

## INVENTORY ON LIFO SUPPORT

The “Budget of the United States Government, Fiscal Year 2011” is 192 pages and costs \$3.69 trillion.

It contains a section on the automobile industry that includes a discussion on the debt obligations and equity acquired from GM and Chrysler and it discusses the CARS or “Cash for Clunkers” program. What this section does *not* include is the discussion of the elimination of the “last-in, first-out” (LIFO) inventory accounting method which is on page 164 of the budget proposal. Unfortunately, the U.S. government wants to capture billions of dollars (*approximately \$59 billion from 2011 to 2020*) in potential tax revenue from companies using the LIFO inventory method including auto dealerships.

*LIFO allows auto dealerships to calculate the cost of goods sold (COGS) and inventory based on the price of the most recently purchased (“last-in”) inventory. Other methods include “first-in, first-out” (FIFO), specific identification and lower of cost or market.*

LIFO generally results in lower cumulative taxable income than the alternatives until all of the inventory is ultimately disposed. An IRS requirement to use the LIFO method is that the company use LIFO for financial reporting also. Therefore, a company can’t use LIFO for tax reporting and FIFO (or other method) for financial reporting. The IRS does allow a company to spread the LIFO adjustment over 4 years if they change inventory accounting methods and certain conditions are met. The FIFO method results in higher taxable income because the COGS includes inventory that was purchased at lower prices in the past and has been sitting on the lot or on the shelf. LIFO increases the COGS and lowers taxable income.

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## SECTION 179D DEDUCTION ALERT!

### *Energy Efficient Commercial Buildings*

This deduction allows taxpayers a deduction for the expense of a commercial building which would normally be recovered through depreciation over several years.

- To qualify, energy-efficient improvements must reduce the total annual energy and power costs by 50%.
- To be eligible, buildings must be completed or renovated after December 31, 2005 and before January 1, 2013.
- Additional documentation, which must be completed by a qualified engineer or contractor, must be submitted.

**If you believe you may be eligible for this deduction please contact our office for further details.**



**Jay Hutto, CPA/ABV, CVA, CFF  
Partner**

Jay has extensive knowledge of the challenges and needs of the automotive industry. The scope of services rendered include: financial statement audits; tax return preparation and planning; and business valuations.

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Last year, Congress quietly dropped plans to eliminate LIFO after companies began lobbying and educating legislators about the ramifications of the change. Even if LIFO survives another year of federal budgeting, it still faces the long-term threat of being wiped out if the United States adopts international financial reporting standards (IFRS), which do not allow the LIFO inventory accounting method. That could stop companies from using LIFO because companies that use the method to reduce taxable income reported to the IRS must also use it for financial reporting. It is uncertain whether companies could continue to use LIFO for financial reporting and qualify the accountant's report on the financial statements for the departure and remain in compliance with LIFO requirements.

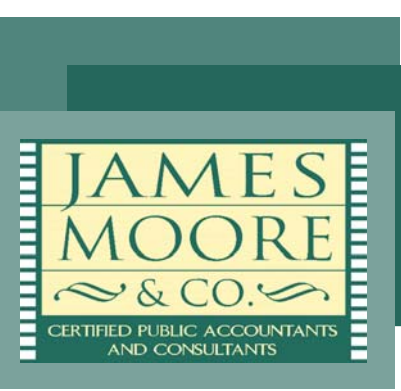
***Auto dealerships like LIFO because it matches current inventory costs and current sales more closely than other methods.***

The NADA and the LIFO Coalition are actively lobbying against the repeal of LIFO. To understand the mismatch, here is an example of how LIFO works. A dealership has a vehicle in its inventory that it bought for \$15,000. It sells the vehicle for \$16,500, and replaces it in inventory for \$15,500. From an economic perspective, the net cash is only \$1,000 (\$16,500 less \$15,500 for the replacement), not the \$1,500 difference between the historic cost and the current sales price. LIFO allows dealerships to use that "last-in" cost to record \$1,000 in taxable income. The remaining \$500 in income is deferred until the company closes its business or is forced to liquidate the inventory. When this occurs, the LIFO reserve (or certain LIFO layers) is recorded into taxable income.



Generally, the sale of old inventory generates revenue to pay the taxes. But if LIFO is simply repealed, income taxes will be due without the additional revenue. As the price of replacement inventory drops or the inventory level drops, taxable income increases, and so does a dealership's tax obligation. The concern is that dealerships that used the tax savings from LIFO reserves to pay-off debt or grow may not have the cash to pay the additional income taxes from a LIFO repeal. There is also concern that during this recession, a switch from LIFO could mean fewer jobs.

There is hope for companies that use LIFO as there remains the possibility that the LIFO inventory accounting method could yet survive again depending on the effect of automotive and other industry outcry against the LIFO repeal on the Obama Administration's budget during this recession.



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