Question from Rep. Thompson

1. **During previous Ways and Means hearings, I have repeatedly raised my many objections to the Administration's proposed repeal of the "Last-In, First-Out" (LIFO) method of accounting for inventories. The degree of retroactivity associated with the Administration's proposal is problematic because the recapture of LIFO reserves can go back several decades, especially for a number of my constituents. Requiring taxpayers to write up their beginning LIFO inventory to its "First-In, First-Out" (FIFO) value in tax year 2013 will result in the recapture of reserves that have accumulated for decades. Do you think this kind of retroactive repeal is fair?**

   The tax deferral provided under the LIFO method is inconsistent with general income tax principles, which require gains be taxed when realized and recognized. The LIFO method allows these gains to be deferred indefinitely, despite the fact that inventory sales are realized and recognized annually. Recognition of accumulated LIFO reserves would put LIFO taxpayers on a more even playing field with other taxpayers that have paid and continue to pay tax on their inventory sales without being able to take advantage of the tax deferral that the LIFO method provides. Eliminating this tax deferral benefit will result in more fair and equal treatment among taxpayers.

   The tax law has long-standing rules governing the consequences of changes in accounting methods. Under these rules, when a taxpayer ceases to use LIFO, it must write-up the value of its inventory from its LIFO value to the value of the inventory under the new accounting method. If this results in taxable income, that income is taken into account over a four-year period. The budget proposal for eliminating LIFO as an accounting method utilizes this same concept, and requires LIFO taxpayers to write-up their inventories. Under the Budget proposal, the tax due from LIFO repeal can be spread over a ten-year period, which is more generous than current law's four-year period, lessening any immediate effect. The requirement that a taxpayer must recognize the tax consequences resulting from a change in accounting method is not a retroactive tax increase. Instead, such a requirement properly reflects the accounting for previously deferred income and puts taxpayers that cease to use LIFO on equal ground with those that have not used it in the past.