Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Concept Unit

Unit Name	LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO	
Primary UIL Code	00472.05-00	LIFO Conformity Requirement

Library Level	**Title**
Knowledge Base	Corporate/Business Issues & Credits
Shelf	Inventory and IRC 263A
Book	Inventory LIFO
Chapter	Conformity Requirement

Document Control Number (DCN)	COR-C-016
Date of Last Update	06/22/20

Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

General Overview

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO

Many United States (U.S.) controlled foreign subsidiaries (CFS) use Last In-First Out (LIFO) to value their inventory on U.S. income tax returns. A taxpayer can treat a foreign subsidiary as a U.S. branch by checking the box on Form 8832, *Entity Classification Election*, and reporting required information on Form 8858, *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*.

A controlled foreign corporation is any foreign corporation in which U.S. shareholders own directly, indirectly, or constructively more than 50 percent of the total value of the stock of such foreign corporation or the total combined voting power of the stock of all classes of stock entitled to vote on any day during the taxable year.

IRC 472(g) requires conformity between financial statement and federal income tax reporting. The United States and Japan are the only countries whose governments permit taxpayers to use LIFO for financial statement reporting. Other countries have adopted the International Financial Reporting Standards (IFRS). Adoption of IFRS for financial statement reporting purposes will cause LIFO termination for U.S. tax purposes, because IFRS does not allow the use of the LIFO inventory method for financial statement reporting.

A U.S. CFS must use the LIFO method for valuing inventory on its financial statements to use the LIFO method for valuing inventory on its U.S. income tax return.

Likewise, a taxpayer using the LIFO method of inventory for U.S. tax reporting purposes must use that same method for all financial statement reporting for credit purposes, and for financial statement reports to shareholders, partners, proprietors, and beneficiaries.

Detailed Explanation of the Concept

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO

Analysis	Resources
Exception to LIFO Conformity - Substantial Foreign Operations A foreign parent of a consolidated group need not use the LIFO method of inventory valuation in the consolidated financial statements of a consolidated group that engages in substantial foreign operations, even though one or more of its subsidiaries use the LIFO method of valuing inventories for federal tax purposes. See Rev. Rul. 78-246. A group engages in substantial foreign operations if the foreign parent owns, either directly or through members of the group, 30 percent or more of the group's total operating assets used in foreign operations. Rev. Rul. 78-246 revokes Rev. Rul. 73-57, which had reached a contrary conclusion. The Internal Revenue Service determined it was appropriate to apply the rule of Rev. Rul. 78-246 to foreign-owned groups of affiliated corporations that issue financial statements on a combined basis, for the reasons stated in Rev. Rul. 78-246.	▪ Rev. Rul. 73-57 ▪ Rev. Rul. 78-246

Detailed Explanation of the Concept (cont'd)

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO	
Analysis	**Resources**
United States Controlled Foreign Subsidiaries However, Rev. Rul. 78-246 does not apply to a United States-owned group of affiliated corporations, because Rev. Rul. 78-246 does not extend to the foreign subsidiary of a domestic parent. See Rev. Rul. 89-41. A broad application of the position in Rev. Rul. 78-246 is not consistent with IRC 472(c), which requires a taxpayer to use LIFO in certain financial statements. Accordingly, a U.S. CFS must use the LIFO method for valuing inventory on its financial statements to use the LIFO method for valuing inventory on its U.S. income tax return. In addition, the enactment of IRC 472(g)(2) (that is, conformity rules are applied on a controlled group basis) includes foreign corporations in the definition of a "group of financially related corporations."	▪ IRC 472(c) ▪ IRC 472(g)(2) ▪ Rev. Rul. 78-246 ▪ Rev. Rul. 89-41

Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td>

<u>Disregarded Entities</u>

A U.S. parent company using LIFO for tax must report the inventory of the foreign disregarded entity on a LIFO basis for book purposes. The U.S. parent must use LIFO for all reporting for credit purposes, reports to shareholders, partners, proprietors and beneficiaries. See the LIFO conformity requirement in Treas. Reg. 1.472–2(e).

Even if a group engages in substantial foreign operations within the meaning of Rev. Rul. 78-246 as explained earlier, that revenue ruling does not apply to United States owned groups of financially related corporations. Accordingly, if a foreign disregarded entity uses the LIFO method of inventory valuation for U.S. federal income tax purposes (but not for foreign financial statement purposes), the foreign disregarded entity cannot use the LIFO method for its inventories when they are included in the consolidated financial statements of the group (i.e., the conformity requirement).

Certain U.S. persons that own foreign disregarded entities (FDEs) directly or indirectly through a tier of FDEs or partnerships, use Form 8858, Information Return *of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*, and its schedules to satisfy the reporting requirements of IRC 6011, 6012, 6031, and 6038, and related regulations. See the instructions for Form 8858 for who must file the form.

</td><td>

- IRC 6011
- IRC 6012
- IRC 6031
- IRC 6038
- Rev. Rul. 78-246
- Treas. Reg. 1.472-2(e)
- Form 8858 - *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*

</td></tr>
</table>

Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td>
<u>Change in Accounting Method</u>

A change from a LIFO Method to a non-LIFO method for valuing inventory is a change in accounting method. See IRC 472(e) and 446.

If the Service terminates a taxpayer's LIFO election due to conformity issues, the taxpayer must follow the rules outlined in Treas. Reg. 1.472-6. Under a Service-imposed LIFO termination, the taxpayer must value the inventory using the below ordering rules:

In conformity with the method the taxpayer used under IRC 471 for inventories not included in its LIFO computations, or
If all the inventory was valued under LIFO, then the inventory method the taxpayer used prior to its adoption of the LIFO method, or
If there were no prior inventories and no inventories valued by a method other than LIFO, then the taxpayer may select a method as long as it is approved by the Commissioner as a clear reflection of income, or
Any method change made pursuant to an application (Form 3115) approved by the Commissioner.

If the Service terminates a taxpayer's LIFO election, the taxpayer will not be entitled to any special relief provisions. The termination adjustment is a change in accounting method under IRC 446 for the earliest year under examination with a corresponding IRC 481(a) adjustment equal to the taxpayer's LIFO tax reserve as of the first day of the year of change (YOC). In addition, there would be a current year adjustment for the method determined above under Treas. Reg. 1.472-6.
</td><td>

IRC 446
IRC 471
IRC 472(e)
IRC 481(a)
Treas. Reg. 1.472-6
Form 3115 - Application for Change in Accounting Method
Rev. Proc. 2002-18 (The procedures under Rev Proc 2002-18 must be followed for a service-imposed method change.)

</td></tr>
</table>

Detailed Explanation of the Concept (cont'd)

<table>
<tr><th colspan="2">LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO</th></tr>
<tr><th>Analysis</th><th>Resources</th></tr>
<tr><td>
<u>Change in Accounting Method (cont'd)</u>

The LIFO reserve is the difference between the ending inventory valued using LIFO and ending inventory valued at current year cost.

Example:
LIFO Cost 800,000
Current year cost <u>1,000,000</u>
LIFO Reserve 200,000

In Rev. Proc. 2015-13, the Service reaffirmed that, absent unusual circumstances, a taxpayer may not readopt the LIFO method for at least five taxable years after terminating the election.

When the Service determines a taxpayer's book inventory method is not a LIFO inventory method, the taxpayer is using an impermissible method of accounting. The Service may change the taxpayer's inventory method of accounting to a permissible non-LIFO inventory method. Please see Chapters 1, 5, and 6 of the Change in Methods book within the Servicewide Virtual Library, Examination Floor, Corporate/Business & Credits Knowledge Base (KB), Methods of Accounting and Timing shelf.
</td><td>
▪ Rev. Proc. 2015-13
▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 1 - Basic Method of Accounting Concepts
▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 - IRC 446(b): Service-Imposed Method Change Issues
▪ Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 6 - IRC 481(a) Adjustments
</td></tr>
</table>

Index of Referenced Resources

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO
IRC 446
IRC 471
IRC 472
IRC 472(c)
IRC 472(e)
IRC 472(g)(2)
IRC 481(a)
IRC 6011
IRC 6012
IRC 6031
IRC 6038
Form 3115 - *Application for Change in Accounting Method*
Form 8858 - *Information Return of U.S. Persons With Respect to Foreign Disregarded Entities (FDEs) and Foreign Branches (FBs)*
Rev. Proc. 2002-18
Rev. Proc. 2015-13
Rev. Rul. 78-246
Rev. Rul. 89-41

Index of Referenced Resources (cont'd)

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO
Rev. Rul. 73-57
Treas. Reg. 1.472-2(e)
Treas. Reg. 1.472-6
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 1 - *Basic Method of Accounting Concepts*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 - *IRC 446(b): Service-Imposed Method Change Issues*
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 6 - *IRC 481(a) Adjustments*

Training and Additional Resources

LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO	
Type of Resource	**Description(s)**
Issue Toolkits	▪ Issue Snapshot - *LIFO Conformity and Exceptions* ▪ Issue Snapshot - *Recapturing a LIFO Reserve*
Other Training Materials	▪ LIFO Audit Techniques and LIFO Issues PPT - 2013-05 ▪ Overview of Basic LIFO PPT - 2012-10

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFS	Controlled Foreign Subsidiaries
FDE	Foreign Disregarded Entities
IFRS	International Financial Reporting Standards
IRC	Internal Revenue Code
KB	Knowledge Base
LIFO	Last In-First Out
Rev. Rul.	Revenue Ruling
Treas. Reg.	Treasury Regulation
YOC	Year of Change

Back to Table of Contents

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
00472.05-00	Practice Unit - *LIFO Conformity Requirement*