“The Current and Future States of LIFO and Available Tax Opportunities”

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Introduction

- Since 1939, many individuals have and continue to debate against LIFO as a viable, economic accounting method.

- Until recently, LIFO faced a possibility of its elimination by the year 2015, as political forces coming from the International Financial Accounting Standards Board, the World Financial Community, and US administration oppose this method.

- The IFRS prohibits LIFO as an acceptable accounting method, and the Obama administration proposed in its 2010 budget to repeal LIFO altogether in the future.

Literature Review

- The tax advantages associated with LIFO have been documented by Tax Laws, Research, Literature, and Congress.
- Internal Revenue Code (IRC) 472 allows for the Last in First Out method of inventory since its inception date in 1939.
- White, Sondhi, and Fried (2008), state that due to the tax advantages associated with LIFO resulting in greater cash flows, the choice of inventory method should point towards LIFO. Dopuch and Pincur (1988) found that the taxation effect was the primary reason a company chose LIFO.
- In order to obtain the tax benefit, three elements have to be satisfied. First, there has to be a scenario of; increasing inventory prices (inflation); second, a buildup or increase in inventory, known as a LIFO reserve, and third, there has to be an income tax.
- The US government has estimated that presently less than 15% of publically traded companies use LIFO, and that the corporate tax rate of 35% can be reduced to 30.5%.
- As a defense to LIFO users, non LIFO firms have the option to adapt the Lower Cost or Market Method (LCM).
- The Tax deferred argument under FASB 109 can be made in defense of LIFO.
- Finally, a question that comes to mind is whether the elimination of LIFO will have any dent on the Federal Deficit which at present is 16.5 trillion dollars

Recent Developments & Current State of LIFO

- For the period 2006 to early 2012, LIFO was facing pressures from both the International Reporting Standards Board in cooperation with the SEC, and the U.S. Congress for its possible complete elimination by the year 2014.
- On November 15, 2007, the SEC exempted foreign firms from including reconciliation from IFRS to U.S GAAP when filing on U.S. Stock Exchanges.
- On June 18, 2008, the SEC issued a press release stating that the worlds securities regulators are uniting to increase their oversight of international accounting standards.
- On January 1, 2011, more than 100 countries have adapted IFRS or a variation, including our neighboring country, Canada.
- The development of a financial crisis in Europe questioned whether accounting information really causes economic downturns.
- The SEC questioned a number of items, starting with adequate funding needs in there continued success. A lack of reporting consistency among IFRS users is also a major SEC concern. Significant accounting reporting gaps were cited such as the treatment of contingency losses.
- The SEC in its most recent July 13, 2012 report, has stated that the US will not be adopting IFRS anytime soon due to the reason that the IFRS has significant reporting gaps.
- There is no timetable of further IFRS review by the SEC.

The Future of LIFO

There are four possibilities of LIFO going forward, and illustrated as follows:

CASE	***Financial Reporting Purposes***	***Tax Purposes***
1	YES	YES
2	NO	YES
3	YES	NO
4	NO	NO

Tax Planning Opportunities Available for the Current Users of LIFO

Assuming the repeal of LIFO, or a switch from LIFO voluntarily which is more suitable, what are some of the tax planning opportunities available to taxpayers to help ease in this transition?

(1) Extended Payment Adjustment Period: Under current tax rules, if a taxpayer charges its accounting period from LIFO to another acceptable method, and its results in a higher inventory value (income total), the difference in additional tax is payable over a period of four years. Under the current Obama Administration's 2010 Budget Proposal, the difference would be spread to taxable income and payable over eight years. Consequently, the termination of LIFO would be mitigated as the resulting extra tax would be payable to the tax authorities over an eight year period. In an atmosphere of economic slowdown, many entities have chosen this route.

(2) Lower Inventory amounts and switch to a Just in Time (JIT) inventory purchasing system. Lower inventory levels will somewhat insulate against increased income (added income tax payments), and will also lead to a better inventory management approach, resulting in a lower carrying costs.

Conclusion

- The probability of the elimination of LIFO as an acceptable accounting method is very unlikely any time in the foreseeable future. In the authors opinion, LIFO will continue as is in the indefinite future, and will not be addressed again until after the 2016 presidential election.
- Worldwide financial reporting will continue to have differences with the US, and whether SEC working with the International Reporting Board continue remains to be seen.
- In the event of LIFO's eventual repeal, the author recommends several tax strategies to help ease the burden of this change. Additional research examining the managerial, non-tax advantages of FIFO when compared to LIFO should be addressed, as well as the effect of the US deficit by the continued allowance of LIFO use.

Author's Biography

- Peter Harris, CPA, CFA is a Professor and Chair of the Accounting and Finance department at the New York Institute of Technology. Previously, he has worked for Ernst and Young LLP. He is an author of over 60 refereed journal articles and 150 intellectual contributions. He has presented and continued to present seminars to nationally and globally audiences on topics relating to financial reporting and taxation. In addition, he is a member of several professional organizations.
- Simran Kaur is an MBA student majoring in Accounting at the New York Institute of Technology. She is an honors students who has published two refereed articles. She serves as the President for the School of Management's Student Advisory Board, Student Ambassador, and Dean's Intern. Her exemplary work has earned her many accolades.

Questions? Comments? Suggestions?

THANK YOU!

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