Part III

Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions.
(Also Part I, §§ 446, 471, 472, 1.446-1, 1.471-8, 1.472-1.)

Rev. Proc. 98-49

SECTION 1. PURPOSE

This revenue procedure provides guidance to taxpayers that use the dollar-value last-in, first-out (LIFO) inventory method and the inventory price index computation (IPIC) method regarding the computation of a percent change for the first taxable year in which such percent change is computed with reference to a revised *CPI Detailed Report* (CPI) or a *PPI Detailed Report* (PPI) for any index category affected by such revisions. A revised CPI or PPI is one that contains new index categories, eliminates some previously reported index categories, resets the base year of some index categories, or does not report the relative weights of some index categories. Generally, under this revenue procedure, any reasonable method of computing a percent change for a selected index category affected by revisions to the CPI or PPI will be accepted by the Internal Revenue Service. This revenue procedure also provides a specific safe harbor method that will be considered a reasonable method for these purposes.

SECTION 2. BACKGROUND

.01 Section 472(a) of the Internal Revenue Code authorizes a taxpayer to use the LIFO inventory method in accordance with regulations prescribed by the Secretary.

.02 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 method is used consistently and clearly reflects the taxpayer’s income.

.03 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.

.04 Section 1.472-8(e)(3)(i) authorizes the use of the IPIC method to compute the LIFO value of a dollar-value inventory pool. An inventory price index computed in the manner provided in § 1.472-8(e)(3) will be accepted by the Commissioner as an appropriate method of computing an index, and the use of such index will be accepted as accurate, reliable, and suitable.

.05 Section 1.472-8(e)(3)(ii) provides that an inventory price index computed under the IPIC method must be a stated percentage of the percent change in the selected consumer or producer price index or indexes. The stated percentage for a taxpayer in a taxable year in which it is an eligible small business is 100 percent of the percent change in the selected price indexes. The stated percentage for all other taxpayers is

80 percent of the percent change in the selected price indexes. If it is necessary to select more than one specific consumer or producer price index for an inventory pool, the stated percentage of the percent change is the stated percentage of the weighted average percent change for such indexes. Such weighed average is computed by reference to the relative amounts of current-year costs in the inventory pool for each index category of goods.

.06 Section 1.472-8(e)(3)(iii) describes the process for selecting consumer and producer price indexes under the IPIC method. Inventory items in each of the taxpayer’s pools are classified according to the detailed listings in the appropriate tables of the CPI or PPI (formerly known as *Producer Prices and Price Indexes*) and assigned to various index categories. § 1.472-8(e)(3)(iii)(B). Indexes and weights published by the United States Bureau of Labor Statistics (BLS) are used to compute the percent change for each index category to which inventory items have been assigned. Id. In many cases, the selected index for an index category must be converted into a cost price index prior to the computation of the percent change for the index category. § 1.472-8(e)(3)(iii)(C). In the case of a taxpayer using the retail inventory method, the index selected must be the index as of the last month of the taxpayer's taxable year. Id. Taxpayers that do not use the retail method must select indexes as of the month or months most appropriate to the taxpayer's method of determining the current-year cost of the inventory pool under § 1.472-8(e)(2)(ii), or make a one-time binding election of an appropriate representative month during the taxable year. Id.

.07 The BLS frequently makes changes to the categories included in the CPI or PPI. For example, the BLS revised the categories of goods listed in the January 1998 CPI by introducing some new categories as of January 1998 and eliminating or resetting some existing categories as of December 1997. Consequently, January 1999 will be the first month for which it is possible to compute a percent change for a 12-month period with reference to the BLS published indexes for any affected index category (as described in section 3 of this revenue procedure). Moreover, the BLS did not publish weights for some index categories.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer that uses the dollar-value LIFO inventory and IPIC methods pursuant to § 1.472-8(e)(3) for any taxable year in which a percent change for an index category for the 12-month period ending with the appropriate index month, as defined in § 1.472-8(e)(iii)(C) ("index month"), (or, in the case of a short taxable year, the applicable period) cannot be computed by the taxpayer in strict conformity with § 1.472-8(e)(3)(ii) or (iii) because of revisions to the CPI or PPI as described in section 2.07 of this revenue procedure (“affected index category”).

SECTION 4. APPLICATION

A taxpayer described in section 3 of this revenue procedure may use any reasonable method of computing a percent change for each affected index category, provided such method is used consistently for all affected index categories within a particular taxable year. The procedure for computing a percent change for an affected index category set forth in section 5 of this revenue procedure is deemed to be a reasonable method for these purposes.

SECTION 5. PROCEDURE

.01 When a revised CPI or PPI includes new index categories or eliminates or resets old index categories, a taxpayer may compute a total percent change for each affected index category represented in the taxpayer's ending inventory in accordance with the procedure provided in this section 5.01. This total percent change will be a combination of the percent change for the second portion of the taxable year based on the revised index category and the corresponding percent change for the first portion of the taxable year based on the old index category.

(1) A taxpayer must first compute the percent change for each affected index category set forth in the revised CPI or PPI for the period between the first month covered by the revised CPI or PPI and the index month ("the second portion") as follows:

(a) Using the appropriate table of the revised CPI or PPI for the index month, all specific inventory items must be placed in the most detailed index category that includes that specific inventory item (without regard to the index selection requirements in § 1.472-8(e)(3)(iii)(B)).

(b) The percent change of each revised CPI or PPI index category for the second portion is determined using the following formula:

[(A-B) / B) * 100]

where:

A = Cumulative index for index month (adjusted, as necessary, to reflect a cost or retail price index)

B = Cumulative index for last month of old CPI or PPI as published for the first month of revised CPI or PPI (adjusted, as necessary, to reflect a cost or retail price index).

(2) A taxpayer must then compute a percent change for each affected index category set forth in the old CPI or PPI for the period between the preceding year's index month and the last month covered by the old CPI or PPI ("the first portion") as follows:

(a) Using the appropriate table of the old CPI or PPI for the preceding year’s index month, all specific inventory items must be placed in the most detailed index category that includes that specific inventory item (without regard to the index selection requirements of § 1.472-8(e)(3)(iii)(B)).

(b) The percent change of each old CPI or PPI index category for the first portion is determined using the following formula:

[(C-D) / D) * 100]

where:

C = Cumulative index for last month of old CPI or PPI as published for the last month of old CPI or PPI (adjusted, as necessary, to reflect a cost or retail price index)

D = Cumulative index for preceding year's index month (adjusted, as necessary, to reflect a cost or retail price index).

(3) The taxpayer will then determine the total percent change for each index category set forth in the revised CPI or PPI represented in the ending inventory by combining the percent change for the second portion with the corresponding percent change for the first portion using the following formula:

({[(X + 100) * (Y + 100)] / 100} - 100)

where:

X = Percent change for the second portion

Y = Percent change for the first portion.

For purposes of computing the total percent change for each revised CPI or PPI index category, the corresponding percent change for the first portion is the percent change for the old CPI or PPI index category that includes the specific inventory item(s) included in the revised CPI or PPI index category. If specific inventory items included in a single revised CPI or PPI index category were separately included in different old CPI or PPI index categories, the corresponding percent change for the first portion is the weighted average percent change of such old CPI or PPI percent changes. The costs to be used in computing such weighted average must be the relative current-year costs in ending inventory.

.02 When § 1.472-8(e)(3)(iii)(B)(5) requires a taxpayer to compute a percent change for a selected index category using the BLS weights and the CPI or PPI does not report the relative weights for one or more of the taxpayer's detailed index categories within a selected index category, the taxpayer may weight the detailed index categories actually present in its ending inventory within such selected index category using the taxpayer's actual inventory weights.

SECTION 6. EXAMPLE

.01 The following example illustrates the index selection and computation procedure described in section 5 of this revenue procedure. X, a retailer, uses the retail inventory method along with the dollar-value LIFO and IPIC inventory methods and files its returns on the basis of a taxable year ending on January 31. Under § 1.472-8(e)(3)(iii)(C), X is required to select indexes from the CPI as of January, the last month of X's taxable year. X has five items in its only dollar-value LIFO pool on January 31, 1998 -- tomatoes, bananas, lemons, oranges, and peaches. The retail selling prices of the goods were tomatoes, $1,000; bananas, $80; lemons, $50; oranges, $50; and peaches, $20.

.02 Pursuant to § 1.472-8(e)(3)(iii)(B), X assigns the items to the most detailed listings in the January 1998 CPI as follows:

tomatoes are assigned to “Tomatoes”; bananas are assigned to "Bananas;" lemons are assigned to "Citrus fruits;" oranges are assigned to "Oranges, including tangerines;" and peaches are assigned to "Other fresh fruits."

.03 X selects the index for “Tomatoes” because tomatoes represent more than 10% of its total inventory value. §§ 1.472-8(e)(3)(iii)(B)(1) and (4). X can compute a total percent change for “Tomatoes” in accordance with §§ 1.472-8(e)(3)(ii) and (iii) using the information contained in the CPI for January 1997 and January 1998. Thus, the “Tomatoes” index category is not an affected index category, and X must compute the total percent change for that index category in accordance with §§ 1.472-8(e)(3)(ii) and (iii). Because no remaining detailed index category contains 10% or more of X’s total inventory value, X must investigate successively less detailed index category levels. § 1.472-8(e)(3)(iii)(B)(2). X discovers that the remainder of its inventory fits within the “Fresh fruits” index category. X, however, may not use the published “Fresh fruits” index for the remainder of its goods, because X’s inventory does not include apples. § 1.472-8(e)(3)(iii)(B)(5). X must compute a percent change for the “Fresh fruits” index category using the BLS indexes and weights published for the detailed index categories actually present in its inventory. Id. However, the BLS did not publish a cumulative index for “Citrus fruits” in the January 1997 CPI or weights for “Oranges, including tangerines” in the January 1998 CPI. Moreover, the BLS reset the base year for “Other fresh fruits” in the January 1998 CPI. Since X cannot compute a total percent change for “Fresh fruits” in strict conformity with §§ 1.472-8(e)(3)(ii) and (iii), X chooses to compute such total percent change using the method described in section 5 of this revenue procedure.

.04 Pursuant to section 5.01(1)(a) of this revenue procedure, X assigns the inventory items within the affected “Fresh fruits” category to the most detailed index categories in the 1998 CPI as follows: bananas are assigned to "Bananas;" lemons are assigned to "Citrus fruits;" oranges are assigned to "Oranges, including tangerines;" and peaches are assigned to "Other fresh fruits." Pursuant to section 5.01(1)(b) of this revenue procedure, X computes the percent changes for the second portion as follows:

Items	1998 Category	Computation	% Change
bananas	Bananas =	[(154.7 - 151.5) / 151.5)] * 100 =	2.1122
lemons	Citrus f=	[(105.6 - 100.0) / 100.0)] * 100 =	5.6000
oranges	Oranges =	[(201.3 - 189.3) / 189.3)] * 100 =	6.3391
peaches	Other ff=	[(96.6 - 100.0) / 100.0)] * 100 =	-3.4000

.05 Pursuant to section 5.01(2)(a) of this revenue procedure, X assigns the items to the most detailed index categories in the January 1997 CPI as follows: bananas are assigned to "Bananas;" lemons are assigned to "Other fresh fruits;" oranges are assigned to "Oranges, including tangerines;" and peaches are assigned to "Other fresh fruits." Pursuant to section 5.01(2)(b) of this revenue procedure, X computes the percent changes for the first portion as follows:

Items	1997 Category	Computation	% Change
bananas	Bananas =	[(151.5 - 161.9) / 161.9)] * 100 =	-6.4237
lemons	Other ff=	[(294.9 - 290.2) / 290.2)] * 100 =	1.6196
oranges	Oranges =	[(189.3 - 187.4) / 187.4)] * 100 =	1.0139
peaches	Other ff=	[(294.9 - 290.2) / 290.2)] * 100 =	1.6196

.06 Pursuant to section 5.01(3) of this revenue procedure, X computes the total percent change for each 1998 CPI detailed index category by combining the corresponding percent changes for the first and second portions as follows:

1998 Category	Computation	% Change
Bananas	= {[(102.1122 * 93.5763) / 100] - 100} =	-4.4472
Citrus f	= {[(105.6000 * 101.6196) / 100] - 100} =	7.3103
Oranges	= {[(106.3391 * 101.0139) / 100] - 100} =	7.4173
Other ff	= {[(96.6000 * 101.6196) / 100] - 100} =	-1.8355

Because the BLS published the total percent change for “Bananas” and “Oranges, including tangerines” in the January 1998 CPI, it was not necessary for X to compute a total percent change for those detailed index categories pursuant to section 5.01 of this revenue procedure.

.07 Pursuant to section 5.02 of this revenue procedure, X computes the weights for each 1998 CPI detailed index category as follows:

1998 Detailed Category	Detailed Category Cost		Selected Category Cost		Weight
Bananas	= $80	/	$200	=	0.40
Citrus fruits	= $50	/	$200	=	0.25
Oranges	= $50	/	$200	=	0.25
Other fresh fruits	= $20	/	$200	=	0.10

Then, X weights the percent change for each 1998 CPI detailed index category and adds them together to determine the total percent change for the “Fresh fruits” index category as follows:

1998 Detailed Category	Weight		% Change		Weighted % Change
Bananas	= 0.40	x	-4.4472	=	-1.7789
Citrus fruits	= 0.25	x	7.3103	=	1.8276
Oranges	= 0.25	x	7.4173	=	1.8543
Other fresh fruits	= 0.10	x	-1.8355	=	-0.1836
Total Percent Change					+1.7194

SECTION 7. METHOD OF ACCOUNTING

The selection of a new consumer or producer price index for a specific inventory item to compute an inventory price index as a result of revisions to the CPI or PPI as described in section 2.07 of this revenue procedure will not be treated as a change in method of accounting. Any other change in the selection of a consumer or producer price index for a specific inventory item is a change in method of accounting for which the taxpayer must secure the consent of the Commissioner as provided in § 446(e). *See* § 1.472-8(e)(3)(iii)(B).

DRAFTING INFORMATION

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