

# LIFO Lookout for Tax Incentives, Automation Opportunities & Optimization Strategies



## LIFOPro

Software & Turnkey Outsourcing Solutions

LIFO-PRO, Inc.

11620 Arbor St, Suite 100

Omaha, NE 68144

(402) 330-8573 office

(877) 848-6583 fax

[lifopro@lifopro.com](mailto:lifopro@lifopro.com)

[www.lifopro.com](http://www.lifopro.com)

# Table of Contents

Topic	Slide #
2021 LIFO Lookout	3
Effect of Inflation on the Financial Statement & Tax Return	4
LIFO Tax Incentives	5
LIFO Benefit Case Studies	6 – 8
Top LIFO Candidates	9
Optimization Strategies & Automation Opportunities	10
Key Takeaways	11
How to Get Started	12



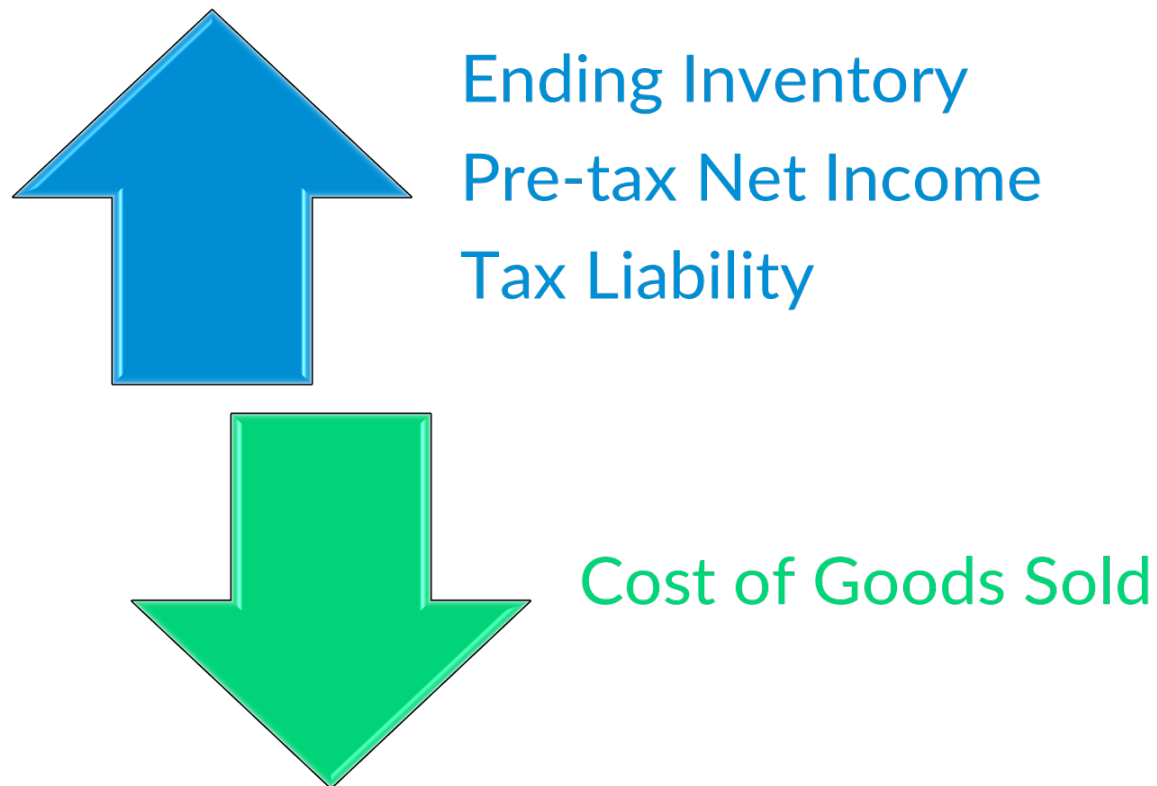
# 2021 LIFO Lookout

- Inflation is alive & kicking
  - Federal reserve has raised its 2021 year end inflation forecast from 1.8% to 2.2%
  - Massive amounts of government stimulus & proposed infrastructure spending expected to create above-average inflation in many industries
  - Improved economic outlook & GDP growth expected to further accelerate price increases
  - Inflation increased substantially in the final months of 2020 & is continuing so far in 2021 in many other industries
  - Many of the raw commodities currently showing inflation will create ripple effect on intermediate & final demand goods, meaning a much wider range of goods are likely to have above average inflation for 2021 year end
  - Soaring fuel prices will create upward pressure on almost all goods as delivery/transportation costs will be realized in all industries
- LIFO's here to stay
  - Widespread IFRS adoption has not come to fruition in the U.S. & is not likely to ever cause LIFO to be impermissible under GAAP
  - The misnomer that just-in-time accounting would eliminate inventories from the balance sheet has been widely debunked because:
    - Use of this method only eliminates one of the three stages of production for manufacturers (finished goods), meaning raw materials & WIP will always be on the balance sheet to maintain adequate supply to maintain production of WIP & FG
    - Wholesalers & retailers widely unaffected by this method since they must maintain a minimum base stock of inventory
  - Used by tens of thousands of companies who have consistent inflation & sufficient inventory balances
- Higher tax rates on the horizon
  - Current political environment suggests increased corporate tax rates for both C-corps & S-corps will be enacted by Congress
  - Increased tax rates make LIFO more valuable since after-tax cash savings from LIFO = tax rate \* LIFO reserve
- Possible relief for qualified inventory liquidations: Could provide relief to LIFO taxpayers who suffered COVID-19 related inventory reductions that subsequently created LIFO income i.e. increased taxable income

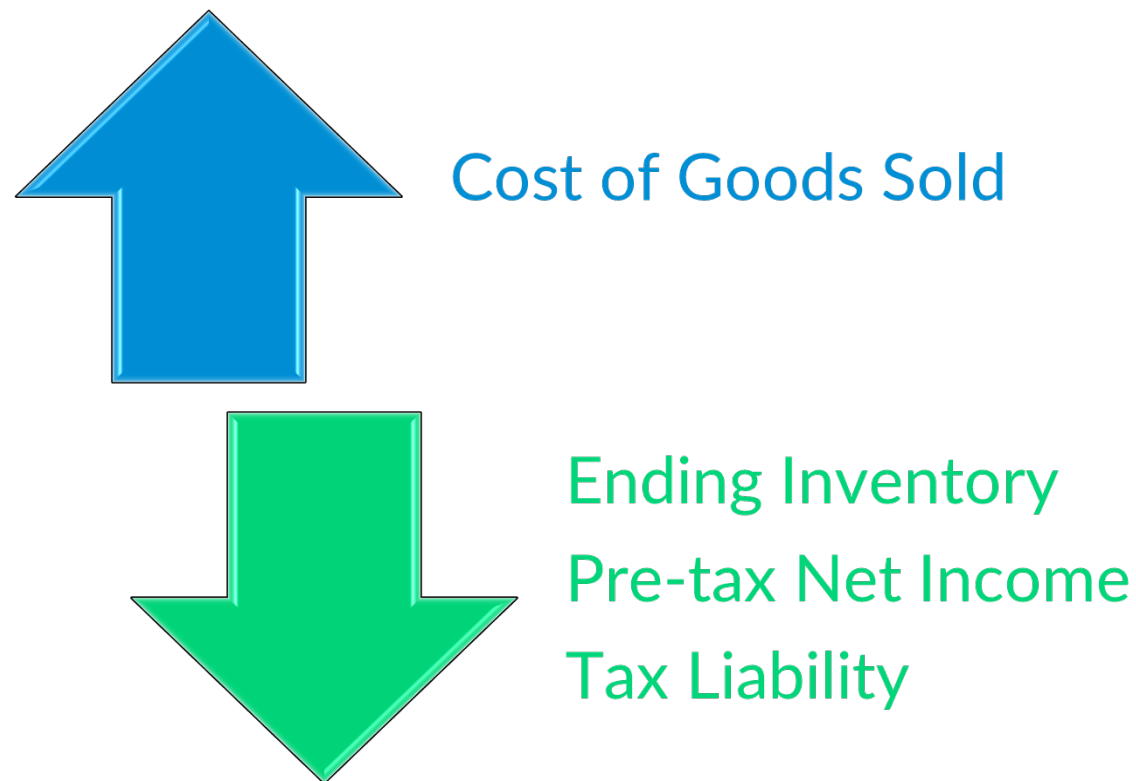


# Effect of Inflation on the Financial Statement & Tax Return

## Without LIFO



## With LIFO



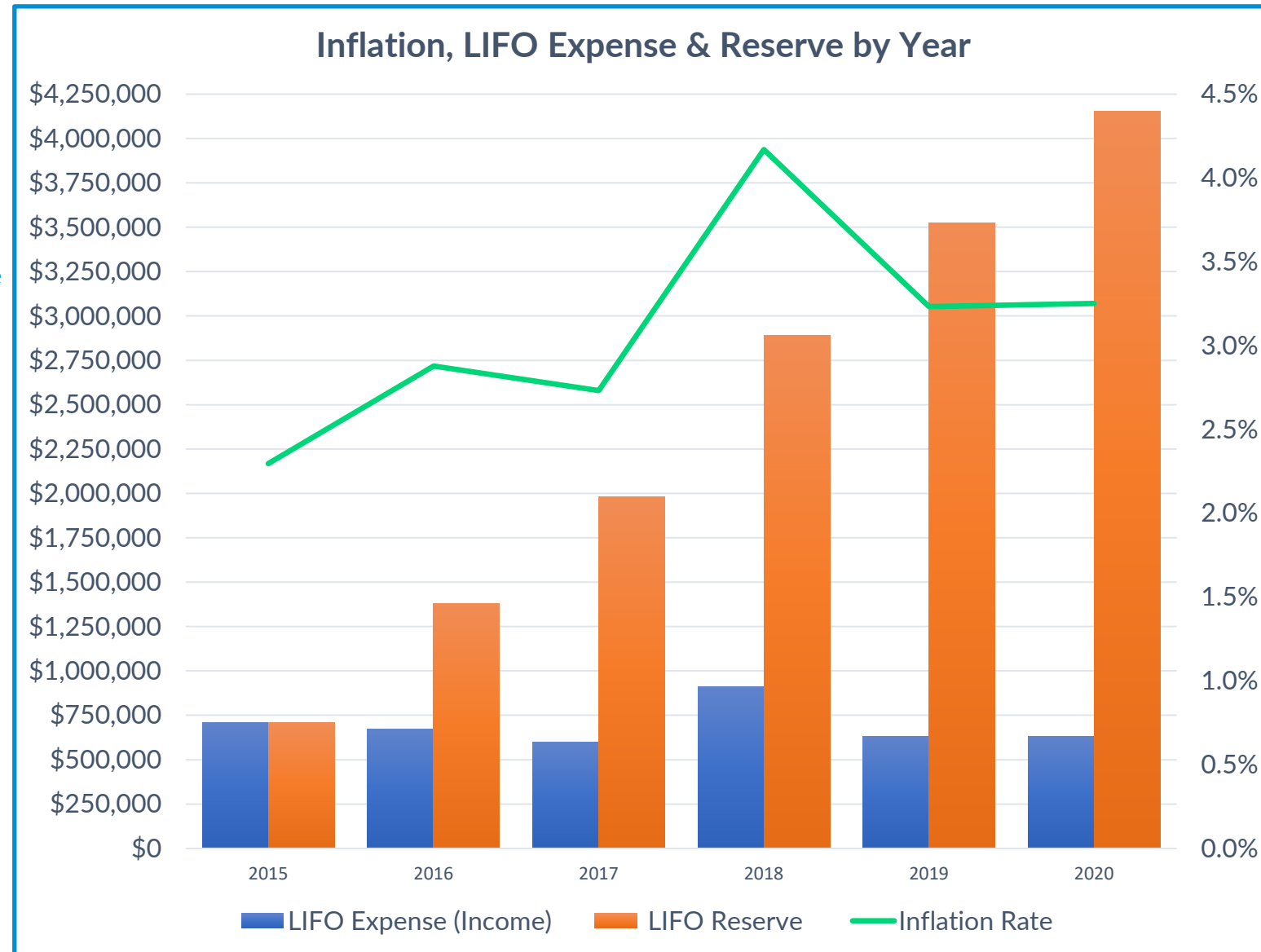
# LIFO Tax Incentives

- During periods of rising costs, LIFO transfers inflated ending inventory from balance sheet to income statement by increasing cost of goods sold & reducing ending inventory balance
- Reduces taxable income in periods of inflation & can create material long-term after-tax cash savings
- Benefits grow in perpetuity & only decreases when there's deflation or substantial inventory liquidation
- No changes required to accounting system as inventories maintained at same costs historically used & annual side calculation made to adjust inventories from cost (i.e. FIFO or average cost) to LIFO using contra inventory account called LIFO reserve
- **Quick LIFO tax savings formula:**
  - $\text{CY Taxable Income Reduction (LIFO expense)} = \text{Current Year Inflation Rate} * \text{Prior year ending inventory balance @ cost (i.e. FIFO, average cost)}$
  - $\text{CY After Tax Cash Savings} = \text{Current Year LIFO Expense} * \text{Tax Rate}$
- **LIFO tax savings example:**
  - Inputs
    - Year end FIFO balance: \$10M
    - Current year inflation rate: 2.5%
    - Tax rate: 30%
  - Outputs:
    - $\text{CY Taxable Income Reduction (LIFO expense)}: \text{Year end FIFO balance} * \text{Current year inflation rate} = \$250\text{K} (\$10\text{M} * 2.5\%)$
    - $\text{CY After Tax Cash Savings}: \text{LIFO Expense} * \text{tax rate} = \$75\text{K} (\$250\text{K} * 30\%)$



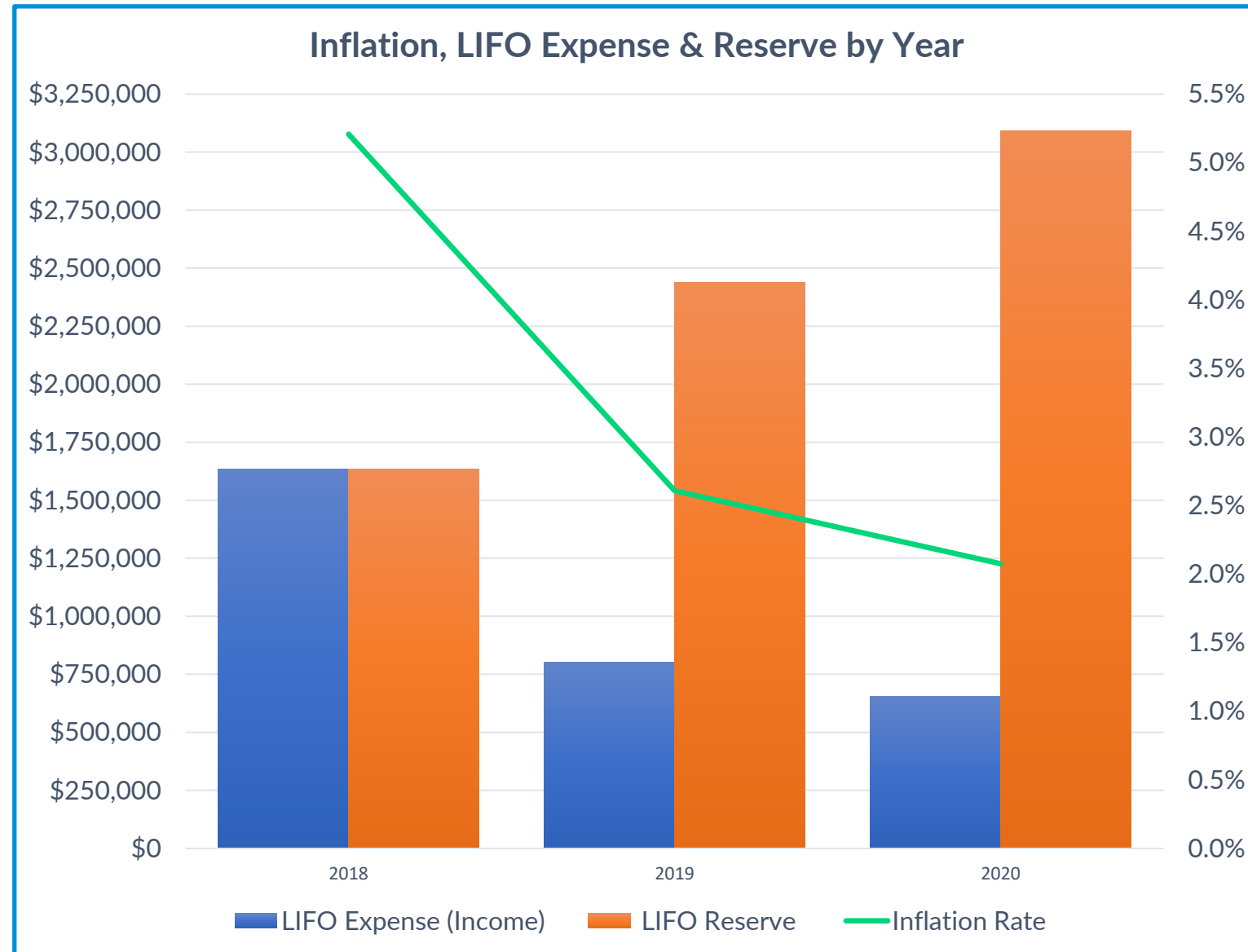
# LIFO Benefit Case Study #1: Building Products Manufacturer

- LIFO Calculation Inputs & Outputs:
  - Years on LIFO: 6 (2015 = 1<sup>st</sup> year on LIFO)
  - 2020 y/e inventory balance @ cost: \$25M
  - Average annual inflation rate: 3.2%
  - **2020 y/e LIFO reserve (taxable income reduction): \$4.2M**
- Benefits
  - Cumulative after-tax savings = LIFO reserve \* avg. tax rate
  - Current year LIFO reserve = \$4.2M
  - Average tax rate: 30%
  - **After-tax cash savings: \$4.2M \* 30% = \$1.3M**
- Costs
  - Annual turnkey outsourcing solutions cost: \$3,500
  - Cumulative turnkey outsourcing solutions cost: \$21K
- Return on Investment
  - $\frac{\text{Cumulative after-tax cash savings} - \text{Cumulative cost}}{\text{Cumulative cost}}$
  - **ROI = (\$1.3M - \$21K) ÷ \$21K; \$1.1M ÷ 21K = 6289%**
- Cost as a percentage of after-tax cash savings:
  - $\$21K \div \$1.3M = 1.6\%$
- Cumulative after-tax interest savings:
  - Avg. prime rate + 1% \* cumulative after-tax cash savings
  - = (3% + 1%) \* \$1.3M; 4% \* \$1.3M = \$52K



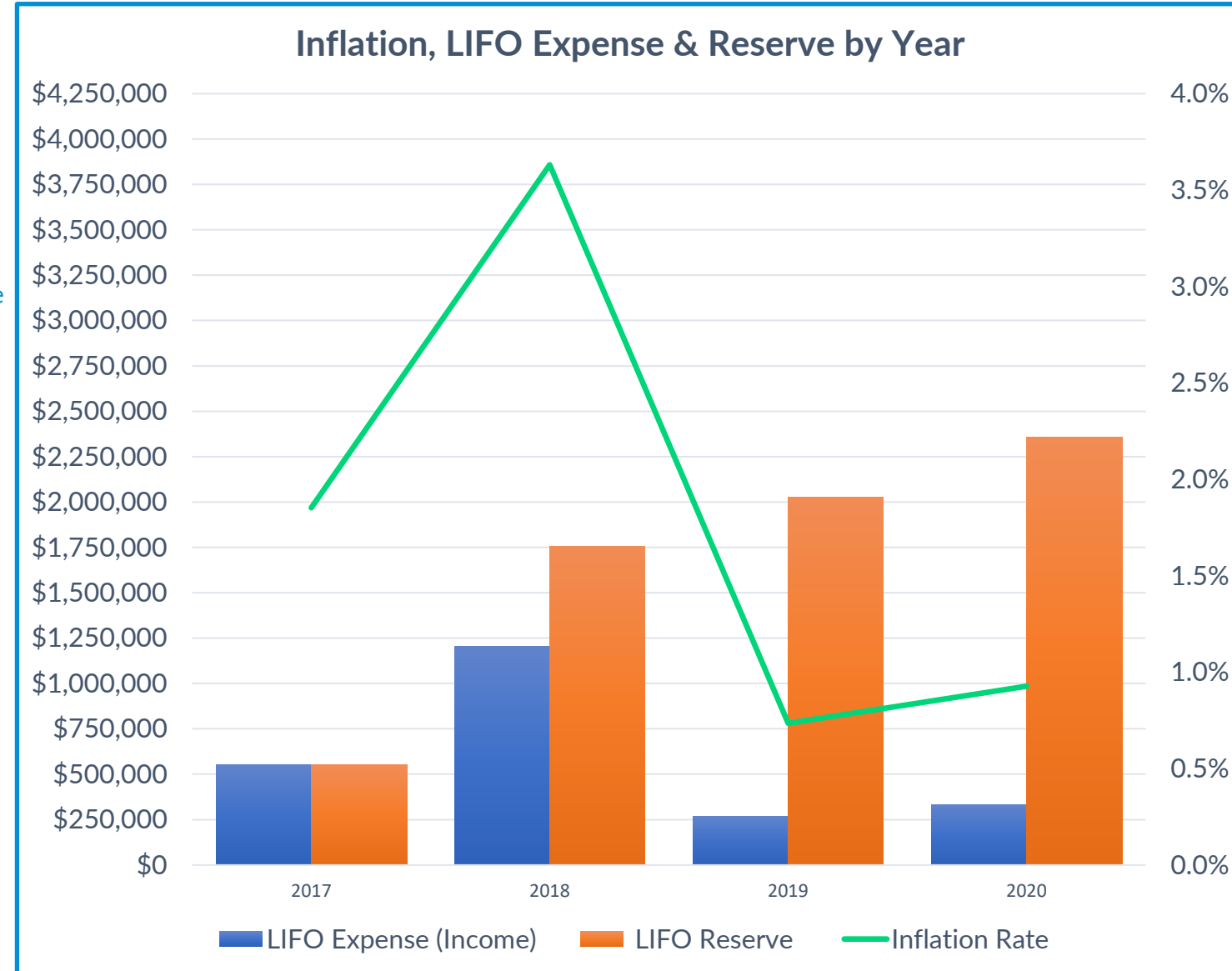
# LIFO Benefit Case Study #2: HVAC & Plumbing Wholesaler

- LIFO Calculation Inputs & Outputs:
  - Years on LIFO: 3 (2018 = 1<sup>st</sup> year on LIFO)
  - 2020 y/e inventory balance @ cost: \$40M
  - Average annual inflation rate: 3.2%
  - **2020 y/e LIFO reserve (taxable income reduction): \$3.1M**
- Benefits
  - Cumulative after-tax savings = LIFO reserve \* avg. tax rate
  - Current year LIFO reserve = \$3.1M
  - Average tax rate: 30%
  - **After-tax cash savings: \$3.1M \* 30% = \$930K**
- Costs
  - Annual turnkey outsourcing solutions cost: \$5K
  - Cumulative turnkey outsourcing solutions cost: \$15K
- Return on Investment
  - $\frac{\text{Cumulative after-tax cash savings} - \text{Cumulative cost}}{\text{Cumulative cost}}$
  - **ROI = (\$930K - \$15K) ÷ \$15K; \$930K ÷ 15K = 6100%**
- Cost as a percentage of after-tax cash savings:
  - $\$15K \div \$930K = 1.7\%$
- Cumulative after-tax interest savings:
  - Avg. prime rate + 1% \* cumulative after-tax cash savings
  - = (3% + 1%) \* \$930K; 4% \* \$930K = \$37K



# LIFO Benefit Case Study #3: Ranch & Home Supply Retailer

- LIFO Calculation Inputs & Outputs:
  - Years on LIFO: 4 (2017 = 1<sup>st</sup> year on LIFO)
  - 2020 y/e inventory balance @ cost: \$37M
  - Average annual inflation rate: 1.8%
  - **2020 y/e LIFO reserve (taxable income reduction): \$2.4M**
- Benefits
  - Cumulative after-tax cash savings = LIFO reserve \* avg. tax rate
  - Current year LIFO reserve: \$2.4M
  - Average tax rate: 30%
  - **After-tax cash savings: \$2.4M \* 30% = \$720K**
- Costs
  - Annual turnkey outsourcing solutions cost: \$5K
  - Cumulative turnkey outsourcing solutions cost: \$20K
- Return on Investment
  - $$\frac{\text{Cumulative after-tax cash savings} - \text{Cumulative cost}}{\text{Cumulative cost}}$$
  - =  $(\$720K - \$20K) \div \$20K$ ;  $\$720K \div 20K = 3500\%$
- Cost as a percentage of after-tax cash savings:
  - $\$20K \div \$720K = 2.8\%$
- Cumulative after-tax interest savings:
  - Avg. prime rate + 1% \* cumulative after-tax cash savings
  - =  $(3\% + 1\%) * \$720K$ ;  $4\% * \$720K = \$29K$

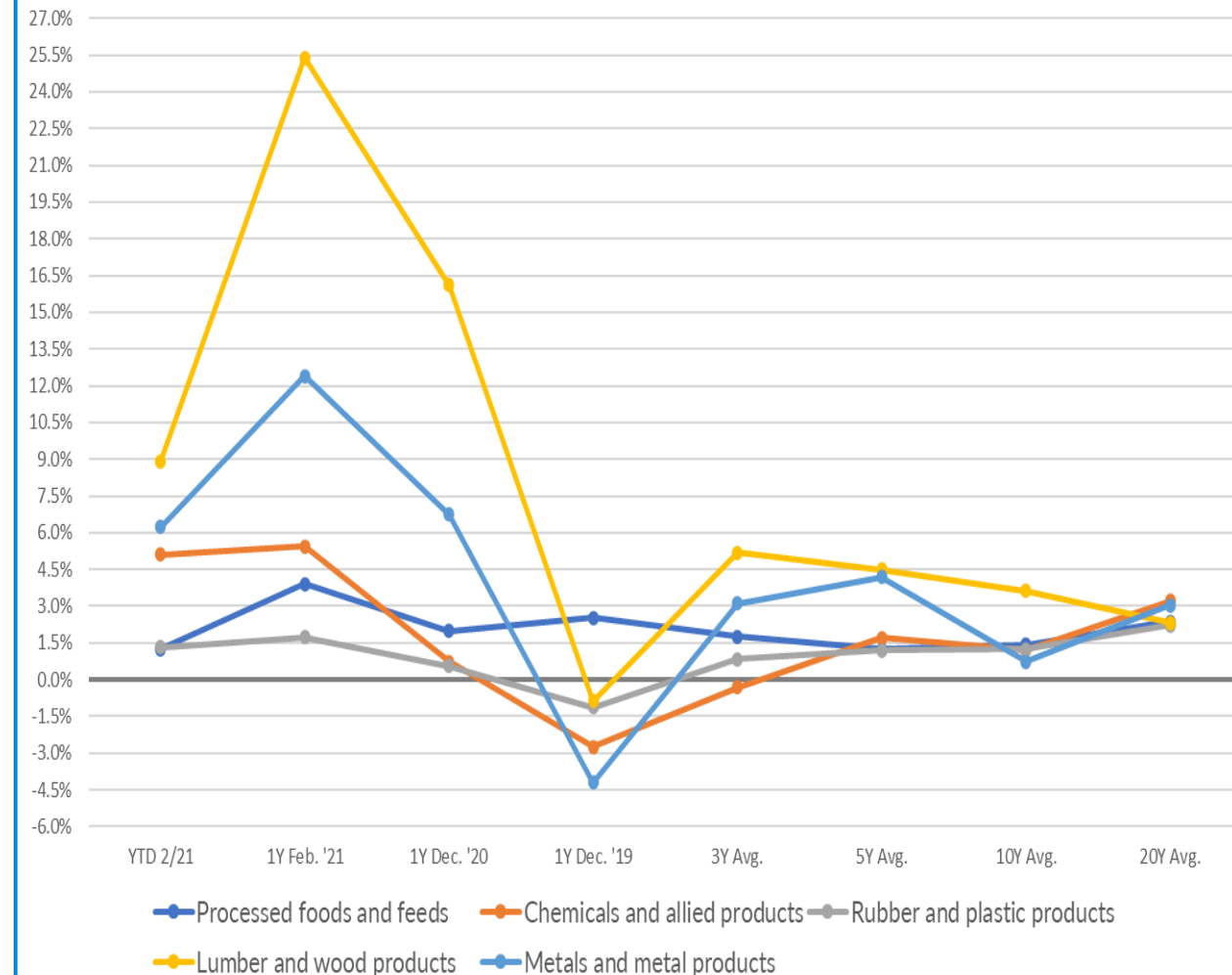




# Top LIFO Candidates

- In general:
  - Almost any industry other than consumer electronics are good LIFO candidates
  - Includes manufacturers, wholesalers & retailers
- Top LIFO candidates by industry/primary business activity
  - Supermarkets & convenience stores
  - Dealerships
    - Auto dealers
    - Ag/farm machinery & equipment dealers
    - RV & powersport dealerships
    - Construction machinery & equipment dealers
  - HVAC & plumbing equipment/supplies manufacturers, wholesalers & retailers
  - Alcohol manufacturers, wholesalers & retailers
  - Home supply, building supply & hardware stores
  - Furniture manufacturers, wholesalers & retailers
  - Plastic resins & product manufacturers, wholesalers & retailers
  - Chemicals manufacturers/wholesalers
  - Metal/metal products & machinery manufacturers/wholesalers
- 2021 Top LIFO candidates
  - Metals & metal products
  - Lumber & wood products
  - Chemicals & allied products
  - Processed foods & feeds
  - Rubber & plastic products

2021 Top LIFO Candidates by Two-Digit BLS Major Commodity Group



# Optimization Strategies & Automation Opportunities

- Optimization strategies
  - Tax savings maximization
    - Switching from internal to external indexes (IPIC CPI/PPI)
    - Expanding LIFO election scope
    - Reducing the number of LIFO pools
  - Best LIFO practices
    - Correcting calculation errors, including:
      - Increment & decrement calculation errors
      - Cumulative index calculation errors
    - Switching from double extension to link chain
    - Switching from dual to single index method
- Automation & Outsourcing Opportunities
  - Software
    - Replace manual spreadsheet LIFO calculations with software to eliminate calculation errors & guarantee accuracy
    - Improve internal controls, reduce financial statement audit risk & substantive testing
    - Simplify calculation procedures & reduce time spent on LIFO
    - Standardize LIFO policies & procedures to safeguard against employee turnover & simplify training procedures by leveraging software
  - Turnkey outsourcing solutions
    - Completely eliminate the hassle of calculations while growing & maintaining your LIFO tax savings
    - Improve internal controls, reduce financial statement audit risk & substantive testing
    - Minimize time spent on LIFO to sending year end inventory documentation, reviewing LIFOPro reports & completing journal entries



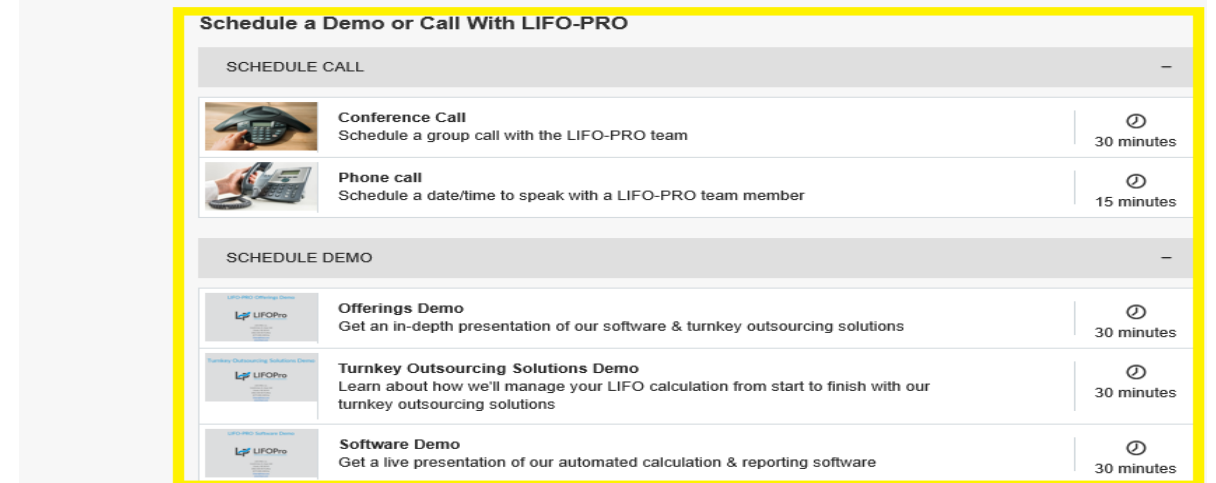
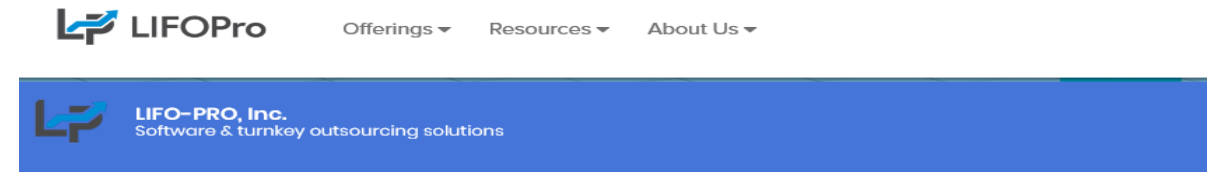
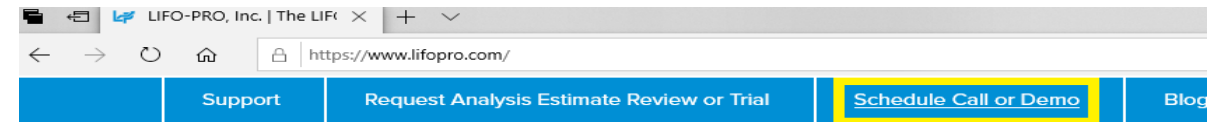
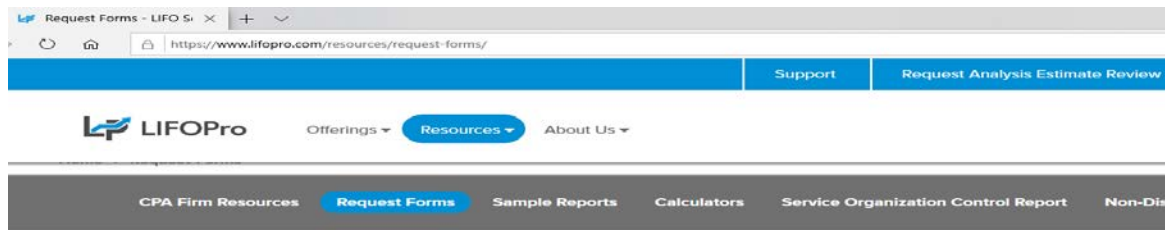
# Key Takeaways

- Companies not on LIFO:
  - **Get a complimentary LIFO Election Benefit Analysis Report**
    - Get the most accurate, in-depth LIFO cost vs. benefit analysis that's only available from the LIFO experts
    - LIFOPro runs a 20 year pro forma LIFO calculation to:
      - Identify if your company's product mix has historically provided sufficient inflation to warrant ever making a LIFO election
      - Quantify what the long-term benefits of LIFO could bring in the future based on the historical results
    - A current year LIFO Calculation estimate is also made to project the tax savings that could be achieved if LIFO were elected this year
    - Includes LIFOPro's recommendations & proposed costs for outsourcing your LIFO calculation or licensing our software
- Companies on LIFO:
  - **Get a complimentary LIFO Calculation, Methods & Best Practices Review Report**
    - LIFO calculation reviewed for accuracy using LIFOPro software
    - Receive in-depth analysis & pro forma LIFO calculation comparisons of present vs. proposed methods from the only LIFO experts
    - Identify opportunities for maximizing tax deferral & reducing IRS audit risk
    - Recommendations, requirements & steps for making changes
    - Includes sample LIFOPro reports using your company's actual LIFO data
    - Also includes software license & turnkey outsourcing solutions cost estimates
  - **Trial the LIFOPro software**
    - Plug & play using your company's actual historical LIFO data
    - Run parallel manual calculations & automated calculations in software to compare the results
    - Quantify amount of time savings from automating calculation
    - Identify opportunities for improving reporting transparency & simplifying documentation



# How to Get Started

- Get free 90-day LIFOPro software trial, LIFO Election Benefit Analysis or cost estimate at our website: <https://www.lifopro.com/resources/request-forms/>
- Learn more about our software at our website: <https://www.lifopro.com/offerings/software/>
- Learn more about our turnkey outsourcing solutions at our website: <https://www.lifopro.com/offerings/services/>
- Schedule a call or WebEx demo at our website: <https://live.vcita.com/site/smleud97dkmgnd9/online-scheduling>



Call us at 402-330-8573 Monday – Friday 8AM – 5PM CST

Email us at [lifopro@lifopro.com](mailto:lifopro@lifopro.com)

