Inventories; LIFO; financial conformity requirements; affiliated group with foreign parent. The LIFO method of inventory valuation need not be used in the consolidated financial statements of certain foreign parent corporations that own, either directly or through members of their consolidated groups, operating assets of substantial value which are used in foreign operations, even though one or more of their subsidiaries use the LIFO method of valuing inventories for tax purposes; Rev. Rul. 73-57 revoked.

Rev. Rul. 78-246 [1]

The Internal Revenue Service has reconsidered the position set forth in Rev. Rul. 73-57, 1973-1 C.B. 218, concerning the issuance of consolidated financial statements by a group of corporations with a foreign parent corporation where one or more of the subsidiary corporations use the last-in, first-out (LIFO) method of valuing inventories for Federal income tax purposes.

Rev. Rul. 70-457, 1970-2 C.B. 109, holds that if a corporation uses the LIFO inventory method for Federal income tax purposes, such method must also be used with respect to the inventories to the extent the inventories are included in the consolidated financial statements of any other corporation.

Rev. Rul. 73-57 holds that Rev. Rul. 70-457 is applicable to all taxpayers using the LIFO method of inventory valuation for Federal income tax purposes, whether the common parent is domestic or foreign.

Section 472(a) of the Internal Revenue Code of 1954 authorizes the use of the LIFO inventory method for Federal income tax purposes.

[1] Also released as News Release IR-1999, dated May 24, 1978.

Section 472(c) of the Code requires that for the first year the LIFO method is used the LIFO method must also be used in computing income for purposes of reports to shareholders, partners, other proprietors or beneficiaries, and for credit purposes.

Section 472(e)(2) of the Code provides that the Commissioner may terminate the taxpayer's use of the LIFO method if the taxpayer uses any method other than LIFO in computing income for purposes of reports to shareholders, partners, other proprietors, or beneficiaries or to creditors in any year subsequent to the first year that the LIFO method is used.

Section 1.472-2(e) and (g) of the Income Tax Regulations essentially restate the requirements of section 472(c) and (e)(2) of the Code.

The requirements of sections 472 (c) and (e)(2) of the Code were enacted to ensure that the LIFO method "conforms as nearly as may be to the best accounting practice in the trade or business . . . ." (*H. Rep. No. 2330,* 75th Cong., 3d Sess. 34 (1938)). The legislative history of section 472 indicates that the conformance "to the best accounting practice" is to be made on the basis of United States standards of accounting practice. Because Congress was concerned solely with domestic accounting practice, the conformity requirements of section 472 should not be extended to determine what is the "best accounting practice" in foreign countries.

Therefore, it has been concluded that it is inappropriate to impose the LIFO method of inventory valuation upon a foreign parent corporation with respect to the inventory of any subsidiary that uses the LIFO method of inventory valuation for Federal income tax purposes when the group is engaged in substantial foreign operations. Accordingly, the LIFO method of inventory valuation need not be

used in the consolidated financial statements of the foreign parent if it owns, either directly or through members of its consolidated group, operating assets of substantial value which are used in foreign operations. In making this determination operating assets regardless of their physical location will be treated as used in foreign operations if they are owned by, and used in the business of, corporations that: (1) are members (including the parent) of the consolidated group; (2) are foreign corporations; (3) do not use the LIFO method of accounting for Federal income tax purposes; and (4) engage in a business outside the United States. A corporation is considered a member of the consolidated group if it is a consolidated member for financial accounting purposes. Operating assets for purposes of this test are all of the assets necessary for the conduct of an active operating company. Operating assets will be considered to be of substantial value if they constitute 30 percent or more of the total operating assets of the consolidated group. This determination will be made annually and normally will be made on the basis of the asset valuation reflected in the consolidated financial statements of the group for the year.

Whether a foreign parent is engaged in substantial foreign operations will be decided on the basis of all the facts and circumstances presented if the consolidated group does not satisfy the 30 percent test in the preceding paragraph.

Accordingly, subject to the above conditions, when a corporation uses the LIFO method of inventory valuation for Federal income tax purposes, such method need not also be used with respect to its inventories when such inventories are included in the consolidated financial statements of its foreign parent corporation. In all cases, however, a corporation that uses the LIFO method for Federal income tax purposes must otherwise comply with the conformity requirements of section 472(c) and (e)(2) of the Code in inventorying its goods to ascertain income, profit, or loss for the purposes of a report or statement (covering the taxable year for which the LIFO method is used) to shareholders, partners, other proprietors, or beneficiaries, or for credit purposes.

Rev. Rul. 73-57 is revoked.