LIFO Inventory Valuation for Auto Dealerships

Under current regulations there are four methods that an auto dealership may use to compute the LIFO valuation of new and used vehicle inventories. The dealership may use the following acceptable methods:

**Simplified Dollar-Value Method** - This method is allowable for small auto dealerships for any taxable year if its average annual gross receipts for the three preceding years is not greater than $5,000,000. This method uses price inflation from government indexes and is fairly simple to use.

**Inventory Price Index Computation Method** - This method commonly called the IPIC method is available to all auto dealership taxpayers and also uses price inflation from government indexes and is fairly simple to use. An auto dealership using the IPIC method must use this method for all inventories that the dealership has elected to value under the LIFO method.

**General Dollar-Value Method** - This method is also available to all auto dealership taxpayers and uses the dealership’s own cost data to price inflation. The computations under this method are more complex and require specific knowledge of each vehicle included in inventory. The method provides the dealership some control over computed price inflation as it is based on the dealership’s inventory of vehicles.

**Alternative LIFO Method for New and Used Vehicles** - This method actually is two distinct methods, one for new vehicles and one for used vehicles. Both of these methods are comprehensive and include several required sub-methods and special requirements and somewhat provides a safe harbor methodology for dealers computing LIFO valuations under these methods.

Most auto dealerships have elected to use the alternative methods for computing LIFO valuations for new and used vehicles and a closer look at these two methods is warranted.

**Alternative LIFO Method for New Vehicles**

This method may only be used by an automobile dealership engaged in the trade or business of retail sales of new vehicles to value its inventory of new vehicles. The method by definition includes and use of this method is conditioned on using all the sub-methods and special requirements included within the method. These sub-methods and special requirements include the following:
Separate Pools for New Cars and New Trucks - For each separate trade or business all new cars (regardless of manufacturer), including demonstrators, should be included in one pool, and all new light-duty trucks (regardless of manufacturer), including demonstrators, should be included in one pool. All crossover vehicles should be assigned to either the car or truck pool based on a facts and circumstances basis. Light-duty trucks are defined as trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2 or 3 trucks. See below for a special election to use only one pool for both new cars and light-duty trucks and a definition of trade or business.

Item of Inventory - An item of inventory should be determined using the manufacturer’s base model code that represents the most detailed description of the base model’s characteristics.

Use of Base Cost - The actual base cost of the specific vehicles included in ending inventory is used to compute the index for a pool. The base cost of each vehicle is not adjusted for options, accessories or other costs.

Actual Cost is Current Year Cost - The actual cost of the specific vehicles on hand at the end of the year will be the current cost of such vehicles. Actual cost includes the base cost plus options, accessories and other costs.

New item - A new item is any new or reassigned base model code, as described above, that is caused by a change in an existing vehicle or represents a vehicle that did not previously exist. Additionally a new item exists if there is a change in the platform of the vehicle that results in a change of the track width or wheel base of the vehicle regardless if there is a change in the base model code.

New Item Assigned Index of One - The current year base cost of a new item, as described above, is used as both the current year and prior year base cost.

Item not Stocked in Prior Year - The prior year base cost of a vehicle not stocked by the dealer in the prior year is determined by the manufacturer’s price list in effect as of the first day of the last month of the prior taxable year.

Computational Methodology - The alternative LIFO method for new vehicles also includes a step by step method to compute the LIFO value of each pool of an auto dealer’s year end inventory.
Conditions - There are conditions that must be followed to adopt and continue the use of the LIFO method of inventory valuation and these apply to an auto dealer that adopts the use of the alternative LIFO method.

Additionally an auto dealer should maintain and retain complete records of the computations of the LIFO inventory value as well as the actual purchase invoice of each vehicle included in year end inventory.

Vehicle Pool Method

Auto dealers that are subject to the General Dollar-Value Method or the Alternative LIFO Method for new vehicles may also use the Vehicle Pool Method. The Vehicle Pool Method allows the dealer to establish one pool for all new vehicles as long as the vehicle’s gross vehicle weight does not exceed 14,000 pounds.

Auto dealers that are subject to the Simplified Dollar-Value Method or the Inventory Price Index Computation Method establish one pool for new cars and light duty trucks under the procedures and rules of the those methods.

Separate Trade or Business - Regulations generally do not provide a concrete definition of “separate trade or business” and the determination is made on a facts and circumstances basis. Items to be considered include:

- Is one set of books and records kept or are separate sets of books and records kept?
- Is one credit line established for all operations or are separate credit lines established for operations?
- Do employees work for all operations or do employees work only for a specific operation?
- Is one bank account established for all operations or are separate bank accounts established for operations?

Alternative LIFO Method for Used Vehicles

This method may only be used by taxpayers that sell used cars or used light-duty trucks to value its inventory of used vehicles. The method by definition includes and use of this method is conditioned on using all the sub-methods and special requirements included within the method. These sub-methods and special requirements include the following:
Definition of Used Vehicles- Used vehicles are previously titled vehicles and do not include demonstrators.

Separate Pools for Used Cars and Used Trucks- For each separate trade or business all used cars (regardless of manufacturer) should be included in one pool, and all used light-duty trucks (regardless of manufacturer) should be included in one pool. All crossover vehicles should be assigned to either the car or truck pool based on a facts and circumstances basis. Light-duty trucks are defined as trucks with a gross vehicle weight of 14,000 pounds or less, which are also referred to as class 1, 2 or 3 trucks. See below for a special election to use only one pool for both used cars and used light-duty trucks and a definition of trade or business.

Use of Base Cost- The base cost of the specific vehicles included in ending inventory is used to compute the index for a pool. The base cost of each vehicle is the associated price listed in an official used vehicle guide utilized by the dealer that is the most relevant combination of a base model description and a base model code listed in the official used vehicle guide.

Use of Official Used Vehicle Guide- Used vehicle guides are defined as those that are widely recognized and utilized in the used vehicle dealer industry for business purposes in the regions involved and is regularly and consistently used by the dealership in valuing inventory for federal income tax purposes. Any change in the used vehicle guide used under this LIFO method or change in the manner of its utilization under this LIFO method is considered a change in accounting method that requires the consent of the IRS.

Current Year Cost- Current year cost is determined as follows:

Purchased Used Vehicles- Current year cost is the purchase price of the used vehicle plus all other costs properly allocated to the used vehicle including reconditioning and delivery costs.

Trade-in Vehicles- Current year cost is the wholesale price listed in an used vehicle guide in effect on the date of trade-in, is the most relevant combination of base model description and base code, is adjusted for actual vehicle mileage and condition and installed options and accessories, plus all other costs properly allocated to the used vehicle such as reconditioning costs.

Index Computations- Current year base cost is determined for vehicles in ending inventory by reference to the official used vehicle guide in effect on the last day of the dealer’s current tax year.
Prior year base cost is determined for vehicles in ending inventory by reference to the official used vehicle guide in effect on the last day of the dealer’s prior tax year. Base cost is determined by use of a vehicle in average condition and not adjusted for options, accessories, reconditioning costs, or any other adjustment reflected in the official used vehicle guide. Prior year base cost is determined using a comparable vehicle of the same age (i.e. a comparable vehicle of the same age for a 2006 Ford Mustang in ending inventory is a 2005 Ford Mustang).

**New item** - A new item occurs when there is no price for a comparable vehicle of the same age in the official used vehicle guide in effect on the last day of the dealer’s prior tax year. Additionally a new item exists if there is a change in the platform of the vehicle that results in a change of the track width or wheel base of the vehicle regardless if there is a change in the base model code.

**New Item Assigned Index of One** - The current year base cost of a new item, as described above, is used as both the current year and prior year base cost.

**Short Taxable Year** - For a short taxable year the computed annual index needs to be adjusted by the actual number of months in the short taxable year.

**Computational Methodology** - The alternative LIFO method for used vehicles also includes a step by step method to compute the LIFO value of each pool of an auto dealer’s year end inventory.

**Conditions** - There are conditions that must be followed to adopt and continue the use of the LIFO method of inventory valuations and these apply to an auto dealer that adopts the use of the alternative LIFO method.

Additionally an auto dealer should maintain and retain complete records of the computations of the LIFO inventory value as well as relevant official used vehicle guides, and complete records of current year cost of vehicles in ending inventory for each open year, including invoices for purchased vehicles and official used vehicle guides used to cost trade-ins.

**Vehicle Pool Method**

Auto dealers that are subject to the General Dollar-Value Method or the Alternative LIFO Method for used vehicles may also use the Vehicle Pool Method. The Vehicle Pool Method allows the dealer to establish one pool for all used vehicles as long as the vehicle’s gross vehicle weight does not exceed 14,000 pounds.
Auto dealers that are subject to the Simplified Dollar-Value Method or the Inventory Price Index Computation Method establish one pool for used cars and light duty trucks under the procedures and rules of the those methods.

**Separate Trade or Business**- Regulations generally do not provide a concrete definition of “separate trade or business” and the determination is made on a facts and circumstances basis. Items to be considered include:

- Is one set of books and records kept or are separate sets of books and records kept?
- Is one credit line established for all operations or are separate credit lines established for operations?
- Do employees work for all operations or do employees work only for a specific operation?
- Is one bank account established for all operations or are separate bank accounts established for operations?

*The preceding is presented for information purposes only. If you have questions related to any subject in the preceding information you can contact the author, Lou Galbraith AutoDealerCFO at the email address loug@autodealercafo.com.*