



American Institute of CPAs  
1455 Pennsylvania Avenue, NW  
Washington, DC 20004-1081

December 13, 2012

Internal Revenue Service  
Attention: CC:PA:LPD:PR (REG-125949-10)  
Room 5203  
P.O. Box 7604  
Benjamin Franklin Station  
Washington, D.C. 20044

RE: Comments on Proposed Regulations under Section 471 - Guidance Regarding the Retail Inventory Method of Accounting (REG-125949-10)

Dear Sir or Madam:

The American Institute of Certified Public Accountants (AICPA) is writing in response to Notice of Proposed Rulemaking (REG-125949-10),<sup>1</sup> which requested comments regarding proposed regulations under section 471 of the Internal Revenue Code, relating to the retail inventory method of accounting. These comments were developed by the Retail Inventory Method Task Force of the AICPA's Tax Methods and Periods Technical Resource Panel, and approved by the Tax Executive Committee.

The AICPA is the world's largest member association representing the accounting profession with nearly 386,000 members in 128 countries and a 125 year heritage of serving the public interest. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

The AICPA commends the Internal Revenue Service (IRS) and the Department of Treasury (Treasury) for issuing the proposed regulations, which clarify the computation of ending inventory values under the retail inventory method of accounting, in a format

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<sup>1</sup> [http://www.irs.gov/irb/2011-45\\_IRB/ar15.html](http://www.irs.gov/irb/2011-45_IRB/ar15.html).

that makes the regulations easier to read and comprehend. The guidance, once finalized, will be helpful to our members.

Our attached comments cover a variety of key considerations as Treasury and IRS work on finalizing the regulations. In particular, our comments address the following topics:

A. Cost Complement Measurement Period

The AICPA recommends that the final regulations allow taxpayers to make an election to calculate the cost complement based on goods purchased during a measurement period shorter than the entire tax year and the beginning inventory for the elected measurement period and that the measurement period be treated as a method of accounting that could not be changed without the consent of the Commissioner.

B. Treatment of Beginning Inventory under the LIFO Retail Inventory Method

The AICPA recommends that the final regulations clarify whether taxpayers using the last-in, first-out (LIFO) retail inventory method are permitted or required to exclude beginning inventory from the numerator and denominator of the cost complement.

C. Scope of Retail Inventory Method

The AICPA requests that the scope of the retail inventory method under the final regulations be revised to provide that a taxpayer may use the retail inventory method to value ending inventory for a department, a class of goods, a sub-class of goods, a style of goods, any other similar group of goods, or a stock-keeping unit.

D. Markdown Allowances and Margin Protection Payments

The AICPA requests that subparagraph (b)(2)(iii)(A) of the proposed regulations be deleted. Alternatively, if the IRS and Treasury are unwilling to adopt this approach, the AICPA recommends that the final regulations allow retailers to reduce the numerator of the cost complement for markdown allowances and margin protection payments related to purchases recorded at permanently reduced retail selling prices using any reasonable method to determine the amount of markdown allowances and margin protection payments related to purchases recorded at permanently reduced retail selling prices.

E. Treatment of Sales-Based Vendor Allowances

The AICPA requests subparagraph (b)(2)(ii) of the proposed regulations be deleted. The subparagraph excludes a reduction for sales-based vendor allowances from the numerator of the cost complement, which is inconsistent with the treatment of sales-based vendor allowances for purposes of determining cost of goods available for sale used to calculate

cost of goods sold. The AICPA believes that the cost of goods available for sale used in the retail inventory method calculation should be the same as the taxpayer's cost of goods available for sale used to calculate cost of goods sold.

F. Impact on Small Taxpayers

The AICPA believes the proposed regulations create a significant disadvantage for small taxpayers compared to larger, similarly situated taxpayers. For example, large retailers with greater bargaining power are better able to negotiate with vendors to receive allowances that are permitted as a reduction to the cost of purchases in the numerator of the cost complement. However, small retailers typically do not have the bargaining power to negotiate with vendors to receive these types of allowances and are more likely to receive allowances that are not permitted as a reduction to the cost of purchases in the numerator of the cost complement under the proposed regulations. Therefore, because the proposed regulations create an economic disadvantage for small taxpayers, the AICPA requests that all inventory allowances be treated as a reduction to the cost of purchases in the numerator of the cost complement, as provided in the current regulations.

G. New and Burdensome Recordkeeping Requirements

Requiring taxpayers to track different types of inventory allowances will require many taxpayers to invest significant amounts of time and money to modify or replace existing systems to distinguish and track inventory allowances at the level required by the proposed regulations, even though all inventory allowances are properly treated as a reduction to the cost of goods purchased for all other purposes. Imposing this new burden on all taxpayers using the retail inventory method, which was designed to accommodate the recordkeeping used by retailers, is in direct contrast with the purpose of the method. This burden would be especially difficult for small retailers that would not have the time, financial resources, or expertise to apply the new rules. Accordingly, the AICPA requests that all inventory allowances be treated as a reduction to the cost of purchases in the numerator of the cost complement.

Each of these topics is addressed in detail in the attachment.

\* \* \* \* \*

We appreciate your consideration of our comments and welcome a further discussion of the comments. Members of the task force are available to meet with government officials in this regard. If you have any questions, please contact Jim Martin, Chair, AICPA Retail Inventory Method Task Force at (202) 414-1511, or [james.e.martin@us.pwc.com](mailto:james.e.martin@us.pwc.com); Carol Conjura, Chair, AICPA Tax Methods and Periods Technical Resource Panel at (202)

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533-3040, or [cconjura@kpmg.com](mailto:cconjura@kpmg.com); or Jason Cha, AICPA Technical Manager, at (202) 434-9231, or [jcha@aicpa.org](mailto:jcha@aicpa.org).

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Jeffrey A. Porter". The signature is fluid and cursive, with the first name "Jeffrey" being the most prominent.

Jeffrey A. Porter, CPA  
Chair, AICPA Tax Executive Committee

Enclosure

cc: Andrew Keyso, Jr., Associate Chief Counsel, (Income Tax & Accounting), Internal Revenue Service  
Scott Dinwiddie, Special Counsel to the Associate Chief Counsel (Income Tax & Accounting), Internal Revenue Service  
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Natasha M. Mulleneaux, Attorney, Office of Chief Counsel (Income Tax & Accounting, Branch 6), Internal Revenue Service  
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**AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS**

**Comments on Proposed Regulations under Section 471 Guidance Regarding the  
Retail Inventory Method of Accounting (REG-125949-10)**

**Developed by:  
Retail Inventory Method Task Force**

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**Approved by:  
Tax Methods and Periods Technical Resource Panel  
and  
Tax Executive Committee**

Submitted to:  
Department of the Treasury  
Internal Revenue Service

December 13, 2012

# AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

## Comments on Proposed Regulations under Section 471 Guidance Regarding the Retail Inventory Method of Accounting (REG-125949-10)

December 13, 2012

Set forth below are the American Institute of Certified Public Accountants' (AICPA's) comments on the proposed regulations under section 471 in response to Notice of Proposed Rulemaking (REG-125949-10) pertaining to the retail inventory method of accounting.

The AICPA recommends that the regulations be revised to address the following issues.

### A. Cost Complement Measurement Period

Proposed Reg. § 1.471-8(b)(2) provides that the cost complement is computed based on "the value of beginning inventory plus the cost of goods purchased *during the taxable year*." (Emphasis added.) The AICPA suggests that the final regulations allow taxpayers to make an election to calculate the cost complement based on goods purchased during a measurement period shorter than the entire tax year (e.g., current season; the last quarter of the year; the last inventory turn) and the beginning inventory for the elected measurement period. In addition, the AICPA recommends that the measurement period be treated as a method of accounting that could not be changed without the consent of the Commissioner.

### B. Treatment of Beginning Inventory under the LIFO Retail Inventory Method

Proposed Reg. § 1.471-8(b)(2) provides that the cost complement is computed based on *beginning inventory* plus goods purchased during the tax year. In practice, when the retail inventory method is used in conjunction with the last-in, first-out (LIFO) inventory method, beginning inventory is sometimes excluded from the numerator and denominator of the cost complement. Use of this practice is mentioned in TAM 8140013 and TAM 8751005. TAM 8140013 provides that "the cost complement for the current year is derived solely from current purchases to avoid tainting the figure with historical cost figures captured in LIFO inventory." TAM 8751005 states, "[under] the LIFO retail inventory method, beginning inventory is excluded from the cost complement computation. This exclusion is necessary because real increases in inventory in a given year, that is, increases adjusted for inflation, are attributable to purchases made during that year." Determination of the cost complement without beginning inventory is also used in an example in Rev. Rul. 79-115, where the taxpayer uses the LIFO inventory method, even though the revenue ruling states the general rule that beginning inventory is included in the numerator and denominator of the cost complement. In addition, Rev. Rul. 77-480, prior to being modified by Rev. Proc. 2008-43, concluded that the moving average method was not a proper method of determining current-year cost under the LIFO inventory method because the moving average method uses costs from prior years (i.e., beginning inventory). However, there is currently no authoritative guidance on which taxpayers may rely to

exclude beginning inventory from the numerator and denominator of the cost complement under the LIFO retail inventory method. Therefore, the AICPA recommends that the final regulations clarify whether taxpayers using the LIFO retail inventory method are permitted or required to exclude beginning inventory from the numerator and denominator of the cost complement.

### **C. Scope of Retail Inventory Method**

Proposed Reg. § 1.471-8(d) provides that a taxpayer may use the retail inventory method to value ending inventory “for a department, a class of goods, or a stock-keeping unit.” Historically, taxpayers using the retail inventory method have been permitted to value ending inventory (i.e., calculate and apply cost complements) at various levels ranging from each department to each stock-keeping unit (SKU). The AICPA believes the proposed regulations are intended to reflect this flexible approach. In addition to the levels described in the proposed regulations, many taxpayers calculate and apply a separate cost complement for each sub-class of goods, each style of goods, or other similar groups of goods. The AICPA is concerned that an IRS agent examining a taxpayer that uses one of these methods could question the method because the proposed regulations refer only to a department, a class of goods, or a SKU and do not mention a sub-class of goods, a style of goods, or other similar groups of goods. Therefore, in order to avoid controversy based on a literal reading of the regulations, the AICPA requests that the scope of the retail inventory method under the final regulations be revised to provide that a taxpayer may use the retail inventory method to value ending inventory for a department, a class of goods, a sub-class of goods, a style of goods, any other similar group of goods, or a stock-keeping unit.

### **D. Markdown Allowances and Margin Protection Payments**

Generally, under the retail inventory method, an allowance, discount, or price rebate that is an adjustment to the purchase price of inventory decreases the numerator of the cost complement, resulting in a reduction of ending inventory value. Under the retail lower of cost or market (LCM) method, if the allowance, discount, or price rebate is related to a permanent markdown of the retail selling price of goods in ending inventory (as in the case of a margin protection payment or markdown allowance), the ending inventory value is also reduced as a result of the decrease in the retail selling price of the goods in ending inventory. According to the preamble to the proposed regulations, the IRS and Treasury believe the reduction of ending inventory value caused by reducing both the numerator of the cost complement and the retail selling price of the goods in ending inventory does not clearly reflect income. To address this concern, Prop. Reg. § 1.471-8(b)(2)(iii)(A) provides that “[a] taxpayer using the retail inventory method to approximate LCM may not reduce the numerator of the cost complement by the amount of an allowance, discount, or price rebate that is related to or intended to compensate for a permanent reduction in the taxpayer's retail selling price of inventory (for example, a margin protection payment or markdown allowance).”

The proposed regulations assume that all permanent reductions in the retail selling price of inventory are treated as permanent markdowns that are not reflected in the retail selling price of goods purchased during the year (i.e., the denominator of the cost complement). However, in practice, many retailers treat a permanent reduction in the retail selling price of inventory as a permanent markdown for the quantities on hand but record future purchases of the goods at the reduced retail selling price. Therefore, goods purchased before the permanent reduction in the retail selling price are included in the denominator of the cost complement at the original retail selling price, and the permanent markdown related to these goods is excluded from the denominator of the cost complement. However, goods purchased after the permanent reduction in the retail selling price are included in the denominator of the cost complement at the permanently reduced retail selling price. In fact, Prop. Reg. § 1.471-8(b)(2)(i)(B) appears to require this treatment, providing that the denominator of the cost complement “is the retail selling prices of beginning inventory plus the retail selling prices of goods purchased during the year (that is, the bona fide retail selling price of the items *at the time acquired*)<sup>1</sup>...”. (Emphasis added.)

Under the proposed regulations, if a retailer receives markdown allowances or margin protection payments in connection with the permanent reduction in the retail selling price, the retailer would not be permitted to treat any of the allowances or payments as a reduction to the cost of purchases in the numerator of the cost complement. As a result, if goods purchased after the permanent reduction in the retail selling price are included in the denominator of the cost complement at the permanently reduced retail selling price, the value of ending inventory calculated under the retail inventory method will be higher than actual cost.

For example, assume R, a retailer using the retail LCM method, has no beginning inventory and purchases 10 tables at the beginning of the year for \$60 each, for a total of \$600. R offers the tables for sale at \$100 each, for an aggregate retail selling price of \$1,000. R is unable to sell any tables at a price of \$100, so R permanently reduces the retail selling price to \$80 each. Later in the year, R purchases 30 additional tables for \$60 each, for a total of \$1,800. R records the purchase of these tables at the permanently reduced retail selling price of \$80 each, for a total of \$2,400. R's supplier agrees to provide a markdown allowance of \$12 per table for all tables purchased by R, for a total of \$480. R sells 25 tables during the year and has 15 tables in ending inventory. Under the proposed regulations, the cost of goods purchased during the year in the numerator of the cost complement is \$2,400 (\$600 + \$1,800) because R is not permitted to reduce the numerator to account for any of the markdown allowance. The retail selling price of goods purchased during the year in the denominator of the cost complement is \$3,400 (\$1,000 + \$2,400). Therefore, the cost complement is 70.588% (\$2,400/\$3,400). The aggregate retail selling price of R's ending inventory is \$1,200 (15 \* \$80). Therefore, R's ending inventory value under the retail inventory method is \$847 (70.588% \* \$1,200). However, the actual cost of

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<sup>1</sup> In order to avoid potential confusion and controversy, the AICPA also recommends that this parenthetical language be revised as follows: “(that is, the bona fide retail selling price of the items at the time acquired, without regard to temporary markups and temporary markdowns).”

the tables in ending inventory is \$720 (15 \* \$48). As a result, R's ending inventory value calculated under the retail inventory method is overstated by \$127 (\$847 - \$720).

Moreover, the proposed regulations contradict a long history of established case law and IRS published guidance concluding that all inventory allowances<sup>2</sup> received from vendors must be treated as a reduction to the purchase price of the inventory, regardless of how they are measured or when they are received. See, for example, *The Thomas Shoe Co.*, 1 B.T.A. 124 (1924), acq. IV-1 CB 3 (1925); *Pittsburgh Milk Co. v. Commissioner*, 26 T.C. 707 (1956); *Sun Microsystems, Inc. v. Commissioner*, T.C. Memo 1993-467; Rev. Rul. 76-96; Rev. Rul. 84-41. In the preamble to the proposed regulations, the IRS and Treasury provided no indication that the previously published guidance or established case law would no longer be followed by the government. Instead, the proposed regulations appear to selectively revoke the government's long standing position – solely for purposes of computing cost complements under the retail inventory method. Under the proposed regulations, the markdown allowances and margin protection payments would still be treated as a reduction to the purchase price of the goods for all other purposes, including computing the cost of goods available for sale for purposes of the cost of goods sold deduction. However, the proposed regulations would bifurcate these inventory allowances from the purchase price solely for purposes of computing retail inventory method cost complements, in a contradiction of the above mentioned authorities.

The AICPA believes the proposed regulations could cause potential distortions to the ending inventory value computed under the retail LCM method, as demonstrated above. Furthermore, the AICPA believes the proposed regulations represent a significant deviation from the historical treatment of inventory allowances as established by case law and IRS published guidance. Therefore, the AICPA requests that the IRS and Treasury delete subparagraph (b)(2)(iii)(A) of the proposed regulations. Alternatively, if the IRS and Treasury are unwilling to adopt this approach, the AICPA recommends that the final regulations allow retailers to reduce the numerator of the cost complement for markdown allowances and margin protection payments related to purchases recorded at permanently reduced retail selling prices using any reasonable method to determine the amount of markdown allowances and margin protection payments related to purchases recorded at permanently reduced retail selling prices.

#### **E. Treatment of Sales-Based Vendor Allowances**

For a taxpayer that values ending inventory using first-in, first-out (FIFO) cost (or FIFO LCM), the value of the inventory remaining on hand at year end is generally determined based on the current year cost of those particular items. For a taxpayer that values ending inventory using the retail inventory method, this is not the case. The retail inventory method does not determine the cost of inventory solely by reference to the quantities in ending inventory. Under the retail inventory method, the retail selling price of ending

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<sup>2</sup> The term “inventory allowances” as used in this letter does not include cash discounts, payments for services, or reimbursements of expenses.

inventory is converted to approximate cost using a cost-to-retail ratio, or cost complement, based on total goods available for sale during the taxable year. Specifically, the numerator of the cost complement includes: 1) the cost of beginning inventory subsequently sold during the year, 2) the cost of goods purchased and sold during the year, and 3) the cost of goods purchased during the year and still on hand at year end. As a result, based on the mechanics of the retail inventory method, the value of ending inventory is determined, in part, by reference to the cost of goods sold during the tax year.

When a taxpayer receives a purchase-based vendor allowance, the allowance is often a one-time refund payment from the vendor. The payment may partially relate to goods physically on hand at year end, but it may also relate to goods that were purchased and subsequently sold during the taxable year. Under Prop. Reg. § 1.471-8, taxpayers are required to adjust the numerator of the cost complement for purchase-based vendor allowances to reflect the taxpayer's true cost of the items. This adjustment to the numerator is not limited to just the goods purchased during the year that remain physically on hand at year end. Rather, taxpayers must adjust the numerator of the cost complement for purchase-based vendor allowances to the extent they relate to goods physically on hand at year end and to the extent they relate to any goods purchased and sold during the tax year. For any goods purchased and sold during the tax year, the cost used to calculate the retail inventory method cost complement is the same cost used to calculate the cost of goods sold deduction (i.e., both calculations reflect the original purchase price less the purchase-based vendor allowance).

For example, assume R, a retailer using the retail inventory method, has no beginning inventory and purchases 10 chairs during the year for \$30 each, for a total of \$300. At the beginning of the year, R negotiated a purchase-based vendor allowance with the chair supplier that entitles R to receive a refund of \$2 for each chair purchased, if R purchases at least 8 chairs during the year. R offers the chairs for sale at \$50 each and sells 8 chairs during the year. Before year end, R receives the negotiated payment of \$20 ( $10 * \$2$ ) from the supplier. To compute the cost of goods sold deduction, R first determines the total cost of goods available for sale during the year of \$280 [ $10 * (\$30 - \$2)$ ]. R then subtracts from that amount the value of ending inventory computed using the retail inventory method. Under the proposed regulations, the cost of goods available for sale during the year in the numerator of the cost complement is \$280 [ $10 * (\$30 - \$2)$ ]. In the case of a purchase-based vendor allowance, R's cost of goods available for sale used to calculate the cost of goods sold deduction (\$280) is equal to R's cost of goods available for sale used to calculate the retail inventory method cost complement (\$280).

When a taxpayer receives a sales-based vendor allowance, the allowance relates to goods that were purchased from the supplier and then subsequently sold. Just like a purchase-based vendor allowance, a sales-based vendor allowance is offered to the taxpayer to reduce the overall cost of acquiring goods for sale and is intended to be a retroactive reduction to the taxpayer's purchase price of the goods. However, Prop. Reg. § 1.471-8 does not permit the taxpayer to reduce the cost of the related goods in the numerator of the cost complement by the sales-based vendor allowance. As a result, the numerator of the

cost complement under the proposed regulations does not reflect the taxpayer's true cost of the items purchased and held for sale during the year.

As discussed above, the proposed regulations contradict a long history of established case law and IRS published guidance concluding that all inventory allowances received from vendors must be treated as a reduction to the purchase price of the inventory, regardless of how they are measured or when they are received. In the preamble to the proposed regulations, the IRS and Treasury provided no indication that the above mentioned authorities would no longer be followed by the government. Instead, the proposed regulations appear to selectively revoke the government's long standing position – solely for purposes of computing cost complements under the retail inventory method. Under the proposed regulations, sales-based vendor allowances would still be treated as a reduction to the purchase price of the goods for all other purposes, including computing the cost of goods available for sale for purposes of the cost of goods sold deduction. However, the proposed regulations would bifurcate sales-based vendor allowances from the purchase price solely for purposes of computing retail inventory method cost complements, in a contradiction of the above mentioned authorities.

In addition, as noted in the preamble to the proposed regulations, “Under proposed §1.471-3(e) (75 FR 78944), the amount of an allowance, discount, or price rebate a taxpayer earns by selling specific merchandise (a sales-based vendor allowance) *is a reduction in the cost of the merchandise sold* (emphasis added).” The AICPA believes that the exclusion of all sales-based vendor allowances from the numerator of the cost complement under Prop. Reg. § 1.471-8(b)(2)(ii) (i.e., sales-based vendor allowances are not a reduction to the cost of merchandise sold) is inconsistent with the position taken in Prop. Reg. § 1.471-3(e) (i.e., sales-based vendor allowances are a reduction in the cost of the merchandise sold). Applying these two proposed regulations together will result in a dual cost for items purchased and sold during the year that are subject to a sales-based vendor allowance – one cost for purposes of computing the retail inventory method cost complement and a separate cost for purposes of computing the cost of goods sold deduction.

For example, assume R, a retailer using the retail inventory method, has no beginning inventory and purchases 10 chairs during the year for \$30 each, for a total of \$300. At the beginning of the year, R negotiated a sales-based vendor allowance with the chair supplier that entitles R to receive a refund of \$2 for each chair sold during the year. R offers the chairs for sale at \$50 each and sells 8 chairs during the year. Before year end, R receives the negotiated payment of \$16 (8 \* \$2) from the supplier. To compute the cost of goods sold deduction, R first determines the total cost of goods available for sale during the year of \$284 [8 \* (\$30 - \$2) + (2 \* \$30)]. R then subtracts from that amount the value of ending inventory computed using the retail inventory method. Under the proposed regulations, the cost of goods available for sale during the year in the numerator of the cost complement is \$300 [10 \* \$30] because R is not permitted to reduce the cost of the good in the numerator by the sales-based vendor allowance. In the case of a sales-based vendor allowance under the proposed regulations, R's cost of goods available for sale used to calculate the cost of

goods sold deduction (\$284) does not equal R's cost of goods available for sale used to calculate the retail inventory method cost complement (\$300).

The AICPA believes that the cost of an item of inventory should be consistent and should not vary based on whether the taxpayer is calculating the cost of goods sold deduction versus calculating the retail inventory method cost complement. For example, assume the same facts as above, however R is permitted to include sales-based vendor allowances in the numerator of the cost complement. To compute the cost of goods sold deduction, R first determines the total cost of goods available for sale during the year of  $\$284 [8 * (\$30 - \$2) + (2 * \$30)]$ . R then subtracts from that amount the value of ending inventory computed using the retail inventory method. The cost of goods available for sale during the year in the numerator of the cost complement is  $\$284 [8 * (\$30 - \$2) + (2 * \$30)]$  because R reduces the cost of items sold during the year by the sales-based vendor allowance. Unlike the above scenario, R's cost of goods available for sale used to calculate the cost of goods sold deduction (\$284) equals R's cost of goods available for sale used to calculate the retail inventory method cost complement (\$284).

Both purchase-based vendor allowances and sales-based vendor allowances are a retroactive reduction to the taxpayer's purchase price of the goods. As noted above, the AICPA believes that the cost of an item of inventory should be consistent and should not vary based on whether the taxpayer is calculating the cost of goods sold deduction versus calculating the retail inventory method cost complement. The cost of goods available for sale used in the retail inventory method calculation should be the same as the taxpayer's cost of goods available for sale used to calculate cost of goods sold. Accordingly, the AICPA requests that the IRS and Treasury delete subparagraph (b)(2)(ii) of the proposed regulations.

## **F. Impact on Small Taxpayers**

By providing that markdown allowances, margin protection payments, and sales-based vendor allowances (collectively, "prohibited allowances") must be treated differently from other vendor allowances ("permitted allowances"), the proposed regulations create a significant disadvantage for small taxpayers compared to larger, similarly situated taxpayers. For example, large retailers with greater bargaining power are better able to negotiate with vendors to receive permitted allowances, rather than prohibited allowances. Small retailers that receive prohibited allowances typically do not have the bargaining power to negotiate with vendors to convert those prohibited allowances to permitted allowances.

Similarly situated taxpayers using the retail method should not be subject to different tax treatment based on the types of vendor allowances received. Since all inventory allowances received from vendors are an adjustment to the ultimate purchase price of the inventory, regardless of how they are measured or when they are received, all inventory allowances should be treated consistently and should be included in the numerator of the cost complement.

The AICPA believes the distinction that is drawn by the proposed regulations ignores the economics of the underlying business transaction. As a practical matter, the inventory allowances offered to a retailer are based on many different factors. Yet, all of these inventory allowances, regardless of what they are called or how they are measured, are aimed at determining the net purchase price of the inventory. The inventory allowances are always provided to reduce the cost of the inventory purchased from the vendor, not to provide an additional income stream to the retailer. Therefore, the AICPA requests all inventory allowances be treated as a reduction to the cost of purchases in the numerator of the cost complement, as provided in the current regulations. Providing a different tax result for different types of inventory allowances would elevate form over the economic substance of the transaction.

### **G. New and Burdensome Recordkeeping Requirements**

The retail inventory method is specifically permitted in acknowledgement of the fact that retailers are engaged in a unique industry in which the normal rules of inventory valuation may not apply well. The retail inventory method is a simplified approach to inventory valuation that averages the net purchase cost of all goods available for sale and the retail selling price of all goods available for sale. As with all simplified methods, the imprecision of an averaging convention is outweighed by the avoided time and effort (for both taxpayers and the IRS) that would be required to perform more precise calculations at a more detailed level.

The proposed regulations would require taxpayers using this simplified method to distinguish between various types of inventory allowances that may not be easily distinguished because existing systems and processes are often not capable of separately tracking the different types of allowances. For example, an agreement could provide that the taxpayer is entitled to a markdown allowance for all goods sold at a marked down price, including both temporary markdowns and permanent markdowns. Currently, the taxpayer would have no business purpose to separately track the portion of the allowance received for goods that were sold at the temporarily marked down price and the portion of the allowance received for goods that were sold at the permanently marked down price. To track these separately would create a significant administrative burden and would have no purpose other than to comply with the proposed regulations.

Many taxpayers will be required to invest significant amounts of time and money to modify or replace existing systems to distinguish and track inventory allowances at the level required by the proposed regulations, even though all inventory allowances are properly treated as a reduction to the cost of goods purchased for all other purposes. Imposing this new burden on all taxpayers using retail inventory method, which was designed to accommodate the recordkeeping used by retailers, is in direct contrast with the purpose of the method. This burden would be especially difficult for small retailers, who would not have the time, financial resources, or expertise to apply the new rules. Accordingly, the

AICPA requests that all inventory allowances be treated as a reduction to the cost of purchases in the numerator of the cost complement.