26 CFR 601.204: *Changes in accounting periods and in methods of accounting.*

(Also Part I, §§ 446, 472; 1.446–1, 1.472–1.)

Rev. Proc. 97–36

SECTION 1. PURPOSE

This revenue procedure provides an alternative last-in, first-out (LIFO) inventory computation method (the "Alternative LIFO Method") for a taxpayer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks ("automobile dealer"). A taxpayer may change to or adopt the Alternative LIFO Method. The procedures for a taxpayer to change to the Alternative LIFO Method are provided in Rev. Proc. 97–37, page 18, which provides simplified and uniform procedures to obtain automatic consent to make this and other changes in methods of accounting. This revenue procedure modifies and supersedes Rev. Proc. 92–79, 1992–2 C.B. 457.

.02 The Alternative LIFO Method described in this revenue procedure is the same method of accounting that was described in Rev. Proc. 92–79. Accordingly, a taxpayer that properly changed to or adopted this method pursuant to Rev. Proc. 92-79 is not required to change its method of accounting to comply with this revenue procedure.

SECTION 2. BACKGROUND

.01 *In general.* Section 472(a) of the Internal Revenue Code provides that a taxpayer may use the LIFO inventory method of inventorying goods if, among other requirements, the change to, and use of, the method is in accordance with such regulations as the Secretary may prescribe as necessary in order that the use of the method may clearly reflect income.

.02 *Dollar-value LIFO method.* Section 1.472–8(a) of the Income Tax Regulations provides that any taxpayer may elect to determine the cost of its LIFO inventories under the dollar-value LIFO method of accounting, provided such method is used consistently and clearly reflects income in accordance with the rules of that section.

.03 *Link-chain method.* Section 1.472–8(e)(1) permits the use of a "link-chain" method of computing the LIFO value of a dollar-value pool if the "double-extension" method and an "index" method would be impractical or unsuitable in view of the nature of the inventory in the dollar-value pool. Further, in applying a link-chain method, an index may be computed by "double extending" a representative portion of the inventory in a dollar-value, link-chain pool at both the current-year cost and the prior-year cost. Additionally, an index may be computed under a link-chain method using other sound and consistent statistical methods.

.04 *Acceptable methods.* Under existing LIFO inventory provisions, there are three general dollar-value LIFO methods:

(1) *Simplified dollar-value LIFO method.*

(a) Section 474 provides an elective simplified dollar-value LIFO method for eligible small businesses. In general, a taxpayer is an eligible small business for any taxable year if its average annual gross receipts for the three preceding years do not exceed $5,000,000.

(b) The simplified dollar-value LIFO method under § 474 is based on a so-called link-chain method of computing the LIFO value of an inventory pool. Under § 474, inventory pools are established by the major categories in the applicable Government price index, and an annual index for each pool is obtained from that Government price index. Therefore, under § 474, an eligible automobile dealer uses a single inventory pool for new automobiles and new trucks under the major category, transportation equipment, in the Producer Price Index ("PPI") published by the Bureau of Labor Statistics ("BLS").

(c) Under this link-chain method, two price indexes are computed for each pool, an annual index and a cumulative index. The annual index represents the change in price level of goods in the ending inventory of the pool for the current year from the price level of comparable goods for the prior year. Under § 474, the annual index for computing the LIFO value of an automobile dealer's single inventory pool is obtained using the price change from the preceding taxable year for the major index category, transportation equipment, from the PPI.

(d) The cumulative index represents the price level change from the beginning of the base year to the end of the current year and is the product of each of the annual indexes. The cumulative index is used to convert the total current-year cost in an inventory pool at the close of the taxable year to base-year dollars by dividing the total current-year cost by the cumulative index, and also to determine the value of any incremental increase in the pool to be added to the ending inventory of the preceding year by multiplying that increment by the cumulative index.

(2) *Inventory price index computation method.*

(a) Section 1.472-8(e)(3) provides another simplified dollar-value LIFO method, the inventory price index computation (IPIC) method, which is available to all taxpayers. An automobile dealer using the IPIC method must use that method in determining the value of all goods for which the automobile dealer has elected to use the LIFO method. Under the IPIC method, special inventory pooling rules permit an automobile dealer to establish a single inventory pool for new automobiles and new trucks under the major category of the applicable Government price index published by the BLS. *See* § 1.472–8(e)(3)(iv) and Rev. Proc. 84–57, 1984–2 C.B. 496.

(b) The IPIC method under § 1.472–8(e)(3) is also based on a link-chain method of computing the LIFO value of an inventory pool. The annual index for the pool is generally computed using a stated percentage of the percent change in the applicable detailed index(es) for the major category of the applicable Government price index. The stated percentage is 80 percent unless a taxpayer qualifies as an eligible small business under § 474, in which case the stated percent is 100 percent.

(3) *General dollar-value LIFO method.*

(a) If an automobile dealer does not want to use either the simplified dollar-value LIFO method for certain small businesses provided in § 474 of the Code (if the taxpayer is eligible) or the IPIC method provided in § 1.472–8(e)(3), the automobile dealer may use the general dollar-value LIFO inventory rules contained in § 1.472–8. Under these general rules, an automobile dealer establishes inventory pools for each separate trade or business under § 1.472–8(c) by major lines, types, or classes of goods (for example, one separate pool for all new automobiles and another separate pool for all new trucks). *See Fox Chevrolet, Inc. Maryland v. Commissioner,* 76 T.C. 708 (1981), *acq.*, 1984–2 C.B. 1, and *Richardson Investments, Inc., and Subsidiaries v. Commissioner,* 76 T.C. 736 (1981).

(b) An automobile dealer may use the double-extension method, an index method, or a link-chain method, to compute the LIFO value of its inventory pools. Under all three of these methods, automobile dealers use their own cost data to compute the index for each pool. Because of the nature of the items in their pools, automobile dealers generally use a link-chain method. The annual index for each pool under the link-chain method is computed by "double extending" (that is, pricing) the vehicles (or "items") in each inventory pool as of the close of the taxable year at the automobile dealer's own current year cost and at the automobile dealer's own prior-year cost. For each pool, the total current-year cost of the vehicles in ending inventory is divided by the total prior-year cost of the vehicles in ending inventory to compute the annual index for the current year. The vehicles used to determine the dealer's own prior-year cost of vehicles in the current year's ending inventory must be comparable to the vehicles used to compute the current-year cost of vehicles in the current year's ending inventory. For purposes of this revenue procedure, this is referred to as the § 1.472-8 "comparability requirement."

.05 *New alternative method.* In addition to the three general dollar-value LIFO methods briefly described in section 2.04 of this revenue procedure, this revenue procedure provides an additional dollar-value LIFO method for automobile dealers, the Alternative LIFO Method. This method is described in section 4 of this revenue procedure.

SECTION 3. SCOPE

The Alternative LIFO Method is available to any automobile dealer engaged in the business of retail sales of new automobiles or new light-duty trucks for its LIFO inventories of new automobiles and new light-duty trucks. Light-duty trucks are trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2, or 3 trucks.

SECTION 4. ALTERNATIVE LIFO METHOD

.01 *In general.*

(1) The Alternative LIFO Method is a comprehensive dollar-value, link-chain LIFO method of accounting that encompasses several LIFO sub-methods and may only be used by an automobile dealer engaged in the trade or business of retail sales of new automobiles or new light-duty trucks to value its inventory of new automobiles and new light-duty trucks.

(2) The Alternative LIFO Method is designed to simplify the dollar-value computations of automobile dealers. Under the authority of § 1.446–1(c)(2)(ii), the Commissioner will waive strict adherence of the § 1.472–8 comparability requirement in applying the Alternative LIFO Method, provided a taxpayer uses the compensating sub-methods described in section 4.02 of this revenue procedure, which, in the opinion of the Commissioner, are necessary to ensure that the Alternative LIFO Method clearly reflects income. These sub-methods include requirements that (1) the current-year cost of a new item be used as the prior year cost for the new item, and (2) the automobile dealer use the manufacturer's base model codes to define items for purposes of § 1.472–8. Generally, the manufacturer's base model codes used in defining items and identifying new items under the Alternative LIFO Method have an average life of approximately five to seven years.

(3) The Alternative LIFO Method includes, by definition, all its sub-methods. Individual sub-methods used alone, or in combination with some but not all of the sub-methods of the Alternative LIFO Method, may not clearly reflect income. Therefore, use of the Alternative LIFO Method is conditioned upon an automobile dealer computing its LIFO inventory using all the sub-methods, definitions, and special rules provided in section 4.02 of this revenue procedure, and the computational methodology provided in section 4.03 of this revenue procedure.

(4) The Alternative LIFO Method will be accepted by the Commissioner as an appropriate method of computing an inventory index, and the use of the Alternative LIFO Method to compute the value of the inventory pool or pools will be accepted as accurate, reliable, and suitable. The automobile dealer's computations under the Alternative LIFO Method are, however, subject to verification by the district director upon examination of the automobile dealer's return.

.02 *Sub-methods, definitions, and special rules.*

(1) *LIFO pools.* For each separate trade or business, (a) all new automobiles (regardless of manufacturer), including those used as demonstrators, must be included in one dollar-value LIFO pool, and (b) all new light-duty trucks (regardless of manufacturer), including those used as demonstrators, must be included in another separate dollar-value LIFO pool.

(2) *Specific identification increment method*. The current-year cost of the items making up a pool must be determined by reference to the actual cost of the specific new automobiles or new light-duty trucks in ending inventory. Therefore, the actual cost of the specific vehicles on hand at year end will be the current-year cost of such vehicles.

(3) *Item of inventory.* An item of inventory ("item category") must be determined using the entire manufacturer's base model code number that represents the most detailed description of the base vehicle's characteristics, such as model line, body style, trim level, etc. The manufacturer's base model code numbers are almost always used as part of the vehicle identification on each dealer invoice (for example, a domestic model, trim level, 4-door sedan has a specific model code; a foreign model, 4-door sedan, trim level,

5-speed has a specific model code). In the case of conversion vans, an item of inventory must be determined using both (a) the entire manufacturer's base model code, as described in the preceding sentence, and (b) the most detailed conversion package designation.

(4) *Cost of the vehicle used for purposes of computing the pool index.* The actual base vehicle cost of each of the specific vehicles in ending inventory is used to compute the index under the Alternative LIFO Method. The base vehicle cost of each vehicle is not adjusted for any options, accessories, or other costs. The pool index computed from only the base vehicle cost of vehicles is applied to the total vehicle cost, including options, accessories, and other costs, of all vehicles in the pool at the end of the taxable year.

(5) *Definition of a new item.* A new item category, which is an item category not considered in existence in the prior taxable year, is one of the following: (a) any new or reassigned manufacturer's model code, as described in section 4.02(3) of this revenue procedure, that is caused by a change in an existing vehicle, or (b) a manufacturer's model code, as described in section 4.02(3) of this revenue procedure, created or reassigned because the classified vehicle did not previously exist. Additionally, if there is no change in a manufacturer's model code, but there has been a change to the platform (i.e., the piece of metal at the bottom of the chassis that determines the length and width of the vehicle and the structural set-up of the vehicle) that results in a change in track width or wheel-base, whether or not the same model name was previously used by the manufacturer, a new item category is created.

(6) *Treatment of a new item not in existence in the prior year.* The automobile dealer must use the current-year base vehicle cost of the new item category as the prior-year base vehicle cost of that item category.

(7) *Item in existence in the prior year, but not stocked.* If an item in ending inventory was not stocked by the automobile dealer at the end of the prior year, but was in existence in the prior year, the automobile dealer must determine the prior-year base vehicle cost for that item by reconstructing what the base vehicle cost for the item category would have been using a manufacturer's price list that provides dealer purchase prices. For each such item category, the manufacturer's price list that must be used by the automobile dealer is the list in effect as of the beginning of the last month of the prior taxable year.

.03 *Computational methodology.*

The following rules are applied to compute the LIFO value for each pool of an automobile dealer's ending inventory under the Alternative LIFO Method:

STEP 1. Obtain the actual invoice for each vehicle in the automobile dealer's ending inventory.

STEP 2. For each pool, group all the invoices from Step l by item category, as defined in section 4.02(3) of this revenue procedure.

STEP 3. For each item category, add together the dealer's base vehicle costs of all vehicles within each item category, from Step 2.

STEP 4. Within each pool, compute an average base vehicle cost for each item category by dividing the result from Step 3 for each item category by the number of vehicles in the item category. This average base vehicle cost for each item will be used in Step 6 of the succeeding year's computations using the Alternative LIFO Method.

STEP 5. For each pool, compute the total current-year base vehicle cost of the pool by adding together the separate item category totals from Step 3.

STEP 6. For each pool, compute the total base vehicle cost of the ending inventory at prior-year's base vehicle cost. First, multiply the number of vehicles in the current year's ending inventory for each item category by the average base vehicle cost of the same item category from Step 4 of the preceding year's inventory calculation. If the same item was not in the prior year's ending inventory, see sections 4.02(6) and 4.02(7) of this revenue procedure. Then, add together the total prior-year base vehicle cost of all of the item categories.

STEP 7. For each pool, compute the current-year (annual) index by dividing the amount from Step 5 by the amount from Step 6.

STEP 8. For each pool, compute the cumulative index by multiplying the current-year index from Step 7 by the cumulative index at the end of the preceding year (from Step 8 of the preceding year's computation).

STEP 9. For each pool, compute the total current-year total- vehicle cost by adding together the total invoice cost, including installed options, accessories, and other inventoriable cost(s), of all the vehicles in inventory at the end of the current year.

STEP 10. For each pool, compute the total cost of the current-year's ending inventory at base-year cost by dividing the total current-year total-vehicle cost of all the vehicles in ending inventory, from Step 9, by the cumulative index from Step 8.

STEP 11. For each pool, determine if there is an increment for the current year by comparing the total cost of the pool's current-year ending inventory at base-year cost, from Step 10, with the total cost of the pool's preceding year's ending inventory at base-year cost, using the amount from Step 10 of the preceding year's calculation. If the amount from Step 10 of the current year's calculation is greater, there is an increment.

STEP 12. For each pool, value the current year's increment at current-year cost by multiplying the increment amount from Step 11 by the cumulative index from Step 8.

STEP 13. If there is no increment for a pool, but, rather, a liquidation (also referred to as a decrement), reduce the LIFO layers in reverse chronological order until the liquidation is fully absorbed.

STEP 14. For each pool, add together the current year's increment, if any, at current-year cost and the prior years' increments at each prior year's current-year cost to compute the total LIFO value for the pool.

SECTION 5. CHANGING TO ALTERNATIVE LIFO METHOD

.01 *Automatic change.* Except as provided in section 5.02 of this revenue procedure, an automobile dealer wanting to change to the Alternative LIFO Method must follow the provisions in Rev. Proc. 97–37.

.02 *Nonautomatic change.* An automobile dealer that uses the IPIC method for goods other than new automobiles, new light-duty trucks, parts and accessories, used automobiles, and used trucks, must change to the Alternative LIFO Method under Rev. Proc. 97–27, 1997–21 I.R.B. 10.

.03 *Conditions.* An automobile dealer changing to the Alternative LIFO Method must comply with the following conditions:

(1) the automobile dealer must keep its books and records for the year of change and for later taxable years on the LIFO inventory method and use the LIFO inventory method for all reports, including consolidated financial statements, if any, and statements for credit purposes, in conformity with the provisions of § 1.472–2(e) of the regulations;

(2) the automobile dealer must value its inventory of new automobiles and new light-duty trucks as of the end of the year of change and for later taxable years under the Alternative LIFO Method, as provided in section 4 of this revenue procedure, unless it obtains permission to change to another recognized method;

(3) the automobile dealer changing from the IPIC method for its inventory of parts and accessories, used automobiles, and used trucks must value its inventory of parts and accessories, used automobiles and used trucks as of the end of the year of change and for later taxable years under the methods provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, unless it obtains permission to change to another recognized method;

(4) the conversion from the specific goods method, if applicable, to the dollar-value method must be made in accordance with § 1.472–8(f)(2);

(5) the automobile dealer must file Form 970, Application to Use LIFO Inventory Method, with its federal income tax return for the year of change and otherwise comply with the provisions of § 472(d) and § 1.472–3 (*see also* Rev. Rul. 76–282, 1976–2 C.B. 137) to extend the LIFO election (i) to include any new automobiles and new light-duty trucks (for example, demonstrators) to which the LIFO election did not previously apply but that are required to be included in LIFO pools under the Alternative LIFO Method, and (ii) for an automobile dealer changing from the IPIC method, to include any parts and accessories, used automobiles, and used trucks, to which the LIFO election did not previously apply but that are required to be included in LIFO pools under section 10.03 of the APPENDIX to Rev. Proc. 97–37, as of the beginning of the year of change;

(6) the automobile dealer must effect the change to the Alternative LIFO Method, and in the case of an automobile dealer changing from the IPIC method to the methods provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, using the cut-off method. Under the cut-off method, the value of the automobile dealer's new automobile and new light-duty truck inventory, and in the case of an automobile dealer changing from the IPIC method, the parts and accessories, used automobile, and used truck inventory, at the beginning of the year of change must be the same as the value of such inventory at the end of the preceding taxable year plus market value restorations, if any, required pursuant to section 5.03(5) of this revenue procedure;

(7) the automobile dealer must combine and/or separate the dollar-value inventory pool or pools, including any pool resulting from section 5.03(4) of this revenue procedure, if applicable, to conform to the inventory pooling rules provided in section 4 of this revenue procedure, and in the case of an automobile dealer changing from the IPIC method, to the inventory pooling rules provided in section 10.03(2)(b) of the APPENDIX of Rev. Proc. 97–37, in accordance with the provisions of § 1.472–8(g)(2);

(8) in effecting the changes, any layers of inventory increments previously determined and the LIFO value of such increments must be retained. Instead of using the earliest taxable year for which the automobile dealer adopted the LIFO method for any items in the inventory pool or pools, the year of change must be used as the base year in determining the LIFO value of the inventory pool or pools for the year of change and later taxable years (the cumulative index at the beginning of the year of change will be 1.00). The base-year costs of layers of increments in the pool or pools at the beginning of the year of change must be restated in terms of the new base-year costs, using the year of change as the new base year; and

(9) the automobile dealer must maintain and retain complete records of the computations of the LIFO inventory under the Alternative LIFO Method, as well as copies of the actual purchase invoice for each vehicle used in the computation.

SECTION 6. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 92–79, 1992–2 C.B. 457, is modified, and as modified, is superseded. However, see the transition rules in section 13.02 of Rev. Proc. 97–37.

SECTION 8. EFFECTIVE DATE

This revenue procedure is effective on August 18, 1997.

SECTION 9. ELECTING LIFO AND ADOPTING THE ALTERNATIVE LIFO METHOD

.01 *In general.* An automobile dealer that adopts the Alternative LIFO Method provided in this revenue procedure at the time the automobile dealer makes an election to use (or extend) the dollar-value LIFO inventory method must complete and file a statement of election made on a current Form 970, pursuant to the instructions for Form 970, or in such other manner as may be acceptable to the Commissioner. The use of the Alternative LIFO Method should be clearly indicated on the Form 970, or an attachment to the Form 970, and reference should be made to this revenue procedure. Appropriate LIFO sub-method elections that are an integral part of the Alternative LIFO Method, which are contained on the Form 970, must be selected on the Form 970 upon adoption of the Alternative LIFO Method.

.02 *Conditions.* A taxpayer adopting the Alternative LIFO Method must comply with the conditions stated in section 5.03(1), (2), and (9) of this revenue procedure.

SECTION 10. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1551.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collections of information in this revenue procedure are in section 5. This information is necessary and will be used to determine whether the taxpayer is properly using the Alternative LIFO Method. The collections of information are required for the taxpayer to use the Alternative LIFO Method. The likely recordkeepers are individuals, business or other for-profit institutions, and small businesses or organizations.

The estimated total annual recordkeeping burden is 200,000 hours.

The estimated annual burden per recordkeeper is 25 hours. The estimated number of recordkeepers is 8,000.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

DRAFTING INFORMATION

This revenue procedure was drafted in the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Richard H. Berken on 202-622-4970 (not a toll-free call).