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Memorandum**

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subject: Selecting Appropriate Month under §1.472-8(e)(3)(iii)(B)(3) of the Income Tax Regulations.

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Under § 1.472-8(e)(3)(iii)(B)(3) of the Income Tax Regulations, how does a taxpayer that uses the inventory price index computation ("IPIC") method to price a dollar-value pool determine the "appropriate" month for selecting price indexes from tables published monthly by the Bureau of Labor Statistics ("BLS")?

CONCLUSION

The taxpayer must select the month that is most consistent with its method of determining current-year cost under § 1.472-8(e)(2)(ii) and its history of inventory production or purchases during the taxable year.

FACTS

Taxpayer was incorporated on January 2, 2007. Immediately thereafter, Taxpayer began purchasing goods for resale. Taxpayer's monthly purchases and product mix were fairly uniform during 2007. Taxpayer does not purchase seasonal goods. During 2007, Taxpayer's inventories turned 6.5 times (or once every 1.83 months). Thus, the mid-point of Taxpayer's last inventory turn occurred in December.

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For the taxable year ended December 31, 2007, Taxpayer filed Form 970, Election To Use LIFO Inventory Method. On Form 970, Taxpayer elected to use the IPIC method to price two pools and to use the most-recent-acquisitions method to determine the current-year cost of inventories. Taxpayer did not elect to use a representative month for selecting price indexes from a BLS table. In addition, Taxpayer did not adopt the retail method. See §§ 1.471-8; 1.472-1(k). When preparing the federal income tax return for that first taxable year, Taxpayer used price indexes published by the BLS for November to compute the IPI for both pools.

### LAW

Section 1.472-8(e)(2)(ii) provides generally that the total current-year cost of items making up a pool may be determined: (a) by reference to the actual cost of the goods most recently purchased or produced; (b) by reference to the actual cost of the goods purchased or produced during the taxable year in the order of acquisition; (c) by application of an average unit cost equal to the aggregate cost of all of the goods purchased or produced throughout the taxable year divided by the total number of units so purchased or produced; or (d) pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Section 1.472-8(e)(3)(iii)(A) provides in relevant part that the computation of an IPI [inventory price index] for a dollar-value pool requires the following four steps, which are described in more detail in § 1.472-8(e)(3)(iii): First, selection of a BLS table and an appropriate month; second, assignment of items in a dollar-value pool to BLS categories (selected BLS categories); third, computation of category inflation indexes for selected BLS categories; and fourth, computation of the IPI.

Section 1.472-8(e)(3)(iii)(B)(1) provides generally that under the IPIC method, an inventory price index is computed using the consumer or producer price indexes for certain categories (BLS price indexes and BLS categories, respectively) listed in the selected BLS table of the "CPI Detailed Report" or the "PPI Detailed Report" for the appropriate month.

Section 1.472-8(e)(3)(iii)(B)(2) provides in relevant part that manufacturers, processors, wholesalers, jobbers, and distributors must select BLS price indexes from Table 6 of the "PPI Detailed Report", unless the taxpayer can demonstrate that selecting BLS price indexes from another table of the "PPI Detailed Report" is more appropriate. Retailers may select BLS price indexes from either Table 3 of the "CPI Detailed Report" or from Table 6 (or another more appropriate table) of the "PPI Detailed Report."

Section 1.472-8(e)(3)(iii)(B)(3) provides generally that in the case of a retailer using the retail method, the appropriate month is the last month of the retailer's taxable year. In the case of all other taxpayers, the appropriate month is the month most consistent with the method used to determine the current-year cost of the dollar-value pool under

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§ 1.472-8(e)(2)(ii) and the taxpayer's history of inventory production or purchases during the taxable year. A taxpayer not using the retail method may annually select an appropriate month for each dollar-value pool or make an election on Form 970, "Application to Use LIFO Inventory Method," to use a representative appropriate month (representative month). An election to use a representative month is a method of accounting and the month elected must be used for the taxable year of the election and all subsequent taxable years, unless the taxpayer obtains the Commissioner's consent under § 1.446-1(e) to change or revoke its election.

### ANALYSIS

After selecting the appropriate BLS table, a taxpayer must determine which monthly BLS price indexes to use when computing each pool's IPI. Under § 1.472-8(e)(3)(iii)(B)(3), a taxpayer may determine the "appropriate" month each year or may elect to use a "representative" month. In either case, the taxpayer's selection must be based on the criteria in § 1.472-8(e)(3)(iii)(B)(3). The balance of this memorandum concerns the criteria to be used when annually selecting the appropriate month for the items within a pool.

Section 1.472-8(e)(3)(iii)(B)(3) requires retailers using the retail method to use the last month of the taxable year as the appropriate month. When using the retail method, all retailers must determine the retail value of ending inventories, which is computed by multiplying the number of units of each item in ending inventories by the end-of-year retail price of those units. Thus, requiring retailers to use end-of-year price indexes should ensure that their inventory methods will clearly reflect income.

In contrast, § 1.472-8(e)(3)(iii)(B)(3) does not dictate the appropriate month for taxpayers that do not use the retail method. Instead, this regulation prescribes two criteria that allow a taxpayer to determine its own appropriate month. Under § 1.472-8(e)(3)(iii)(B)(3), the appropriate month is the month most consistent with the taxpayer's method of determining the current-year cost of inventories under § 1.472-8(e)(2)(ii) ("first criterion") and the taxpayer's history of inventory production or purchases during the taxable year ("second criterion"). Notwithstanding the interchangeable use of "an" and "the" in § 1.472-8(e)(3)(iii), in general, only one month of a given taxable year can satisfy both of these criteria.

The first criterion in § 1.472-8(e)(3)(iii)(B)(3) requires only the identification of the taxpayer's method of accounting. For example, when a taxpayer's method of determining the current-year cost of inventories is the earliest-acquisitions method, an early month in the taxable year will be appropriate, and a late month in the taxable year will not be appropriate. Conversely, when a taxpayer's method of determining the current-year cost of inventories is the most-recent-acquisitions method, a late month in the taxable year will be appropriate, and an early month in the taxable year will not be appropriate. The second criterion in § 1.472-8(e)(3)(iii)(B)(3), which requires an

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analysis of the taxpayer's annual acquisition of goods, can require a result different from what would have obtained if only the first criterion were required.

Section 1.472-8(e)(3)(iii)(B)(4) *Example 1* ("Example 1") shows how a taxpayer determines the appropriate month:

*Example 1.* A wholesaler of seasonal goods timely files a Form 970, "Application to Use LIFO Inventory Method," for the taxable year ending December 31, 2001. The taxpayer indicates elections to use the dollar-value LIFO method, to determine the current-year cost using the earliest acquisitions method in accordance with paragraph (e)(2)(ii)(b) of this section, and to use the IPIC method under paragraph (e)(3) of this section. Although the taxpayer purchases inventory items regularly throughout the year, the items purchased vary according to the seasons. The seasonal items on hand at December 31, 2001, are purchased between October and December. Thus, based on the taxpayer's use of the earliest acquisitions method of determining current-year cost and its experience with inventory purchases, the appropriate month for the items represented in the ending inventory at December 31, 2001, is October.

The result in *Example 1* reflects the application of § 1.472-8(e)(3)(iii)(B)(3)'s two criteria to the taxpayer's inventories of seasonal goods, but in reverse order. First, the taxpayer must consider the purchase history of the items in *ending* inventories. The purchase history of items not represented in ending inventories is irrelevant. In *Example 1*, the relevant purchase history is all purchases during the months of October, November, and December. Second, the taxpayer must consider its method of determining the current-year cost of the items in the pool. In *Example 1*, the taxpayer uses the earliest-acquisitions method. Thus, in *Example 1*, October is the appropriate month.

Of course, the result in *Example 1* might have been different if the facts had been different. Presumably, the fact that the taxpayer regularly purchases goods throughout the year means that the taxpayer regularly purchases seasonal goods throughout October, November, and December, too. But if this taxpayer had purchased 92 percent of its seasonal goods in December, the holding might have been that December is the appropriate month. In other words, the second criterion would have trumped the first criterion twice.

Applying § 1.472-8(e)(3)(iii)(B)(3)'s two criteria to this case, we find that for 2007, Taxpayer should have used December as its appropriate month for both pools. Under the first criterion, December is the month most closely linked to Taxpayer's use of the most-recent-acquisitions method of determining the current-year cost of inventories. The second criterion does not require a different result because Taxpayer's purchases and product mix were fairly uniform during 2007.

Please call (202) 622-4970 if you have any further questions.

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