentation of the taxpayer's income, profit, or loss." The IFRS information was reported on the face of the income statement and not as part of a note to the income statement.

Moreover, even if the tabulated financial statements conformed to the requirements of Section 472(e) and the Regulations thereunder, the Taxpayer also provided the lending bank with the same balance sheet and income statement it provided to the Foreign Parent. These documents were prepared based solely on IFRS. These documents were not identified as supplemental, explanatory, or appendixes. For instance, the balance sheet was not clearly identified as a supplement to or explanation of the taxpayer's primary presentation. Similarly, the income statement was not marked as an appendix or otherwise clearly identified as a supplement to or explanation of the taxpayer's primary position.

Therefore, these documents do not meet the exception for supplemental or explanatory information, and no other exception applies. ***Accordingly, the issuance of these financial statements to the lending bank violated the LIFO conformity requirements.***

YEAR-END PLANNING & PROJECTIONS FOR LIFO INVENTORIES

NEED FOR PLANNING & PROJECTIONS

In the first year of an election to use the Last-In, First-Out (LIFO) method to value inventories, it is important to properly elect the method by filing Form 970, satisfy the requirements to be eligible to use the method and to select the appropriate sub-methods (i.e., dollar-value, link-chain index, item identification, valuation of increment, etc.) for the calculations.

After the first year on LIFO ... and before the end of each succeeding year ..., it is equally important to consider proper planning techniques in order to retain, to the greatest extent possible, the tax deferral benefits provided by the use of LIFO.

Proper planning techniques include (1) projections (well before the end of the year) of the anticipated change in the LIFO reserve at year-end and (2) consideration of the impact of the change in the LIFO reserve on the overall tax planning strategy for the entity and its owners.

One aspect of the second consideration relates to either the reduction of the current year's tax liability or the impact on the use of existing net operating loss carryovers or carrybacks for C Corporations or the flowthrough of either additional income or deductions to the S Corporation shareholders or partners.

Another aspect is the consideration of what actions, if any, can legitimately be taken before year-end to accomplish a different (i.e., either a more desirable or a less painful) result.

This article addresses these planning techniques and considerations more fully.

PROJECTIONS FOR TAX PLANNING PURPOSES

It is unrealistic to attempt any serious planning for a business that uses the LIFO method to value its inventories without first projecting the change in the LIFO reserves for year-end.

The impact of a projected change in the LIFO reserve, which in turn impacts net taxable income or loss for the year, may be large enough to warrant revising either upward or downward the amounts of the fourth quarter estimated tax payments by the entity or by its shareholders or partners to whom the income or loss effect will flow through.

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YEAR-END PLANNING & PROJECTIONS FOR LIFO INVENTORIES

Make projections early. These projections should be made early enough before year-end so that consideration by management can be given to (1) the financial impact of what is likely to happen as a result of the projected change in the LIFO reserve and (2) whether legitimate steps, motivated by sound business reasons, can be undertaken to produce a result different from that shown by the projections to be expected at year-end.

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

No one wants to be caught off-guard or without any idea of how large or small the LIFO reserve increase or decrease - and recapture - is going to be at year-end.

In some instances, inventory levels may be expected to be (considerably) lower at year-end, and it is concluded that nothing can be done to avoid the projected LIFO reserve payback consequences. Even in this unfortunate situation, it is far better to know - at an earlier date - the extent of the impending repayment or "hit" so that other buffering or mitigating actions can be taken. Or, so that adequate financing can be arranged if the business expects that it will be unable to pay the additional tax out of its cash flows.

PROJECTIONS TO COMPLY WITH FINANCIAL STATEMENT CONFORMITY REQUIREMENTS

When a taxpayer using LIFO is under great pressure to issue the year-end financial statements before the detailed LIFO computations can be made, the taxpayer must be sure that any financial statements that are issued comply with all of the conformity reporting requirements.

Under these circumstances, the taxpayer might (1) use a reasonable estimate of the inflation rate for the year or (2) employ a different - faster or easier to compute - LIFO computation methodology for the financial statements than the LIFO method that is being used for income tax return purposes.

Projections for auto dealerships. As discussed in the accompanying article on conformity requirements, the timing of the issuance of year-end financial statements is a particularly acute problem facing many automobile dealerships. Often, this results in the dealership using estimates of the change in the LIFO reserve for the year on the year-end statements

see **YEAR-END PLANNING & PROJECTIONS,** page 38

PROJECTIONS ... STEP-BY-STEP

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

   Alternatively, if a decrement is projected for the year, carry back the decrement (expressed in base dollars) against prior years' increments (also expressed in base dollars) on a LIFO or reverse-chronological-order basis. This means that the most recent/last layer built up is the first one eliminated, and then prior years' layers are eliminated in reverse-chronological order. In other words, a decrement in 2012 is carried back first against any 2011 increment, then against 2010, then against 2009, then against 2008, etc. until the entire amount of the 2012 decrement (expressed in base dollars) has been fully accounted for. In some instances, a decrement may end up being carried all the way back to the original first LIFO year base layer.
5. ***Add*** all the resulting layers of inventory at their respective LIFO valuations to get the end-of-the-year inventory stated at its LIFO valuation,
6. ***Subtract*** the ending inventory at its LIFO valuation from the ending inventory at its actual or estimated current non-LIFO cost to determine the projected LIFO reserve as of the end-of-the-year,
7. ***Subtract*** the *actual* LIFO reserve as of the beginning-of-the-year from the projected LIFO reserves as of the end-of-the-year. The result determined in this final step is the estimate of the change in the LIFO reserve for the year.
8. ***Reconcile and prove out*** the projected changes to understand why the reserve is going up or down. See ***"Why LIFO Reserves Change the Way They Do"*** on page 39.

(Continued from page 37)

which are sent to manufacturers and credit corporations.

Revenue Ruling 97-42 states explicitly that a reasonable estimate of the change in the LIFO reserve may be used for this purpose. It also requires that after the final computation of the change in the LIFO reserve has been made for the year, the net amount to adjust from the projected amount of change to the actual amount of change for the year must be reported on the 13th statement ***as a charge against (or as a credit to) income for that year.***

PROJECTION MECHANICS, STEP-BY-STEP

Projecting year-end changes in LIFO reserves need not be too difficult nor time-consuming. This should be true regardless of whether the projection is for income tax planning purposes or for compliance with the conformity requirements on year-end statements to be issued before the LIFO calculations can be completed.

Making projections of year-end LIFO reserve change for a LIFO pool involves the need to estimate ***only two amounts:***

1. The ending inventory level (at actual cost), and
2. The overall inflation (or deflation) percentage experienced by that inventory for the year.

All other factors necessary to complete a projection are based on ***four (already-known) facts related to the beginning of the year:***

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

The computation of the projected change in a LIFO reserve is made by plugging in the estimates of (1) the year-end inventory level and (2) the current year's rate of inflation or inflation index ... and then "working backwards." These eight steps are detailed in the table on page 37.

UNDERSTANDING WHY (PROJECTED) LIFO RESERVES GO UP OR DOWN

Taxpayers using LIFO are often surprised when they are told that even though their year-end inventory levels are projected to be significantly lower than they were at the beginning of the year, their LIFO reserves are expected to increase or that their LIFO reserves will go down by only a small amount.

The only guess-work involved in these projections relates to the two estimates identified above. Everything else follows the precise laws of mathematics.

The *Practice Guide* on the page 39 explains why LIFO reserves change the way they do. A little more explanation follows.

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

The LIFO recapture, or payback, can be ***precisely calculated*** because it is based on the different rates of recapture potential that are associated with each annual layer of LIFO "increment" that has been built up over the years.

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

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

In other words, a 2012 decrement will be first carried back against any 2011 increment, then against any 2010 increment, then against any 2009, then against 2008, etc. until the entire amount of 2012 decrement (expressed in base dollars) has been fully accounted for. In some instances, a decrement may end up being carried all the way back to reduce the original first LIFO year base inventory.

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

Case studies on projections, LIFO reserve reconciliations and proofs. Over the years, numerous projection case studies have been included in the *LIFO Lookout* to illustrate and expand the discussion

see **YEAR-END PLANNING & PROJECTIONS,** page 40

Practice Guide

WHY LIFO RESERVES CHANGE THE WAY THEY DO

Background

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

Change Factors

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

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

Upward ... Increases

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

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

Downward ... Decreases

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

No Effect

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

Articles Analyzing Changes in LIFO Reserves

- *"Dealers Low on New Vehicle Inventory at Year-End May Face Stiff LIFO Reserve Recapture ... Planning May Lessen the Blow: Analysis of LIFO Reserve Recapture Rates & Computation of 'Break Even' Point for a LIFO Reserve"* in the Year-End 2009 *LIFO Lookout* (pages 40-47).
- "*Strange ... But Explainable ... Results from the Wacky World of Negative LIFO Reserves,*" in the December 1998 *LIFO Lookout.* This article, with supporting schedules, analyzes pay-back mechanics where negative LIFO reserves are involved.
- "*Another Rebasing Example - With Proofs: Why LIFO Reserves Go Up Even Though Inventory Levels Go Down and Despite Rebasing Indexes to 1.000 in Between*" in the June 1993 *LIFO Lookout.*
- "*Why Do Some LIFO Reserves Go Up Even Though Inventory Levels Go Down?*" in the March 1992 *LIFO Lookout*

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on LIFO reserve projection computations. Most recently, see *"Dealers Low on New Vehicle Inventory at Year-End May Face Stiff LIFO Reserve Recapture ... Planning May Lessen the Blow: Analysis of LIFO Reserve Recapture Rates & Computation of 'Break Even' Point for a LIFO Reserve"* in the Year-End 2009 *LIFO Lookout* (pages 40-47).

WORKING OUT OF ANTICIPATED YEAR-END LIQUIDATION OR DECREMENT SITUATIONS

When a liquidation or decrement situation is anticipated, the starting point is to calculate the pay-back potential from a series of reduced inventory levels.

In other words, as the year-end inventory drops, how much more (or less) is the LIFO reserve going to change? These calculations determine what the real LIFO recapture vulnerability - referred to as the "relative points of pain" - will be as the anticipated current-year's decrement is carried-back on a LIFO basis against the prior LIFO layers that have been built up over the years.

This recapture potential will be different for every LIFO pool, since each pool has its own unique history, characteristics and inflation/deflation experience. The LIFO reserve repayment potential impact should be computed for ***each*** LIFO pool and expressed as a readily understandable dollar amount.

Armed with this diagnostic information, taxpayers anticipating liquidations of prior inventory layers at year-end may be able to lessen the impact of the anticipated LIFO recapture in at least four ways.

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

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

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

YEAR-END PLANNING STRATEGIES THAT FAILED

Sometimes taxpayers have gone "too far" in trying to minimize the recapture impact of liquidations of their LIFO inventories. As might be expected, in some cases (where they were caught by the IRS), the IRS has successfully nullified their year-end inventory liquidation avoidance measures.

In 1996, the Tax Court observed that taxpayers often "desire a higher base-year cost of ending inventory in a given year to avoid liquidating a LIFO layer, →

Alternatives	**PLANNING STRATEGIES TO DELAY, DEFER OR DIFFUSE LIFO RECAPTURE**
Manage Inventory Levels	• Attempt to increase or "manage" the year-end inventory level through transactions that might not otherwise have been considered, but which still have some degree of business justification (other than solely attempting to minimize the impact of LIFO layer liquidations).
Year-End Change	• If eligible, consider changing to a fiscal year-end that is prior to the year-end expected to be adversely affected by the significant inventory reduction.
Switch to the IPIC/BLS Method	• Consider changing to the IPIC/BLS method in order to include other inventories in a broader LIFO pool (under the automatic change provisions in Sec. 22.06 of the *Appendix* to Rev. Proc. 2011-14). ◆ The IPIC Method LIFO Regulations (Reg. Sec. 1.472-8(e)(3)) were finalized in January 2002, and may make use of the IPIC method more attractive in some situations.
Strategic Termination of the LIFO Election	• Alternatives relating to ***terminating the LIFO election*** include (1) preemptively terminating the entire LIFO election in the year before the year in which the inventory level drops significantly, or (2) terminating the entire LIFO election effective for the year the inventory level drops significantly. • If the taxpayer is an auto dealership, consider the "pool-split and partial LIFO termination" strategy for a portion of the new vehicles on LIFO (as suggested by the discussion of Situation 3 in ILM 200935024). ◆ Considerations include ... Does the dealer intend to remain in business just selling used vehicles and/or maintaining active service department operations? Might the dealer acquire another new vehicle franchise to replace the lost franchise?

causing a match of historical costs against current revenues." (See *E. W. Richardson*, Tax Court Memo Decision 1996-368). Taxpayers tried to achieve this result by stepping up their purchases of inventory at year-end, sometimes through some rather ingenious or convoluted means.

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

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

2. ***Illinois Cereal Mills***, (86-1 USTC 9371 affirming T.C. Memo 1983-468, Dec. 40,342(M), 46 TCM 1001, August, 1983). Legal ownership of the goods did not justify inclusion in the taxpayer's inventory because the taxpayer did not intend to use the corn in its milling business.

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

BLUEPRINT FOR A SUCCESSFUL YEAR-END STRATEGY

These three cases and IRS Revenue Ruling 79-188 are discussed briefly on pages 42-43. They are also discussed more fully in *"Managing LIFO Inventory Levels ... What Not to Do & How Not to Do It,"* in the March 1997 *LIFO Lookout* on pages 3-12.

Revenue Ruling 79-188. As indicated by (1) the summary *"Year-End Purchases Checklist"* below and (2) the more detailed *"Checklist for Identifying Issues & Documenting Year-End Purchases"* on page 44, it is possible to give Revenue Ruling 79-188 a more positive spin and to interpret it to indirectly suggest some planning considerations that - if executed carefully - may result in mitigating the impact of a projected LIFO inventory liquidation.

TAM 9847003 also provides evidence of how closely the IRS scrutinizes year-end inventory levels and transactions.

In this TAM, the IRS concluded that an affiliated group had engaged in inventory-level manipulation stating: "The Group simply used Y (one affiliated member) as a purchasing and holding company so that it could manipulate the quantity of goods in X's (another affiliated member) ending inventory, thereby artificially inflating X's cost of goods sold ... This purchasing arrangement was designed to artificially reduce the Group's taxable income and avoid taxes; it had no independent purpose...Although papers were drawn up to place formal ownership with Y, the ***objective economic realities*** indicate that X had effective command over the Y purchases."

YEAR-END PURCHASES CHECKLIST

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

Accordingly, in TAM 9847003, the IRS National Office (1) concluded that X was the owner of the Y purchases and should have included them in its inventory, and (2) pursued the adjustment to correct the year-end inventory levels through the Group's corporate restructuring by raising unauthorized change in accounting method issues and requiring Section 481(a) adjustments.

A WARNING ABOUT AGGRESSIVE YEAR-END INVENTORY PLANNING

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

see **YEAR-END PLANNING & PROJECTIONS,** page 45

REV. RUL. 79-188 & THREE TAX CASES ... WHAT NOT TO DO & HOW NOT TO DO IT

Revenue Ruling 79-188 ... 1979

Rev. Rul. 79-188 addressed the question of whether the cost of raw materials purchased by a jewelry manufacturer immediately before year-end and followed by resale of the same raw material soon after the start of the next taxable year was properly a part of the manufacturer's raw material ending inventory "if the taxpayer has no significant purpose to use the raw material in manufacture."

The taxpayer was engaged in the manufacture and sale of jewelry, and it maintained an inventory of gold for use in its manufacturing operations. In 1969, it had elected the LIFO inventory method for the gold content of raw materials, work-in-process, and finished goods. The taxpayer used gold only as a raw material incorporated into the jewelry it manufactured.

During 1977, the taxpayer experienced a substantial decrease in sales of finished gold jewelry. In response to this sales decline, the taxpayer allowed its gold inventory to decline significantly. However, four days before the end of the year, the taxpayer made a substantial purchase of gold from its supplier at market value. In January 1978, all of the gold purchased on December 28 was sold back to the same supplier at market value. Payment for the gold purchased on December 28, 1977 was not made until after the gold was repurchased by the supplier.

The taxpayer's LIFO layers were established at $35 per ounce. The gold purchase just before year-end was made at $200 per ounce. Had the purchase not been made, the taxpayer would have penetrated its LIFO layers, thereby charging out its lower priced inventory against cost of sales.

Citing the "clear reflection of income" requirement found in Section 471, the Ruling states that raw materials are inventoriable only if they have been acquired for the purpose of sale in the ordinary course of business or for the purpose of being physically incorporated into merchandise intended for sale. Therefore, ***the purpose for which raw material is purchased is a major factor in determining whether such "material" is "inventoriable" by the taxpayer.***

In this case, the taxpayer - in the ordinary course of its business - only used gold only as a raw material from which it fashioned jewelry. The IRS concluded that the gold purchased and sold by the taxpayer right before and after year-end was acquired with no significant purpose for being manufactured into jewelry ... but rather it had been purchased to avoid a penetration of the taxpayer's LIFO layers by artificially increasing its end-of-year inventory.

Holding. Since that gold purchased by the taxpayer was never used in its manufacturing process, it was not properly includable in the taxpayer's raw material ending inventory for purposes of Sections 471 and 472.

Ballou and Company, Inc. ... 1985

This case involved a fact pattern closely resembling that discussed in Revenue Ruling 79-188.

The taxpayer, B.A. Ballou, manufactured jewelry, jewelry findings and electronic components. One of the raw materials used in its jewelry manufacturing operations was fine gold (karat gold). Anticipating a drop in its year-end inventory level, the taxpayer engaged in year-end purchases involving its gold LIFO inventory.

The U.S. Claims Court refused to recognize these transactions because it concluded that these purchases were outside the scope of the ordinary course of the taxpayer's business. The Court held that year-end purchases were made to provide an artificial increase in its inventory of fine gold to prevent penetration into lower-cost LIFO layers and the resulting increase in taxable income and Federal tax. It noted that although the taxpayer's use of an inventory treatment for its financial accounting was reasonable for planning purposes, it was not adequate to clearly reflect income for tax accounting purposes.

In distinguishing what might be permissible for financial accounting in contrast with tax accounting, the Court indicated that for financial accounting purposes, the primary goal is to provide useful information to management, shareholders, creditors, and others properly interested in order to protect parties properly interested from being misled. Financial accounting is hospitable to estimates, probabilities and reasonable certainties.

In contrast, in determining what is acceptable accounting for income tax purposes, the primary goal of the income tax system is the equitable collection of revenue and the IRS' major responsibility is to protect the public fisc. Therefore, the computation of taxable income for a particular tax year requires precision as to the transactions applicable to that year.

REV. RUL. 79-188 & THREE TAX CASES ... WHAT NOT TO DO & HOW NOT TO DO IT

Ingredient Technology Corporation ... 1983

This 1983 case involved (1) sham transactions without business purpose, (2) secret negotiations and (3) intentional destruction of documents. ***It resulted in two tax fraud convictions.*** A U.S. Court of Appeals affirmed a District Court's (1) tax fraud conviction of Ingredient Technology Corp. (ITC/formerly SuCrest) and (2) the tax fraud conviction of its former president because the year-end LIFO inventories had been overstated.*

This case involved agreements by a sugar refiner (ITC/SuCrest) which had arranged to purchase sugar so that it would be in its inventory at year-end. Almost immediately after the purchase, the taxpayer resold the sugar to the supplier under terms that guaranteed no risk of loss or chance for gain. The Court concluded that these transactions were without economic substance, and they had been made solely for the purpose of tax avoidance.

Although ITC/SuCrest had legal title to the sugar on the year-end date, the inventory was never intended to be used nor sold in the course of its business, but only to inflate inventory for a short time solely for tax purposes. After all, the taxpayer was a refiner - not a seller or broker - of raw sugar.

The taxpayer argued that its inventory was not overstated because it in fact had legal title to the raw sugar in question on the year-end date even though it had previously agreed to resell it to its seller. The taxpayer further argued that, in any event, the element of willfulness was negated because "the tax laws were too unclear."

The Court stated that while title may be necessary for inclusion in inventory, title in itself is not alone sufficient for that purpose ... at least where the parties' purpose is solely tax avoidance. From the beginning, it was never intended that the sugar which was on board ship would be for ITC/SuCrest "an income-producing factor." On the contrary, it was never intended to be refined, and ITC/SuCrest was not in the business of selling or brokering raw sugar. The transaction was designed ***not*** to earn money for ITC/SuCrest.

"There was absolutely no beneficial interest on the part of ITC/SuCrest except to inflate inventory for a few days solely for tax purposes, and there was no prospect of gain from the transaction. This "beneficial interest factor" alone should be sufficient to disqualify ITC/SuCrest's purchase from its LIFO base. "Taxation is not so much concerned with the refinements of title as it is with ***actual command*** over the property taxed."

** For the "juicy stuff" that led to the two tax fraud convictions resulting from secret negotiations and intentional destruction of documents, you'll have to read this case on your own.*

Illinois Cereal Mills ... 1983

Illinois Cereal Mills, Inc. (ICM) operated a large corn mill which purchased and processed "vast amounts" of shelled corn. Near the end of its fiscal years in 1973, 1974 and 1975, ICM purchased warehouse receipts under contracts requiring a reconveyance of those warehouse receipts shortly after the end of each year. The issue in this case was whether the corn represented by certain warehouse receipts was properly includable in the year-end LIFO inventories.

The Tax Court quoted the decision in *Ingredient Technology* ... "that the concept of inventory from an accounting and/or from a tax standpoint ... would be meaningless if it were to include property bought, agreed to be resold, never intended to be utilized in the trade or business of the taxpayer (except for tax purposes), and in fact under the corporate taxpayer's dominion, control, and at its risk about as long as the pea in the proverbial shell game is under the shell."

Even if ICM had a valid business reason for its low physical inventories at times, the Tax Court said that the crucial fact was that ICM did not intend to use the warehouse-receipt corn in its milling business. The mere legal ownership of the corn at the end of the year, while necessary, was not sufficient to make it an inventory item ... ***Actual command*** over the property and not mere refinements of title is determinative for tax purposes.

The Court did not attach any significance to the testimony of ICM's president that ICM had engaged in similar warehouse-receipt transactions in the past. Although consistency in inventory practices is important, such practices are still required to clearly reflect the taxpayer's income.

Accordingly, ICM could not increase its year-end LIFO inventory of raw corn to include the goods purchased under these warehouse receipts because it did not intend to use the warehouse-receipt corn in its milling business. Therefore, the corn represented by the warehouse receipts was not properly includable in the year-end inventory.

Source: De Filipps, W.J. *"Managing LIFO Inventory Levels: What Not to Do & How Not to Do It," LIFO Lookout*, March 1997.

Managing Inventory Levels

CHECKLIST FOR IDENTIFYING ISSUES & DOCUMENTING YEAR-END PURCHASES

* *Use these item numbers to reference any comments in the space provided below or on an attached sheet.*	*Yes*	*No*
1. Were the year-end inventory purchases ***legitimate business transactions***?		
2. Were the purchases made ***in the open market***?		
3. Were the year-end purchases ***customary for the type of business*** the taxpayer is in?		
4. Were any of the purchases made from a ***related party***? If so, describe in detail below.		
5. Did the taxpayer have ***dominion and control*** over the goods purchased?		
6. Was title to the goods purchased vested in the taxpayer?		
7. Did the taxpayer bear the risk of loss on the goods purchased before year-end?		
8. Were the goods acquired with the ***intention*** of ... • Physically becoming a part of the merchandise intended for sale to customers in the ordinary course of business ... (or) • Incorporating them into the manufacturing process?		
9. Was/is the accounting treatment employed appropriate for reporting income for financial purposes and was/is it in accordance with generally accepted accounting principles?		
10. Was any attempt made to conceal the transaction or to deal at less than arm's-length in negotiating the transaction?		
11. Were any of the year-end purchase transactions reversed in the following year?*		
12. Were any of the purchased goods in question sold back to the original seller or to a related party? If yes, explain.† † *Have you specifically looked for this and/or conducted an independent effort to verify these matters?*		
13. Were any of the goods not disposed of by sales to regular customers in the ordinary course of business? Explain.		
14. Did the purchase of goods at the end of the year result in achieving average or normal inventory levels consistent with month-end inventory levels earlier in the year and/or year-end inventory levels in prior years?		
15. Have you inquired into the possible existence of any unusual or irregular year-end purchases with all appropriate individuals? • With whom?______________________________ • When?____________________		
16. If you have a representation letter from the client, have you included appropriate representations relative to year-end inventory purchase transactions in the letter?		
17. Are any of the year-end purchasing activities similar to those activities of the taxpayers in the three cases (i.e. *Ingredient Technology Corporation, Illinois Cereal Mills, Ballou and Company, Inc.*) in which the IRS successfully disallowed taxpayers' efforts to "manage" their year-end inventory levels to try to avoid recapture of their LIFO reserves? If so, provide details below.		
18. Do any of the year-end purchasing activities resemble the fact pattern in Revenue Ruling 79-188 in which the IRS addresses taxpayers' efforts to "manage" their year-end inventory levels to try to avoid recapture of their LIFO reserves? If so, provide details below.		

* ***Comments:***

(Continued from page 41)

Other practical considerations to be weighed in the balance (if aggressive year-end planning techniques are being contemplated) should include the possibilities that the Internal Revenue Service may seek to impose penalties, or higher statutory interest rates, if it considers the actions taken to avoid LIFO layer invasions and recapture to be without any support or merit.

Schedule UTP (Uncertain Tax Positions). If taxpayers take "extremely" aggressive actions in trying to raise their year-end inventory levels to avoid repayment of their LIFO reserves, filing Schedule UTP in corporate income tax returns may be another important consideration.

Schedule UTP is only required by businesses filing Form 1120 if certain threshold requirements are met and if the corporation or a related party issue audited financial statements reporting all or a portion of the corporation's operations for all or a portion of the corporation's tax year. Therefore, some taxpayers will not have to consider filing Schedule UTP if audited financial statements have not been issued.

DEALERSHIPS' LOSS OR TERMINATION OF FRANCHISES

This section addresses a question that has been raised by many auto dealerships as a result of the fallout from the bankruptcies of Chrysler and General Motors in 2009 and from continuing pressure from most other manufacturers to reduce the number of dealers in their distribution systems.

This questions is, ***"How does (might) a dealer's loss or termination of a franchise by the manufacturer affect the dealership's LIFO calculations?"***

Because some manufacturers are still (aggressively) seeking to terminate dealer franchises, affected dealers may have to decide whether or not they should voluntarily or "preemptively" terminate their LIFO elections. And, if so, when? These are strategic decisions.

The uncertainty over what to do is not so much due to a lack of guidance from the IRS as it is due to the lack of having a crystal ball.

If the dealership does not proactively terminate its LIFO election, then the LIFO reserve ***to some extent*** may be recaptured at the end of the year. This recaptured LIFO reserve amount will be taken into income 100% in the current year.

It is important to ***accurately*** project whether a significant portion of the LIFO reserve will be recaptured when the year-end inventory level is expected to be significantly lower.

Off-the-wall estimates that are based on percentage of inventory level change correlations are usually inaccurate. In other words, it is worse than inaccurate to assume that the reduction of a given percentage (for example, 45%) in ending inventory level would cause or result in a recapture of the same percentage (45%) of the LIFO reserve for that pool. There are no such direct percentage correlations.

The amount of LIFO reserve that will be recaptured will depend upon (1) how large the reduction in the year-end inventory level is, when that reduced level is compared with the beginning-of-the-year inventory level, and (2) the LIFO valuations of the annual layers which will have to be invaded in order to fully absorb the carryback of the decrement - expressed in base dollars - incurred in the current year.

Different dealership fact patterns (scenarios) will suggest different courses of action.

Possibility #1 ... Dealership with multiple franchises, only one (or two or three) of which are being terminated.

Dealerships that lose franchises sometimes are able to offset the effect of the elimination of new vehicles related to the lost franchise(s) in inventory by replacing them with new vehicles for other franchises which they still retained.

In these instances, the repayment of the dealership's LIFO reserve that is "attributable to the (vehicles in the) lost franchise" may be negligible or very small ... if there is any repayment at all.

Possibility #2 ... Dealership with a single franchise which is being (or was) terminated, either directly or indirectly, by the manufacturer; however, the dealer intends to stay in business just selling used vehicles and/or maintaining active service department operations.

The LIFO reserve recapture may be reduced by the (possible) acquisition in the same year of another new vehicle franchise to, in effect, replace the lost franchise.

Another important factor hinges on the concept of "separate trades or businesses." This relates to the dealership's continuation of relatively limited activities such as staying in business just selling used vehicles and/or maintaining active service department operations.

If the dealership proactively decides to terminate its LIFO election and the dealership stays in business, it is allowed to recapture its LIFO reserve (i.e., the amount of the LIFO reserve as of the beginning of the year) over a four (4) year spread period.

see **YEAR-END PLANNING & PROJECTIONS,** page 47

ILM Questions & Answers

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

Situation Questions	*Answers & Comments*
Situation 1 If an automobile dealer that loses one of its five dealer franchises ("franchises") properly obtains automatic consent to terminate its election to use the LIFO method for the dollar-value pool that includes only the new vehicles sold under that lost franchise, must the taxpayer accelerate the corresponding Section 481(a) adjustment because its ending inventories for the year of change do not include any of those new vehicles?	***No...*** The automobile dealer must include only one-fourth of the Section 481(a) adjustment in the taxable income of each year of the four taxable years that begin with the year of change ("four-year adjustment period"). ***Comment:*** The dealer in Situations 1 & 2 is not using the Alternative LIFO Method. Instead, the dealer has multiple pools, one for each franchise or one for each manufacturer.
Situation 2 Is the answer in Situation 1 the same if the automobile dealer loses its only franchise but still operates the remaining portions of its trade or business?	***Yes...*** There is no acceleration of the Sec. 481(a) adjustment if the dealer continues to operate the remaining portions of its trade or business.
Situation 3 If the automobile dealer maintains one pool for all new vehicles, may the automobile dealer change from the LIFO method for only the vehicles sold under the lost franchise? ***Facts in Situation 3*** The facts in Situation 3 are the same as in Situation 1, except that effective for the taxable year ending December 31, 2007, the dealership had elected to use the Vehicle-Pool Method for all new vehicles. (Rev. Proc. 2008-23) Accordingly, in this situation, the dealer is using the Alternative LIFO Method under Rev. Proc. 97-36. On January 1, 2009, the LIFO reserve attributable to the single pool was $40x. If Taxpayer used its LIFO method for the taxable year ending December 31, 2009, the LIFO reserve would be reduced by $8x as a result of having no Pontiac vehicles in ending inventory. ***Note:*** *See text of ILM for full discussion of facts, law and analysis of Situations 1, 2 and 3.*	***No... The automobile dealer may not change its LIFO method of accounting for some (but not all) of the vehicles that are within the scope of a single dollar-value pool.*** However, the automobile dealer may either... • Change from the LIFO method for its single dollar-value pool that includes all new vehicles (i.e., terminate its entire LIFO election), or • Change its dollar-value pooling method to a method of pooling based on vehicles sold under each franchise ***and*** change from the LIFO method for the dollar-value pool that includes only the vehicles sold under the lost franchise. ***Comments:*** • The two changes in method (CAMs) suggested in the second IRS answer above (i.e., a "pool-split and partial LIFO termination" strategy) cannot both be made as automatic changes (i.e., not requiring advance consent from the IRS). • The "pool-split" CAM requires advance permission from the IRS. The termination of the LIFO election CAM for the vehicles related to the terminated franchise can be made as an automatic change. • The computation of the amount of the LIFO reserve attributable to the new vehicles related to the lost (Pontiac) franchise could be problematic. The amount is simply given as $8x, with no further explanation. (See Reg. Sec. 1.472-8(g)) • ***Query:*** Could the dealership change its pooling method to include "all new vehicles manufactured by the same ***manufacturer***," rather than by ***franchise***? In many cases, pooling by manufacturer would be broader than pooling by franchise, although there might be some tradeoffs.

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

(Continued from page 45)

There will be no acceleration of a Section 481(a) adjustment (which takes the LIFO reserve into income) if the dealership continues to operate the remaining portions of its trade or business.

IRS guidance in ILM 200935024. This IRS Legal Memorandum (ILM) explains how a dealer's loss of a franchise affects (or does not affect) the acceleration of the Section 481(a) adjustment 4-year spread period in three specific fact situations. See page 46 for a brief discussion of this ILM.

The Situation 3 scenario in the ILM discusses a single LIFO pool being split, with the splitting of that pool followed by the termination of the LIFO election for one (or more) of the components of that pool. In that situation, permission from the IRS must be obtained in advance in order to split the pool.

Then, after the single pool has been split, the dealership may terminate the LIFO election for one (or more) of the components without advance consent/permission from the IRS.

The discussion of Situation 3 in ILM 200935023 suggests what might be a beneficial strategy for a dealer to minimize LIFO recapture when the manufacturer terminates a franchise. Essentially, this strategy is referred to as the ***"pool-split and partial LIFO termination"*** strategy. It requires a dealership to file two separate Forms 3115, and it is discussed in the exhibit below.

However, pursuing this *"pool-split and partial LIFO termination"* strategy involves consideration of several implementation issues. These include (1) timing, (2) computational, (3) cost and (4) alternative pooling issues.

Timing problem. If the dealership finds out about this strategy ***after*** the end of the year and wants to pursue it ... it is too late to file the Form 3115 to split the pool because that Form 3115 is required to be filed ***before*** the end of the year of change. Perhaps the dealership 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.

Computational problem. Computational issues can arise in determining the amount of the LIFO reserve (as the beginning of the year of change) that is attributable to each of the sub-pools by franchise that are to be created as a result of splitting the pool.

This is a special problem if the Alternative LIFO Method has been used because all new vehicles, regardless of manufacturer or franchise, are required to be included in the same pool. And, the problem is exacerbated if multiple franchises acquired in different years are involved.

Cost problem. User fees are expensive.

Multiple sub-pools problem. In the ILM guidance, the IRS required the dealership to break up its large single LIFO pool into multiple/separate/smaller pools ***by franchise***. In some dealership situations, breaking a large single pool into multiple pools by franchise may not be beneficial. This is best illustrated by examining the ILM guidance on this subject in more detail.

see **YEAR-END PLANNING & PROJECTIONS,** page 48

Minimizing Recapture

"Pool Split & Partial LIFO Termination" Strategy

Essentially, this ***"pool-split and partial LIFO termination"*** strategy requires a dealership to file two separate Forms 3115. The current revision of Form 3115 is dated Dec. 2009 and the current revision of the Instructions is dated March 2012.

The ***first*** required Form 3115 requests ***advance permission*** from the IRS to break up or split the dollar-value LIFO pool that contains the new vehicles for all of the dealership's franchises into separate LIFO pools (i.e., one LIFO pool for each franchise). This Form 3115 ...

(1) Must be filed with the IRS ***before the end of the year***,
(2) Requires the payment of a user fee, and
(3) Is filed under Revenue Procedure 97-27 because advance consent is required from the IRS to make the change.

The ***second*** required Form 3115 to be filed in order to complete this strategy requests permission to terminate the LIFO election for the pool (or pools) related to the new vehicles for the franchise(s) that is(are) being terminated. This Form 3115 ...

(1) May be filed ***after the end of the year*** as part of the tax return for the year of change,
(2) Does not require the payment of a user fee, and
(3) Is filed under Revenue Procedure 2011-14 because it is an ***automatic change*** in accounting method and Form 3115 is required to be filed with the IRS for all LIFO election terminations.

However, pursuing this ***"pool-split and partial LIFO termination"*** strategy involves consideration of several implementation issues (timing, computational, cost and alternative pooling issues) which are discussed above.

(Continued from page 47)

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 the vehicle inventory of one franchise 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 a better possible solution for dealers who have a multiple franchise fact pattern? Are there other possible variations, in addition to the one discussed in Situation 3 in the ILM, for dealing with multiple franchise fact patterns?

If a dealer were to follow the two-step strategy approach, could it request - and receive - permission from the IRS 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."

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 and Lincoln or for Chrysler and Jeep.

Note: if allowed by the IRS, this suggested pooling arrangement *by manufacturer* 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.

Uncertainty ... It is uncertain whether the IRS would allow a dealership to split a single vehicle pool under any arrangement other than by franchise.

OTHER IDEAS AUTO DEALERS MIGHT CONSIDER IF FACED WITH SIGNIFICANT PROJECTED DECREMENTS

If the dealership is going to remain in business, and it has not yet changed to combine its two pools for new vehicles under the Alternative LIFO Method into a single, combined pool, then by all means, making that change to the Vehicle-Pool Method should be considered.

Depending on the facts, sometimes a significant portion of the LIFO reserve recapture projected for a dealership that is still using two LIFO pools for new vehicles can be avoided by combining the pools. In essence, if the change in method were made to use a single LIFO pool for all new vehicles, a portion of the overall decrement that would have been experienced (in what would have been a separate pool) for one of the two pools could be offset against an increment that might be experienced (in what would have been the other separate pool). This has been discussed in numerous articles and case studies in previous issues/Editions of the *LIFO Lookout*. (See *Section V - "Combining Pools"* of the *LIFO Lookout* Index of Articles at www.defilipps.com.)

Alternatively, if the dealership prefers to continue using separate LIFO pools for new automobiles and for new light-duty trucks, after determining which pool (new automobiles or new light-duty trucks) has the greater LIFO repayment potential, a dealer may simply try before year-end to have more inventory (dollars) in the pool that has the greater LIFO reserve repayment potential.

In other words, if the LIFO repayment payback potential is 20% on the base dollar in one pool and 70% on the base dollar in the other pool, the dealer should try to have more inventory dollars at year-end in the latter (70% repayment potential) pool.

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

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

NOTHING VENTURED, NOTHING GAINED?

Some of these strategies may be rationalized under a "Nothing ventured, nothing gained" attitude. They are only generalized here, and they should be carefully and more fully evaluated before further action is taken. However, if the IRS digs deeply and considers them to have been motivated solely by LIFO liquidation-avoidance, the Service may be expected to vigorously challenge them.

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

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

The summary table and charts are on pages 50-53. In general, based on our one-of-each new vehicle item category compilations for this year-end, we are expecting that inflation rates will be closer to 4% for Lexus and Mazda ... closer to 3% for Buick, Nissan and Volvo ... and closer to 2% for Chevrolet, Ford, GMC trucks, Hyundai, Infiniti and Suzuki.

Our "one-of-each item category" report information includes intro-2013 model prices, unless the 2013 intro price was subsequently updated, and that information is also in our database for the end of the year. December 1, 2011 is the reference date for the equivalent of the calendar year 2012 beginning of the year date; i.e., December 31, 2011/January 1, 2012.

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

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

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

We hope you will find our one-of-each inflation indexes to be useful in estimating LIFO reserve changes or in comparing your results with ours. The detailed analyses for each make and model appear on pages 54-60.

Two Pools or Single Pool for New Vehicles? We've included information on pages 50-51for those dealerships that have already changed, or may be considering changing, to the single, combined LIFO pool (i.e., the "Vehicle-Pool") method permitted by Revenue Procedure 2008-23.

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

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

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

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

We will use the information on pages 50-60 in connection with many of our year-end LIFO reserve projection activities. In the December 2004 *LIFO Lookout*, we included ***Practice Guides*** and sample formats showing how we do our year-end projections.

Conformity reminder.Many dealerships make a projection of the change in the LIFO reserve for the year, and that change is reflected on the 12th statement. Remember that ***after*** the final computation of the change in the LIFO reserve for the year has been made, the net amount to adjust from the projected amount of change to the actual amount of change for the year must be reported on the 13th statement ***as a charge against (or as a credit to) income for that same year.***

In other words, both the projected change and the adjustment to agree that amount to the actual change in the LIFO reserve for the year must be reflected as a charge against (or as a credit to) income ***in the income statement for that same year.***

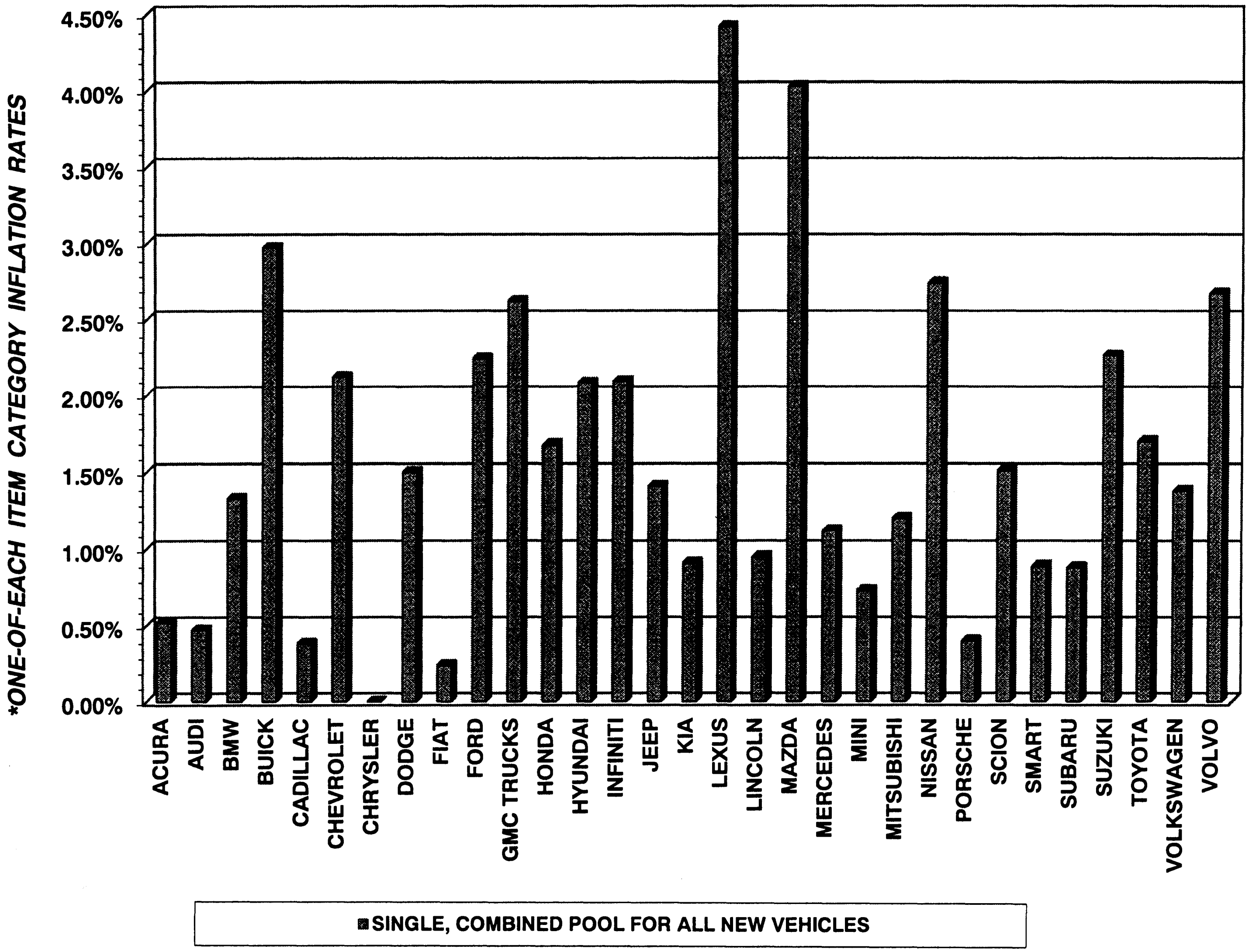
MODEL/ITEM CATEGORY INFLATION SURVEY FOR QUICK, ONE-OF-EACH, LIFO ESTIMATES DEALER COST FOR THE YEAR ENDED 12/31/12

INFLATION ESTIMATE REPORT BY MAKE BASED ON INFORMATION AVAILABLE

	POOL #1 NEW AUTOMOBILES	POOL #2 NEW L-D TRUCKS	ALL NEW VEHICLES COMBINED
ACURA	0.66%	0.30%	0.52%
AUDI	0.44%	0.69%	0.47%
BMW	1.39%	0.87%	1.33%
BUICK	3.76%	2.02%	2.97%
CADILLAC	0.07%	0.70%	0.38%
CHEVROLET	0.89%	2.45%	2.12%
CHRYSLER	(0.66)%	0.96%	(0.45)%
DODGE	(0.02)%	1.80%	1.50%
FIAT	0.24%	0.00%	0.24%
FORD	2.55%	2.21%	2.24%
GMC TRUCKS	0.00%	2.62%	2.62%
HONDA	1.40%	2.05%	1.68%
HYUNDAI	2.44%	0.91%	2.08%
INFINITI	2.59%	1.21%	2.09%
JEEP	0.00%	1.41%	1.41%
KIA	1.13%	0.75%	0.91%
LEXUS	5.07%	2.78%	4.42%
LINCOLN	1.71%	0.50%	0.95%
MAZDA	4.46%	3.17%	4.03%
MERCEDES	1.06%	1.33%	1.12%
MINI	0.73%	0.00%	0.73%
MITSUBISHI	0.66%	1.69%	1.20%
NISSAN	3.73%	2.39%	2.74%
PORSCHE	0.30%	0.98%	0.40%
SCION	1.51%	0.00%	1.51%
SMART	0.89%	0.00%	0.89%
SUBARU	0.81%	0.99%	0.88%
SUZUKI	2.51%	1.61%	2.26%
TOYOTA	1.39%	1.80%	1.70%
VOLKSWAGEN	1.36%	1.48%	1.38%
VOLVO	2.22%	3.49%	2.67%

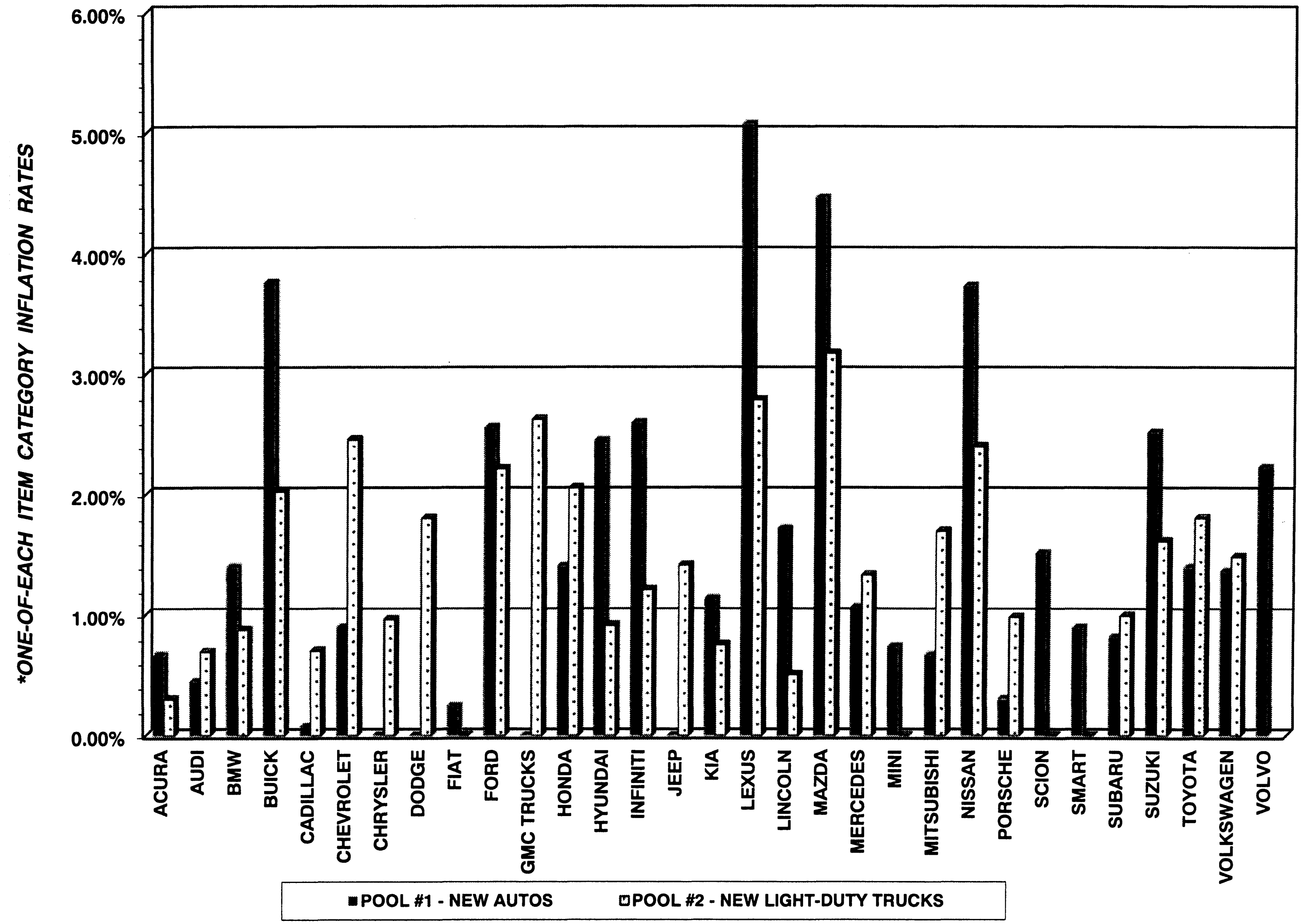
Source: ***De Filipps' SuperLIFO™***

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



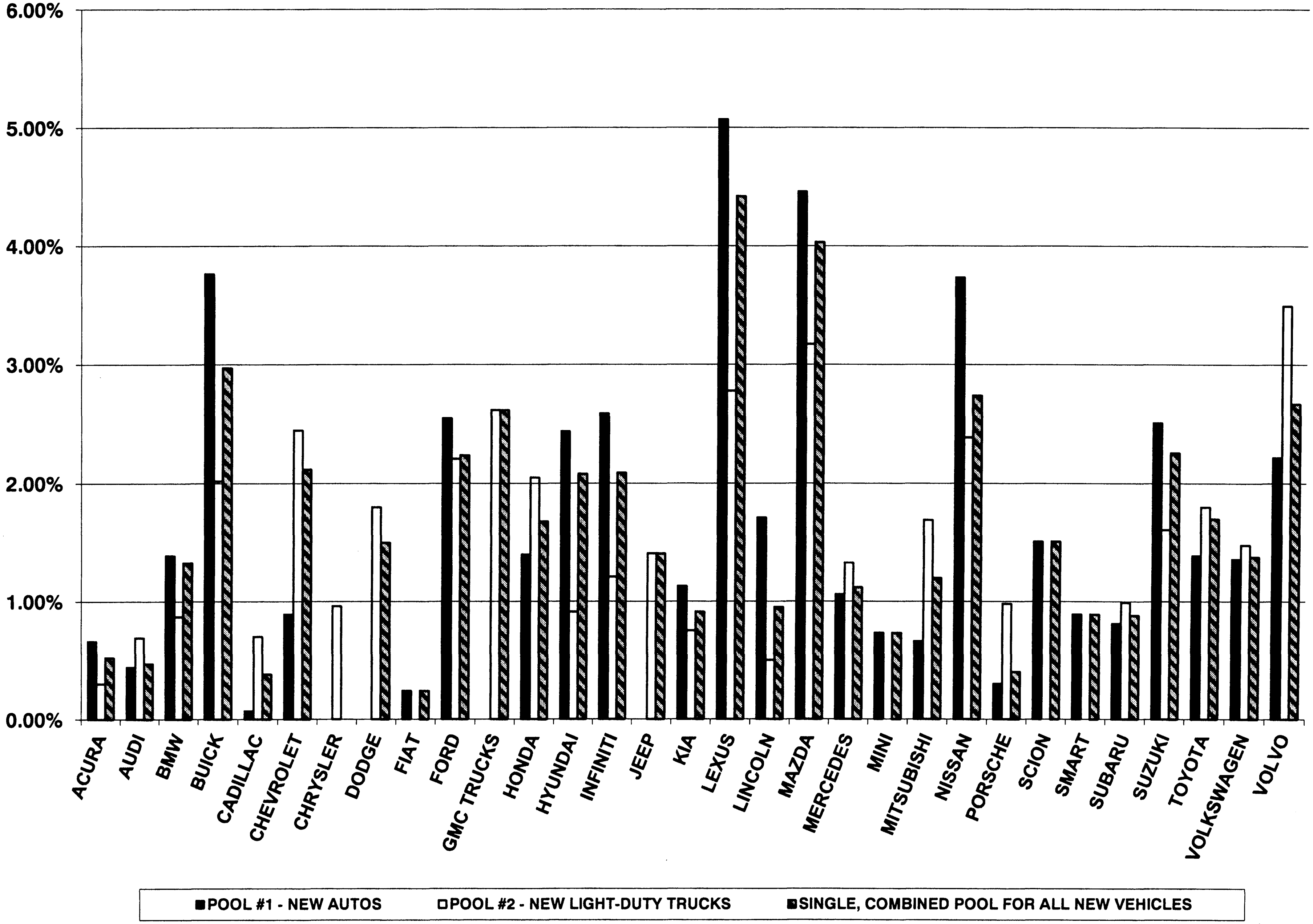
Source: De Filipps' ***SuperLIFO***™

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



Source: De Filipps' *SuperLIFO*™

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



Source: De Filipps' *SuperLIFO*™

*ONE-OF-EACH ITEM CATEGORY INFLATION RATES

PAGE: 1

JANUARY 10, 2013

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
ACURA								
NEW AUTOS - POOL #1								
ILX	0	6	6		168,557	168,557	0	0.00%
RL	0	0	0				0	N/A%
TL	7	0	7	269,349		270,460	1,111	0.41%
TSX	7	0	7	216,388		219,627	3,239	1.50%
TOTAL NEW AUTOS	14	6	20	485,737	168,557	658,644	4,350	0.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MDX	5	0	5	227,137		228,382	1,245	0.55%
RDX	0	4	4		138,420	138,420	0	0.00%
ZDX	0	1	1		47,083	47,083	0	0.00%
TOTAL NEW L-D TRUCKS	5	5	10	227,137	185,503	413,885	1,245	0.30%
TOTAL ACURA	19	11	30	712,874	354,060	1,072,529	5,595	0.52%
AUDI								
NEW AUTOS - POOL #1								
A3	4	0	4	108,922		108,922	0	0.00%
A4	3	0	3	93,375		93,467	92	0.10%
A5	4	0	4	151,314		154,102	2,788	1.84%
A6	2	1	3	85,190	41,292	127,410	928	0.73%
A7	1	0	1	55,103		55,894	791	1.44%
A8	1	4	5	124,157	296,487	421,574	930	0.22%
ALLROAD	0	1	1		39,600	39,600	0	0.00%
R8	0	0	0				0	N/A%
RS5	0	1	1		64,078	64,078	0	0.00%
S4	2	0	2	89,282		89,838	556	0.62%
S5	1	2	3	55,150	96,028	151,178	0	0.00%
S6	0	1	1		66,868	66,868	0	0.00%
S7	0	1	1		73,284	73,284	0	0.00%
S8	0	1	1		102,300	102,300	0	0.00%
TT	3	0	3	126,901		127,876	975	0.77%
TTS	2	0	2	90,210		90,860	650	0.72%
TOTAL NEW AUTOS	23	12	35	979,604	779,937	1,767,251	7,710	0.44%
NEW LIGHT-DUTY TRUCKS - POOL #2								
Q5	1	2	3	33,108	88,166	121,554	280	0.23%
Q7	3	0	3	146,615		148,195	1,580	1.08%
TOTAL NEW L-D TRUCKS	4	2	6	179,723	88,166	269,749	1,860	0.69%
TOTAL AUDI	27	14	41	1,159,327	868,103	2,037,000	9,570	0.47%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
BMW								
NEW AUTOS - POOL #1								
1 SERIES	6	2	8	201,070	83,905	285,940	965	0.34%
3 SERIES	13	10	23	539,860	368,365	912,355	4,130	0.45%
5 SERIES	10	1	11	531,755	56,210	597,630	9,665	1.64%
6 SERIES	6	3	9	467,080	231,840	709,600	10,680	1.53%
7 SERIES	11	2	13	1,047,875	151,155	1,230,860	31,830	2.65%
M3	2	0	2	118,175		118,540	365	0.31%
M5	0	1	1		82,710	82,710	0	0.00%
M6	0	1	1		97,610	97,610	0	0.00%
X6	3	0	3	201,665		205,255	3,590	1.78%
Z4	3	0	3	154,565		153,365	(1,200)	(0.78)%
TOTAL NEW AUTOS	54	20	74	3,262,045	1,071,795	4,393,865	60,025	1.39%
NEW LIGHT-DUTY TRUCKS - POOL #2								
X1	0	3	3		93,335	93,335	0	0.00%
X3	2	0	2	72,910		75,530	2,620	3.59%
X5	6	0	6	338,750		340,540	1,790	0.53%
TOTAL NEW L-D TRUCKS	8	3	11	411,660	93,335	509,405	4,410	0.87%
TOTAL BMW	62	23	85	3,673,705	1,165,130	4,903,270	64,435	1.33%
BUICK								
NEW AUTOS - POOL #1								
LA CROSSE	10	2	12	323,394	67,896	405,792	14,502	3.71%
REGAL	7	0	7	203,938		213,667	9,729	4.77%
VERANO	3	1	4	69,442	27,941	99,183	1,800	1.85%
TOTAL NEW AUTOS	20	3	23	596,774	95,837	718,642	26,031	3.76%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ENCLAVE	6	4	10	234,298	143,679	389,787	11,810	3.12%
ENCORE	0	8	8		205,652	205,652	0	0.00%
TOTAL NEW L-D TRUCKS	6	12	18	234,298	349,331	595,439	11,810	2.02%
TOTAL BUICK	26	15	41	831,072	445,168	1,314,081	37,841	2.97%
CADILLAC								
NEW AUTOS - POOL #1								
ATS	0	16	16		631,474	631,474	0	0.00%
CTS	23	0	23	1,019,692		1,021,180	1,488	0.15%
XTS	0	7	7		351,181	351,181	0	0.00%
TOTAL NEW AUTOS	23	23	46	1,019,692	982,655	2,003,835	1,488	0.07%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
ESCALADE	23	0	23	1,580,599		1,580,599	0	0.00%
SRX	7	0	7	285,144		298,270	13,126	4.60%
TOTAL NEW L-D TRUCKS	30	0	30	1,865,743		1,878,869	13,126	0.70%
TOTAL CADILLAC	53	23	76	2,885,435	982,655	3,882,704	14,614	0.38%
CHEVROLET								
NEW AUTOS - POOL #1								
CAMARO	11	1	12	350,635	57,163	412,865	5,067	1.24%
CAPRICE	1	0	1	29,750		30,477	727	2.44%
CORVETTE	6	1	7	372,750	69,092	442,252	410	0.09%
CRUZE	6	5	11	111,755	98,126	211,867	1,986	0.95%
IMPALA	6	0	6	154,818		156,059	1,241	0.80%
MALIBU	0	9	9		220,484	220,484	0	0.00%
SONIC	12	2	14	184,906	39,573	231,103	6,624	2.95%
SPARK	0	6	6		81,744	81,744	0	0.00%
VOLT	1	0	1	37,579		37,579	0	0.00%
TOTAL NEW AUTOS	43	24	67	1,242,193	566,182	1,824,430	16,055	0.89%
NEW LIGHT-DUTY TRUCKS - POOL #2								
BLACK DIAMOND AVALANCHE	6	0	6	238,931		230,430	(8,501)	(3.56)%
CAPTIVA SPORT	3	1	4	70,024	28,134	98,875	717	0.73%
COLORADO	16	0	16	374,801		377,102	2,301	0.61%
COLORADO CHASSIS CAB	2	0	2	40,929		41,083	154	0.38%
EQUINOX	8	0	8	204,917		212,877	7,960	3.88%
EXPRESS CARGO VAN	14	0	14	429,335		438,906	9,571	2.23%
EXPRESS CUTAWAY VAN	6	0	6	185,726		189,622	3,896	2.10%
EXPRESS PASSENGER VAN	7	0	7	231,462		235,661	4,199	1.81%
SILVERADO 1500	35	0	35	1,089,215		1,136,484	47,269	4.34%
SILVERADO 2500HD	28	0	28	958,181		978,161	19,980	2.09%
SILVERADO 3500HD	38	0	38	1,359,866		1,386,498	26,632	1.96%
SILVERADO 3500HD CHASSIS CAB	12	0	12	377,415		385,333	7,918	2.10%
SUBURBAN	13	0	13	568,187		594,219	26,032	4.58%
TAHOE	8	0	8	360,181		369,491	9,310	2.58%
TRAVERSE	8	0	8	266,838		275,760	8,922	3.34%
TOTAL NEW L-D TRUCKS	204	1	205	6,756,008	28,134	6,950,502	166,360	2.45%
TOTAL CHEVROLET	247	25	272	7,998,201	594,316	8,774,932	182,415	2.12%
CHRYSLER								
NEW AUTOS - POOL #1								
200	7	0	7	175,255		176,840	1,585	0.90%
300	12	1	13	437,731	30,870	462,741	(5,860)	(1.25)%
TOTAL NEW AUTOS	19	1	20	612,986	30,870	639,581	(4,275)	(0.66)%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
TOWN & COUNTRY	3	0	3	97,507		98,441	934	0.96%
TOTAL NEW L-D TRUCKS	3	0	3	97,507		98,441	934	0.96%
TOTAL CHRYSLER	22	1	23	710,493	30,870	738,022	(3,341)	(0.45)%
DODGE								
NEW AUTOS - POOL #1								
AVENGER	3	0	3	64,200		63,710	(490)	(0.76)%
CHALLENGER	3	0	3	95,505		95,278	(227)	(0.24)%
CHARGER	8	1	9	253,566	28,144	282,286	576	0.20%
DART	0	3	3		53,198	53,198	0	0.00%
VIPER	0	2	2		205,298	205,298	0	0.00%
TOTAL NEW AUTOS	14	6	20	413,271	286,640	699,770	(141)	(0.02)%
NEW LIGHT-DUTY TRUCKS - POOL #2								
DURANGO	8	0	8	271,740		272,572	832	0.31%
GRAND CARAVAN	4	0	4	102,220		100,780	(1,440)	(1.41)%
JOURNEY	8	0	8	204,668		201,600	(3,068)	(1.50)%
RAM CARGO VAN	1	0	1	21,770		21,773	3	0.01%
RAM CHASSIS CAB	0	0	0				0	N/A%
RAM PICKUP	79	2	81	2,937,378	52,853	3,058,562	68,331	2.29%
TOTAL NEW L-D TRUCKS	100	2	102	3,537,776	52,853	3,655,287	64,658	1.80%
TOTAL DODGE	114	8	122	3,951,047	339,493	4,355,057	64,517	1.50%
FIAT								
NEW AUTOS - POOL #1								
500	4	1	5	71,585	18,820	90,380	(25)	(0.03)%
500C	2	0	2	40,340		40,680	340	0.84%
TOTAL NEW AUTOS	6	1	7	111,925	18,820	131,060	315	0.24%
TOTAL FIAT	6	1	7	111,925	18,820	131,060	315	0.24%
FORD								
NEW AUTOS - POOL #1								
FIESTA	4	2	6	55,702	34,073	90,669	894	1.00%
FOCUS	6	1	7	127,019	22,100	153,000	3,881	2.60%
FUSION	0	8	8		227,265	227,265	0	0.00%
MUSTANG	11	0	11	356,195		371,998	15,803	4.44%
POLICE INTERCEPTOR	0	2	2		51,264	51,264	0	0.00%
TAURUS	6	0	6	172,618		178,691	6,073	3.52%
TOTAL NEW AUTOS	27	13	40	711,534	334,702	1,072,887	26,651	2.55%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
C-MAX	0	3	3		80,676	80,676	0	0.00%
CUTAWAY	5	3	8	125,331	67,642	195,056	2,083	1.08%
E-SERIES	17	0	17	483,864		498,607	14,743	3.05%
EDGE	8	0	8	251,591		251,620	29	0.01%
ESCAPE	0	7	7		182,010	182,010	0	0.00%
EXPEDITION	8	0	8	323,804		334,290	10,486	3.24%
EXPEDITION EL	8	0	8	344,802		355,799	10,997	3.19%
EXPLORER	6	1	7	189,744	38,027	230,500	2,729	1.20%
F150 PICKUP	51	2	53	1,664,581	93,032	1,808,097	50,484	2.87%
F250 SUPER DUTY PICKUP	32	2	34	1,144,092	97,886	1,268,468	26,490	2.13%
F350 SUPER DUTY CHASSIS CAB	36	0	36	1,213,026		1,236,198	23,172	1.91%
F350 SUPER DUTY PICKUP	50	4	54	1,843,061	198,550	2,078,045	36,434	1.78%
F450 SUPER DUTY PICKUP	4	1	5	207,920	61,697	275,270	5,653	2.10%
FLEX	6	0	6	195,804		208,865	13,061	6.67%
POLICE INTERCEPTOR	0	2	2		54,932	54,932	0	0.00%
TRANSIT CONNECT	8	0	8	171,567		174,540	2,973	1.73%
TOTAL NEW L-D TRUCKS	239	25	264	8,159,187	874,452	9,232,973	199,334	2.21%
TOTAL FORD	266	38	304	8,870,721	1,209,154	10,305,860	225,985	2.24%
GMC TRUCKS								
NEW LIGHT-DUTY TRUCKS - POOL #2								
ACADIA	10	0	10	370,748		383,640	12,892	3.48%
SAVANA CARGO VAN	14	0	14	429,335		438,906	9,571	2.23%
SAVANA CUTAWAY VAN	6	0	6	185,726		189,622	3,896	2.10%
SAVANA PASSENGER VAN	7	0	7	231,462		235,661	4,199	1.81%
SIERRA 1500 SERIES PICKUP	37	0	37	1,185,828		1,235,546	49,718	4.19%
SIERRA 2500HD SERIES PICKUP	30	0	30	1,053,184		1,074,899	21,715	2.06%
SIERRA 3500HD CHASSIS CAB	12	0	12	379,693		387,774	8,081	2.13%
SIERRA 3500HD SERIES PICKUP	42	0	42	1,547,016		1,576,978	29,962	1.94%
TERRAIN	8	2	10	219,395	68,020	294,662	7,247	2.52%
YUKON	20	0	20	949,743		975,959	26,216	2.76%
TOTAL NEW L-D TRUCKS	186	2	188	6,552,130	68,020	6,793,647	173,497	2.62%
TOTAL GMC TRUCKS	186	2	188	6,552,130	68,020	6,793,647	173,497	2.62%
HONDA								
NEW AUTOS - POOL #1								
ACCORD	0	21	21		528,130	528,130	0	0.00%
CIVIC	25	0	25	506,657		517,977	11,320	2.23%
CR-Z	6	0	6	121,773		125,246	3,473	2.85%
FIT	5	0	5	82,324		84,306	1,982	2.41%
INSIGHT	4	0	4	79,104		80,793	1,689	2.14%
TOTAL NEW AUTOS	40	21	61	789,858	528,130	1,336,452	18,464	1.40%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
CR-V	0	0	0				0	N/A%
CROSSTOUR	8	0	8	236,750		240,766	4,016	1.70%
ODYSSEY	7	0	7	228,946		233,413	4,467	1.95%
PILOT	12	0	12	382,450		392,045	9,595	2.51%
RIDGELINE	5	0	5	147,858		150,151	2,293	1.55%
TOTAL NEW L-D TRUCKS	32	0	32	996,004		1,016,375	20,371	2.05%
TOTAL HONDA	72	21	93	1,785,862	528,130	2,352,827	38,835	1.68%
HYUNDAI								
NEW AUTOS - POOL #1								
ACCENT	6	0	6	88,125		91,420	3,295	3.74%
AZERA	0	1	1		30,096	30,096	0	0.00%
ELANTRA	6	6	12	102,452	110,024	217,262	4,786	2.25%
EQUUS	2	0	2	116,316		117,246	930	0.80%
GENESIS	11	0	11	307,477		325,269	17,792	5.79%
SONATA	7	0	7	166,756		165,657	(1,099)	(0.66)%
VELOSTER	4	4	8	69,172	85,472	155,214	570	0.37%
TOTAL NEW AUTOS	36	11	47	850,298	225,592	1,102,164	26,274	2.44%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SANTA FE	0	6	6		157,146	157,146	0	0.00%
TUCSON	8	0	8	179,415		182,477	3,062	1.71%
VERACRUZ	0	0	0				0	N/A%
TOTAL NEW L-D TRUCKS	8	6	14	179,415	157,146		3,062	0.91%
TOTAL HYUNDAI	44	17	61	1,029,713	382,738	1,441,787	29,336	2.08%
INFINITI								
NEW AUTOS - POOL #1								
G	2	0	2	93,129		96,362	3,233	3.47%
G25	3	0	3	94,154		95,630	1,476	1.57%
G37	12	0	12	464,968		477,490	12,522	2.69%
M	5	0	5	251,808		257,948	6,140	2.44%
TOTAL NEW AUTOS	22	0	22	904,059		927,430	23,371	2.59%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EX35	4	0	4	138,779		139,517	738	0.53%
FX35	3	0	3	129,534		130,411	877	0.68%
FX50	1	0	1	54,924		56,819	1,895	3.45%
JX	0	2	2		77,518	77,518	0	0.00%
QX56	2	0	2	112,437		115,115	2,678	2.38%
TOTAL NEW L-D TRUCKS	10	2	12	435,674	77,518	519,380	6,188	1.21%
TOTAL INFINITI	32	2	34	1,339,733	77,518	1,446,810	29,559	2.09%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/31/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
JEEP								
NEW LIGHT-DUTY TRUCKS - POOL #2								
COMPASS	6	0	6	131,693		132,305	612	0.46%
GRAND CHEROKEE	7	0	7	256,528		263,295	6,767	2.64%
PATRIOT	6	0	6	121,351		121,871	520	0.43%
WRANGLER	7	0	7	189,987		191,973	1,986	1.05%
TOTAL NEW L-D TRUCKS	26	0	26	699,559		709,444	9,885	1.41%
TOTAL JEEP	26	0	26	699,559		709,444	9,885	1.41%
KIA								
NEW AUTOS - POOL #1								
FORTE	10	0	10	171,730		173,650	1,920	1.12%
OPTIMA	3	0	3	66,500		67,250	750	1.13%
RIO	8	1	9	119,520	17,070	138,140	1,550	1.13%
TOTAL NEW AUTOS	21	1	22	357,750	17,070	379,040	4,220	1.13%
NEW LIGHT-DUTY TRUCKS - POOL #2								
SORENTO	10	1	11	265,960	22,370	288,960	630	0.22%
SOUL	5	0	5	79,650		81,675	2,025	2.54%
SPORTAGE	7	0	7	157,655		158,930	1,275	0.81%
TOTAL NEW L-D TRUCKS	22	1	23	503,265	22,370	529,565	3,930	0.75%
TOTAL KIA	43	2	45	861,015	39,440	908,605	8,150	0.91%
LEXUS								
NEW AUTOS - POOL #1								
CT	2	0	2	56,084		57,861	1,777	3.17%
ES	0	2	2		70,208	70,208	0	0.00%
GS	0	3	3		144,434	144,434	0	0.00%
IS	7	0	7	249,378		259,272	9,894	3.97%
IS F	1	0	1	55,170		57,288	2,118	3.84%
LFA	0	0	0				0	N/A%
LS	5	0	5	352,860		386,166	33,306	9.44%
TOTAL NEW AUTOS	15	5	20	713,492	214,642	975,229	47,095	5.07%
NEW LIGHT-DUTY TRUCKS - POOL #2								
GX	2	0	2	99,042		102,748	3,706	3.74%
LX	0	1	1		74,731	74,731	0	0.00%
RX	4	1	5	155,768	43,945	206,388	6,675	3.34%
TOTAL NEW L-D TRUCKS	6	2	8	254,810	118,676	383,867	10,381	2.78%
TOTAL LEXUS	21	7	28	968,302	333,318	1,359,096	57,476	4.42%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/31/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
LINCOLN								
NEW AUTOS - POOL #1								
MKS	3	0	3	125,271		129,170	3,899	3.11%
MKZ	0	3	3		103,086	103,086	0	0.00%
TOTAL NEW AUTOS	3	3	6	125,271	103,086	232,256	3,899	1.71%
NEW LIGHT-DUTY TRUCKS - POOL #2								
MKT	2	0	2	85,203		87,012	1,809	2.12%
MKX	2	0	2	76,088		76,083	(5)	(0.01)%
NAVIGATOR	4	0	4	226,624		226,756	132	0.06%
TOTAL NEW L-D TRUCKS	8	0	8	387,915		389,851	1,936	0.50%
TOTAL LINCOLN	11	3	14	513,186	103,086	622,107	5,835	0.95%
MAZDA								
NEW AUTOS - POOL #1								
MAZDA2	4	0	4	61,310		62,699	1,389	2.27%
MAZDA3	14	3	17	271,451	61,141	355,024	22,432	6.74%
MAZDA6	6	0	6	134,487		140,452	5,965	4.44%
MIATA MX-5	8	4	12	207,756	105,432	320,944	7,756	2.48%
TOTAL NEW AUTOS	32	7	39	675,004	166,573	879,119	37,542	4.46%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CX-5	0	7	7		167,660	167,660	0	0.00%
CX-9	6	0	6	178,135		187,681	9,546	5.36%
MAZDA5	4	0	4	79,650		83,610	3,960	4.97%
TOTAL NEW L-D TRUCKS	10	7	17	257,785	167,660	438,951	13,506	3.17%
TOTAL MAZDA	42	14	56	932,789	334,233	1,318,070	51,048	4.03%
MERCEDES								
NEW AUTOS - POOL #1								
C CLASS	9	1	10	365,407	42,536	413,420	5,477	1.34%
CL CLASS	4	0	4	590,829		598,874	8,045	1.36%
CLS CLASS	3	0	3	224,600		226,932	2,332	1.04%
E CLASS	12	1	13	690,891	52,394	750,736	7,451	1.00%
S CLASS	7	0	7	828,234		831,805	3,571	0.43%
SL CLASS	0	2	2		233,709	233,709	0	0.00%
SLK CLASS	3	0	3	153,264		154,680	1,416	0.92%
SLS CLASS	1	1	2	176,328	191,580	377,115	9,207	2.50%
TOTAL NEW AUTOS	39	5	44	3,029,553	520,219	3,587,271	37,499	1.06%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
G CLASS	1	1	2	99,603	125,399	230,989	5,987	2.66%
GL CLASS	3	0	3	196,879		199,776	2,897	1.47%
GLK CLASS	2	0	2	69,996		71,848	1,852	2.65%
M CLASS	2	3	5	93,917	189,518	283,985	550	0.19%
SPRINTER	10	0	10	383,088		387,236	4,148	1.08%
TOTAL NEW L-D TRUCKS	18	4	22	843,483	314,917	1,173,834	15,434	1.33%
TOTAL MERCEDES	57	9	66	3,873,036	835,136	4,761,105	52,933	1.12%
MINI								
NEW AUTOS - POOL #1								
COOPER	12	3	15	283,590	80,820	367,065	2,655	0.73%
TOTAL NEW AUTOS	12	3	15	283,590	80,820	367,065	2,655	0.73%
TOTAL MINI	12	3	15	283,590	80,820	367,065	2,655	0.73%
MITSUBISHI								
NEW AUTOS - POOL #1								
I-MIEV	0	0	0				0	N/A%
LANCER	11	0	11	240,781		242,372	1,591	0.66%
TOTAL NEW AUTOS	11	0	11	240,781		242,372	1,591	0.66%
NEW LIGHT-DUTY TRUCKS - POOL #2								
OUTLANDER	5	0	5	119,077		121,998	2,921	2.45%
OUTLANDER SPORT	4	3	7	80,337	67,200	149,120	1,583	1.07%
TOTAL NEW L-D TRUCKS	9	3	12	199,414	67,200	271,118	4,504	1.69%
TOTAL MITSUBISHI	20	3	23	440,195	67,200	513,490	6,095	1.20%
NISSAN								
NEW AUTOS - POOL #1								
370Z	8	0	8	282,388		296,110	13,722	4.86%
ALTIMA	6	5	11	140,279	123,747	266,131	2,105	0.80%
GT-R	2	0	2	174,140		191,153	17,013	9.77%
LEAF	0	0	0				0	N/A%
MAXIMA	2	0	2	60,814		62,149	1,335	2.20%
SENTRA	0	7	7		119,019	119,019	0	0.00%
VERSA	6	1	7	80,895	13,212	97,058	2,951	3.14%
TOTAL NEW AUTOS	24	13	37	738,516	255,978	1,031,620	37,126	3.73%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
NEW LIGHT-DUTY TRUCKS - POOL #2								
ARMADA	6	0	6	255,007		265,118	10,111	3.96%
CUBE	3	0	3	49,565		51,297	1,732	3.49%
FRONTIER PICKUP	26	0	26	630,135		642,804	12,669	2.01%
JUKE	8	0	8	170,780		175,362	4,582	2.68%
MURANO	8	0	8	257,981		264,755	6,774	2.63%
NV	14	0	14	376,680		384,344	7,664	2.03%
PATHFINDER	0	8	8		249,140	249,140	0	0.00%
QUEST	4	0	4	124,098		121,535	(2,563)	(2.07)%
ROGUE	6	0	6	134,216		138,464	4,248	3.17%
TITAN	14	0	14	425,165		444,457	19,292	4.54%
XTERRA	7	0	7	183,995		187,817	3,822	2.08%
TOTAL NEW L-D TRUCKS	96	8	104	2,607,622	249,140	2,925,093	68,331	2.39%
TOTAL NISSAN	120	21	141	3,346,138	505,118	3,956,713	105,457	2.74%
PORSCHE								
NEW AUTOS - POOL #1								
911	8	6	14	1,012,776	555,862	1,568,638	0	0.00%
BOXSTER	0	2	2		99,000	99,000	0	0.00%
CAYMAN	0	0	0				0	N/A%
PANAMERA	7	3	10	669,600	247,950	925,386	7,836	0.85%
TOTAL NEW AUTOS	15	11	26	1,682,376	902,812	2,593,024	7,836	0.30%
NEW LIGHT-DUTY TRUCKS - POOL #2								
CAYENNE	5	2	7	305,400	123,662	433,252	4,190	0.98%
TOTAL NEW L-D TRUCKS	5	2	7	305,400	123,662	433,252	4,190	0.98%
TOTAL PORSCHE	20	13	33	1,987,776	1,026,474	3,026,276	12,026	0.40%
SCION								
NEW AUTOS - POOL #1								
FR-S	0	2	2		47,595	47,595	0	0.00%
IQ	1	0	1	14,503		14,720	217	1.50%
TC	4	0	4	76,916		78,976	2,060	2.68%
XB	2	0	2	31,873		31,872	(1)	(0.00)%
XD	2	0	2	29,914		30,674	760	2.54%
TOTAL NEW AUTOS	9	2	11	153,206	47,595	203,837	3,036	1.51%
TOTAL SCION	9	2	11	153,206	47,595	203,837	3,036	1.51%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
SMART								
NEW AUTOS - POOL #1								
FORTWO	3	0	3	41,730		42,102	372	0.89%
TOTAL NEW AUTOS	3	0	3	41,730		42,102	372	0.89%
TOTAL SMART	3	0	3	41,730		42,102	372	0.89%
SUBARU								
NEW AUTOS - POOL #1								
BRZ	0	4	4		102,896	102,896	0	0.00%
IMPREZA	22	0	22	508,050		512,394	4,344	0.86%
LEGACY	9	0	9	200,169		202,373	2,204	1.10%
TOTAL NEW AUTOS	31	4	35	708,219	102,896	817,663	6,548	0.81%
NEW LIGHT-DUTY TRUCKS - POOL #2								
FORESTER	8	0	8	190,223		193,221	2,998	1.58%
OUTBACK	12	0	12	296,408		299,161	2,753	0.93%
TRIBECA	1	0	1	30,657		30,657	0	0.00%
XV CROSSTREK	0	3	3		65,847	65,847	0	0.00%
TOTAL NEW L-D TRUCKS	21	3	24	517,288	65,847	588,886	5,751	0.99%
TOTAL SUBARU	52	7	59	1,225,507	168,743	1,406,549	12,299	0.88%
SUZUKI								
NEW AUTOS - POOL #1								
KIZASHI	6	0	6	136,170		141,114	4,944	3.63%
SX4	6	2	8	100,769	38,206	140,942	1,967	1.42%
TOTAL NEW AUTOS	12	2	14	236,939	38,206	282,056	6,911	2.51%
NEW LIGHT-DUTY TRUCKS - POOL #2								
EQUATOR	0	0	0				0	N/A%
GRAND VITARA	3	2	5	65,757	44,302	111,835	1,776	1.61%
TOTAL NEW L-D TRUCKS	3	2	5	65,757	44,302	111,835	1,776	1.61%
TOTAL SUZUKI	15	4	19	302,696	82,508	393,891	8,687	2.26%

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
TOYOTA								
NEW AUTOS - POOL #1								
AVALON	2	5	7	62,668	164,611	228,189	910	0.40%
CAMRY	8	0	8	184,545		187,045	2,500	1.35%
COROLLA	5	0	5	81,953		82,840	887	1.08%
MATRIX	5	0	5	93,793		97,002	3,209	3.42%
PRIUS	8	7	15	195,961	172,884	374,602	5,757	1.56%
YARIS	7	0	7	105,038		106,564	1,526	1.45%
TOTAL NEW AUTOS	35	12	47	723,958	337,495	1,076,242	14,789	1.39%
NEW LIGHT-DUTY TRUCKS - POOL #2								
4RUNNER	5	0	5	165,510		167,476	1,966	1.19%
FJ CRUISER	3	0	3	75,089		77,989	2,900	3.86%
HIGHLANDER	10	3	13	314,840	86,894	413,676	11,942	2.97%
LAND CRUISER	0	1	1		70,307	70,307	0	0.00%
RAV4	0	0	0				0	N/A%
SEQUOIA	9	0	9	430,318		438,684	8,366	1.94%
SIENNA	10	2	12	319,478	60,274	384,088	4,336	1.14%
TACOMA PICKUP	20	0	20	432,568		443,437	10,869	2.51%
TUNDRA	28	3	31	842,321	130,549	980,686	7,816	0.80%
VENZA	10	0	10	288,102		297,952	9,850	3.42%
TOTAL NEW L-D TRUCKS	95	9	104	2,868,226	348,024	3,274,295	58,045	1.80%
TOTAL TOYOTA	130	21	151	3,592,184	685,519	4,350,537	72,834	1.70%
VOLKSWAGEN								
NEW AUTOS - POOL #1								
BEETLE	24	6	30	565,512	145,986	715,338	3,840	0.54%
CC	2	9	11	77,468	286,531	365,973	1,974	0.54%
EOS	3	1	4	106,047	35,040	144,956	3,869	2.74%
GOLF	25	0	25	613,281		618,980	5,699	0.93%
GTI	32	0	32	848,402		857,946	9,544	1.12%
JETTA	42	4	46	896,346	90,028	1,003,810	17,436	1.77%
JETTA GLI	12	0	12	296,196		307,160	10,964	3.70%
PASSAT	23	0	23	586,922		595,386	8,464	1.44%
TOTAL NEW AUTOS	163	20	183	3,990,174	557,585	4,609,549	61,790	1.36%
NEW LIGHT-DUTY TRUCKS - POOL #2								
ROUTAN	0	0	0				0	N/A%
TIGUAN	11	0	11	306,668		312,393	5,725	1.87%
TOUAREG	9	0	9	435,723		440,997	5,274	1.21%
TOTAL NEW L-D TRUCKS	20	0	20	742,391		753,390	10,999	1.48%
TOTAL VOLKSWAGEN	183	20	203	4,732,565	557,585	5,362,939	72,789	1.38%

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JANUARY 10, 2013

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

BODY STYLE	CONT. ITEMS	NEW ITEMS	TOTAL ITEMS	12/01/11 PRICE	NEW ITEMS	ENDING PRICE	DOLLAR CHANGE	PERCENT CHANGE
VOLVO								
NEW AUTOS - POOL #1								
30 SERIES	6	2	8	159,800	53,157	218,080	5,123	2.41%
70 SERIES	10	0	10	372,898		382,439	9,541	2.56%
S60	3	6	9	105,938	225,976	335,537	3,623	1.09%
S80	6	0	6	234,154		241,486	7,332	3.13%
TOTAL NEW AUTOS	25	8	33	872,790	279,133	1,177,542	25,619	2.22%
NEW LIGHT-DUTY TRUCKS - POOL #2								
XC60	10	0	10	384,225		395,975	11,750	3.06%
XC90	6	0	6	232,556		242,332	9,776	4.20%
TOTAL NEW L-D TRUCKS	16	0	16	616,781		638,307	21,526	3.49%
TOTAL VOLVO	41	8	49	1,489,571	279,133	1,815,849	47,145	2.67%

De Filipps' LIFO LOOKOUT
First-class postage paid at Mt. Prospect, IL

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