



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. "CROSSOVER" VEHICLES ...

HOW SHOULD THEY BE TREATED FOR LIFO PURPOSES? Recently, the IRS announced that it will consider the issue of proper classification of "crossover" vehicles in dealers' dollar-value LIFO inventory computations.

This comes in response to a letter the IRS received from the National Automobile Dealers Association (NADA) suggesting this issue for consideration as part of the IRS' Industry Issue Resolution (IIR) Program.

These developments are discussed on page 4. We've also reprinted NADA's letter and the letter that we sent to the IRS four years ago on the same subject. At that time, we suggested the advisability of setting up a third LIFO pool for crossover vehicles and some transitional procedures to implement this change in accounting method.

We never received a reply from the IRS, so, we're looking forward to seeing what it comes up with now when it tackles this issue.

#2. WINERY'S LIFO CALCULATIONS LEAVE A BITTER TASTE IN IRS' MOUTH.

In a recent audit of the LIFO calculations for a winery, the Service found that this producer of bottled wines did not properly establish "item" definitions for "goods" in its LIFO calculations.

The IRS asked many questions about the LIFO calculations which the taxpayer could not answer because it had not retained sufficient books, records and other accounting information.

In Field Attorney Advice (FAA) 20064301F, the IRS concluded that the winery's LIFO inflation indexes did not "clearly reflect income." You know what that means! The IRS National Office left unanswered the question of whether the deficiencies in the taxpayer's LIFO calculations were so severe that its LIFO election should be terminated.

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#3. THE IMPORTANCE OF "ITEM" DEFINITION & SOME LIFO LANDMARK CASES. The taxpayer in the above FAA happened to be a winery. What's important is that (according to the IRS' *Audit Guide for the Wine Industry*) the IRS classifies or treats wineries as **manufacturers**.

We've devoted considerable attention to this FAA because what the IRS had to say in this document (about this winery's/taxpayer's "item" definitions for LIFO purposes) has equal relevance to all manufacturers, as well as to other kinds of businesses using LIFO.

On page 20, we've included a supplementary discussion on the importance of item definition and a few landmark LIFO cases on this subject. Two cases, in particular ... *Amity Leather Products, Co.* and *Hamilton Industries, Inc.* ... are relied on in the FAA, and they have significant precedential value in countless other LIFO contexts. They should not be overlooked by LIFO practitioners.

#4. "KINDER, GENTLER IRS?" ... DEPENDS ON WHOM YOU LISTEN TO.

In researching this FAA, we came across the testimony of one winemaker several years ago before a Congressional subcommittee concerning the recovery of attorney's fees after the IRS brings a case and then drops it or loses it in the Tax Court. The background for this testimony see **LIFO UPDATE**, page 2