

Impact of Reduced Inventories on LIFO Benefits



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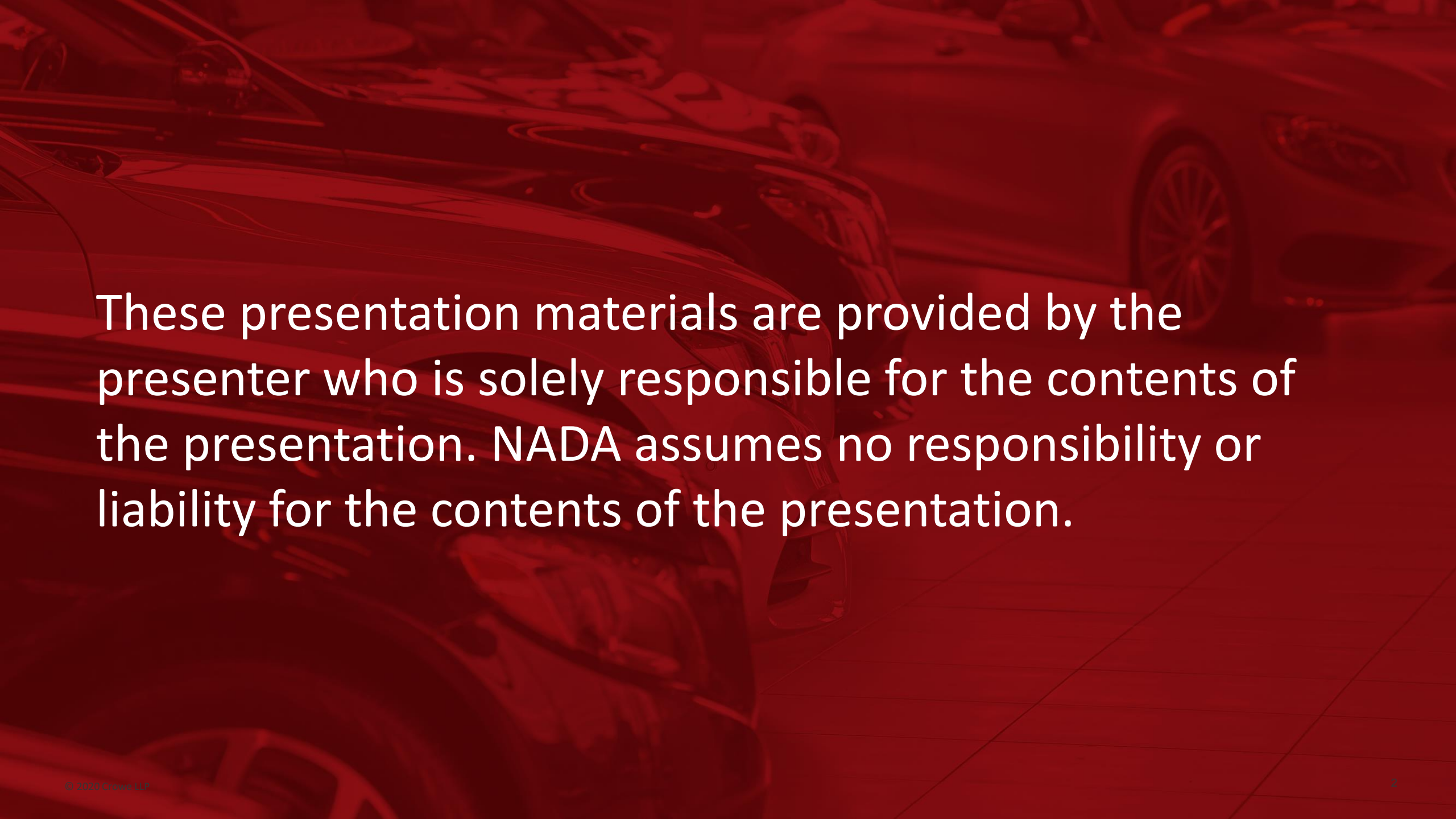
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Inventory Disruptions

- Manufacturer supply chain disruptions
- Reduction in year-end inventories
 - Up to 40% on new vehicles
- LIFO Reserve depends on history of inventory levels and inflation
 - Recapture not pro rata to drop in inventory levels
 - 40% inventory reduction might result in 25% LIFO recapture
 - Might vary significantly from dealer to dealer
 - Based on existing LIFO layers and impact of reductions

LIFO Refresher

- Maximum LIFO benefit equals:
 - PY Inventory Level times CY Inflation
- Reduced Inventory LIFO Impact:
 - Dependent on LIFO Layer history
 - Years in which inventory levels increased and inflation in those years

2019 ENDING	
FIFO Inventory	\$ 5,000,000
LIFO Reserve	\$(2,000,000)
LIFO Inventory	\$ 3,000,000

LIFO Example

2019 Ending

FIFO Inventory	\$ 5,000,000	
LIFO Reserve	\$ (2,000,000)	
LFO Inventory	\$ 3,000,000	

2020 Ending (Liquidation Year)

FIFO Inventory	\$ 3,000,000	
LIFO Reserve	\$ (1,500,000)	(\$500K LIFO recapture / income)
LFO Inventory	\$ 1,500,000	

2021 Ending (Replacement Year)

FIFO Inventory	\$ 5,000,000	
LIFO Reserve	\$ (1,590,000)	(\$90K LIFO benefit / expense)
LFO Inventory	\$ 3,410,000	

Impact on Dealers

Estimate 20% of dealers may be significantly impacted

- Significant variation among manufacturers

LIFO Conformity

- Compute estimate now based on November inventory levels

What options exist?

LIFO Recapture Options – Section 473 Relief

- IRC Sec. 473
 - “Qualified Inventory Interruption” and “Qualified Liquidation”
 - As determined by the “Secretary”
 - Up to three-year replacement period



LIFO Recapture Options – Section 473 Relief

- IRC Sec. 473
 - Liquidation year (2020) filed based on actual inventories
 - If inventory levels recover in replacement year (2021-2023)
 - Adjustment to income in liquidation year (2020) amended return
 - Adjustment to inventory basis in replacement year (2021-2023)
 - Mechanics extremely complex and cumbersome under language in Code
 - NADA Advocating for Dealers
 - Requesting determination that COVID has caused a Qualified Inventory Interruption – Sec. 473 Applies
 - Based on disruption caused by global government responses and impact on foreign trade
 - » Supply of parts and vehicles worldwide
 - Safe Harbor Approach Requested
 - Manufacturer certification of inventory disruption
 - Simplified Calculation
 - » Deferral in liquidation year of estimated adjustment (no subsequent amended returns)
 - If not fully restored income in replacement year



LIFO Recapture Options

New Vehicle LIFO Pooling

- Vehicle Pool Method if not already using

Change from Alternative LIFO Method to IPIC

- Pooling with used vehicles and parts
- Trade off – potentially less future benefit
- Form 3115 Required
 - Five years to change back

LIFO Recapture



- LIFO Termination
 - Guideline of 50% or greater LIFO reserve recapture
 - Possibly selling business in next few years
 - Form 3115 – four year spread
 - Change as of beginning of year
 - Risk of tax rate increase
 - Five years to re-elect LIFO



Questions?

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