

How Tariffs Impact Your Bottom Line—and What to Do About It



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Tariffs are more than just a trade issue—they can significantly affect your tax reporting and financial strategy. If your company imports materials or finished goods, understanding how tariffs impact your inventory costing could help you avoid unexpected tax burdens and identify opportunities for improvement.

In this article, we break down:

- How tariffs factor into inventory accounting for income tax purposes
- Key pitfalls that can trigger unfavorable tax consequences

Why Inventory Tax Accounting Should Be on Your Radar

Tariffs may not be top of mind when considering income taxes, but they should be. Rising tariff rates, especially in an inflationary environment, can directly impact how inventory is valued for tax purposes. Without careful planning, this can lead to significant book-to-tax differences and missed opportunities for tax savings.

Aligning your financial and tax inventory costing is essential—not only for compliance, but for managing your company's cash flow and tax position more effectively.

Understanding Tariffs in the Context of Inventory Costing

Both financial and tax accounting require that companies capitalize certain costs into inventory, typically acquisition costs like freight and tariffs, along with direct labor and materials. However, the rules and expectations differ in several key ways.

- **Financial accounting** may treat tariffs as variable costs, depending on their materiality. Inventory is often valued using net realizable value, based on the estimated selling price minus the costs to complete and sell it.
- **Tax accounting**, on the other hand, emphasizes capitalizing *actual costs*, including tariffs and other acquisition expenses, under IRS UNICAP (Uniform Capitalization) rules.

Suppose you're using **standard costing**, which sets product costs based on historical averages or expectations. In that case, tariff fluctuations can create a mismatch between book and tax inventory values, especially if those tariffs change mid-year and aren't captured in real time.

What to Watch For: Common Issues and Actionable Steps

1. Uncapitalized Tariff Costs and Variances

If your systems aren't capturing tariffs accurately in inventory costing, you may be undercapitalizing these costs for tax purposes. That can trigger significant book-to-tax adjustments at year-end, and potentially underpayment penalties.

Action step: Revisit your cost accounting methods. Analyze whether tariff-related costs are properly included in your inventory capitalization for both book and tax. Companies using standard costing or burden rates should regularly review and update those rates, especially in volatile tariff environments.

2. Customs Value and Related-Party Transactions

For companies importing goods from related parties, be aware: if the final customs value is lower than what's being recorded for tax purposes, and the difference isn't one of the IRS's allowed exceptions, your tax deduction may be limited.

Action step: Ensure consistency between declared customs value and inventory costing, and consult with a tax advisor if transactions involve markups or shared services across borders.

Planning Tip: Using LIFO to Capture Inflation-Driven Cost Increases

Rising tariffs often signal inflation in product or material costs. That's where the **Last-In, First-Out (LIFO)** inventory method can help.

Under LIFO, the most recent (and often most expensive) inventory costs are used to calculate the cost of goods sold (COGS). In inflationary environments, this can result in higher deductions and lower taxable income.

Action step: Evaluate whether switching to or adjusting your LIFO method makes sense for your business. You'll need to consider:

- Whether you qualify under U.S. GAAP (note: IFRS prohibits LIFO)
- Which inflation index to use (e.g., Producer Price Index vs. Consumer Price Index)
- Compliance requirements like the LIFO conformity rule and annual maintenance

Remember that while the **Producer Price Index (PPI)** doesn't directly include tariffs, it reflects the pricing decisions producers make *because* of tariffs. Meanwhile, the **Consumer Price Index (CPI)** includes tariffs and may offer a more complete view of inflationary effects in certain industries.

Take a Proactive Approach to Tariff-Related Tax Planning

As tariff policies evolve, the tax consequences of inventory costing decisions grow more complex. Now's the time to work closely with both your tax and supply chain advisors to:

- Ensure compliance with capitalization rules
- Minimize book-to-tax adjustments
- Explore accounting method changes that support your financial goals

An experienced advisor can help you assess how tariffs are impacting your bottom line and what steps you can take to manage risk, stay compliant, and turn challenges into opportunities.

If you're dealing with the complexities of tariffs, inventory costing, or accounting method changes, our team is here to help you make informed decisions that move your business forward.