



## Lessen The Load of Rising Inflation

---

*Author:* Chris Henderson

*Organization:* [LIFO Systems](#)

*Newsletter:* [Accounting and Tax Update](#) - December 2005

With the broad-based inflation we've experienced in 2005, now is the time to help your clients with inventory put rising work for their businesses. While most view inflation by its clear downsides, Last In First Out (LIFO) accounting is a tool that CPAs can use to turn this negative into a positive. The LIFO inventory method enables businesses to defer federal income based on inventory inflation.

### **Who can benefit from LIFO?**

Good candidates for LIFO include manufacturers, wholesalers and retailers that are experiencing inflation and carry a mid-year-end inventory of \$2,000,000 or more. Those that fit the criteria may use potentially substantial 2005 inflation to significantly reduce federal income taxes.

### **LIFO – Why take another look?**

LIFO enables a business to defer income based on inventory inflation. There are many different LIFO methods, but in January 2002 the IRS issued updated regulations for a method that has been available for more than twenty years. Inventory Price Index Computation (IPIC) LIFO is a specific method using inflation data published by the Bureau of Labor Statistics to measure inflation. Prior to these new regulations, taxpayers could only use 80% of the inflation.

### **What kind of tax benefit is available?**

The following examples represent the first-year LIFO reserve (reduction in inventory value) for several different businesses.

#### **Fence Wholesaler**

YE Inventory: \$23 million

1st Yr. LIFO Reserve: \$4 million

#### **Heavy Truck Retailer**

YE Inventory: \$15 million

1st Yr. LIFO Reserve: \$360,000

#### **Steel Wholesaler**

YE Inventory: \$10 million

1st Yr. LIFO Reserve: \$1.6 million

#### **Concrete Pipe Manufacturer**

YE Inventory: \$2.4 million

1st Yr. LIFO Reserve: 181,000

#### **Garage Door Manufacturer**

YE Inventory: \$23 million

1st Yr. LIFO Reserve: \$4.4 million

#### **Manufacturer of Steel Buildings**

YE Inventory: \$37 million

1st Yr. LIFO Reserve: \$8.7 million

### **What if my client is already on LIFO?**

Many businesses on LIFO measure internal inflation on an item-by-item basis. In many cases, the government-published indexes utilized in the IPIC methodology results in more inflation which, under the LIFO method, yields lower inventory values and better tax benefits.

### **What other considerations are important when considering LIFO?**

For clients with a December year-end, now is the time to explore potential LIFO benefits. Time is of the essence because electing LIFO for tax purposes must also have a LIFO provision on its financial statements. This "conformity requirement" is strictly enforced by IRS.

The LIFO impact on financial statements must be discussed with any company shareholders and/or debt holders. To the extent that LIFO reduces taxes, it also reduces book income. Creditors normally approve the LIFO election when they understand the cash flow benefits.

**Conclusion:** Be prepared for the 2005 year end and explore the potential tax benefits of implementing the LIFO method for your clients. This article used several benefit examples; however, the variety of inventory types potentially exposed to inflation in 2005 is vast. Experts like LIFO Systems' inventory categorization specialists can assist a firm by quickly and accurately estimating the potential benefit available for any current or prospective clients.

Chris Henderson, CPA is Director of Accounting for LIFO Systems. LIFO Systems makes otherwise time consuming, complex and highly specialized tax benefit opportunities readily available to businesses and CPAs across the nation. Its sophisticated automated processes ensure accurate, consistent, cost-effective and timely results. <http://www.lifosystems.com>



Are you interested in writing for future newsletters? Send us an email to [newsletter\\_authors@lorman.com](mailto:newsletter_authors@lorman.com) with your contact information and any topics you would like to write on.



To subscribe to Lorman Newsletters please visit us at [www.lorman.com/newsletters](http://www.lorman.com/newsletters).

---

The material appearing in this web site is for informational purposes only and is not legal advice. Transmission of this information is not intended to constitute, and receipt does not constitute, an attorney-client relationship. The information provided herein is intended only as general information which may not reflect the most current developments. Although these materials may be prepared by professionals, they should not be used as a substitute for professional services. If legal or other professional advice is required, the services of a professional should be sought.

The opinions or viewpoints expressed herein do not necessarily reflect those of Lorman Education Services. All materials and content were prepared by persons and/or entities other than Lorman Education Services, and said other persons and/or entities are solely responsible for their content.

Any links to other web sites are not intended to be referrals or endorsements of these sites. The links provided are maintained by the respective organizations, and they are solely responsible for the content of their own sites.

Lorman Education Services, P.O. Box 509, Eau Claire, WI 54702-0509

© 2000 -2005 Lorman Business Center, Inc. All rights reserved.

[Privacy Policy](#) [Terms & Conditions](#)

Need help? 1-866-352-9539