

2022 LIFO Lookout & Opportunities Guide

LIFO-PRO, Inc.
11620 Arbor St
Omaha, NE 68144
(402) 330-8573 office
(877) 848-6583 fax
lifopro@lifopro.com
www.lifopro.com



LIFOPro
Software & Turnkey Outsourcing Solutions



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2022 LIFO Lookout

- **LIFO Related Congressional Updates**

- LIFO repeal remains absent from current Congressional agenda & any future near-term threats are very unlikely
- **Inflation Reduction Act (IRA)** excludes any type of LIFO repeal provisions
 - Only companies on LIFO that could be affected would be the 100 – 200 largest companies with \$1B or more of GAAP income whom don't have tax liability
 - Unknown regarding which of those companies are on LIFO, but it's unlikely that they'd terminate their LIFO elections as a result of having to pay the alternative minimum tax

- **Inflation Outlook: PPI**

- Year to date 2022 BLS inflation for the 6 months ended June 2022 has been far higher than historical averages in all industries other than raw metals
- Inflation will likely recede for the remainder of the year, but will still be well above average & create opportunities for companies not on LIFO
- **Metals**
 - Raw materials metals prices peaked late last year & have been largely deflationary in 2022
 - Intermediate & finished goods products made largely of metal such as machinery & equipment (11) have remained well above their historical averages YTD & will likely be above average at year end, too.
- **Petroleum, chemicals & plastic:**
 - Petroleum peaked early in the year & subsequently decreased over the last few months, but assuming the year end price stays close to current levels, 12M ended December PPI Petroleum inflation will be between 30% - 40%
 - Intermediate & finished goods plastics products will also have very high inflation by the end of the year.
- **Food**
 - Inflation has continued an extremely inflationary trajectory & there have been month over month increases for all periods through June '22
 - Economists are forecasting for food prices to peak and modestly decline for the remainder of the year, but most are expecting 12M ended December PPI food inflation to be far higher than historical averages



2022 LIFO Lookout

- **Inflation Outlook: CPI**

- All categories are near record highs or well above historical averages
- Food & vehicle inflation remains well above historical averages

- **Inventory Levels**

- Based on clients with January – June fiscal year ends, most 2022FYE inventory balances have been higher than 2021FYE & almost none have been lower
- Same can be said for clients with December year ends who have performed interim LIFO estimates using current period inventory balances
- Above facts have the following implications for companies electing LIFO for the 2022 year end
 - Assuming 2022 vs. 2021 inflation constant, having higher 2022 vs. 2021 year end base year cost will create larger year one LIFO reserve
 - Layer erosion LIFO income can be mostly if not completely avoided, which will prevent year one LIFO reserve from being reduced as a result of inventory liquidations

- **IRS LIFO Enforcement**

- Noticeable increase in IRS LIFO examinations after the release of the LIFO records practice unit in early 2021
- IRS LIFO enforcement was practically non-existent in the 5-10 years preceding the practice unit release, but LIFOPro has already had a number of clients receiving IDRs following the practice unit release, & requests were verbatim to the items listed in the practice unit
- Previously, IRS challenged taxpayers on advanced LIFO compliance issues such as calculation accuracy & methods compliance when chief counsel's office employed LIFO experts & field offices employed LIFO specialists
- Service's current focus on LIFO records compliance places a much higher importance on the following:
 - Maintaining adequate documentation of inflation calculation
 - Proper application of inflation index calculation
- IRS has essentially broadened the exposure and risk posed to LIFO taxpayers despite lacking LIFO experts & dedicated LIFO specialists since examining records compliance is much more straight-forward & less controversial than more advanced LIFO compliance issues



2022 Inflation Environment – BLS PPI

PPI Code	02	03	05	06	07	08	08	09	10	11	12	13	14	15
BLS PPI Category Description	Processed foods & feeds	Textile products & apparel	Fuels, related products & power	Chemicals & allied products	Rubber & plastic products	Lumber & wood products	Lumber & wood products	Pulp, paper, & allied products	Metals & metal products	Machinery & equipment	Furniture & household durables	Nonmetallic mineral products	Transportation equip.	Misc. products
Inflation Measurement Period														
7 Months Ended July '22 (YTD)	10.0%	7.6%	34.8%	8.1%	8.7%	5.2%	5.2%	9.0%	-0.8%	7.0%	6.7%	10.5%	3.2%	6.2%
July '22 ÷ September '21	9.5%	11.8%	37.6%	9.0%	13.8%	14.4%	14.4%	12.4%	4.0%	9.3%	8.9%	12.0%	4.6%	7.8%
12 Months Ended July '22	13.4%	14.1%	41.0%	12.5%	16.8%	0.8%	13.7%	8.0%	10.9%	11.1%	13.3%	5.1%	7.8%	0.0%
12 Months Ended June '22	11.3%	14.8%	69.4%	12.8%	18.8%	-6.4%	-6.4%	15.6%	15.7%	11.1%	11.8%	12.2%	5.2%	8.5%
12 Months Ended Dec '21	10.4%	15.4%	38.3%	22.9%	21.1%	16.4%	16.4%	16.0%	43.3%	7.1%	10.9%	7.8%	3.9%	6.3%
12 Months Ended Dec '20	2.0%	-0.2%	-6.3%	0.7%	0.6%	16.1%	16.1%	3.0%	6.7%	1.0%	1.6%	2.1%	0.9%	2.8%
12 Months Ended Dec '19	2.5%	-0.4%	-6.2%	-2.7%	-1.1%	-0.9%	-0.9%	-2.3%	-4.2%	1.6%	2.0%	1.5%	0.5%	4.0%
12 Months Ended Dec '18	0.7%	3.7%	4.2%	1.1%	3.1%	1.1%	1.1%	2.5%	7.3%	2.5%	3.9%	4.1%	1.3%	2.3%
12 Months Ended Dec '17	0.4%	1.5%	10.4%	7.2%	3.1%	4.9%	4.9%	2.4%	5.6%	0.9%	1.6%	2.3%	0.8%	2.4%
12 Months Ended Dec '16	0.5%	-0.3%	8.3%	2.5%	0.3%	2.0%	2.0%	1.0%	6.0%	0.0%	0.1%	2.0%	1.0%	1.8%
12 Months Ended Dec '15	-6.2%	-1.0%	-19.8%	-4.8%	-2.6%	-2.1%	-2.1%	-1.1%	-11.3%	0.3%	0.7%	1.5%	1.0%	1.9%
12 Months Ended Dec '14	4.2%	1.3%	-13.6%	0.0%	0.4%	3.2%	3.2%	-0.1%	-0.5%	0.7%	1.5%	3.8%	1.3%	1.4%
12 Months Ended Dec '13	-0.8%	0.9%	0.6%	0.5%	1.7%	5.4%	5.4%	1.7%	-1.8%	1.0%	0.7%	2.7%	1.1%	1.5%
12 Months Ended Dec '12	4.1%	-0.5%	-3.0%	0.8%	0.8%	5.8%	5.8%	1.0%	-2.3%	0.6%	1.2%	2.5%	1.8%	2.5%
12 Months Ended Dec '11	7.2%	7.8%	8.7%	7.2%	6.7%	1.8%	1.8%	0.6%	3.6%	1.9%	3.0%	2.4%	2.6%	3.6%
12 Months Ended Dec '10	5.0%	2.2%	12.3%	7.3%	4.1%	3.5%	3.5%	7.8%	9.7%	-0.3%	0.3%	0.6%	0.7%	2.9%
12 Months Ended Dec '09	-0.7%	0.2%	18.5%	2.7%	-2.4%	-1.4%	-1.4%	-1.3%	3.8%	0.3%	0.6%	-1.6%	0.4%	0.1%
12 Months Ended Dec '08	5.6%	2.1%	-24.0%	2.5%	8.3%	-1.0%	-1.0%	3.4%	-2.8%	2.7%	4.8%	9.5%	3.6%	2.6%
12 Months Ended Dec '07	8.2%	1.6%	18.2%	9.0%	1.8%	-0.1%	-0.1%	3.8%	4.0%	-0.1%	1.4%	2.0%	0.9%	2.6%
12 Months Ended Dec '06	2.2%	0.9%	-5.8%	3.9%	1.3%	-3.0%	-3.0%	4.0%	12.1%	3.2%	1.0%	7.7%	2.5%	2.4%
12 Months Ended Dec '05	1.5%	1.8%	30.6%	8.4%	10.5%	1.2%	1.2%	2.5%	5.1%	0.8%	3.5%	8.1%	0.1%	8.4%
12 Months Ended Dec '04	2.5%	1.6%	19.8%	12.4%	5.4%	4.9%	4.9%	4.3%	19.4%	0.9%	2.5%	5.4%	2.6%	3.2%
12 Months Ended Dec '03	7.0%	-0.2%	11.0%	5.2%	3.0%	7.1%	7.1%	1.8%	4.4%	-0.7%	0.5%	1.6%	2.3%	-1.5%
12 Months Ended Dec '02	1.3%	-0.6%	20.9%	5.5%	0.3%	0.9%	0.9%	2.0%	3.0%	-0.7%	0.2%	0.8%	-0.8%	0.0%
3 Year Annual Average	4.9%	4.7%	6.7%	6.4%	6.4%	10.2%	10.2%	5.3%	13.6%	3.2%	4.7%	3.8%	1.7%	4.3%
5 Year Annual Average	3.2%	3.8%	6.9%	5.5%	5.1%	7.3%	7.3%	4.1%	10.7%	2.6%	3.9%	3.5%	1.5%	3.6%
10 Year Annual Average	1.7%	1.9%	0.2%	2.6%	2.5%	5.0%	5.0%	2.3%	4.1%	1.5%	2.4%	3.0%	1.3%	2.7%
20 Year Annual Average	2.8%	1.8%	4.9%	4.5%	3.2%	3.2%	3.2%	2.6%	5.1%	1.2%	2.1%	3.3%	1.4%	2.5%
Years with Inflation: '02 - '21	17 of 20	13 of 20	13 of 20	17 of 20	17 of 20	14 of 20	14 of 20	16 of 20	14 of 20	15 of 20	20 of 20	19 of 20	19 of 20	18 of 20



2022 Inflation Environment – Auto Dealers

BLS Category Code	Consumer Price Indexes (CPI)				Producer Price Indexes (PPI)		
	SS45011	SS45021	SETA02	SETC	14110131	141105	1412
BLS Category Description / Inflation Measurement Period	New cars	New trucks	Used cars and trucks	Motor vehicle parts & equipment	Passenger cars	Trucks, vans & SUVs	Motor vehicles parts
7 Months Ended July '22 (YTD)	4.7%	4.2%	3.1%	6.8%	1.7%	3.3%	2.8%
July '22 ÷ September '21	9.5%	8.1%	12.3%	11.3%	2.9%	4.6%	3.9%
12 Months Ended July '22	11.7%	10.1%	6.6%	14.1%	3.3%	5.0%	4.5%
12 Months Ended June '22	12.5%	11.1%	7.1%	14.9%	3.3%	4.4%	5.5%
12 Months Ended Dec '21	12.0%	11.6%	37.3%	11.3%	2.1%	3.5%	5.3%
12 Months Ended Dec '20	2.1%	1.9%	10.0%	0.4%	1.1%	-0.2%	0.8%
12 Months Ended Dec '19	0.1%	0.3%	-0.7%	1.8%	0.4%	-0.3%	-0.9%
12 Months Ended Dec '18	0.2%	-0.7%	1.4%	2.2%	0.0%	0.8%	1.8%
12 Months Ended Dec '17	-1.1%	-0.1%	-1.0%	-0.5%	-0.4%	1.0%	0.5%
12 Months Ended Dec '16	-0.2%	0.6%	-3.5%	-1.0%	-0.1%	2.8%	-0.2%
12 Months Ended Dec '15	-0.4%	0.7%	0.4%	-0.3%	2.1%	1.6%	-0.4%
12 Months Ended Dec '14	-0.1%	1.3%	-4.2%	-0.7%	1.1%	1.8%	0.1%
12 Months Ended Dec '13	-0.6%	1.4%	-4.5%	-2.1%	-0.4%	2.0%	0.2%
12 Months Ended Dec '12	1.1%	2.1%	-3.2%	0.9%	0.3%	3.3%	0.5%
12 Months Ended Dec '11	4.0%	2.3%	-0.8%	5.9%	2.3%	3.2%	2.2%
12 Months Ended Dec '10	-1.1%	1.0%	1.1%	3.3%	-2.2%	-0.3%	1.2%
12 Months Ended Dec '09	3.6%	6.6%	1.7%	1.3%	0.1%	2.1%	-1.1%
12 Months Ended Dec '08	-1.1%	-5.3%	1.9%	7.4%	3.0%	2.5%	3.1%
12 Months Ended Dec '07	-0.4%	-0.2%	2.0%	3.7%	-1.2%	-1.6%	0.8%
12 Months Ended Dec '06	0.2%	-2.0%	1.8%	4.8%	-0.5%	2.0%	3.1%
12 Months Ended Dec '05	0.8%	-1.9%	0.2%	3.7%	-3.4%	-5.6%	1.1%
12 Months Ended Dec '04	0.5%	0.5%	-1.6%	2.0%	1.8%	0.7%	1.2%
12 Months Ended Dec '03	-2.1%	-1.5%	-3.3%	0.7%	4.0%	3.3%	-0.9%
12 Months Ended Dec '02	-2.0%	-2.2%	-3.9%	1.1%	-4.0%	-3.5%	-0.1%
3 Year Annual Average	3.8%	3.7%	11.1%	3.6%	1.2%	1.0%	1.7%
5 Year Annual Average	2.6%	2.5%	8.5%	3.0%	0.6%	0.9%	1.5%
10 Year Annual Average	1.3%	1.9%	3.4%	1.1%	0.6%	1.6%	0.8%
20 Year Annual Average	0.7%	0.8%	1.4%	2.3%	0.3%	0.9%	0.9%
Years with Inflation: '02 - '21	10 of 20	12 of 20	10 of 20	15 of 20	11 of 20	14 of 20	14 of 20



Potential IRS LIFO Records Compliance Issues

- **Records Adequacy/Availability**

- Many LIFO taxpayers did not maintain inflation calculation documentation until recently when accounting information systems became electronic
- Other LIFO taxpayers have document retention policies that may have caused for detailed inflation calculation records to be unavailable prior to a certain point in time
- Some LIFO taxpayers still use periodic method and/or rely on external inventory count services to obtain detailed records
- Many LIFO taxpayers have haphazard and/or non-existent LIFO documentation & record-keeping policies and procedures

- **Inflation calculation compliance**

- Many LIFO taxpayers take shortcuts to calculate inflation, such as:
 - Calculating current year indexes by groups/classes of items rather than by the most detailed record or stock-keeping unit
 - Excluding new items from current year index calculation
- Other LIFO taxpayers are using questionable sample sizes & unnecessarily excluding large portions of their goods from inflation calculation
 - Using sample population for inflation calculation was sufficient if not essential prior to the existence of electronic records
 - Many companies now have sophisticated accounting information systems & maintain perpetual records of most if not all inventories
 - Practice unit suggests that inflation calculation should be made based on the most detailed records available in taxpayers accounting system, and although it does not go as far to say as much, it can be presumed that the taxpayer could be challenged by the Service if using samples when records for all goods are readily available



2022 LIFO Planning Strategies & Opportunities

- **Companies NOT on LIFO: Free LIFO Benefit Analysis for Scoping out New Potential Adoptions (includes fee quote)**
 - 2022 year end inflation will likely be well or far above historical averages
 - 2022 year end inventory balances will very likely be higher than last year
 - Material 2022 year end LIFO tax deferral/savings potential is likely for many industries, including:
 - Auto dealers using IPIC method & CPI
 - Food
 - Chemicals
 - Plastics products
 - Machinery & equipment
 - Furniture & household durables
 - Non-metallic minerals products
 - IPIC inflation measured as of December 2022 year end could be more inflationary than internal indexes for the 2022 year end for the following reasons:
 - Freight cost decreases occurring on imported good will have a more material negative impact on internal indexes than external indexes
 - 12M December '22 inflation is likely to be less than 6M/12 ended June '22 inflation
 - BLS price data is lagging by one month since half of the price surveys are lagging by one month. For example, July CPI uses price surveys collected between the middle of June through mid-July
 - Many companies can use an appropriate month that's earlier than their year end month. For example, a company using FIFO with an inventory turnover rate of 3 will have 4 months worth of purchases in ending inventory, and as a result, one could justify the use of 12M ended September, October, November or December 2022 PPI
 - Assuming that the month over month & year over year price changes have peaked and begin to decline for the remainder of the year, it's very likely for the BLS inflation to be higher than internal indexes & for IPIC vs. internal index LIFO reserve to be significantly higher
 - Inflation in 2023 and beyond can be expected to be much lower than inflation experienced over the last two years, making it important for all good LIFO candidates to explore electing for the 2022 year end



2022 LIFO Planning Strategies & Opportunities

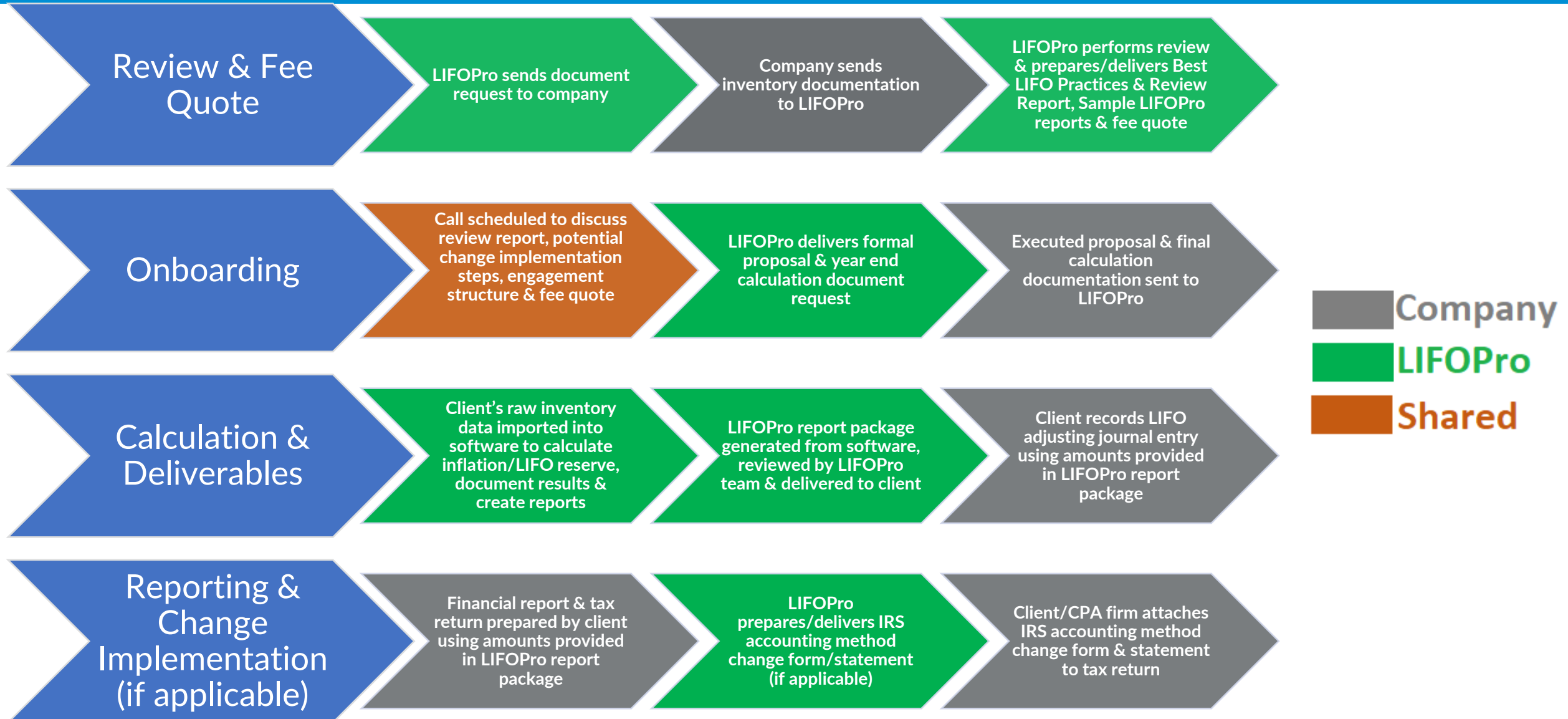
- **Companies on LIFO: Free Best Practices & Calculation Review to identify the following (includes fee quote):**
 - Calculation review to identify potential errors
 - IRS audit risk review to identify compliance issues such as LIFO records adequacy
 - Best practices review, including risk minimization & tax deferral maximization strategies such as:
 - Switch to IPIC method
 - **Tax deferral maximization**
 - **Auto dealers** – IPIC CPI inflation will likely be 2-4 times higher than alternative LIFO method inflation, so switch could create material tax savings
 - **Greater tax deferral/savings than internal indexes:** Many companies will have greater CPI/PPI inflation than internal indexes for reasons such as:
 - Imported or purchased for resale products sourced from abroad have much less inflation than domestically-sourced goods
 - BLS inflation uses uniform inflation indexes for all items, but internal indexes gives new items zero inflation if new item cost is not reconstructed, which can materially reduce overall inflation index when there's high item turnover and/or high inflation
 - **Risk minimization**
 - Switch to IPIC method from internal indexes to IPIC method provides audit protection for calculation errors & LIFO records compliance issues that occurred for periods prior to the change
 - Service generally considers item definition for internal index calculations to be the most detailed record available in the taxpayer's accounting system
 - For IPIC calculations, items are defined as the BLS CPI/PPI categories applicable to the taxpayer's goods
 - Essentially lowers the bar to maintain adequate inflation calculation records when IPIC method is used
 - **Opportunity to outsource LIFO calculation or utilize LIFO software**
 - Minimize IRS audit exposure & maximize LIFO records adequacy/compliance
 - Outsourcing allows companies to preserve LIFO tax savings while avoiding all the hassle
 - Software allows companies to minimize time spent managing LIFO in-house while maximizing accuracy, automation & transparency
 - All LIFOPro engagements includes up to 40 hours of IRS audit support at no additional cost



LIFO Benefit Analysis & Turnkey Solutions Process Flow: First Year



Review & Turnkey Outsourcing Solutions Process Flow: First Year



Note: Best LIFO Practices & Review is an optional complimentary offering. It does not have to be performed to obtain a turnkey outsourcing solutions fee quote and/or engage LIFOPro for turnkey solutions



Turnkey Outsourcing Solutions Process Flow: Recurring – External Indexes

Interim
(Prior to
Year end)

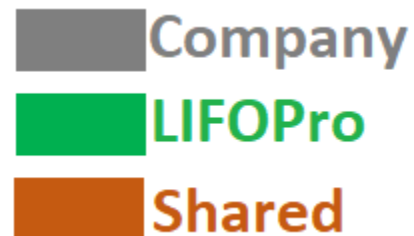
Up to three interim estimates provided using prior year end product mix & year to date external index inflation upon client request

LIFO calculation service reminder sent 30- 60 days prior to client's year end containing year end calculation documentation requirement list, estimated service fee & interim estimate

Post Year
End

Client sends raw inventory documentation to LIFOPro

LIFOPro prepares/modifies raw client data, LIFO calculation completed, reviewed, PDF report package emailed to client & client emailed invoice



Turnkey Outsourcing Solutions Process Flow: Recurring – Internal Indexes

Interim
(Prior to
Year end)

Client sends raw inventory
documentation required to
perform interim estimates
(if applicable)

LIFOPro
prepares/modifies raw
client data, LIFO
calculation completed,
reviewed & LIFOPro
report package sent to
client

Post Year
End

Client sends raw inventory
documentation to LIFOPro

LIFOPro
prepares/modifies raw
client data, LIFO
calculation completed,
reviewed & LIFOPro
report package sent to
client

Company

LIFOPro

Shared



How to Get Started – Companies Not on LIFO

- Get a complimentary LIFO Election Benefit Analysis to obtain the estimated tax savings from LIFO
- Includes the following:
 - Current year estimated tax savings from LIFO
 - 20 year pro forma LIFO calculation using Bureau of Labor Statistics Consumer/Producer Price Indexes to determine the historical inflation trends, whether a company is a good LIFO candidate & what inflation measurement source should be used
 - How LIFO Works appendix covering all the must-knows about LIFO
- See sample LIFO Election Benefit Analysis report here: [Sample LIFO Election Benefit Analysis Report](#)
- **How to get started**
 - Send LIFOPro documentation required to receive complimentary LIFO Election Benefit Analysis
 - Required LIFO election benefit analysis documentation:
 - Current & prior period's **item detail reports** (Also known as stock status or inventory valuation report)
 - Combined federal & state tax rate (optional; tax savings will be estimated using range of tax rates if not provided)
 - See our documentation request listing here: [LIFO Benefit Analysis Documentation Request](#)
 - Send above-listed documentation to lifopro@lifopro.com or upload here: <https://spaces.hightail.com/uplink/LIFO-PRO>
 - LIFOPro will email you analysis report & fee quote within one week of receiving above documentation
 - LIFOPro will also contact you to schedule a time to discuss analysis results, fee quote & implementation steps
 - LIFOPro will turn around calculation & deliver PDF report package as quickly as needed to meet financial reporting/tax return deadlines

LIFO-PRO, Inc.

Visit our website: <https://www.lifopro.com>

Email us at lifopro@lifopro.com

Call us at 402-330-8573 M – F 8am – 5pm CDT



How to Get Started – Companies on LIFO

- **Best LIFO Practices Review & turnkey outsourcing solutions fee quote documentation**
 - LIFO layer history/carryforward schedule from last two periods closed
 - Inflation index calculation documentation from the last period closed (also known as item detail, stock status or inventory valuation report)
 - Product hierarchies (if available)
 - LIFO calculation policies & procedures documentation (if available)
 - Any other schedules/documents not listed above used to complete prior year LIFO calculation
- See our documentation request listing here: **[Review & fee quote documentation request](#)**
- Send documentation to LIFOPro@LIFOPro.com or upload here: <https://spaces.hightail.com/uplink/LIFO-PRO>
- LIFOPro will email review report, fee quote & sample LIFOPro report package within one week of receiving above documentation (LIFOPro will also contact you to schedule a time to discuss engagement options, documentation requirements, expected/required receivables/deliverables timing)

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