Part III

Administrative, Procedural, and Miscellaneous

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. 2001-23

SECTION 1. PURPOSE

This revenue procedure provides an alternative last-in, first-out (LIFO) inventory computation method (the Used Vehicle Alternative LIFO Method) for taxpayers that sell used automobiles or used light-duty trucks ("used vehicle dealers"). A used vehicle dealer may change to or adopt the Used Vehicle Alternative LIFO Method. Used vehicle dealers generally may obtain automatic consent to change their method of accounting to the Used Vehicle Alternative LIFO Method by following the procedures in Rev. Proc. 99-49, 1999-52 C.B. 725, (or its successor) as modified by this revenue procedure.

SECTION 2. BACKGROUND

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

.02 Section 472(b) and ' 1.472-1(a) of the Income Tax Regulations require taxpayers using the LIFO inventory method to treat goods remaining on hand at the close of the taxable year as being: first, those included in the opening inventory of the taxable year, in the order of acquisition and to the extent thereof; and second, those acquired during the taxable year. Section 472(b) and ' 1.472-2 require taxpayers using the LIFO method to inventory their goods at cost.

.03 Section 1.472-8(a) provides that any taxpayer may elect to determine the cost of its LIFO inventories under the Adollar-value@ LIFO method, provided such method is used consistently and clearly reflects the income of the taxpayer in accordance with the rules of that section.

.04 Section 1.472-8(e)(1) provides for the use of a "link-chain" method of computing the value of a dollar-value LIFO pool if the taxpayer can demonstrate that the use of either an index method or the double-extension method would be impractical or unsuitable in view of the nature of inventory in the dollar-value LIFO pool. Adequate records must be maintained by the taxpayer to support the appropriateness, accuracy, and reliability of a link-chain method.

.05 Section 1.472-3(d) provides that whether or not the taxpayer=s application for the adoption and use of the LIFO inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer=s income tax returns.

.06 Section 446(e) and ' 1.446-1(e)(2)(i) provide that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with ' 446(e).

SECTION 3. SCOPE

The Used Vehicle Alternative LIFO Method may be used to value LIFO inventories of used automobiles and used light-duty trucks. For purposes of this revenue procedure, used automobiles and used light-duty trucks refer to previously titled vehicles and do not include demonstrator vehicles. Light-duty trucks, which are also referred to as class 1, 2, or 3 trucks, are defined for purposes of this revenue procedure as trucks with a gross vehicle weight of 14,000 pounds or less.

SECTION 4. THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*.

(1) The Used Vehicle Alternative LIFO Method is a comprehensive link-chain, dollar-value LIFO inventory method encompassing several required sub-methods and special rules that may only be used to value LIFO inventories of used automobiles and used light-duty trucks. In general, a taxpayer using the Used Vehicle Alternative LIFO Method computes a dollar-value LIFO pool index with reference to average base vehicle prices reported in an official used vehicle guide. This optional method of accounting for used vehicle inventories is designed to simplify the dollar-value LIFO computations of used vehicle dealers.

(2) In the opinion of the Commissioner, income will be clearly reflected by

utilization of the Used Vehicle Alternative LIFO Method, provided that a taxpayer follows the sub-methods and special rules described in section 4.02 of this revenue procedure and the computational methodology contained in section 4.03. The Used Vehicle Alternative LIFO Method includes, by definition, all of its sub-methods.

(3) The Used Vehicle Alternative LIFO Method will be accepted by the Commissioner as an appropriate method of computing a LIFO inventory index and the use of that index to compute the value of a dollar-value LIFO pool will be accepted as accurate, reliable, and suitable. All computations under the Used Vehicle Alternative LIFO Method, however, are subject to verification upon examination of the used vehicle dealer's income tax returns.

(4) A taxpayer that uses the Used Vehicle Alternative LIFO Method for a trade or business must use this method of accounting to value the entire inventory of used automobiles and used light-duty trucks held by that trade or business. A taxpayer also is required to file (or have previously filed) an election to use the LIFO inventory method, pursuant to the requirements of ' 1.472-3, that applies to all of that inventory.

.02 *Sub-methods and special rules*.

(1) *Use of base vehicle prices*. In general, indexes must be computed using prices for base vehicles that best relate, under the guidelines specified in this revenue procedure, to the used vehicles actually held by the taxpayer. Base vehicle is defined for purposes of this revenue procedure as the most relevant combination of (a) a detailed base model description, consisting of model line, body style, and trim level (*e.g.*, Honda Accord 4D Sedan EX), and (b) an associated manufacturer's base model

code number that appears in the official used vehicle guide utilized by the taxpayer and relates to a used vehicle held by the taxpayer.

(2) *Use of official used vehicle guides*. For purposes of this revenue procedure, Aofficial used vehicle guides@ are defined as those that (a) are widely recognized and utilized in the used vehicle dealer industry for business purposes in the regions involved, and (b) are regularly and consistently used by the taxpayer in valuing inventory for federal income tax purposes. Any change in the particular used vehicle guide utilized by a taxpayer in connection with the Used Vehicle Alternative LIFO Method or any change in the precise manner of its utilization (*e.g.*, a change in the specific guide category that a taxpayer uses to represent vehicles of average condition for purposes of section 4.02(5)(a) of this revenue procedure) represents a change in method of accounting for which the taxpayer must secure the consent of the Commissioner in accordance with the requirements of Rev. Proc. 97-27, 1997-1 C.B. 680 (or its successor).

(3) *LIFO pools*. A taxpayer that uses the Used Vehicle Alternative LIFO Method must establish, for each trade or business that sells used vehicles, a dollar-value LIFO pool for all used automobiles (regardless of manufacturer) and another separate dollar-value LIFO pool for all used light-duty trucks (regardless of manufacturer). Used sport utility vehicles and used hybrid vehicles (*e.g.* vans and mini-vans) may be included initially in either the used automobile or the used light-duty truck dollar-value LIFO pool; however, once a choice is made, all like vehicles must be similarly treated in subsequent years.

(4) *Determination of the current-year cost of vehicles in ending inventory*. Under the Used Vehicle Alternative LIFO Method, the current-year cost of each used vehicle in ending inventory must be determined in accordance with this section 4.02(4).

(a) *Purchased vehicles*. The current-year cost for each used vehicle purchased includes its purchase price plus reconditioning costs, delivery charges, and all other costs properly allocated to that particular vehicle under the taxpayer=s method of accounting (which includes the taxpayer=s method of accounting for ' 263A costs).

(b) *Trade-in vehicles*. The current-year cost for each used vehicle acquired via trade-in includes its Acost@ plus reconditioning costs and all other costs properly allocated to that particular vehicle under the taxpayer=s method of accounting (which includes the taxpayer=s method of accounting for ' 263A costs). The cost of a vehicle acquired via trade-in must be determined by reference to the wholesale price listing, as permitted by Rev. Rul. 67-107, 1967-1 C.B. 115, in an official used vehicle guide for a similarly equipped, comparable base vehicle that reflects the trade-in vehicle=s actual mileage and condition. The cost of a trade-in vehicle also must include prices reflected in the guide for installed options and accessories, if any. The official used vehicle guide from which prices are drawn to determine the cost of a trade-in vehicle must be the guide that covers the day of acquisition of that specific vehicle.

(5) *Inventory pool index guidelines*.

(a) *Computation of an inventory pool index*. For each inventory pool, current-year and prior-year base vehicle prices for each used vehicle in ending inventory are totaled and the totals are used to compute a current-year index for the pool under the Used

Vehicle Alternative LIFO Method. These base vehicle prices must be determined by reference to prices reported in an official used vehicle guide for comparable base vehicles of the same age and in average condition, unadjusted for options, accessories, reconditioning costs, or other costs. AAverage condition@ is defined for purposes of this revenue procedure as the category that best represents a vehicle in average condition in the taxpayer=s official used vehicle guide. Thus, although Aaverage@ prices would be used for guides in which this category does appear, it would be appropriate to select and use a comparable category, *e.g.*, Aclean@ prices, in the case of other used vehicle guides in which there is no average category. Current-year indexes for each inventory pool are then multiplied by prior-year cumulative indexes for that pool to compute a current-year cumulative index. Once a current-year cumulative index is computed for each inventory pool using base vehicle prices, that index is then applied to the total current-year cost (as determined under section 4.02(4), including options, accessories, reconditioning costs, and other costs) of all vehicles in the pool at the end of the taxable year in order to determine whether an inventory increment or decrement has occurred.

(b) *Determination of comparable base vehicle prices for index computations*. Current-year base vehicle prices for all vehicles in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer=s current taxable year for the specific vehicles held in inventory. Prior-year base vehicle prices for comparable vehicles of the same age as those in ending inventory must be determined by reference to the official used vehicle guide covering the last day of the taxpayer=s preceding taxable year. (In the case of a short taxable year, see section 4.02(5)(d) of this revenue procedure.) For example, a calendar year 2000 taxpayer that had a *1998 Vehicle X* (a particular model, body style and trim level) in ending inventory would determine associated base vehicle prices for its index computation as follows: the current-year base vehicle price for this vehicle would be the base price (without adjustment for any options, accessories, reconditioning costs, or other costs) for a *1998 Vehicle X* in average condition from the guide covering December 31, 2000; the associated prior-year base vehicle price would be the base price for a *1997 Vehicle X* in average condition (a comparable vehicle of the same age) from the guide covering December 31, 1999.

(c) *Procedure when a prior-year comparable base vehicle listing does not exist*. When no prior-year base vehicle price for a comparable vehicle of the same age as a vehicle in ending inventory appears in the official used vehicle guide covering the last day of the taxpayer=s preceding taxable year (*e.g.*, *Vehicle X* was introduced for the first time in the 1998 model year, and thus there was no corresponding *1997 Vehicle X*), current-year base vehicle price must be used as prior-year base vehicle price in index computations. Current-year base vehicle price must also be used as prior-year base vehicle price in the event that a change in wheelbase or track-width from one year to the next has occurred for a particular type of vehicle without a corresponding change in the relevant official used vehicle guide combination of detailed base model description and associated manufacturer=s base model code number.

(d) *Procedure in the case of a short taxable year*. Under the Used Vehicle

Alternative LIFO Method, all current-year indexes must be adjusted in the case of a short taxable year (*i.e.*, a return for a period of less than 12 months). This adjustment involves adjusting the current-year index, as computed on a full year basis, as follows: current-year index for short taxable year = 1 + [(current-year index for full year - 1) x (number of months in short year / 12)]. For example, a new calendar year taxpayer that came into existence on July 1, 2000, would use official used vehicle guides covering December 31, 1999, and December 31, 2000, in its index calculations to compute a full year index for 2000 and then adjust that index by the number of months actually contained in its short taxable year (*i.e.*, six months).

.03 *Computational methodology*. The following methodology must be applied to compute the value of each dollar-value LIFO pool in a used vehicle dealer's ending inventory under the Used Vehicle Alternative LIFO Method:

STEP 1. Using an official used vehicle guide, as defined in section 4.02(2) of this revenue procedure, determine the detailed base model description and associated manufacturer=s base model code number combination that applies to each vehicle in ending inventory.

STEP 2. Determine the current-year cost of each vehicle in ending inventory in accordance with section 4.02(4) of this revenue procedure. Then, for each pool, calculate the total current-year cost of all vehicles in ending inventory.

STEP 3. For each vehicle in ending inventory, using the related description and code number from STEP 1, determine current-year and prior-year base vehicle price as indicated in section 4.02(5) of this revenue procedure.

STEP 4. For each pool, calculate the total current-year base vehicle price and the total prior-year base vehicle price for all vehicles in ending inventory by adding the respective numbers from STEP 3. Divide the total current-year base vehicle price of all vehicles by the total prior-year base vehicle price of all vehicles to determine the current-year pool index. In the case of a short taxable year, adjust this index as indicated in section 4.02(5)(d) of this revenue procedure.

STEP 5. For each pool, compute the cumulative index for the current taxable year by multiplying the cumulative index from the immediately preceding taxable year by the current-year index from STEP 4. For the first taxable year in which the Used Vehicle Alternative LIFO Method is used, the cumulative index for the immediately preceding taxable year is 1.00.

STEP 6. For each pool, calculate ending inventory at base-year cost by dividing total current-year cost from STEP 2 by the cumulative index from STEP 5.

STEP 7. For each pool, determine whether there is an inventory increment or decrement by comparing ending inventory at base-year cost for the current year from STEP 6 to beginning inventory at base-year cost (from STEP 6 of the prior-year calculation), or, for the first taxable year in which this method is used, to beginning inventory (as determined under section 5.02(3) of this revenue procedure, if applicable). If ending inventory at base-year cost is greater, there is an increment. Multiply this increment by the cumulative index from STEP 5 to calculate the LIFO value of the increment (*i.e.* the layer of increment). Alternatively, if ending inventory at base-year cost is less than beginning inventory at base-year cost, a liquidation (also referred to as an inventory decrement) has occurred. Reduce the prior-year LIFO layers of increment in reverse chronological order until the liquidation is fully absorbed.

STEP 8. For each pool, add together the current year=s layer of increment, if any, at current-year cost and the remaining prior years= layers of increment at each prior year=s historical current-year cost to compute the total LIFO value of the inventory pool.

SECTION 5. CHANGING TO THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*. A change to the Used Vehicle Alternative LIFO Method is a change in method of accounting to which the provisions of ' 446 and the regulations thereunder apply.

.02 *Automatic change to the Used Vehicle Alternative LIFO Method*. Except as provided in section 5.03(2) of this revenue procedure (which applies only to certain taxpayers that use the Inventory Price Index Computation (IPIC) method), a used vehicle dealer that wants to change to the Used Vehicle Alternative LIFO Method must follow the automatic change in accounting method provisions in Rev. Proc. 99-49 (or its successor), with the following modifications:

(1) the scope limitations in section 4.02 of Rev. Proc. 99-49 do not apply, provided the change is made for the first or second taxable year ending on or after December 31, 2000, unless the taxpayer=s method of valuing its LIFO inventories of used automobiles or used light-duty trucks is an issue pending within the meaning of section 6.01(6) of Rev. Proc. 2000-38, 2000-40 I.R.B. 310. If the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115, Application for

Change in Accounting Method, to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time that it files the copy of the Form 3115 with the national office;

(2) a change to the Used Vehicle Alternative LIFO Method under the provisions of Rev. Proc. 99-49 must be effected on a cut-off method, which requires that the value of the taxpayer's used automobile and used light-duty truck inventory at the beginning of the year of change must be the same as the value of that inventory at the end of the preceding taxable year, plus cost restorations, if any, required pursuant to section 5.04(5) of this revenue procedure. However, if the taxpayer has previously improperly accounted for a bulk bargain purchase, the taxpayer, as part of a change to the Used Vehicle Alternative LIFO Method, must first change its method of accounting to comply with *Hamilton Industries, Inc. v. Commissioner*, 97 T.C. 120 (1991), and compute a ' 481(a) adjustment for that part of the change (*see* Announcement 91-173, 1991-47 I.R.B. 29);

(3) in effecting a change to the Used Vehicle Alternative LIFO Method under Rev. Proc. 99-49, any LIFO inventory cost increments previously determined and the value of those increments must be retained. Instead of using the earliest taxable year for which the taxpayer adopted LIFO as the base year, the year of change must be used as the new base year in determining the value of all existing LIFO cost increments 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 cost of all LIFO cost increments at the beginning of the year of change must be restated in terms of new base-year costs,

using the year of change as the new base year, and the indexes for previously determined inventory increments must be recomputed accordingly. The new base-year cost of a pool is equal to the total current-year cost of all the vehicles in the pool;

(4) when filing Form 3115, Application for Change in Accounting Method, taxpayers are reminded to complete all applicable parts of the form, including Part I of Schedule B, and, in lieu of the label required by section 6.02(3) of Rev. Proc. 99-49, are instructed to write "Filed under Rev. Proc. **[INSERT NUMBER OF THIS REV. PROC.]**" at the top of the form; and,

(5) taxpayers must comply with the additional conditions stated in section 5.04 of this revenue procedure.

.03 *Procedure for IPIC taxpayers with used vehicles as well as other goods in inventory*.

(1) *Automatic change*. A used vehicle dealer using the IPIC method that also has parts and accessories, new automobiles, or new light-duty trucks in inventory may incorporate a change, using a cut-off method, from IPIC to another acceptable LIFO method for these other goods into the change to the Used Vehicle Alternative LIFO Method for used automobiles and used light-duty trucks made pursuant to this revenue procedure under the provisions of Rev. Proc. 99-49. When changing from IPIC to a dollar-value LIFO method for parts and accessories, new automobiles, or new light-duty trucks, a separate inventory pool must be established for each of these types of inventory.

(2) *Nonautomatic change*. A used vehicle dealer that uses the IPIC method and

has in inventory goods other than used automobiles, used light-duty trucks, parts and accessories, new automobiles, and new light-duty trucks must change to the Used Vehicle Alternative LIFO Method under the provisions of Rev. Proc. 97-27 (or its successor). When making the change to the Used Vehicle Alternative LIFO Method, the taxpayer must (a) effect the change using the cut-off method described in section 5.02(2) of this revenue procedure, (b) use the year of change as the new base year, with all LIFO inventory cost increments previously determined and the value of those increments retained, as described in section 5.02(3) of this revenue procedure, (c) attach to its Form 3115 a schedule setting forth the classes of goods for which it had elected to use the LIFO method and was using IPIC, as well as the accounting method changes that are being made for each class of goods, and (d) comply with the conditions stated in section 5.04 of this revenue procedure.

.04 *Conditions of change*. A used vehicle dealer that changes to the Used Vehicle Alternative LIFO Method must comply with the following conditions:

(1) the used vehicle dealer must comply with the requirements incident to the adoption and use of the LIFO inventory method provided in 1.472-2, including the requirement to 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);

(2) the used vehicle dealer must maintain and retain complete records of index computations under the Used Vehicle Alternative LIFO Method, including relevant used

vehicle guides, and complete records of the current-year cost of vehicles held in ending inventory for each open year, including purchase invoices for each vehicle purchased and used vehicle guides used to cost trade-ins consistent with the requirements of ' 1.472-8(d);

(3) the used vehicle dealer must combine and/or separate its dollar-value LIFO pool(s) in accordance with ' 1.472-8(g)(2) to conform with the pooling requirements of section 4.02(3) of this revenue procedure, including any pool(s) resulting from section 5.04(4) of this revenue procedure;

(4) the used vehicle dealer must convert from a specific-goods LIFO method, if applicable, to the Used Vehicle Alternative LIFO Method in accordance with ' 1.472-8(f)(2); and,

(5) the used vehicle dealer must elect to adopt or extend LIFO, and comply with the cost restoration provisions of ' 472(d) and ' 1.472-3 (*see also* Rev. Rul. 76-282, 1976-2 C.B. 137), for any used automobiles or used light-duty trucks to which a LIFO election did not previously apply but that are required to be included in dollar-value LIFO pools under the Used Vehicle Alternative LIFO Method.

SECTION 6. ELECTING LIFO AND ADOPTING THE USED VEHICLE ALTERNATIVE LIFO METHOD

.01 *In general*. If a used vehicle dealer is required to make an election to adopt or extend LIFO in connection with adoption of the Used Vehicle Alternative LIFO Method, the used vehicle dealer must complete and file a statement of election of the LIFO inventory method on Form 970, Application to Use LIFO Inventory Method. The use of the Used Vehicle Alternative LIFO Method should be clearly indicated on the Form 970, or in an attachment thereto, and a reference should be made to this revenue procedure.

.02 *Conditions*. (1) The five year limitation on re-election of LIFO provided in section 10.01(2) of the APPENDIX of Rev. Proc. 99-49 will be waived for affected taxpayers desiring to elect the Used Vehicle Alternative LIFO Method pursuant to this revenue procedure.

(2) A taxpayer electing LIFO and adopting the Used Vehicle Alternative LIFO Method must comply with the conditions stated in section 5.04 of this revenue procedure.

SECTION 7. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: CC:ITA:7, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 99-49 is modified and amplified to include this automatic change in section 10 of the APPENDIX.

The APPENDIX of Rev. Proc. 99-49 is modified to provide that the automatic accounting method change provided in section 10.02, which relates to a change in the method of determining the cost of used vehicles purchased or taken as a trade-in, does not apply to taxpayers that have adopted or changed to the Used Vehicle Alternative LIFO Method.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2000.

DRAFTING INFORMATION

The principal author of this revenue procedure is Alan J. Tomsic of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Tomsic on (202) 622-4970 (not a toll-free call).