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INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Index Number: 472.08-01
Control Number: TAM-113240-98

LEGEND:

T =

A =

A1 =

A2 =

A3 =

B =

B1 =

B2 =

City Y =

date 1 =

ISSUE(S): Whether T can maintain one new automobile inventory pool and one new truck inventory pool under Rev. Proc. 92-79, 1992-2 C.B. 457.

CONCLUSION: T can maintain one new automobile inventory pool and one new truck inventory pool under Rev. Proc. 92-79.

FACTS:

T, an S corporation, is engaged in retail sales and service of new and used automobiles and trucks. T is a franchised dealer for three divisions of A, an automobile and light duty truck manufacturer, and two divisions of B, another automobile manufacturer. T holds five franchises, one for each division of A and B. T sells new and used vehicles at three different lots

all of which are located in City Y. At one location T sells used vehicles as well as new automobiles and trucks manufactured by A. The new vehicles sold at this location include vehicles covered by three separate franchise agreements between T and A, an A1 franchise, an A2 franchise and an A3 franchise. In addition, T sells new automobiles manufactured by B, B1 and B2, as well as used vehicles at two other separate locations. In addition, T operates a service department and a parts department at each location.

The franchise agreements between T and B require T to sell new B1 automobiles exclusively at one location and to sell new B2 automobiles exclusively at a separate location. No other types of new vehicles are permitted to be sold on the same lot as new B1 automobiles and new B2 automobiles. Originally, T sold new B1 automobiles at the same location as new vehicles manufactured by A. However, at some time prior to the years in issue, B required T to begin selling new B1 automobiles at a separate location. Similarly, B would not grant a franchise to T to sell new B2 automobiles unless such automobiles were the only types of new vehicles sold at a location. Accordingly, T now sells (1) new automobiles manufactured by A at one location, (2) new B1 automobiles at a separate location, and (3) new B2 automobiles at another separate location.

The franchise agreements between T and B and T and A require that salesmen have certain certifications to sell a particular division's new vehicles and that service technicians have certain certifications to work on a particular division's new vehicles. T's franchise agreements also obligate T to furnish monthly financial statements to A and B. These monthly financial statements require T to present financial information with respect to new vehicles sales regarding each franchise separately. Although this information is listed separately, all of the financial information related to T is presented on these forms.

T maintains only one complete set of books and records. T's books treat each location as a division. The financial records of each location, at least the income statement items, can be retrieved and presented separately. T has a single checking account. All payroll checks and other checks are issued from the central accounting office. Each location maintains a petty cash fund.

The corporate vice president serves as the general manager for both locations that sell automobiles manufactured by B. In addition, each location has a manager for the sales department, a

manager for the service department, and a manager for the parts department. T has certain employees, aside from top management, accounting, and other administrative personnel, that serve T as a whole and are not limited to serving a particular location. Examples of employees that serve T as whole include, (1) a single used car manager who purchases used vehicle inventory for all locations, (2) parts delivery personnel, (3) parts counter personnel who rotate locations to fill-in scheduling, (4) facilities maintenance personnel, and (5) used vehicle salespersons who may sell the used vehicle inventory of any location.

In addition to advertising each location and each franchise separately, T runs advertisements that promote T as a whole (including all locations). T has one floor plan source in lieu of different sources for each location. All of the inventory of T is financed through a single line of credit that is secured by all of T's vehicles.

T elected to use the Alternative LIFO Method described in Rev. Proc. 92-79[1], 1992-2 C.B. 457, for its taxable year ended date 1. T includes all of its new automobiles in one inventory pool and all of its new trucks in one inventory pool.

The examining agent has proposed to adjust the number of inventory pools of T. Specifically, the agent proposes to require T to maintain separate pools for each geographical location, i.e., (1) a pool for all new automobiles manufactured by A, (2) a pool for all new trucks manufactured by A, (3) a pool for all new B1 automobiles, and (4) a pool for all new B2 automobiles. The agent contends that the taxpayer is required to maintain separate pools under the provisions of Rev. Proc. 92-79.

LAW AND ANALYSIS:

Section 446(a) of the Internal Revenue Code provides that taxable income is computed under the method on the basis of which the taxpayer regularly computes his income in keeping his books.

Section 446(b) provides that if the method of accounting used by the taxpayer does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.

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[1]Rev. Proc. 92-79 was modified and superseded by Rev. Proc. 97-36, 1997-33 I.R.B. 14, which was effective on August 18, 1997.

Section 472(a) authorizes a taxpayer to use the last-in, first-out (LIFO) inventory method to inventory goods specified in an application to use such method in accordance with regulations prescribed by the Secretary.

Section 1.472-8(a) of the Income Tax Regulations provides that a taxpayer may elect to determine the cost of its LIFO inventories under the dollar-value LIFO method, provided that the method is used consistently and clearly reflects the taxpayer's income.

Section 1.472-8(c) provides that items of inventory in the hands of wholesalers, retailers, jobbers, and distributors shall be placed into pools by major lines, types, or classes of goods. In determining such groupings, customary business classifications of the particular trade in which the taxpayer is engaged is an important consideration.

Section 1.472-8(e)(1) authorizes three methods for computing the LIFO value of a dollar-value inventory pool: (1) the double-extension method, (2) an index method, and (3) the link-chain method.

In Peterson Produce Co. v. United States, 205 F.Supp. 229 (1962), affd. 313 F.2d 609 (8th Cir. 1963), the United States District Court Western District Arkansas held that the broiler division of the taxpayer was not a separate trade or business from the taxpayer's breeding farm operation. The court's holding was based in part upon its findings that the taxpayer's divisions were too interdependent and well-integrated to be considered separate and distinct and there was not a sufficient separation of the books and records. In Burgess Poultry Market, Inc. v. United States, 64-2 USTC 9515 (E.D.Tex. 1964), the court held that the taxpayer's poultry raising operation and broiler processing operation were separate and distinct trades or businesses. In that case, the court considered the fact that the taxpayer maintained separate sets of books, had separate bank accounts for each operation, and had separate employees for each operation.

Rev. Proc. 92-79 provides an alternative LIFO inventory computation method (the Alternative LIFO Method) for taxpayers engaged in the trade or business of retail sales of new automobiles or new light-duty trucks. The Alternative LIFO Method is a comprehensive dollar-value, link-chain LIFO method that encompasses several LIFO sub-methods. Section 4.01 of Rev. Proc. 92-79 provides that the Alternative LIFO Method is designed to simplify the dollar-value computations of automobile dealers

and that 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 and the computational methodology provided in section 4.03.

Section 4.02(1) of Rev. Proc. 92-79 provides the sub-method required for LIFO pooling. Specifically, for each separate trade or business, all new automobiles (regardless of manufacturer), must be included in one dollar-value LIFO pool and all new light-duty trucks (regardless of manufacturer) must be included in another separate dollar-value LIFO pool. Since T elected to use the Alternative LIFO Method, T must adhere to the pooling requirements of section 4.02(1) of Rev. Proc. 92-79. T includes all of its new automobiles in one dollar-value pool and all of its new trucks in a separate dollar-value pool. The examining agent proposes to require T to pool all of the new automobiles held for sale at each geographical location in separate dollar-value LIFO pools because the agent believes that each geographical location of T is a separate trade or business within the meaning of Rev. Proc. 92-79. T contends that its locations are not separate trades or businesses.

Initially, we note that the factors relied upon by the examining agent in this case to establish the separateness of the geographical locations relate to the requirements of the different franchise agreements or derive from these requirements. Under its present franchise agreements, T is required to maintain three separate geographical locations, submit monthly financial statements to A and B, and have certain certified new vehicle salesmen and service technicians.

In fact, T sold all of its new vehicles from one geographical location until T's franchise agreements began to require separate locations. Once required to establish separate locations, it was only reasonable that T also have some degree of separateness of employees and employee supervision at each location. T also wrote invoices, collected financial information from customers, approved sales, and collected sales proceeds at each location. We believe that a taxpayer may transact business from separate locations without each location being considered a separate trade or business; separate geographical locations alone are not sufficient to create separate and distinct trades or businesses.

Each of T's franchise agreements require T to furnish monthly financial statements with respect to the division covered by the franchise agreement to either A or B wherein certain

financial information with respect to that division's (franchise's) new vehicles sales is separately stated. T fulfills these requirements by separating certain income statement items from its books. In this case, T only maintains one complete set of books and records. Although this set of books and records is separable, at least with respect to income statement items as noted above, that factor alone is not a sufficient basis upon which the Service may rely in order to require T to treat each of its locations as a separate trade or business for purposes of section 4.02(1) of Rev. Proc. 92-79.

Another factor relied upon by the examining agent in determining that each geographical location is a separate trade or business is that each location has its own new vehicle sales personnel and its own mechanics. That fact is, in part, dictated by the requirements in the franchise agreements regarding salesmen certification. Moreover, at the location where vehicles manufactured by A are sold, some of the salesmen exclusively sell only one division's new vehicles because of the franchise's certification requirements. Accordingly, even at a single location some salesmen only sell certain types of new vehicles.

Rev. Proc. 92-79 specifically recognizes that a trade or business could include different manufacturers. Furthermore, it is reasonable to assume that the drafters of this document recognized that most vehicle manufacturers require in their franchise agreements terms and conditions similar to those involved in this case. Accordingly, we believe that in considering the trade or business requirement in Rev. Proc. 92-79, controlling significance cannot be given to the factors discussed above. Otherwise, the pooling rules of Rev. Proc. 92-79, which recognize that different manufacturers can be included in a single pool, would tend to be frustrated.

Based upon the particular facts and circumstances of this case, we believe that T is operating as a single trade or business at separate locations. Some of the factors we relied upon in reaching this conclusion include the following. T is engaged in the same type of activities (i.e., those related to new and used vehicle sales and service) at all three locations. In addition to upper-level management, accounting personnel and administrative personnel, other employees of T work at more than one of T's geographical locations; for example, the same employee is the general manager of both locations that sell automobiles manufactured by B and the used car manager manages all used vehicle sales for all of T's locations and purchases all used vehicles that are not acquired through trade-in sales, at all of T's locations. T only has one checking account out of which all

payroll and other expenses are paid. T has one line of credit that is secured by all of T's inventory, regardless of location or manufacturer.

Under the particular facts and circumstances of this case, we believe that T is operating as a single trade or business and, accordingly, under Rev. Proc. 92-79, T must include all new automobiles in a single dollar-value LIFO pool and all new light duty trucks in another separate dollar-value LIFO pool.

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CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

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