

Internal Revenue Service

Department of the Treasury

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Person to Contact:

Telephone Number:

Refer Reply To:

CC:ITA:6 – PLR-102741-02

Date: June 5, 2002

LEGEND:

A =
B =
C =
D =
E =

Dear _____ :

This letter responds to your request for a ruling on whether the conformity rules of section 472(g) of the Internal Revenue Code [“the Code”] apply to the facts described below.

FACTS:

A, a C corporation, is a wholesaler of C. A uses the accrual method of accounting, and files its federal income tax return, Form 1120, on a 52-53 week fiscal year ending on the Saturday closest to January 31 of each year. A uses the last-in, first-out (LIFO) inventory method for federal income tax purposes.

A is one of a group of D corporations included in the consolidated financial statements of B. Each of these corporations is a wholesaler of E. Each corporation files its own separate federal income tax return and reports its inventory under the LIFO method. B has a financial interest, either directly or indirectly, in each corporation.

B maintains no inventory of its own, and reports the inventory of its affiliated corporations in its consolidated financial statements under the LIFO method. A wishes to change its method of accounting for its inventory from the LIFO method to the first-in, first-out (FIFO) method. In its consolidated financial statements, B will account for A’s inventory under the FIFO method.

LAW AND ANALYSIS:

Under section 472(a) of the Code, a taxpayer may elect the LIFO inventory method by filing an application in a manner specified by the Secretary in regulations. However, the taxpayer's election and subsequent use of the LIFO method must be in accordance with such conditions that the Secretary might prescribe, so that the use of the LIFO method clearly reflects income.

Section 472(c) of the Code imposes the condition that a taxpayer electing the LIFO method for income tax reporting purposes must also use the LIFO method for financial reporting to shareholders, partners, other proprietors, or beneficiaries, or for credit purposes. Additionally, section 472(e) extends this requirement to years subsequent to the year in which the taxpayer elects LIFO.

In Insilco Corp. v. Commissioner, 73 T.C. 589 (1979), aff'd by unpublished opinion, 659 F.2d 1059 (2d Cir. 1981), nonacq., 1982-2 C.B. 3, nonacq. withdrawn, 1987 C.B. 1, the Tax Court addressed the application of the conformity rule to a parent corporation and its subsidiaries. Insilco Corporation's subsidiaries reported their inventories under the LIFO method both to Insilco for financial reporting purposes and on their separate federal income tax returns. The parent corporation reported its subsidiaries' inventories on a non-LIFO basis in its consolidated financial statements. The government challenged this practice on the theory that for purposes of the LIFO conformity rule, Insilco's shareholders were shareholders of its subsidiaries, also. The Tax Court rejected this argument, holding that Insilco's consolidated report to its shareholders did not violate the LIFO conformity requirement of section 472(e).

In response, Congress legislatively overturned the Insilco decision by enacting section 472(g) of the Code in section 95 of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, 616. In pertinent part, section 472(g) provides that any group of corporations "consolidating or combining for purposes of financial statements" shall be treated as one taxpayer for LIFO conformity purposes. Thus, section 472(e) applies to corporations issuing consolidated financial statements for financial reporting purposes, unless the Secretary, pursuant to regulations, approves a change to a method of accounting other than LIFO or requires a change to a method other than LIFO in order to clearly reflect income. Accordingly, under sections 472(e) and 472(g), if subsidiaries use the LIFO method, then their parent must use LIFO for the purpose of its financial statements to shareholders, partners, or other proprietors, or to beneficiaries, or for credit purposes.

The facts in Rev. Rul. 88-69, 1988-2 C.B. 124, are a variant of the LIFO conformity rule scenario. In the revenue ruling, a manufacturing corporation (P) filed a consolidated federal income tax return for itself and its two manufacturing subsidiaries, X and Y. P reported its own and X's inventory under the LIFO inventory method for federal income tax purposes, but reported Y's inventory under a non-LIFO method. In the group's

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consolidated financial statements, P reported its own and X's inventory under the LIFO method, but reported Y's inventory under a non-LIFO method.

In its analysis, the Service reasoned as follows:

The purpose of the LIFO conformity requirement is to ensure that taxpayers not use the LIFO method for tax purposes unless that method conforms as nearly as possible to the best accounting practice in the taxpayer's trade or business. See H.R. Rep. No. 432, 98th Cong., 2d Sess. 1380 (1984). Thus, if a taxpayer does not use the LIFO method for tax purposes for a particular trade or business, there is no inference that the LIFO method is the best accounting practice for that trade or business, and the LIFO conformity requirement does not apply to that trade or business. This remains true even if the taxpayer conducts one or more other trades or businesses for which the LIFO method is used for tax purposes (and thus for which the LIFO method must be the best accounting practice, as shown by compliance with the LIFO conformity requirement).

Under section 472(g) of the Code, all members of the same group of financially related corporations shall be treated as one taxpayer for purposes of the LIFO conformity requirement. Thus, the conformity requirement is applicable to a subsidiary only to the extent that such requirement would apply to a separate trade or business of a single taxpayer.

Accordingly, the Service held in Rev. Rul. 88-69 that section 472(g) does not require a taxpayer using the LIFO inventory for federal income tax purposes to report the inventory of its subsidiary under the LIFO method in consolidated financial statements if the subsidiary uses a non-LIFO inventory method for federal income tax purposes.

Similarly to the facts of Rev. Rul. 88-69, A will report its inventory using a non-LIFO method, i.e., the FIFO method. Accordingly, B's reporting A's inventory under the FIFO method on B's consolidated financial statements will not violate the conformity requirement of sections 472(g) of the Code.

CONCLUSION:

When A changes from the LIFO inventory method to another method for federal income tax purposes, the computation and reporting of A's income using the FIFO method in B's consolidated financial statements will not violate the conformity requirements of sections 472(e) and 472(g) of the Internal Revenue Code.

CAVEATS:

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter

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ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Thomas A. Luxner
Branch Chief
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: