



# Internal Revenue Service

DEPARTMENT OF THE TREASURY

## LB&I Concept Unit

<b>Unit Name</b>	LIFO Conformity	
<b>Primary UIL Code</b>	00472.05-00	LIFO Conformity Requirement

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

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# General Overview

## LIFO Conformity

A taxpayer electing the Last in – First out (LIFO) method for tax purposes must generally use the LIFO method in its financial statements. The regulations provide a few exceptions to this general rule. Treas. Reg. 1.472-2(e) covers the financial statement conformity requirements for a taxpayer using the LIFO inventory method. It also explains the exceptions to the requirements discussed below.

Other LIFO conformity requirements include:

- If a taxpayer uses a LIFO method for income tax reporting, then they must use a LIFO method for financial statement reporting.
- A taxpayer may use a different LIFO method for book than it uses for income tax reporting. For example, a taxpayer may use the double extension LIFO method for financial statement reporting and the link chain LIFO method for income tax reporting.

# Detailed Explanation of the Concept

## LIFO Conformity

Analysis	Resources
<p><u>Two Conformity Requirements</u></p> <p>First, the LIFO conformity rules apply to the first taxable year the taxpayer adopts LIFO. A taxpayer must establish that it is using only LIFO and no other inventory method. See IRC 472. The conformity rules apply to all reports or statements of income, profit, or loss to shareholders, beneficiaries or credit holders. There are some exceptions to this rule as noted later.</p> <p>Second, the LIFO conformity rules apply to future taxable years. Once a taxpayer has elected LIFO, it must continue to report under this method for financial reporting unless the taxpayer also changes to a non-LIFO method for tax purposes.</p> <p>If a taxpayer violates the LIFO reporting requirement, the IRS may require the taxpayer to change its LIFO method of accounting to a non-LIFO method for tax purposes.</p>	<ul style="list-style-type: none"><li>▪ <i>BNA Tax Management Portfolio Income Tax Accounting 570-3rd Sec. III-C</i></li><li>▪ <i>Federal Income Taxation of Inventories Para 11.03</i></li><li>▪ IRC 472</li><li>▪ IRC 472(g)</li><li>▪ Treas. Reg. 1.472-2(e)</li></ul>

# Detailed Explanation of the Concept (cont'd)

LIFO Conformity	
Analysis	Resources
<p><u>Exceptions to Financial Statement Reporting Requirements</u></p> <p>A taxpayer electing the LIFO method has five exceptions to the financial reporting requirements provided in Treas. Reg. 1.472-2(e):</p> <ol style="list-style-type: none"> <li>1. Supplemental and explanatory information - A LIFO taxpayer may use a non-LIFO method for information reported as a supplement or explanation to the taxpayer's primary financial statement. A taxpayer may not report supplemental and explanatory information on the face of the income statement. Examples of permitted non-LIFO disclosures include news releases, letters to shareholders or creditors, management analysis section of the annual report, or other supplemental reports that do not accompany the income statement.</li> <li>2. Certain balance sheet disclosures - A LIFO taxpayer may use a non-LIFO method to value inventory on its balance sheet. A taxpayer may not disclose non-LIFO earnings when making these balance sheet disclosures.</li> <li>3. Internal management reports - A LIFO taxpayer may use a non-LIFO method in internal management reports. A taxpayer must not provide these non-LIFO internal management reports to any shareholders or other equity holders. The regulations do not provide a definition of "internal management reports."</li> </ol>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.472-2(e)</li> <li>▪ Treas. Reg. 1.472-2(e)(1)(iii)</li> <li>▪ Treas. Reg. 1.472-2(e)(3)</li> <li>▪ Treas. Reg. 1.472-2(e)(4)</li> </ul>



# Detailed Explanation of the Concept (cont'd)

LIFO Conformity	
Analysis	Resources
<p><u>Audit Tips</u></p> <p>Review a LIFO taxpayer's annual reports to identify any financial information reported on a non-LIFO basis. In addition, review internal management reports and interim reports to ensure the taxpayer meets the exceptions stated earlier.</p> <p>Consider any internal non-LIFO reports released to shareholders or interim reports that exceed one year a potential conformity violation issue. Consider the conformity rules as they apply to consolidated financial statements and be aware of the exceptions to the conformity rules.</p> <p>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. See Rev. Proc. 2002-18.</p> <p>Additional information on Service-imposed method change issues is in the Servicewide Virtual Library (VL). Go to the Examination floor, then the Corporate/Business Issues &amp; Credits Knowledge Base (KB), and select the Change in Methods book on the Methods of Accounting and Timing shelf.</p>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2002-18</li> <li>▪ Corporate/Business Issues &amp; Credits KB, Change in Methods Book, Ch. 5 - <i>IRC 446(b): Service-Imposed Method Change Issues</i></li> </ul>

# Index of Referenced Resources

<b>LIFO Conformity</b>
IRC 472
IRC 472(g)
Treas. Reg. 1.472-2(e)
Rev. Proc. 78-246
Rev. Proc. 79-23
Rev. Rul. 89-41
Rev. Rul. 2002-18
<i>BNA Tax Management Portfolios Income Tax Accounting, 570-3rd</i>
<i>Federal Income Taxation of Inventories Para 11.03</i>
Corporate/Business Issues & Credits KB, Change in Methods Book, Ch. 5 - <i>IRC 446(b): Service-Imposed Method Change Issues</i>

# Training and Additional Resources

LIFO Conformity	
Type of Resource	Description(s)
Issue Toolkits	<ul style="list-style-type: none"><li>▪ Issue Snapshot - <i>LIFO Record Keeping Requirements</i></li><li>▪ Issue Snapshot - <i>Recapturing a LIFO Reserve</i></li></ul>
Other Training Materials	<ul style="list-style-type: none"><li>▪ Overview of Basic LIFO PPT - 2012-10</li><li>▪ LIFO Audit Techniques and LIFO Issues PPT - 2013-05</li></ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
IRC	Internal Revenue Code
KB	Knowledge Base
LIFO	Last in - First out
NOPA	Notice of Proposed Adjustment
Rev. Proc.	Revenue Procedure
Rev. Rul.	Revenue Ruling
Treas. Reg.	Treasury Regulations
VL	Virtual Library

# Index of Related Practice Units

<b>Associated UIL(s)</b>	<b>Related Practice Unit</b>
00472.05-00	<i>LIFO Conformity for U.S. Corporations with Foreign Subsidiaries Using LIFO</i>
00472.01-00	<i>Adopting LIFO</i>