Cost of Goods Sold (COGS)

Do you have a business that sells a product? If you do, you will have to determine what it costs you to acquire the product that you sold. This seems obvious. However, business owners often get this concept wrong. That's because the amount you get to deduct is limited to the cost of what you actually sold... not the TOTAL cost to acquire product(s).

Why is Cost of Goods Sold important to you?

- Because money spent on products that didn't sell can't be deducted in the current tax year... it must be deducted in a future tax year (when the product sells) or may never be deducted at all (if the product never sells or if you used the product for personal use).
- Because it requires special recordkeeping (so your tax preparer can file an accurate return).

What you need for your tax appointment?

1. The amount spent for: raw materials, the shipping of these materials to your business, the labor of people directly involved in the creation of the product, or other materials which became part of the product.
2. If you are simply buying products for resale your task is much simpler. You just need information on how much the product cost you to obtain.
3. The cost of items that you use yourself.
4. The cost of items that you use for promotional use (give aways etc.).
5. How much of your inventory you have left at year end, and how much that ending inventory cost you.

In simple terms; what you spent, less the cost of what's left over, becomes what you had to pay for what your customers purchased. This is what can be deducted. What it cost you to acquire what **did not** sell will be included in your inventory and carried-over to the next tax year.

What should you do?

If this still sounds a little too complicated then do not fear. There are ways to simplify the process. One way is to keep track of the cost and sales of each individual product/SKU on separate worksheets rather than a complicated master inventory of all products. This breaks-up a large task into a series of manageable steps.

What if you didn't keep tract of inventory costs and you can't reconstruct it?

If you don't have COGS recordkeeping and your business has gross receipts under $25 million you have the option of deducting the cost of your unsold inventory in the year purchased. The details of this provision of the Tax Cuts and Jobs Act (valid for tax years 2018 through 2025 only) are beyond the scope of this fact-sheet. Furthermore, not keeping track of your profit margins isn't advisable. If you have to use this method due to poor recordkeeping then ask for professional help.