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Outsourcing Logistics Can Help Small Businesses Compete

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Outsourcing logistics can help small businesses compete

Every successful company has a core competency. It might be retailing, financial management, food preparation, etc.

To get ahead in today's competitive business environment, you need to be better than the other guy at something. So, the question arises: What is that something that outsourcing logistics could help with?

Most companies don’t do a good job at logistics. If you are a world-class oil refinery, why would you believe you are a world class logistician, too?

Even if your company is good at logistics, do you want to spend time, effort and capital on logistics when your organization could invest improving your true core competency?

These are realistic questions every allowing business must evaluate. The truth is your company may or may not benefit by outsourcing your logistics needs.

The first step is to identify whether your organization is a viable candidate to outsource.

Most people mistakenly assume you have to be a Fortune 500 type company to make this work. There is some validity to the concept that larger companies are more likely targets for logistics outsourcing.

The truth is that the largest organizations often have highly skilled internal employees doing their logistics and do not gain much benefit by outsourcing. Small organizations often can benefit from outsourcing specific tasks or skill sets. So size should not preclude a company from making a pragmatic decision to outsource its logistics outsourcing needs.

Therefore, your company needs to identify a number of critical items to determine the viability of logistics outsourcing. The goal is to identify how much your organization spends on logistics and how important it is to the overall success of the company. If you spend less than $200,000 per year on logistics and inventory, you are not going to be a high priority target for Third Party Logistics, or 3PL, companies.

However, you may need to potentially defer the inflationary gain on inventory purchases indefinitely. As long as inventory levels are steady or growing, the taxpayer never is deemed to have sold any of its older, lower-cost inventory. As with all tax deferrals, the tax man will come sooner or later to get paid.

If inventory prices or levels fall, businesses will be deemed to have sold the units purchased in a prior period, and the deferred inflationary gain in those periods will be recognized in taxable income.

In the meantime, another attempt to tax these deferred gains has emerged. In consecutive budget proposals, the Obama administration has proposed ending the use of LIFO for federal income tax purposes and requiring users to recapture historic LIFO reserves into income. These reserves would be recaptured into taxable income ratably over 10 years.

In consecutive budget proposals, the Obama administration has proposed ending the use of LIFO (as an inventory accounting method) for federal income tax purposes and requiring users to recapture historic LIFO reserves into income. These reserves would be recaptured into taxable income ratably over 10 years.

In essence LIFO is a tax deferral allowing businesses that have elected the method to potentially defer the inflationary gain on inventory purchases indefinitely. As long as inventory levels are steady or growing, the taxpayer never is deemed to have sold any of its older, lower-cost inventory. As with all tax deferrals, the tax man will come sooner or later to get paid.

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These reserves would be recaptured into taxable income ratably over 10 years. According to the budget proposal, repeal of LIFO would bring in approximately $59 billion in tax revenue. But ending LIFO may not prove so simple. Many people defend LIFO as a proper method for tax purposes, arguing that it provides for a matching of income and expenses.

There is great debate to the extent prices are increasing because of inflation, the LIFO method ensures the higher-price inventory gets included in costs of goods sold while matching that amount with the current revenue, which leads to a better reflection of income.

Plus, LIFO repeal would result in recognition of taxable income with no economic income, meaning taxation without receipt of dollars. This could be a difficult pill to swallow for many businesses.

Regardless of whether Congress enacts the White House proposal to repeal LIFO, another threat to LIFO’s survival is lurking. The accounting method would be eliminated under the pending framework of international financial reporting standards (IFRS) that would take effect if the United States adopts IFRS.

The seemingly inevitable shift from GAAP to IFRS raises the issue of whether companies will be able to continue using LIFO for tax purposes in light of the conformity requirement.

Simply doing nothing to change the conformity requirement would result in a tax increase without Congress or the White House having to actually vote for or sign one into law. With the ever-increasing deficit, this could be an appealing outcome for lawmakers.

So what does this all mean?

Companies using the LIFO method need to pay close attention and plan for a potential tax bill. For companies deciding whether to use the LIFO method, this is a reminder that all accounting method elections require careful consideration to ensure all facets of the decision are considered.

If you are considering a LIFO election or would like to know the tax consequences if you are forced to take your LIFO reserve back into income, you should consult your financial advisor.

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