

## Private Letter Ruling 9332003, 4/21/1993, IRC Sec(s). 472

AUTO DEALER USED FLAWED LIFO METHOD.

A new car dealer elected the dollar-value LIFO method of valuing inventories, used the link-chain method of computing the LIFO value of its dollar-value inventory pools, and elected the earliest acquisitions method of determining current-year costs. In practice, however, the dealer used a modified dual-index method. In the year under examination, the dealer had two pools, consisting of two types of new autos.

In computing the annual LIFO index, the actual cost of the vehicles in ending inventory as shown on the manufacturers' invoices were used as the current year cost of items making up each vehicle pool. The prior year's latest manufacturers' bulletin price of a similar vehicle was used as the beginning-of-the-year cost for each vehicle in ending inventory.

New items in ending inventory were excluded from the computation of the annual LIFO index. New items were vehicles assigned a new body code by the manufacturer. The dealer did not otherwise make adjustments when equipment or options were different between items in beginning and ending inventory.

The dealer stated that 100 percent of the value of the vehicles in one pool and 98.97 percent of the value of the vehicles in the second pool were double extended in the audit year. In the previous year, however, those figures were 74.83 percent and 72.94 percent, respectively.

The beginning-of-the-year and current-year costs of all items except new models were collected by pool, and an index -- the annual LIFO index -- was computed by dividing current-year costs by beginning-of-the-year costs. The cumulative index was computed by multiplying the current annual LIFO index by the prior year's cumulative index. The base-year cost was calculated by taking the total current-year cost of ending inventory (including new models) and dividing it by the cumulative index. That division restated the ending inventory at base-year cost. Any increase or decrease in inventory was determined by comparing beginning inventory at base-year cost with ending inventory at

base-year cost. Any increase in inventory (expressed in base-year dollars) was then converted into current-year cost using the prior year's cumulative index. The result was the LIFO value of the increase. The dealer also treated minivans as different items from passenger cars.

The Service has ruled in technical advice that the dealer cannot arbitrarily exclude new items when computing its annual LIFO index under the link-chain method. All items in ending inventory should be included in the computation unless a representative sample, or other sound and consistent statistical method, is used. The Service also ruled (1) that the dealer cannot reconstruct the beginning-of-the-year costs of new items using an annual LIFO index derived by excluding new items from the computation; (2) that the reasonableness of the dealer's method of reconstruction requires a facts-and-circumstances analysis by the district director; (3) that the dealer's dual-index method is not permissible and that any increment valuation should be based on cost incurred during the current year, not costs incurred during the prior year; and (4) that minivans should be included in passenger car pools.

## Full Text:

Date: April 21,

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### ISSUES

1. Under the dollar-value, last-in, first-out (LIFO) inventory method, and the link-chain method of computing the LIFO value, can X exclude new models from the computation of the annual LIFO index?
2. May X reconstruct the beginning-of-the-year costs of "new items" under section 1.472-8(e)(2)(iii) of the Income Tax Regulations utilizing an annual LIFO index that excludes "new items" from the computation?
3. Does X have an absolute right to reconstruct the beginning- of-the-year costs of all "new items" under section 1.472-8(e)(2)(iii) of the regulations?
4. In computing its dollar-value LIFO inventory, is X's dual index method permissible?
5. Under X's dollar-value LIFO method of valuing its inventory, should X's minivans be included in a passenger car pool or a truck pool?

### Facts

X is a full service automobile dealership that sold new a and b vehicles during Year 1, the year under examination. In Year 2, X elected the dollar-value LIFO method of valuing inventories. X used the "link-chain" method for computing the LIFO value of its dollar- value inventory pools, and elected the earliest acquisitions method of determining current-year costs. In practice, however, X used a modified dual index method. During Year 1, X had two pools consisting of new a and new b automobiles.

X computed its annual LIFO index using the following link-chain method. First, the actual cost of the vehicles in ending inventory as shown on the manufacturers' invoices were used as the current-year cost of items making up each vehicle pool. Second, the prior year's latest manufacturers' bulletin price of a similar vehicle was used as the beginning-of-the-year cost for each vehicle in ending inventory.

If however, the vehicle in ending inventory was a new model, that vehicle was excluded from the computation of the annual LIFO index. A vehicle was a new item under X's method if the manufacturer assigned a new body code to the vehicle. A new body code was issued, for example, if the manufacturer determined that the vehicle components were different enough from one vehicle to another, or when standard equipment varied within the same body wheelbase. For vehicles other than those with a new body code, X did not make adjustments in order to compare like vehicles if standard

equipment or options were different between the vehicles in ending inventory and the vehicles in beginning inventory.

X represents that under its method, 100 percent of the value of the vehicles in pool a and 98.97 percent of the value of the vehicles in pool b were double extended in Year 1. In the year prior to Year 1, however, X's method of excluding new models resulted in a double extension of only 74.83 percent of the value of the vehicles in pool a and 72.94 percent of the value of the vehicles in pool b.

The beginning-of-the-year and current-year costs of all items (except new models) were collected by pool, and an index -- the annual LIFO index -- was computed by dividing current-year costs by beginning-of-the-year costs. The cumulative index was computed by multiplying the current annual LIFO index by the prior year's cumulative index. The base-year cost was calculated by taking the total current-year cost of ending inventory (including new models) and dividing it by the cumulative index. This division restated the ending inventory at base-year cost. Any increase or decrease in inventory was determined by comparing beginning inventory at base-year cost with ending inventory at base-year cost. Any increase in inventory (expressed in base-year dollars) was then converted into current-year cost using the prior year's cumulative index, rather than the current year's cumulative index. The end result was the LIFO value of the increase.

In Year 3, the full-size c van (previously carried in X's inventory) was discontinued, and the c minivan was introduced. Although X includes c minivans in its passenger car pools, the minivans are treated as different items from the passenger cars. In Year 1, the c minivan represented approximately 35 percent of the value of X's inventory. X does not have a dealership license to sell trucks.

## **Applicable Law**

Section 472(a) of the Internal Revenue Code provides that a taxpayer may use the LIFO inventory method in inventorying goods if, among other requirements, the LIFO method clearly reflects the taxpayer's income.

Section 472(b)(2) of the Code provides that in inventorying goods under the LIFO method, the taxpayer shall inventory them at cost.

Section 1.472-8(a) of the regulations provides that any taxpayer may elect to determine the cost of its LIFO inventories under the dollar-value LIFO method, provided such method is used consistently and clearly reflects income. The dollar-value method of valuing LIFO inventories is a method of determining cost by using "base-year" cost expressed in terms of total dollars rather than the quantity and price of specific goods as the unit of measurement. The term "base-year cost" is the aggregate of the cost (determined as of the beginning of the tax year for which the LIFO method is first adopted, i.e., the base date) of all items in a pool. Under this dollar-value method the goods contained in the taxpayer's inventory are grouped into a pool or pools as described in sections 1.472-8(b) and (c).

Liquidations and increments of items contained in the pool shall be reflected only in terms of a net liquidation or increment for the pool as a whole.

Section 1.472-8(c) of the regulations provides the principles for establishing pools for retailers. Items of inventory shall be placed into pools by major lines, types, or classes of goods.

Section 1.472-8(e)(1) of the regulations provides that a taxpayer may ordinarily use only the double-extension method for computing the base-year and current-year cost of a dollar-value inventory pool. Where the use of the double-extension method is impractical, because of technological changes, the extensive variety of items, or extreme fluctuations in the variety of the items, in a dollar-value pool, the taxpayer may use an index method for computing all or part of the LIFO value of the pool. An index may be computed by double-extending a representative portion of the inventory in a pool or by the use of other sound and consistent statistical methods. The index used must be appropriate to the inventory pool to which it is to be applied. The appropriateness of the method of computing the index and the accuracy, reliability, and suitability of the use of such index must be demonstrated to the satisfaction of the district director in connection with the examination of the taxpayer's income tax returns. The use of any "link-chain" method will be approved only in those cases where the taxpayer can demonstrate to the satisfaction of the district director that the use of either the index method or the double-extension method would be impractical or unsuitable in view of the nature of the pool.

Section 1.472-8(e)(2)(i) of the regulations provides that under the double-extension method the quantity of each item in the inventory pool at the close of the taxable year is extended at both base-year unit cost and current-year unit cost.

Section 1.472-8(e)(2)(ii) of the regulations provides that the total current-year cost of items making up a pool may be determined --

- (a) By reference to the actual cost of goods most recently purchased;
- (b) By reference to the actual cost of the goods purchased during the taxable year in the order of acquisition;
- (c) By the application of an average unit cost equal to the aggregate cost of all of the goods purchased throughout the taxable year divided by the total number of units so purchased; or
- (d) Pursuant to any other proper method which, in the opinion of the Commissioner, clearly reflects income.

Section 1.472-2(d)(1)(ii) of the regulations provides that whichever method of valuing increments is adopted by the taxpayer and approved by the Commissioner must be consistently adhered to in all subsequent taxable years, so long as the LIFO inventory method is used by the taxpayer.

Section 1.472-8(e)(2)(iii) of the regulations provides that under the double-extension method a base-year unit cost must be ascertained for each item entering a pool for the first time subsequent to the beginning of the base year. In such a case, the base-year unit cost of the entering item shall be the current-year cost of that item unless the taxpayer is able to reconstruct or otherwise establish a different cost. If the entering item is a product or raw material not in existence on the base date, its cost may be reconstructed, that is, the taxpayer using reasonable means may determine what the cost of the item would have been had it been in existence in the base year. If the item was in existence on the base date but not stocked by the taxpayer, he may establish, by using available data or records, what the cost of the item would have been to the taxpayer had he stocked the item.

Section 1.472-3(d) of the regulations provides that whether or not the taxpayer's application for adoption and use of the LIFO inventory method should be approved, and whether or not such method, once adopted, may be continued, and the propriety of all computations incidental to the use of such method, will be determined by the Commissioner in connection with the examination of the taxpayer's income tax returns.

Section 446(a) of the Code states that taxable income shall be computed under the method of accounting on the basis of which the taxpayer regularly computes his income in keeping his books.

Section 1.446-1(a)(1) of the regulations states that the term "method of accounting" includes not only the over-all method of accounting of the taxpayer but also the accounting treatment of any item.

Section 446(e) of the Code and section 1.446-1(e)(2)(i) of the regulations state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes.

Section 1.446-1(e)(2)(ii)(a) of the regulations provides that a change in method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. Although a method of accounting may exist under this definition without the necessity of a pattern of consistent treatment of an item, in most instances a method of accounting is not established for an item without such consistent treatment. A material item is any item which involves the proper time for the inclusion of the item in income or the taking of a deduction.

Section 1.446-1(e)(3)(i) of the regulations requires that in order to obtain the Commissioner's consent to a method change, an application must be filed within 180 days after the beginning of the taxable year in which the taxpayer desires to make the proposed change.

Section 481(a) of the Code provides, in part, that if a taxpayer's taxable income for any taxable

year is computed under a method of accounting different from the method used for the preceding taxable year, then there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted.

## **Rationale**

ISSUE 1: The issue is whether X, in computing its LIFO value under the link-chain method, may exclude new items from the computation of the annual LIFO index.

Section 1.472-8(e)(1) of the regulations provides for three methods of computing the LIFO value of a dollar-value pool: the double-extension, the index and the link-chain methods. The regulations prefer the use of the double-extension method by stating that "[a] taxpayer may ordinarily use only the so-called 'double-extension' method for computing the base-year and current-year cost of a dollar-value LIFO pool." Section 1.472-8(e) of the regulations. Under that method, each item in a pool is double-extended, or valued, at the close of the taxable year both at current-year unit cost and base-year unit cost. In contrast, under the index method, a representative portion of items in the pool are extended at both base-year and current-year cost. Section 1.472-8(e)(1) of the regulations. In connection with the examination of the taxpayer's income tax returns, the taxpayer must establish to the satisfaction of the district director the appropriateness of the method of computing the index, and the accuracy, reliability and suitability of the use of such index.

A taxpayer may use the link-chain method only if the taxpayer can demonstrate to the district director that the use of either an index method or double-extension method would be impractical or unsuitable in view of the nature-of the pool. Under the link-chain method, each year's ending inventory is restated at beginning-of-the-year costs rather than at fixed, base-year costs. An annual index (or annual link) is computed each year by comparing ending inventory at current-year cost to ending inventory at beginning-of-the-year cost. The cumulative index is the product of all the annual indexes. The base-year cost of the ending inventory is calculated by taking the actual current-year cost of the ending inventory and dividing it by the cumulative index. This division restates the ending inventory at base-year cost. Any increase or decrease in inventory is determined by comparing beginning inventory at base-year cost with ending inventory at base-year cost. Any increase in inventory (expressed in base-year dollars) is then converted into current-year cost using the cumulative index. The end result is the LIFO value of the increase.

A taxpayer may use an index method in conjunction with the link-chain method only in those cases in which the taxpayer can demonstrate to the satisfaction of the district director that a double-extension of all items in the pool would be impractical or unsuitable in view of the nature of the pool. If the criteria for using an index method in conjunction with the link-chain method are met, the annual LIFO index may be computed by double-extending a representative portion of the inventory in the pool or by the use of other sound and consistent statistical methods.

The Agent's position is that X's method of computing its annual LIFO index is not proper because X arbitrarily excludes new items when computing its annual LIFO index. Accordingly, the Agent states that new models should be treated as new items, and thus should be included in the inventory pool at an index of 1.000.

X, however, argues that its sample is a representative sample which clearly reflects income because a large percentage of the dollar quantity of the inventory items are extended and because the quantity of new models as a percentage of the total inventory is not material. To support its arguments, X points out that in Year 1, 100 percent of the value of the vehicles in pool a and 98.97 percent of the value of the vehicles in pool b were double extended under its method. In the year prior to Year 1, however, X's method of excluding new models resulted in the double extension of only 74.83 percent of the value of the vehicles in pool a and 72.94 percent of the value of the vehicles in pool b.

X cannot arbitrarily exclude certain items when computing its annual LIFO index under the link-chain method. Although X's method resulted in the double-extension of a large percentage of the quantity of X's ending inventory in some years, the accuracy of X's method is dependent upon the number of new models introduced each year. For example, in the year prior to Year 2, X's method resulted in double-extension of only 74.83 percent of the value of the vehicles in pool a and 72.94 percent of the value of the vehicles in pool b. Even if X were able to prove no distortion had ever resulted from its method, there is no assurance that a distortion would not result in some future year. X has not met its burden of establishing that its method results in the double-extension of a representative portion of its inventory, or that X has used other sound and consistent statistical methods. Thus, the index computed that excludes new models does not clearly reflect income. Accordingly, X must consider each item, including the new models in its dollar-value LIFO pools when computing its annual LIFO index under the link-chain method.

ISSUE 2: The issue is whether X's method of reconstructing the beginning-of-the-year costs of new models or new items in ending inventory utilizing an index derived from only a portion of vehicles in ending inventory is a reasonable means of determining what the cost of the new models would have been had they been in existence in the prior year.

Section 1.472-8(e)(2)(iii) of the regulations states that under the double-extension method a base-year unit cost must be ascertained for each item entering a pool for the first time subsequent to the beginning of the base year. Under the link-chain method, the relevant unit cost that must be ascertained for each new item is the beginning-of-the-year unit cost.

The regulations further provide that the base-year unit cost of the entering item shall be the current-year cost of that item unless the taxpayer is able to reconstruct or otherwise establish a different cost. If the entering item is a product or raw material not in existence on the base date, its cost may be reconstructed, that is, the taxpayer using reasonable means may determine what the cost of the item would have been had it been in existence in the base year. If the item was in existence on the base date but not stocked by the taxpayer, he may establish, by using available data or records, what

the cost of the item would have been to the taxpayer had he stocked the item. The taxpayer's method of reconstruction must be satisfactory to the Commissioner. Other than this general guidance, the regulations do not specifically state or give examples of reasonable means of reconstructing the base-year costs of new items.

X asserts that it is using a reasonable method of reconstruction by applying the annual LIFO index, derived from only a portion of vehicles on hand at the end of the year to new models. X argues that, in determining how much a new model would have cost at the beginning of the year, other vehicles produced by the manufacturer should be used as a guide. If the annual LIFO index represents the amount of inflation that would have occurred had the new item been available at the beginning of the year, X states that it would be reasonable to assume that new models would have increased in price at the same rate as other vehicles produced by that same manufacturer. The same administrative staff, raw material suppliers, union contracts, and depreciation schedules, etc., would influence the price of both prior models and new models. X attempted to verify its assumptions by providing data covering a six-year time period that illustrates the inflation of new items from the first year of introduction to the second and third year. In some cases the pool index increased by more than the new model index, and in other cases, the new model index increased by more than the pool index.

Section 1.472-8(e)(1) of the regulations states that an index must be appropriate to the pool to which it is applied. Because new models may vary in their characteristics and costs from existing models, an index computed using only the older models should not be applied automatically to new models. X's use of its annual LIFO index computed using prior models only as a mechanism for computing the beginning-of-the-year costs for new models is not supported by the regulations. It is inappropriate to apply an index derived from one subset of items in a pool to another subset of items.

The application of an index derived from prior models to new models could potentially produce a distortion in X's dollar value computations. These inaccuracies would then cause distortions in computations in subsequent years due to X's use of the link-chain method. Even assuming we accept X's claim that the effect of inflation on older vehicles is reflective of the effect on new models, there is no reasonable assurance that this relationship would continue in the future. Accordingly, an inventory price index for a dollar-value LIFO pool must be computed based on all the items in ending inventory for that pool.

ISSUE 3: The issue is whether X has an absolute right to reconstruct the beginning-of-the-year cost for all new items pursuant to section 1.472-8(e)(2)(iii) of the regulations. Under X's link-chain method, a new model in ending inventory is treated as a new item, and a new beginning-of-the-year cost is reconstructed for that new model.

The Agent has questioned whether reconstruction of the beginning-of-the-year cost of a new item is possible in every situation where there is a new item. If the new item is a new model, or if the new item is a vehicle with significant changes, the Agent argues that there is no reasonable means to



reconstruct, and thus, the beginning-of-the-year cost of the new item should be its current-year cost.

According to the regulations, a base-year cost (or beginning-of-the-year cost under the link-chain method) may be reconstructed for a new item in certain circumstances. The regulations provide that the base-year unit cost of the new item shall be the current-year cost of that item, unless the taxpayer is able to reconstruct or otherwise establish a different cost. In other words, the regulations create a presumption that base-year cost equals the current-year cost for a new item unless the taxpayer can reconstruct or otherwise establish a different cost.

Taxpayers should, however, be afforded the opportunity to reconstruct if they so choose. Such reconstruction is subject to the approval of the district director. The right to reconstruct is an absolute right only in the sense that the taxpayer should be given the opportunity to demonstrate that its reconstruction method is reasonable.

There is little specific guidance on exactly how to reconstruct once it is decided a new item exists. The regulations do provide, however, that if the new item is a product not in existence on the base (or beginning-of-the-year) date, the taxpayer using "reasonable means" may determine what the cost of the item would have been had it been in existence in the base year. If the new item was in existence on the base (or beginning-of-the-year) date but not stocked by the taxpayer, available data or records can be used to establish what the cost of the item to the taxpayer would have been had he stocked the item.

Whether a taxpayer's particular method is reasonable is a determination that should be left to the district director because such a determination requires a facts-and-circumstances analysis. Only the district director, in examining all the relevant facts, can properly make such a determination in all situations. Clearly, however, the regulations recognize that reconstruction may be possible even if the item in question was not in existence on the base date. Therefore, a per se rule against reconstruction in any particular situation cannot be adopted, nor is it logical to adopt a presumption that a taxpayer can reconstruct in every situation in which there is a new item.

A taxpayer's method of reconstruction should be considered reasonable if the taxpayer can demonstrate that the method used is an accurate measure of what the rate of inflation would have been had the new item been in existence in the prior year, or had the item been stocked by the taxpayer in the prior year. For example, had X used an index derived from a portion of its vehicles in ending inventory that X could demonstrate were comparable to a particular new model, application of that index to derive a reconstructed beginning-of-the-year cost for that new model should be acceptable.

ISSUE 4: The issue is whether X's dual index method is permissible. Although X elected the earliest acquisitions method of determining current-year costs, in practice X uses a dual index method. X uses the first index to measure quantity changes and the second index to value increments. The first index is computed based on actual invoice prices of vehicles in ending inventory (as current-year costs) and manufacturers' bulletin prices (as beginning-of-the-year costs). The second index is based on the prior

year's cumulative index, rather than the current year's cumulative index.

Three specific alternative methods of determining the total current-year cost of items making up a pool are provided in section 1.472-8(e)(2)(ii) of the regulations. These alternative methods are (1) the latest acquisitions cost method, (2) the earliest acquisitions cost method, and (3) the average acquisitions cost method. In addition to these three specific alternatives, the regulations also provide that a taxpayer using the dollar-value LIFO method may use any other proper method of determining current-year cost, which, in the opinion of the Commissioner, clearly reflects income.

If properly applied, the use of a two index method or dual indexes should result in an inventory valuation that is substantially the same as if the ending inventory was double-extended on an item-by-item basis. Verification of this result must be satisfactorily demonstrated by the taxpayer to the district director. The Agent has not questioned the propriety of X's use of dual indexes. The scope of the Agent's inquiry relates to the propriety of X's methodology of computing the second (incremental) index.

X argues that applying the prior year index has resulted in a close approximation of the earliest acquisition method because its method results in converting the base price of new layers to the prior year's end-of-the-year cost. Thus, X asserts that its method provides administrative ease, is a fair representation of the earliest acquisition method, and results in a clear reflection of income.

The choice of any particular alternative will have no impact on the determination of whether an increment exists or on the determination of how large an increment or decrement is created when measured at base-year cost. A taxpayer's choice of increment valuation method only affects the determination of the LIFO carrying value of the increment. Under the dollar-value LIFO method, any current increase in ending inventory must be converted back to current-year dollars to reflect that the current change in inventory is attributable to costs of the current year.

X's dual index method does not result in a clear reflection of income. Under X's method, once it is determined that an increment exists, the LIFO value of the inventory is determined by converting the increment (expressed in base-year dollars) into current-year cost by using the prior year's cumulative index. Use of the prior year's cumulative index, however, does not convert the increment into current-year dollars. Rather, use of the prior year's cumulative index restates the increment in terms of the prior's years costs. Accordingly, X's method is not appropriate because the method is not in accordance with its election to use the earliest acquisitions method, nor does it clearly reflect income.

ISSUE 5: The issue is whether X's minivans should be included in a passenger car pool or in a truck pool.

Under the dollar-value LIFO method, retailers are required to place items of inventory into pools by major lines, types or classes of goods. The proper grouping of goods into pools and items is central to the operation of the dollar-value LIFO method. *Wendle Ford Sales Inc. v. Commissioner*, 72 T.C. 447,

452-453 (1979). To produce a clear reflection of income, the goods contained in a taxpayer's LIFO pool and item categories must have similar characteristics. *Amity Leather Products Co. v. Commissioner*, 82 T.C. 726, 734-735.

There is no authority that discusses whether minivans are more like trucks than cars for purposes of dollar-value LIFO pooling. However, in *Fox Chevrolet, Inc. v. Commissioner*, 76 T.C. 708 (1981), and in *Richardson Investments, Inc. v. Commissioner*, 76 T.C. 736 (1981), the Tax Court held that new cars and new trucks should be placed in separate pools because they are sufficiently dissimilar such that each represents a separate and distinct class of goods. One major factor the Tax Court considered was the ultimate use of the vehicles. The Tax Court stated that automobiles are used primarily for the transportation of individuals, whereas trucks are more often bought for the transportation of property and for business use. *Fox Chevrolet*, 76 T.C. at 725.

One consideration in establishing multiple dollar-value pools is to ensure that price trends measured in the pool are similar among the items making up the pool. Analyzing factors such as differences in use, customer appeal, and physical capabilities is necessary in order to properly determine whether price trends of minivans are similar enough to passenger cars to achieve this purpose.

X's c minivans are properly included in its passenger car pools because its minivans are essentially substitutes for station wagons. Although seats can be removed to carry cargo, the primary use of these minivans is to transport passengers. While some minivans may be built on a truck chassis, X represents that these particular minivans are not.

## **Conclusions**

- 1) In computing its annual LIFO index under the link-chain method, X cannot arbitrarily exclude new items from the computation of the index. All items in ending inventory should be included in the computation unless a representative sample, or other sound and consistent statistical method, is used.
- 2) X cannot reconstruct the beginning-of-the-year costs of new items using an annual LIFO index derived by excluding new items from the computation.
- 3) Whether a taxpayer's method of reconstruction is reasonable within the meaning of the regulations requires a facts-and- circumstances analysis by the district director.
- 4) X's dual index method is not permissible. Any increment valuation should be based on costs incurred during the current year, not costs incurred in the prior year.
- 5) X's minivans should be included in its passenger car pools.

A copy of the Technical Advice Memorandum is to be given to the taxpayer. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.