



August 17, 2021

Mr. John Moriarty
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Safe Harbor Method and Expedited Relief under Section 473

Dear Mr. Moriarty:

The American Institute of CPAs (AICPA) appreciates the continued efforts of the Department of the Treasury (“Treasury”) and the Internal Revenue Service (IRS) to issue timely guidance related to the Coronavirus Aid, Relief and Economic Security Act (CARES Act).¹ The AICPA previously [submitted comments](#) requesting relief under section 473¹ for taxpayers. In our previous letter, we recommended that Treasury and the IRS determine that the foreign trade interruptions resulting from government actions to contain the spread of the 2019 Coronavirus Disease pandemic (“Coronavirus” or “COVID-19”) is considered a “qualified inventory interruption”² and issue the required notice (the “Notice”)³ granting section 473 relief to taxpayers that experienced a qualified liquidation of Last-In, First-Out (LIFO) inventory.

Overview

Our previous comment letter recommended a safe harbor method that alleviates the burden of paying additional taxes on the related income and, in general, eliminates the need to file amended tax returns to obtain section 473 relief. This letter provides details (including examples, below) of: (1) the section 473 safe harbor method, and (2) the need for expedited relief to elect the section 473 safe harbor method.

Recommendation

The AICPA recommends a section 473 safe harbor method providing that, if a taxpayer has experienced a qualified liquidation⁴ for a liquidation year,⁵ the taxpayer would disregard the liquidation for the liquidation year and would retain the LIFO layers related to the opening inventory of the liquidation year.

¹ P.L. 116-136.

¹ Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.

² Under section 473(c)(2)(A).

³ See section 473(c)(2).

⁴ Section 473(c)(1).

⁵ Section 473(d)(1).

Analysis

Under our recommended safe harbor method, the taxpayer does not recognize income attributable to the liquidation of these LIFO layers if the taxpayer completely replaces the inventory by the end of the replacement period.⁶ This safe harbor method alleviates the burden of paying additional taxes on the related income and, in general, eliminates the need to file amended tax returns to obtain section 473 relief.

The safe harbor method will allow a taxpayer to use a substitute current-year cost for the liquidation year equal to the actual current-year cost (e.g., First-In, First-Out (FIFO) cost) of the prior year multiplied by the current-year index. The taxpayer then computes a substitute base cost equal to the substitute current-year cost divided by the current-year cumulative index. This substitute base cost will equal the prior-year base cost. As a result, the LIFO layers that existed prior to the liquidation year will not be liquidated, and the taxpayer will not recognize taxable income related to the liquidation that otherwise would occur in the liquidation year. However, the taxpayer would recognize LIFO income related to deflation, or a LIFO expense related to inflation, based on the current-year index for the liquidation year. The taxpayer will repeat this process for each year of the replacement period until the liquidated inventory is completely replaced, recognizing LIFO income related to deflation, or a LIFO expense related to inflation, based on the current-year index for each year.

If the taxpayer does not fully replace the liquidated inventory by the end of the replacement period, the taxpayer may elect to either: (1) file an amended return for the liquidation year to recognize the taxable income related to the liquidated inventory that was not replaced and pay the related income tax and interest, or (2) in lieu of filing an amended return, compute the taxable income related to the liquidated inventory that was not replaced and pay a specified amount that approximates the time value of money benefit⁷ (similar to the approach described in section 6.02(4) of Rev. Proc. 2002-18) on or before the due date (including any extension) of the federal income tax return for the last year of the replacement period.

Recommendations

The AICPA urges the IRS to expedite publication of guidance providing the section 473 safe harbor method proposed above so that affected taxpayers who have not already filed their federal income tax return for the liquidation year can include the section 473 safe harbor election statement with their timely filed (including any extension) original federal income tax return.

Further, the AICPA recommends providing taxpayers with the flexibility to elect and implement the section 473 safe harbor method, particularly for taxpayers that have already filed their federal income tax return for the liquidation year. Filing an amended return for the liquidation year within 90 days of the date this proposed guidance is published in the Federal Register, or filing a Form 3115, *Application for Change in Accounting Method*, under the automatic consent procedures for any taxable year during the replacement period would permit taxpayers, including partnerships, a late election mechanism to use the proposed section 473 safe harbor method. This is similar to the

⁶ Examples 2-5, below, provide the mechanics and proposed operation of the safe harbor method.

⁷ Additional guidance providing the procedures to make the time value of money payment in lieu of filing an amended return for the liquidation year would be necessary.

relief provided in Rev. Proc. 2020-25 and Rev. Proc. 2020-50 with respect to late bonus depreciation elections.

Analysis

Expedited relief allows taxpayers to avoid the burden of paying additional taxes related to the income resulting from the qualified liquidation for the liquidation year. Transparency and visibility of the tax laws is a guiding principle for sound tax administration. Granting expedited relief under section 473 and allowing taxpayers to use the proposed safe harbor method to mitigate the substantial additional taxes due to circumstances beyond their control was the purpose of *enacting* section 473. Not allowing taxpayers to use relief that should be available reduces that visibility and transparency of the tax laws, leading to unequal and in some cases, unfair, application of those now opaque laws.

A taxpayer that makes a late election to use the section 473 safe harbor method by filing a Form 3115 under the automatic consent procedures would implement the change with a section 481(a) adjustment. The section 481(a) adjustment would equal the difference between: (1) the amount of LIFO income recognized in the federal income tax return for the liquidation year due to the qualified liquidation; and (2) the amount of LIFO expense or income (due to inflation or deflation) that would have been recognized if the taxpayer had applied the section 473 safe harbor method for the liquidation year.⁸ In addition, the taxpayer would restore the liquidated layers as if it had applied the section 473 safe harbor method for the liquidation year.

* * * * *

The AICPA is the world's largest member association representing the accounting profession, with more than 428,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state, and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact David Strong, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (616) 752-4251, or david.strong@crowe.com; Alexander Scott, Senior Manager — AICPA Tax Policy & Advocacy, at (202) 434-9204, or alexander.scott@aicpa-cima.com; or me at (601) 326-7119 or JanLewis@HaddoxReid.com.

Sincerely,



Jan Lewis, CPA
Chair, AICPA Tax Executive Committee

⁸ Example 6, below, provides further details in mechanical operation.

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Mr. Mark Mazur, Acting Assistant Secretary for Tax Policy, Department of the Treasury
Mr. William Paul, Acting Chief Counsel, Internal Revenue Service
Mr. Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Mr. Timothy Powell, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Ms. Kate Abdo, Special Counsel, Income Tax & Accounting, Internal Revenue Service

Examples - Application of Section 473 (Generally); Recommended Section 473 Safe Harbor Method

Example 1: Application of Section 473 – Inventory Fully Replaced After One Year

Company A uses the dollar-value link-chain LIFO inventory method. At the end of 2019, Company A had the following LIFO layers and LIFO reserve:

| Year | 2019 Base Cost | Current- Year Index | Cumulative Index | 2019 LIFO Value |
|------------|-------------------|------------------------|---------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | 1.000000 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 |
| 12/31/1996 | \$ - | 1.019329 | 1.078235 | \$ - |
| 12/31/1997 | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 |
| 12/31/2006 | \$ - | 1.063921 | 1.431455 | \$ - |
| 12/31/2007 | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 |
| 12/31/2008 | \$ - | 0.979993 | 1.471422 | \$ - |
| 12/31/2009 | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 |
| 12/31/2010 | \$ - | 1.007974 | 1.478770 | \$ - |
| 12/31/2011 | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 |
| 12/31/2013 | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 |
| 12/31/2017 | \$ - | 1.025398 | 1.664976 | \$ - |
| 12/31/2018 | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 |
| | | | B | |
| Total | \$64,135,570 | | | \$76,516,494 |
| | A | | | C |

| | | |
|-------------------|-----------|-----------------------|
| 2019 LIFO Value | C | \$ 76,516,494 |
| 2019 FIFO Cost | D | <u>\$109,100,056</u> |
| 2019 LIFO Reserve | C - D = E | <u>\$(32,583,562)</u> |

In 2020, Company A experienced a qualified liquidation of its LIFO inventory due to the COVID-19 pandemic, which resulted in a decrease to ending inventory of approximately 30%. As a result of the LIFO liquidation, Company A had a decrement of \$19,804,551, computed as follows:

| | | |
|-----------------------------|-----------|-----------------------|
| 2020 FIFO Cost | F | \$75,966,610 |
| Current-Year Index | G | 1.007370 |
| PY Cumulative Index | B | <u>1.701085</u> |
| CY Cumulative Index | G * B = H | 1.713622 |
| 2020 Base Cost | F / H = I | \$ 44,331,019 |
| 2019 Base Cost | A | <u>\$ 64,135,570</u> |
| Base Cost of 2020 Decrement | I - A = J | <u>\$(19,804,551)</u> |

At the end of 2020, Company A had the following LIFO layers and LIFO reserve:

| Year | 2019 Base Cost | 2020 Increment / (Decrement) | 2020 Base Cost | Current-Year Index | Cumulative Index | 2019 LIFO Value | 2020 LIFO Value |
|------------|----------------|------------------------------|----------------|--------------------|------------------|-----------------|-----------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | \$ (3,257,774) | \$ 232,389 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 304,584 |
| 12/31/2005 | \$ 7,548,218 | \$ (7,548,218) | \$ - | 1.026542 | 1.345452 | \$10,155,765 | \$ - |
| 12/31/2006 | \$ - | \$ - | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | \$ (744,174) | \$ - | 1.048906 | 1.501462 | \$ 1,117,349 | \$ - |
| 12/31/2008 | \$ - | \$ - | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | \$ (880,755) | \$ - | 0.997044 | 1.467072 | \$ 1,292,131 | \$ - |
| 12/31/2010 | \$ - | \$ - | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | \$ (190,225) | \$ - | 1.004152 | 1.484910 | \$ 282,467 | \$ - |
| 12/31/2012 | \$ 421,748 | \$ (421,748) | \$ - | 1.010261 | 1.500147 | \$ 632,684 | \$ - |

| | | | | | | | |
|------------|--------------|----------------|--------------|----------|----------|--------------|--------------|
| 12/31/2013 | \$ 2,905,222 | \$ (2,905,222) | \$ - | 1.015987 | 1.524130 | \$ 4,427,936 | \$ - |
| 12/31/2014 | \$ 1,522,900 | \$ (1,522,900) | \$ - | 1.020999 | 1.556135 | \$ 2,369,838 | \$ - |
| 12/31/2015 | \$ 431,092 | \$ (431,092) | \$ - | 1.015610 | 1.580426 | \$ 681,309 | \$ - |
| 12/31/2016 | \$ 67,628 | \$ (67,628) | \$ - | 1.027404 | 1.623736 | \$ 109,810 | \$ - |
| 12/31/2017 | \$ - | \$ - | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | \$ (1,017,760) | \$ - | 1.010180 | 1.681925 | \$ 1,711,796 | \$ - |
| 12/31/2019 | \$ 817,055 | \$ (817,055) | \$ - | 1.011392 | 1.701085 | \$ 1,389,880 | \$ - |
| 12/31/2020 | | | \$ - | 1.007370 | 1.713622 | | \$ - |
| | | | | G | H | | |
| Total | \$64,135,570 | \$(19,804,551) | \$44,331,019 | | | \$76,516,494 | \$48,075,682 |
| | A | J | I | | | C | K |

| | | |
|-------------------|-----------|-----------------------|
| 2020 LIFO Value | K | \$ 48,075,682 |
| 2020 FIFO Cost | F | \$ 75,966,610 |
| 2020 LIFO Reserve | K - F = L | <u>\$(27,890,928)</u> |

The LIFO value of the decrement is \$28,440,812, computed as follows:

| | | |
|-------------------------|-----------|-----------------------|
| 2020 LIFO Value | K | \$ 48,075,682 |
| 2019 LIFO Value | C | \$ 76,516,494 |
| LIFO Value of Decrement | K - C = M | <u>\$(28,440,812)</u> |

As a result of the 2020 liquidation, Company A recognized net LIFO income of \$4,692,634, computed as follows:

| | | |
|----------------------------------|-----------|-----------------------|
| 2019 LIFO Reserve | E | \$(32,583,562) |
| 2020 LIFO Reserve | L | <u>\$(27,890,928)</u> |
| 2020 Net LIFO Expense / (Income) | E - L = N | \$ (4,692,634) |

This income is net of LIFO expense of \$804,067 (due to inflation in 2020), computed as follows:

| | | |
|------------------------------|------------------|----------------------|
| 2020 Current Year Index | G | 1.007370 |
| 2020 Inflation | G - 1.000000 = O | 0.007370 |
| 2019 FIFO Cost | D | <u>\$109,100,056</u> |
| 2020 LIFO Expense / (Income) | O * D = P | \$ 804,067 |
| Due to Inflation / Deflation | | |

In 2021, Company A fully replaces the liquidated inventory and has an increment with a base cost of \$22,861,082, computed as follows:

| | | |
|-----------------------------|-----------|----------------------|
| 2021 FIFO Cost | Q | \$114,000,000 |
| Current-Year Index | R | 0.990083 |
| 2020 PY Cumulative Index | H | 1.713622 |
| 2021 CY Cumulative Index | R * H = S | <u>1.696628</u> |
| 2021 Base Cost | Q / S = T | \$ 67,192,101 |
| 2020 Base Cost | I | <u>\$ 44,331,019</u> |
| Base Cost of 2021 Increment | T - I = U | \$ 22,861,082 |

Company A makes a section 473 election for 2021. Therefore, Company A treats the portion of the increment exceeding the 2020 decrement as attributable to 2021 and values this excess amount using the 2021 cumulative index. Company A treats the remainder of the increment as replacing the inventory that was liquidated in 2020 and values this portion of the increment at the LIFO value of the 2020 decrement. Company A computes a weighted average cumulative index for 2021 equal to the total LIFO value of the 2021 increment divided by the total base cost of the 2021 increment.

| | | |
|--|-----------|-----------------------|
| Base Cost of 2021 Increment | U | \$ 22,861,082 |
| Base Cost of 2020 Decrement | J | <u>\$(19,804,551)</u> |
| Base Cost of Excess 2021 Increment | U - J = V | \$ 3,056,531 |
| 2021 Cumulative Index | S | <u>1.696628</u> |
| LIFO Value of 2021 Excess Increment | V * S = W | \$ 5,185,797 |
| LIFO Value of 2020 Decrement | - M = X | <u>\$ 28,440,812</u> |
| LIFO Value of 2021 Increment | W + X = Y | \$ 33,626,609 |
| LIFO Value of 2021 Increment | Y | \$ 33,626,609 |
| Base Cost of 2021 Increment | U | \$ 22,861,082 |
| Weighted Average 2021 Cumulative Index | Y / U = Z | 1.470911 |

At the end of 2021, Company A has the following LIFO layers and LIFO reserve:

| Year | 2020 Base Cost | 2021 Increment / (Decrement) | 2021 Base Cost | Current- Year Index | Cumulative Index | 2020 LIFO Value | 2021 LIFO Value |
|------------|-------------------|------------------------------------|-------------------|------------------------|---------------------|--------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |

| | | | | | | | |
|------------|--------------|--------------|--------------|----------|----------|--------------|--------------|
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 232,389 | | \$ 232,389 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 304,584 |
| 12/31/2005 | \$ - | | \$ - | 1.026542 | 1.345452 | \$ - | \$ - |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ - | | \$ - | 1.048906 | 1.501462 | \$ - | \$ - |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ - | | \$ - | 0.997044 | 1.467072 | \$ - | \$ - |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ - | | \$ - | 1.004152 | 1.484910 | \$ - | \$ - |
| 12/31/2012 | \$ - | | \$ - | 1.010261 | 1.500147 | \$ - | \$ - |
| 12/31/2013 | \$ - | | \$ - | 1.015987 | 1.524130 | \$ - | \$ - |
| 12/31/2014 | \$ - | | \$ - | 1.020999 | 1.556135 | \$ - | \$ - |
| 12/31/2015 | \$ - | | \$ - | 1.015610 | 1.580426 | \$ - | \$ - |
| 12/31/2016 | \$ - | | \$ - | 1.027404 | 1.623736 | \$ - | \$ - |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ - | | \$ - | 1.010180 | 1.681925 | \$ - | \$ - |
| 12/31/2019 | \$ - | | \$ - | 1.011392 | 1.701085 | \$ - | \$ - |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | | \$22,861,082 | \$22,861,082 | 0.990083 | 1.470911 | | \$33,626,609 |
| | | | | R | Z | | |
| Total | \$44,331,019 | \$22,861,082 | \$67,192,101 | | | \$48,075,682 | \$81,702,291 |
| | I | U | T | | | K | AA |

| | | |
|-------------------|-------------|-----------------|
| 2021 LIFO Value | AA | \$ 81,702,291 |
| 2021 FIFO Cost | Q | \$114,000,000 |
| 2021 LIFO Reserve | AA - Q = AB | \$ (32,297,709) |

As a result of its section 473 election, Company A has a LIFO expense of \$4,406,781 and is able to reverse its 2020 LIFO income of \$4,692,634, leaving it with net 2021 LIFO income of \$285,853 (due to deflation in 2021), computed as follows:

| | | |
|----------------------------------|--------------|----------------|
| 2020 LIFO Reserve | L | \$(27,890,928) |
| 2021 LIFO Reserve | AB | \$(32,297,709) |
| 2021 LIFO Expense / (Income) | L - AB = AC | \$ 4,406,781 |
| Reverse 2020 LIFO Income | - N = AD | \$ 4,692,634 |
| Net 2021 LIFO Expense / (Income) | AC - AD = AE | \$ (285,853) |

To reverse its 2020 LIFO income under section 473,⁹ Company A must file an amended federal income tax return for its 2020 tax year.

⁹ See section 473(b).

In this example, Company A fully replaced the liquidated inventory in the first replacement year; therefore, Company A only had to file one amended federal income tax return for its 2020 tax year. However, if Company A did not fully replace the liquidated inventory until later in the replacement period, in 2022 or 2023, it would be required to file an amended federal income tax return for its 2020 tax year after each replacement year. Therefore, Company A may be required to file up to three amended returns for the 2020 tax year. The requirement to file multiple amended tax returns for the same tax year is burdensome for both the taxpayer and the IRS. To mitigate this burden, we recommend adopting the safe harbor method, as exhibited in Examples 2 through 5, below.

Example 2: Section 473 Safe Harbor Method – Inventory Fully Replaced After One Year

The facts are the same as Example 1, except that Company A elects to use the section 473 safe harbor method. Under the safe harbor method, Company A computes a substitute 2020 current-year cost (FIFO cost) equal to the 2019 FIFO cost multiplied by the 2020 current-year index. The substitute FIFO cost is then used to compute a substitute 2020 base cost equal to the 2019 base cost:

| | | |
|------------------------------|-------------|---------------|
| 2019 FIFO Cost | D | \$109,100,056 |
| Current-Year Index | G | 1.007370 |
| Substitute 2020 FIFO Cost | D * G = AF | \$109,904,123 |
| CY Cumulative Index | H | 1.713622 |
| Substitute 2020 Base Cost | AF / H = AG | \$ 64,135,570 |
| 2019 Base Cost | A | \$ 64,135,570 |
| 2020 Increment / (Decrement) | AG - A = AH | \$ - |

As a result, Company A does not recognize the decrement of \$19,804,551¹⁰ attributable to the qualified liquidation under section 473, and none of the LIFO layers are liquidated. The 2020 LIFO layers are identical to the 2019 LIFO layers, and the 2020 LIFO value is equal to the 2019 LIFO value. At the end of 2020, Company A has the following LIFO layers:

| Year | 2019 Base Cost | 2020 Increment / (Decrement) | 2020 Base Cost | Current-Year Index | Cumulative Index | 2019 LIFO Value | 2020 LIFO Value |
|------------|----------------|------------------------------|----------------|--------------------|------------------|-----------------|-----------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |

¹⁰ Reference J

| | | | | | | | |
|------------|--------------|------|--------------|----------|----------|--------------|--------------|
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | | \$ - | \$ - | 1.007370 | 1.713622 | | \$ - |
| | | | | G | H | | |
| Total | \$64,135,570 | \$ - | \$64,135,570 | | | \$76,516,494 | \$76,516,494 |
| | A | AH | AG | | | C | AI |

Under the section 473 safe harbor method, Company A uses the substitute 2020 FIFO cost to compute the 2020 LIFO reserve. Therefore, although the 2020 LIFO value is equal to the 2019 LIFO value, the 2020 LIFO reserve will not equal the 2019 LIFO reserve if there is inflation or deflation in 2020 (i.e., the 2020 current-year index is greater than or less than 1.000000). Company A has a 2020 LIFO reserve of \$33,387,629 and a 2020 LIFO expense of \$804,067 (due to inflation in 2020), computed as follows:

| | | |
|------------------------------|--------------|--------------------------|
| 2020 LIFO Value | AI | \$ 76,516,494 |
| Substitute 2020 FIFO Cost | AF | \$109,904,123 |
| 2020 LIFO Reserve | AI - AF = AJ | \$ (33,387,629) |
| 2019 LIFO Reserve | E | \$ (32,583,562) |
| 2020 LIFO Reserve | AJ | \$ (33,387,629) |
| 2020 LIFO Expense / (Income) | E - AJ = AK | \$ 804,067 ¹¹ |

¹¹ Note that this LIFO expense is identical to the 2020 LIFO expense in Example 1 because under both the section 473 statutory method and the section 473 safe harbor method, Company A recognizes LIFO expense or income in the liquidation year based on the inflation or deflation reflected in the current-year index for the year.

In 2021, Company A fully replaces the liquidated inventory and has an increment with a base cost of \$3,056,531 and a LIFO value of \$5,185,796, computed as follows:

| | | |
|------------------------------|-------------|----------------------|
| 2021 FIFO Cost | Q | \$114,000,000 |
| Current-Year Index | R | 0.990083 |
| PY Cumulative Index | H | 1.713622 |
| CY Cumulative Index | R * H = S | <u>1.696628</u> |
| 2021 Base Cost | Q / S = T | \$ 67,192,101 |
| Substitute 2020 Base Cost | AG | <u>\$ 64,135,570</u> |
| Base Cost of 2021 Increment | T - AG = AL | \$ 3,056,531 |
| CY Cumulative Index | S | <u>1.696628</u> |
| LIFO Value of 2021 Increment | AL * S = AM | \$ 5,185,796 |

As shown above, the base cost of the 2021 increment is the difference between the 2021 base cost and the substitute 2020 base cost.

At the end of 2021, Company A has the following LIFO layers and LIFO reserve:

| Year | 2020 Base Cost | 2021 Increment / (Decrement) | 2021 Base Cost | Current-Year Index | Cumulative Index | 2020 LIFO Value | 2021 LIFO Value |
|------------|----------------|------------------------------|----------------|--------------------|------------------|-----------------|-----------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |

| | | | | | | | |
|------------|--------------|--------------|--------------|----------|----------|--------------|--------------|
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | | \$ 3,056,531 | \$ 3,056,531 | 0.990083 | 1.696628 | | \$ 5,185,796 |
| | | | | R | S | | |
| Total | \$64,135,570 | \$ 3,056,531 | \$67,192,101 | | | \$76,516,494 | \$81,702,290 |
| | AG | AL | T | | | AI | AN |

| | | |
|-------------------|-------------|-----------------|
| 2021 LIFO Value | AN | \$ 81,702,290 |
| 2021 FIFO Cost | Q | \$114,000,000 |
| 2021 LIFO Reserve | AN - Q = AO | \$ (32,297,710) |

Company A has LIFO income of \$1,089,919 (due to deflation in 2021), computed as follows:

| | | |
|------------------------------|--------------|----------------|
| 2020 LIFO Reserve | AJ | \$(33,387,629) |
| 2021 LIFO Reserve | AO | \$(32,297,710) |
| 2021 LIFO Expense / (Income) | AJ - AO = AP | \$ (1,089,919) |

Note that the 2021 ending LIFO value in Example 2 of \$81,702,290 is equal to the 2021 ending LIFO value in Example 1 (with \$1 difference due to rounding). Furthermore, the sum of the 2020 LIFO expense and the 2021 LIFO income in Example 2 is income of \$285,852 (804,067 - 1,089,919), which is equal to the net 2021 LIFO income in Example 1 (with \$1 difference due to rounding).

If Company A did not fully replace the liquidated inventory by the end of 2021 and, instead, replaced the liquidated inventory by the end of 2022 or 2023, Company A would have the same LIFO value at the end of each year and the same LIFO income or expense for each year of the replacement period under the section 473 statutory method and the section 473 safe harbor method. Therefore, if Company A fully replaces the inventory that was liquidated in 2020 by the end of the replacement period, the cumulative net LIFO income or expense under the section 473 safe harbor method and the section 473 statutory method will be the same.

Additionally, by electing the section 473 safe harbor method, Company A can obtain the same results without filing one or more amended federal income tax returns for 2020.

Example 3: Section 473 Safe Harbor Method – Inventory Fully Replaced After Two Years

The facts are the same as Example 2, except that Company A does not fully replace the liquidated inventory at the end of 2021. Under the safe harbor method, Company A computes the 2021 base cost of ending inventory and compares this amount to the substitute 2020 base cost, resulting in a decrement for 2021.

| | | |
|-----------------------------|--------------|-----------------|
| 2021 FIFO Cost | AQ | \$104,500,000 |
| Current-Year Index | R | 0.990083 |
| PY Cumulative Index | H | 1.713622 |
| CY Cumulative Index | R * H = S | <u>1.696628</u> |
| 2021 Base Cost | AQ / S = AR | \$ 61,592,759 |
| Substitute 2020 Base Cost | AG | \$ 64,135,570 |
| Base Cost of 2021 Decrement | AR - AG = AS | \$ (2,542,811) |

Under the safe harbor method, Company A computes a substitute 2021 FIFO cost equal to the substitute 2020 FIFO cost multiplied by the 2021 current-year index and uses this substitute FIFO cost to compute a substitute 2021 base cost that is equal to the 2020 base cost:

| | | |
|------------------------------|--------------|-----------------|
| Substitute 2020 FIFO Cost | AF | \$109,904,123 |
| Current-Year Index | R | 0.990083 |
| Substitute 2021 FIFO Cost | AF * R = AT | \$108,814,204 |
| CY Cumulative Index | S | <u>1.696628</u> |
| Substitute 2021 Base Cost | AT / S = AU | \$ 64,135,570 |
| Substitute 2020 Base Cost | AG | \$ 64,135,570 |
| 2021 Increment / (Decrement) | AU - AG = AV | \$ - |

As a result, Company A does not recognize any of the 2020 decrement attributable to the qualified liquidation under section 473, and none of the LIFO layers are liquidated. The 2021 LIFO layers are identical to the 2020 (and 2019) LIFO layers, and the 2021 LIFO value is equal to the 2020 (and 2019) LIFO value.

At the end of 2021, Company A has the following LIFO layers:

| Year | 2020 Base Cost | 2021 Increment / (Decrement) | 2021 Base Cost | Current- Year Index | Cumulative Index | 2020 LIFO Value | 2021 LIFO Value |
|------------|-------------------|------------------------------------|-------------------|------------------------|---------------------|--------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |

| | | | | | | | |
|------------|--------------|------|--------------|----------|----------|--------------|--------------|
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | | \$ - | \$ - | 0.990083 | 1.696628 | | \$ - |
| | | | | R | S | | |
| Total | \$64,135,570 | \$ - | \$64,135,570 | | | \$76,516,494 | \$76,516,494 |
| | AG | AV | AU | | | AI | AW |

Under the section 473 safe harbor method, Company A uses the substitute 2021 FIFO cost to compute the 2021 LIFO reserve. Therefore, although the 2021 LIFO value is equal to the 2020 LIFO value, the 2021 LIFO reserve will not equal the 2020 LIFO reserve if there is inflation or deflation in 2021 (i.e., the 2021 current-year index is greater than or less than 1.000000). Company A has a 2021 LIFO reserve of \$32,297,710 and 2021 LIFO income of \$1,089,919 (due to deflation in 2021), computed as follows:

| | | |
|------------------------------|--------------|------------------------------|
| 2021 LIFO Value | AW | \$ 76,516,494 |
| Substitute 2021 FIFO Cost | AT | \$108,814,204 |
| 2021 LIFO Reserve | AT - AW = AX | \$ (32,297,710) |
| 2020 LIFO Reserve | AJ | \$ (33,387,629) |
| 2021 LIFO Reserve | AX | \$ (32,297,710) |
| 2021 LIFO Expense / (Income) | AJ - AX = AY | \$ (1,089,919) ¹² |

¹² Note that this LIFO income is identical to the 2021 LIFO income in Example 2 because Company A recognizes LIFO expense or income in each year of the replacement period based on the inflation or deflation reflected in the current-year index for the year, regardless of whether it has fully or partially replaced the liquidated inventory.

In 2022, Company A replaces the remaining portion of the liquidated inventory and has an increment with a base cost of \$892,354 and a LIFO value of \$1,536,934, computed as follows:

| | | |
|------------------------------|--------------|----------------------|
| 2022 FIFO Cost | AZ | \$112,000,000 |
| Current-Year Index | BA | 1.015153 |
| PY Cumulative Index | S | 1.696628 |
| CY Cumulative Index | BA * S = BB | <u>1.722337</u> |
| 2022 Base Cost | AZ / BB = BC | \$ 65,027,924 |
| Substitute 2021 Base Cost | AU | <u>\$ 64,135,570</u> |
| Base Cost of 2022 Increment | BC - AU = BD | \$ 892,354 |
| CY Cumulative Index | BB | <u>1.722337</u> |
| LIFO Value of 2022 Increment | BD * BB = BE | \$ 1,536,934 |

As shown above, the base cost of the 2022 increment is the difference between the 2022 base cost and the substitute 2021 base cost.

At the end of 2022, Company A has the following LIFO layers and LIFO reserve:

| Year | 2021 Base Cost | 2022 Increment / (Decrement) | 2022 Base Cost | Current- Year Index | Cumulative Index | 2021 LIFO Value | 2022 LIFO Value |
|------------|-------------------|------------------------------------|-------------------|------------------------|---------------------|--------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |

| | | | | | | | |
|------------|--------------|------------|--------------|----------|----------|--------------|--------------|
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | \$ - | | \$ - | 0.990083 | 1.696628 | \$ - | \$ - |
| 12/31/2022 | | \$ 892,354 | \$ 892,354 | 1.015153 | 1.722337 | | \$ 1,536,934 |
| | | | | BA | BB | | |
| | \$64,135,570 | \$ 892,354 | \$65,027,924 | | | \$76,516,494 | \$78,053,428 |
| | AU | BD | BC | | | AW | BF |

| | | |
|-------------------|--------------|-----------------|
| 2022 LIFO Value | BF | \$ 78,053,428 |
| 2022 FIFO Cost | AZ | \$112,000,000 |
| 2022 LIFO Reserve | BF - AZ = BG | \$ (33,946,572) |

Company A has a LIFO expense of \$1,648,862 (due to inflation in 2022), computed as follows:

| | | |
|------------------------------|--------------|----------------|
| 2021 LIFO Reserve | AX | \$(32,297,710) |
| 2022 LIFO Reserve | BG | \$(33,946,572) |
| 2022 LIFO Expense / (Income) | AX - BG = BH | \$ 1,648,862 |

Example 4: Section 473 Safe Harbor Method – Inventory Fully Replaced After Three Years

The facts are the same as Example 3, except that Company A does not fully replace the liquidated inventory at the end of 2022. Under the safe harbor method, Company A computes the 2022 base cost of ending inventory and compares this amount to the substitute 2021 base cost, resulting in a decrement for 2022.

| | | |
|-----------------------------|--------------|----------------|
| 2022 FIFO Cost | BI | \$108,000,000 |
| Current-Year Index | BA | 1.015153 |
| PY Cumulative Index | S | 1.696628 |
| CY Cumulative Index | BA * S = BB | 1.722337 |
| 2022 Base Cost | BI / BB = BJ | \$ 62,705,498 |
| Substitute 2021 Base Cost | AU | \$ 64,135,570 |
| Base Cost of 2022 Decrement | BJ - AU = BK | \$ (1,430,072) |

Under the safe harbor method, Company A computes a substitute 2022 FIFO cost equal to the substitute 2021 FIFO cost multiplied by the 2022 current-year index and uses this substitute FIFO cost to compute a substitute 2022 base cost that is equal to the 2021 base cost:

| | | |
|------------------------------|--------------|----------------------|
| Substitute 2021 FIFO Cost | AT | \$108,814,204 |
| Current-Year Index | BA | <u>1.015153</u> |
| Substitute 2022 FIFO Cost | AT * BA = BL | \$110,463,066 |
| CY Cumulative Index | BB | <u>1.722337</u> |
| Substitute 2022 Base Cost | BL / BB = BM | \$ 64,135,570 |
| Substitute 2021 Base Cost | AU | <u>\$ 64,135,570</u> |
| 2022 Increment / (Decrement) | BM - AU = BN | \$ - |

As a result, Company A does not recognize any of the 2020 decrement attributable to the qualified liquidation under section 473, and none of the LIFO layers are liquidated. The 2022 LIFO layers are identical to the 2021 (and 2020 and 2019) LIFO layers, and the 2022 LIFO value is equal to the 2021 (and 2020 and 2019) LIFO value.

At the end of 2022, Company A has the following LIFO layers:

| Year | 2021 Base Cost | 2022 Increment / (Decrement) | 2022 Base Cost | Current- Year Index | Cumulative Index | 2021 LIFO Value | 2022 LIFO Value |
|------------|-------------------|------------------------------------|-------------------|------------------------|---------------------|--------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |

| | | | | | | | |
|------------|--------------|------|--------------|----------|----------|--------------|--------------|
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | \$ - | | \$ - | 0.990083 | 1.696628 | \$ - | \$ - |
| 12/31/2022 | | \$ - | \$ - | 1.015153 | 1.722337 | | \$ - |
| | | | | BA | BB | | |
| Total | \$64,135,570 | \$ - | \$64,135,570 | | | \$76,516,494 | \$76,516,494 |
| | AU | BN | BM | | | AW | BO |

Under the section 473 safe harbor method, Company A uses the substitute 2022 FIFO cost to compute the 2022 LIFO reserve. Therefore, although the 2022 LIFO value is equal to the 2021 LIFO value, the 2022 LIFO reserve will not equal the 2021 LIFO reserve if there is inflation or deflation in 2022 (i.e., the 2022 current-year index is greater than or less than 1.000000). Company A has a 2022 LIFO reserve of \$33,946,572 and a 2022 LIFO expense of \$1,648,862 (due to inflation in 2022), computed as follows:

| | | |
|------------------------------|--------------|----------------------------|
| 2022 LIFO Value | BO | \$ 76,516,494 |
| Substitute 2022 FIFO Cost | BL | \$110,463,066 |
| 2022 LIFO Reserve | BO - BL = BP | \$ (33,946,572) |
| 2021 LIFO Reserve | AX | \$ (32,297,710) |
| 2022 LIFO Reserve | BP | \$ (33,946,572) |
| 2022 LIFO Expense / (Income) | AX - BP = BQ | \$ 1,648,862 ¹³ |

In 2023, Company A replaces the remaining portion of the liquidated inventory and has an increment with a base cost of \$755,436 and a LIFO value of \$1,327,144:

| | | |
|------------------------------|--------------|---------------|
| 2023 FIFO Cost | BR | \$114,000,000 |
| Current-Year Index | BS | 1.020005 |
| PY Cumulative Index | BB | 1.722337 |
| CY Cumulative Index | BS * BB = BT | 1.756792 |
| 2023 Base Cost | BR / BT = BU | \$ 64,891,006 |
| Substitute 2022 Base Cost | BM | \$ 64,135,570 |
| Base Cost of 2023 Increment | BU - BM = BV | \$ 755,436 |
| CY Cumulative Index | BT | 1.756792 |
| LIFO Value of 2023 Increment | BV * BT = BW | \$ 1,327,144 |

As shown above, the base cost of the 2023 increment is the difference between the 2023 base cost and the substitute 2022 base cost.

¹³ Note that this LIFO expense is identical to the 2022 LIFO expense in Example 3 because Company A recognizes LIFO expense or income in each year of the replacement period based on the inflation or deflation reflected in the current-year index for the year, regardless of whether it has fully or partially replaced the liquidated inventory.

At the end of 2023, Company A has the following LIFO layers and LIFO reserve:

| Year | 2022 Base Cost | 2023 Increment / (Decrement) | 2023 Base Cost | Current- Year Index | Cumulative Index | 2022 LIFO Value | 2023 LIFO Value |
|------------|-------------------|------------------------------------|-------------------|------------------------|---------------------|--------------------|--------------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | | \$ 190,225 | 1.004152 | 1.484910 | \$ 282,467 | \$ 282,467 |
| 12/31/2012 | \$ 421,748 | | \$ 421,748 | 1.010261 | 1.500147 | \$ 632,684 | \$ 632,684 |
| 12/31/2013 | \$ 2,905,222 | | \$ 2,905,222 | 1.015987 | 1.524130 | \$ 4,427,936 | \$ 4,427,936 |
| 12/31/2014 | \$ 1,522,900 | | \$ 1,522,900 | 1.020999 | 1.556135 | \$ 2,369,838 | \$ 2,369,838 |
| 12/31/2015 | \$ 431,092 | | \$ 431,092 | 1.015610 | 1.580426 | \$ 681,309 | \$ 681,309 |
| 12/31/2016 | \$ 67,628 | | \$ 67,628 | 1.027404 | 1.623736 | \$ 109,810 | \$ 109,810 |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | | \$ 1,017,760 | 1.010180 | 1.681925 | \$ 1,711,796 | \$ 1,711,796 |
| 12/31/2019 | \$ 817,055 | | \$ 817,055 | 1.011392 | 1.701085 | \$ 1,389,880 | \$ 1,389,880 |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | \$ - | | \$ - | 0.990083 | 1.696628 | \$ - | \$ - |
| 12/31/2022 | \$ - | | \$ - | 1.015153 | 1.722337 | \$ - | \$ - |
| 12/31/2023 | | \$ 755,436 | \$ 755,436 | 1.020005 | 1.756792 | | \$ 1,327,144 |
| | | | | BS | BT | | |
| Total | \$64,135,570 | \$ 755,436 | \$64,891,006 | | | \$76,516,494 | \$77,843,638 |
| | BM | BV | BU | | | BO | BX |

| | | |
|-------------------|--------------|------------------------|
| 2023 LIFO Value | BX | \$ 77,843,638 |
| 2023 FIFO Cost | BR | \$114,000,000 |
| 2023 LIFO Reserve | BX - BR = BY | <u>\$ (36,156,362)</u> |

Company A has a LIFO expense of \$2,209,790 (due to inflation in 2023), computed as follows:

| | | |
|------------------------------|--------------|----------------|
| 2022 LIFO Reserve | BP | \$(33,946,572) |
| 2023 LIFO Reserve | BY | \$(36,156,362) |
| 2023 LIFO Expense / (Income) | BP - BY = BZ | \$ 2,209,790 |

The safe harbor method enables taxpayers to obtain relief under section 473 without amending their 2020 federal income tax return each year the liquidated inventory is replaced during the replacement period if the liquidated inventory is fully replaced during, or by the end of, the replacement period.

Example 5: Section 473 Safe Harbor Method – Inventory Partially Replaced After Three Years

The facts are the same as Example 4, except that Company A does not fully replace the liquidated inventory by the end of the replacement period. Under the safe harbor method, Company A computes the 2023 base cost of ending inventory and compares this amount to the substitute 2022 base cost, resulting in a decrement for 2023.

| | | |
|-----------------------------|--------------|----------------|
| 2023 FIFO Cost | CA | \$100,000,000 |
| Current-Year Index | BS | 1.020005 |
| PY Cumulative Index | BB | 1.722337 |
| CY Cumulative Index | BS * BB = BT | 1.756792 |
| 2023 Base Cost | CA / BT = CB | \$ 56,921,935 |
| Substitute 2022 Base Cost | BM | \$ 64,135,570 |
| Base Cost of 2023 Decrement | CB - BM = CC | \$ (7,213,635) |

Company A has not fully replaced the liquidated inventory by the end of the replacement period and must recognize this decrement attributable to the 2020 qualified liquidation under section 473.

At the end of 2023, Company A has the following LIFO layers and LIFO reserve:

| Year | 2022 Base Cost | 2023 Increment / (Decrement) | 2023 Base Cost | Current-Year Index | Cumulative Index | 2022 LIFO Value | 2023 LIFO Value |
|------------|----------------|------------------------------|----------------|--------------------|------------------|-----------------|-----------------|
| 12/31/1990 | \$14,388,471 | | \$14,388,471 | | 1.000000 | \$14,388,471 | \$14,388,471 |
| 12/31/1991 | \$ 1,765,027 | | \$ 1,765,027 | 1.029480 | 1.029480 | \$ 1,817,060 | \$ 1,817,060 |
| 12/31/1992 | \$ 131,322 | | \$ 131,322 | 0.999406 | 1.028868 | \$ 135,113 | \$ 135,113 |
| 12/31/1993 | \$ 3,948,039 | | \$ 3,948,039 | 1.001234 | 1.030138 | \$ 4,067,025 | \$ 4,067,025 |
| 12/31/1994 | \$ 1,317,990 | | \$ 1,317,990 | 1.010561 | 1.041017 | \$ 1,372,050 | \$ 1,372,050 |
| 12/31/1995 | \$ 6,358,840 | | \$ 6,358,840 | 1.016111 | 1.057789 | \$ 6,726,311 | \$ 6,726,311 |
| 12/31/1996 | \$ - | | \$ - | 1.019329 | 1.078235 | \$ - | \$ - |
| 12/31/1997 | \$ 2,741,774 | | \$ 2,741,774 | 1.030068 | 1.110655 | \$ 3,045,165 | \$ 3,045,165 |
| 12/31/1998 | \$ 5,811,005 | | \$ 5,811,005 | 1.025072 | 1.138501 | \$ 6,615,835 | \$ 6,615,835 |
| 12/31/1999 | \$ 1,320,541 | | \$ 1,320,541 | 1.051880 | 1.197566 | \$ 1,581,435 | \$ 1,581,435 |

| | | | | | | | |
|------------|--------------|---------------|--------------|----------|----------|--------------|--------------|
| 12/31/2000 | \$ 430,950 | | \$ 430,950 | 1.037991 | 1.243063 | \$ 535,698 | \$ 535,698 |
| 12/31/2001 | \$ 4,539,430 | | \$ 4,539,430 | 1.021974 | 1.270378 | \$ 5,766,792 | \$ 5,766,792 |
| 12/31/2002 | \$ 835,240 | | \$ 835,240 | 1.001574 | 1.272378 | \$ 1,062,741 | \$ 1,062,741 |
| 12/31/2003 | \$ 510,001 | | \$ 510,001 | 1.013080 | 1.289021 | \$ 657,402 | \$ 657,402 |
| 12/31/2004 | \$ 3,490,163 | | \$ 3,490,163 | 1.016790 | 1.310664 | \$ 4,574,431 | \$ 4,574,431 |
| 12/31/2005 | \$ 7,548,218 | | \$ 7,548,218 | 1.026542 | 1.345452 | \$10,155,765 | \$10,155,765 |
| 12/31/2006 | \$ - | | \$ - | 1.063921 | 1.431455 | \$ - | \$ - |
| 12/31/2007 | \$ 744,174 | | \$ 744,174 | 1.048906 | 1.501462 | \$ 1,117,349 | \$ 1,117,349 |
| 12/31/2008 | \$ - | | \$ - | 0.979993 | 1.471422 | \$ - | \$ - |
| 12/31/2009 | \$ 880,755 | | \$ 880,755 | 0.997044 | 1.467072 | \$ 1,292,131 | \$ 1,292,131 |
| 12/31/2010 | \$ - | | \$ - | 1.007974 | 1.478770 | \$ - | \$ - |
| 12/31/2011 | \$ 190,225 | \$ (30,230) | \$ 159,995 | 1.004152 | 1.484910 | \$ 282,467 | \$ 237,578 |
| 12/31/2012 | \$ 421,748 | \$ (421,748) | \$ - | 1.010261 | 1.500147 | \$ 632,684 | \$ - |
| 12/31/2013 | \$ 2,905,222 | \$(2,905,222) | \$ - | 1.015987 | 1.524130 | \$ 4,427,936 | \$ - |
| 12/31/2014 | \$ 1,522,900 | \$(1,522,900) | \$ - | 1.020999 | 1.556135 | \$ 2,369,838 | \$ - |
| 12/31/2015 | \$ 431,092 | \$ (431,092) | \$ - | 1.015610 | 1.580426 | \$ 681,309 | \$ - |
| 12/31/2016 | \$ 67,628 | \$ (67,628) | \$ - | 1.027404 | 1.623736 | \$ 109,810 | \$ - |
| 12/31/2017 | \$ - | | \$ - | 1.025398 | 1.664976 | \$ - | \$ - |
| 12/31/2018 | \$ 1,017,760 | \$(1,017,760) | \$ - | 1.010180 | 1.681925 | \$ 1,711,796 | \$ - |
| 12/31/2019 | \$ 817,055 | \$ (817,055) | \$ - | 1.011392 | 1.701085 | \$ 1,389,880 | \$ - |
| 12/31/2020 | \$ - | | \$ - | 1.007370 | 1.713622 | \$ - | \$ - |
| 12/31/2021 | \$ - | | \$ - | 0.990083 | 1.696628 | \$ - | \$ - |
| 12/31/2022 | \$ - | | \$ - | 1.015153 | 1.722337 | \$ - | \$ - |
| 12/31/2023 | | | \$ - | 1.020005 | 1.756792 | \$ - | \$ - |
| | | | | BS | BT | | |
| | \$64,135,570 | \$(7,213,635) | \$56,921,935 | | | \$76,516,494 | \$65,148,352 |
| | BM | CC | CB | | | BO | CD |

| | | |
|-------------------|--------------|-----------------|
| 2023 LIFO Value | CD | \$ 65,148,352 |
| 2023 FIFO Cost | CA | \$100,000,000 |
| 2023 LIFO Reserve | CD - CA = CE | \$ (34,851,648) |

Company A has a net LIFO expense of \$905,076 based on the change in the LIFO reserve:

| | | |
|----------------------------------|--------------|-----------------|
| 2022 LIFO Reserve | BP | \$ (33,946,572) |
| 2023 LIFO Reserve | CE | \$ (34,851,648) |
| 2023 Net LIFO Expense / (Income) | BP - CE = CF | \$ 905,076 |

This expense is net of LIFO income related to the decrement. The LIFO expense due to inflation in 2023 is \$2,209,814, computed as follows:

| | | |
|------------------------------|--------------------|---------------|
| 2023 Current Year Index | BS | 1.020005 |
| 2023 Inflation | BS - 1.000000 = CG | 0.020005 |
| Substitute 2022 FIFO Cost | BM | \$110,463,066 |
| 2023 LIFO Expense / (Income) | CG * BM = CH | \$ 2,209,814 |
| Due to Inflation / Deflation | | |

The difference between this amount and the 2023 net LIFO expense is the LIFO income related to the decrement.

| | | |
|---|--------------|----------------------|
| 2023 Net LIFO Expense / (Income) | CF | \$ 905,076 |
| 2023 LIFO Expense / (Income) Due to Inflation / Deflation | CH | \$ 2,209,814 |
| 2023 LIFO Income Related to LIFO Decrement | CF - CH = CI | <u>\$(1,304,738)</u> |

Company A would have recognized this income in 2020 if it had not elected and applied the section 473 safe harbor method. Therefore, Company A must either: (1) file an amended return for 2020 to recognize this income and pay the related income tax and interest; or (2) in lieu of filing an amended return, pay a specified amount that approximates the time value of money benefit based on procedures to be provided by the IRS in forthcoming guidance.

Example 6: Form 3115 Filed to Change to the Section 473 Safe Harbor Method

The facts are the same as Example 1, except that Company A files a Form 3115 under the automatic change consent procedures with its 2021 federal income tax return to make a late election to use the section 473 safe harbor method. Company A implements the change with a negative section 481(a) adjustment of \$5,496,701, computed as follows:

| | | |
|---|------------|----------------------|
| 2020 LIFO Expense / (Income) | N | \$(4,692,634) |
| 2020 LIFO Expense / (Income) Due to Inflation/Deflation | P | <u>\$ 804,067</u> |
| Section 481(a) Adjustment – Increase / (Decrease) to Taxable Income | N – P = CJ | <u>\$(5,496,701)</u> |

Pursuant to Rev. Proc. 2015-13, §7.03(1), Company A takes the negative section 481(a) adjustment into account entirely in the year of change.

In addition, Company A restores the liquidated layers so that its LIFO layers at the end of 2020 are the same as the layers presented in Example 2, above. Company A would use the section 473 safe harbor method for 2021 and, if applicable, the remaining years of the replacement period, as set forth in Examples 2 through 5, above.