



LIFO 101

Understanding LIFO and LIFO Reserves

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Last-In-First-Out (LIFO)

- Dates to 1939
- Now codified as IRC § 472
- An accounting method used by businesses to value inventory
 - Generally used by companies purchasing inventory that increases in cost
- Uses the last inventory purchased as the first inventory sold



Taxable Income

- Sales proceeds less the cost of goods sold
- Under LIFO, the cost of goods sold matches the cost of the most recently purchased inventory
- The higher the costs of goods sold, the lower the profit, the lower the taxable income, the lower the tax liability



Cost of Goods Sold

- LIFO better matches the cost of goods sold to the cost of replacing inventory
- Opening inventory (3 beers) + new inventory purchased (5 beers) – ending inventory (3 beers)



SOLD 5

- Under LIFO, the cost of the 5 beers that were sold equals the cost of the most recent beer purchased



LIFO and FIFO

- **Last-in-First-Out**

- Inventory prices increase
- Assumes that company sold the more expensive (new) inventory and the less expensive (old) inventory remains in stock
- Results in lower inventory value
- Results in higher cost of goods sold
- Results in lower taxable income

- **First-in-First-Out**

- Inventory prices decrease
- Assumes that company sold the more expensive (old) inventory and the less expensive (new) inventory remains in stock
- Results in lower inventory value
- Results in higher cost of goods sold
- Results in lower taxable income



LIFO Reserves

- Accumulated over many years = “layers”
- Reserves are the difference between the cost of goods sold under LIFO and what would have been the cost of goods sold under FIFO
- The Obama Administration’s proposal to repeal LIFO would impose a retroactive tax on the historic difference (layers of reserves)
- Reserves are not cash, they are only on the books



LIFO Repeal

- LIFO is an accounting method that accurately measures the income of a company
- LIFO is not a loophole, tax shelter or gimmick
- LIFO repeal is a retroactive tax increase on America's businesses (JCT score is \$70 B)
- LIFO repeal would take cash away from businesses that would otherwise be used to maintain or create jobs