Statement for the Record

HOUSE WAYS AND MEANS COMMITTEE

Hearing on Tax Reform and the U.S. Manufacturing Sector

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The LIFO Coalition (the Coalition), which represents trade associations and businesses of every size and industry sector that employs the LIFO method, was organized in April 2006, when LIFO repeal was first proposed in the Senate as a revenue offset to fund unrelated policies. Since then, the Coalition has grown to include more than 120 members including trade associations representing a wide swath of American industry – including manufacturing, wholesale distribution and retailing – and companies of all sizes. The Coalition's mission is to preserve the option of companies to value their inventories pursuant to the LIFO method for federal income tax purposes. A list of the Coalition members is attached to this document, and can be found at http://www.savelifo.org/pdf/LIFOMemberList.pdf

The LIFO Coalition respectfully submits this Statement for the Record to the House Ways and Means Committee in connection with the hearing on "Tax Reform and the US Manufacturing Sector." The LIFO Coalition membership is not limited to the manufacturing sector, but the issue of LIFO repeal has been considered in a number of recent discussions of broad-based tax reform. The tax reform debate is therefore critically important to all of the industries represented by the Coalition, and we very much appreciate the opportunity to provide our views to your committee.

OVERVIEW OF LIFO

LIFO is an accounting method used by businesses with inventory to clearly determine both "book" income and tax liability and has been an accepted and established accounting method in the United States for 70 years. LIFO and FIFO (first-in, first-out) in fact achieve the same purpose: most closely matching cost of goods sold with cost of purchasing replacement inventory. LIFO is used extensively by both publicly-traded and privately-held companies, manufacturers, extractive industries, wholesaler-distributors, retailers, newspapers, automobile and equipment dealers, and a wide range of other businesses. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. It is widely used by small businesses and is particularly important to businesses which have thin capitalization, small profit margins, and/or particular sensitivity to rising materials costs. Many of these companies have been using LIFO for decades, creating many years of LIFO reserves.

The LIFO Coalition does not believe that repeal of the LIFO method should be a part of any tax reform proposal for two primary reasons: ***the LIFO method is not a tax expenditure, and repeal would be an unprecedented retroactive tax increase.*** The Coalition has previously prepared detailed analyses of these issues, both of which are attached as part of this submission, along with the Coalition's response to a letter from Jeffrey Zeints, Acting Director of OMB, to 22 members of the House of Representatives defending the Administration's call for repeal of the LIFO method.

Repeal of LIFO would have a devastating effect on many of the companies that use it, particularly small, privately-held companies. This point was made emphatically by the Small Business Administration's Office of Advocacy in their September 29, 2009 letter to the Tax Reform Subcommittee of the Presidential Economic Recovery Advisory Board (PERAB). In their letter, they wrote:

> The longer that the business uses LIFO, the larger its reserves will be relative to its inventory. If LIFO were no longer permitted, these reserves would be taxed at rates up to 35 percent, even though the reserves reflect nothing more than the impact of economic inflation on the value of the business' inventory over ten years. ***Ultimately, eliminating the ability to use LIFO would result in tax increases for small business that could ultimately force many small businesses to close.*** (Emphasis added.)

Ironically, proponents of repeal often base their call for repeal on the completely erroneous belief that the companies that use LIFO are large, publicly-traded corporations, primarily gas and oil companies. In fact, in testimony in February before the House Budget Committee, in response to a question from Mr. Yarmuth, OMB Deputy Director for Management Jeffrey Zients made that incorrect claim when he said: "On the LIFO, that disproportionately benefits oil and gas producers who have record profits."

LIFO is not a tax expenditure, is not used exclusively or even primarily by "big oil" or other large corporations but by hundreds of thousands of smaller companies, and its repeal would be a devastating retroactive tax increase that would force many small businesses into insolvency. This is surely not what tax reform is intended to accomplish.

THE COALITION'S PRINCIPAL ARGUMENTS

LIFO repeal would be an unprecedented retroactive tax increase:

The LIFO repeal proposal in the President's FY 2013 budget is estimated to generate about $74 billion. It is important to note, however, that most of the revenue generated by this proposal would come not from prospective repeal of the LIFO method but rather from the proposal's retroactive effect. LIFO users would be required to recalculate their income for all the years in which they used LIFO and "recapture" into taxable income their entire LIFO reserve – the total benefit that they received from the use of the LIFO method over the taxpayer's entire lifetime – often many decades. (For a detailed explanation of the LIFO reserve, please see attached LIFO Coalition papers on retroactivity and tax reform.)

Because the LIFO method has been authorized for more than 70 years, many companies have accumulated extraordinarily large reserves over time. In many cases these reserves are greater than the net worth of the company. The tax liability associated with taking those reserves into income, even over the 10-year period provided by the Administration's LIFO repeal proposal, would severely harm large numbers of businesses and would render many of them insolvent.

The LIFO Coalition is not aware of any other serious revenue raising proposal that has this type of retroactive effect. For example, no proposal for the elimination of accelerated depreciation or the research credit or the mortgage interest deduction includes a requirement that taxpayers pay back the taxes that they saved from the prior use of these methods. No proposal to increase tax rates on dividends and/or capital gains ever suggests that taxpayers pay back the benefits of reduced rates on those types of income for past years.

The income tax liability associated with recapturing the LIFO reserve into taxable income would severely harm most companies and potentially bankrupt many of them. It should be noted that the savings represented by a company's LIFO reserve is not sitting in a liquid investment awaiting the repayment; instead, the savings are reinvested annually in the company's inventory. In this sense, a company's LIFO reserve is different from a depreciation reserve that reflects tax savings which companies are expected to set aside in order to be available to replace plant and equipment that becomes obsolete. The tax saving from a company's LIFO reserve has already been spent because the saving is continually reinvested in replacement inventory.

Recapture of a company's LIFO reserve into taxable income ordinarily occurs only when a company experiences a permanent decline in the level of its inventories. In such circumstances, cash is freed up from the sale of inventory that is not replenished, so that repayment of the prior tax saving from the use of the LIFO inventory method at such time is both logical and appropriate.

In contrast, if a company must repay the tax saving from the prior use of the LIFO inventory method at a time when the company's inventory is not declining in real quantity terms, as would occur if LIFO were repealed retroactively as proposed, cash will not be readily available from the sale of inventory to pay the increased tax burden caused by the recapture of LIFO reserves. Even with a 10-year amortization period for the payment of the retroactive tax burden, a company would be faced with the choice of either shrinking its business or financing its inventory through additional borrowings, assuming that credit is available, or it would go out of business.

It should further be emphasized that if Congress properly rejects the imposition of an unprecedented retroactive tax increase for the reasons noted above, consideration of LIFO repeal in the context of comprehensive tax reform makes little sense – the amount of revenue generated in exchange for reduced rates would be a small percentage of the amounts that have typically been associated with LIFO repeal proposals. Any such amount would not come close to justifying the disruption and other adverse economic and policy consequences that would inevitably result from prospective repeal. For these reasons, therefore, the Congress should reject any tax reform proposal that includes either total (i.e., prospective and retroactive) repeal or prospective-only repeal of the LIFO method.

LIFO is an accepted inventory valuation method, not a tax expenditure:

It is the position of The LIFO Coalition that the LIFO inventory method is not a tax expenditure. It differs significantly from the other provisions now classified as tax expenditures in the Joint Committee on Taxation (JCT) staff's annual list of tax expenditures, should not be classified as a tax expenditure, and should not be eliminated from the Internal Revenue Code in exchange for a reduction in income tax rates as part a tax reform program.

According to a 2010 OMB publication, "A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment." OMB, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2010,* at 298 (2010).

The LIFO inventory method has been part of the Internal Revenue Code since 1939, but for more than 33 years following the enactment of the 1974 Budget Act, LIFO was not classified as a tax expenditure by JCT staff. It was not until a 2008 JCT reexamination of the criteria for defining tax expenditures that JCT staff began classifying the LIFO inventory method as a tax expenditure. The JCT reexamination was not prompted by any change in the 1974 Budget Act; the JCT staff simply invented a new class of tax expenditures labeled "Tax-Induced Structural Distortions" and included the LIFO inventory method in this new class of tax expenditures.

Tax-Induced Structural Distortions are structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not Tax Subsidies) that materially affect economic decisions in a manner that imposes substantial economic efficiency costs.

The foregoing definition of a new category of tax expenditure bears no relationship to the definition of a tax expenditure contained in the 1974 Budget Act. The JCT staff makes no effort to reconcile its definition of tax expenditures with the 1974 Budget Act definition.

The Office of Management and Budget ("OMB") publishes its own list of tax expenditures, and has not classified the LIFO inventory method as a tax expenditure either prior to 2008 or subsequent thereto. See Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2013*.

This inconsistency in classification between two branches of government is particularly significant considering that the OMB under the Obama Administration has proposed that Congress repeal the LIFO inventory method. Thus, even though the Obama Administration favors the repeal of the LIFO method, the Obama Administration does not classify the LIFO inventory method as a tax expenditure.

In fact, under any rational classification system, the LIFO method should not be classified as a tax expenditure. If the criteria for classifying provisions in the federal income tax law as tax expenditures are developed in an objective and logical way, the LIFO inventory method would surely be excluded from classification as a tax expenditure. Under any type of rational income tax system, a reasonable method for distinguishing between merchandise that is sold and merchandise that remains in ending inventory would be absolutely indispensible. Moreover, a system for assigning costs to merchandise that is sold and to the merchandise that remains in ending inventory would also be essential.

The main reason in support of the LIFO inventory method is that, if a company is to remain a going concern, the company must replenish or replace the inventory that it sells. If prices of merchandise are increasing and a company must pay an income tax based on the *historical* cost of the merchandise that is sold, but must pay for replacement merchandise at its higher *replacement* cost, the capital for such replenishment is eroded by the income tax that the company must pay on the inflationary increase in the cost of its inventory The LIFO method enables companies to finance the replacement of inventory that is sold by using the increased after-tax profit that results from employing the LIFO inventory method.

The LIFO method, as well as any other generally accepted method of inventory accounting, thus should be viewed as a rational response to the need for effective tax treatment of inventories. It should not be viewed as a tax expenditure, a "loophole," or any other aberration from the norm.

Repeal of the method thus has no place in a tax reform regime that is designed essentially to lower rates – and perhaps deficits – by repealing tax expenditures or loopholes. It is therefore distinguishable from the many base-broadening elements of recent tax reform proposals in this regard, as well as in the retroactivity uniquely associated with LIFO repeal and discussed earlier.

OTHER MAJOR CONSIDERATIONS

Repeal of the LIFO method is not an appropriate offset to reduced business tax rates:

The size of a company's LIFO reserve, particularly if the company has used the LIFO inventory method for an extended period of time, is likely to dwarf the future tax savings resulting from the reduction in tax rates contemplated by tax reform. If one multiplies the annual inflation rate over the past several decades on a compounded basis by the amount of a company's inventory each year, it is not difficult to see how a company's cumulative LIFO reserve might exceed the company's entire taxable income for a taxable year, if not the company's entire net worth. No realistic amount of rate reduction will significantly ameliorate the size of that additional tax burden.

Most companies using the LIFO inventory method are pass-through entities:

Given that there are approximately 30 million pass-through entities today and fewer than 2 million C corporations and that approximately 36% - 40% of the companies in all industries that maintain inventories use the LIFO method, it is not an exaggeration that hundreds of thousands of companies use the LIFO method. The overwhelming majority of those companies using LIFO are privately-held, and the overwhelming majority of them are not organized as C corporations, but as pass-through entities, and are therefore taxed under the individual rather than the corporate tax code.

Accordingly, the main premise of one type of tax reform that has been discussed, which is to broaden the tax base for corporations while lowering the rate of tax on corporations, would simply be inapplicable to many users of the LIFO inventory method . Repealing that method in exchange for a reduction in corporate tax rates which does not benefit a user of the LIFO inventory method would impose an enormous burden on small businesses not taxed as corporations and would undoubtedly lead to a significant number of business failures.

As noted above, The LIFO Coalition submits that even for corporate taxpayers, tax reform that entails a reduction in corporate tax rates in exchange for the repeal of the LIFO method and other provisions listed as tax expenditures by JCT staff, will not make corporations whole, given the size of the typical LIFO reserve relative to a company's net worth. For non-corporate businesses, repeal of the LIFO inventory method in exchange for rate reductions that benefit only corporate entities would be an unmitigated disaster in financial terms. It's hard to conceive of another tax provision the repeal of which would destroy more businesses and eliminate more jobs than repeal of the LIFO inventory method so constructed.

International financial reporting standards and U.S. competitiveness considerations:

Both of these issues are covered in depth in the attached coalition document, *Reasons Why The Lifo Method Should Not Be Repealed In The Context Of Business Tax Reform*, but both warrant a brief mention in this statement.

First, for the last several years the Securities and Exchange Commission (SEC) has been considering the adoption in the U.S. of the International Financial Reporting Standards (IFRS), which do not permit the use of LIFO. Companies may only use LIFO for federal income tax purposes if they use LIFO for financial reporting purposes (the "LIFO conformity rule"). Accordingly, if the use of IFRS were to be required for SEC registrants, those companies may be barred from continuing to use the LIFO inventory method for federal income tax purposes. Thus, the argument was made that the LIFO method may well be eliminated as a practical matter in the near future and Congress should take action before this happens in order to take credit for the revenue gain that would result from the repeal of the LIFO inventory method.

However, a move by the SEC to adopt IFRS is not imminent, as was made clear in the July 13, 2012 Staff Report on the subject released by the SEC. Further, it is equally clear from the Report that the Commission is unlikely to fully adopt IFRS even if they move in that direction; rather, they are more likely to incorporate IFRS into U.S. GAAP with FASB retaining an active role in the standard setting process. Under such an endorsement process, local deviations from IFRS, such as the use of LIFO, could be accommodated.

The Staff Report specifically notes that LIFO usage is one of several "fundamental differences" between IFRS and U.S. GAAP, concluding that "*In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), and any attempt by the SEC or others to resolve these differences in a time period even as long as five to seven years may prove to be difficult*." See *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers Final Staff Report* at 14.

Second, repeal of LIFO, especially in the context of a tax reform initiative to increase the competitiveness of U.S. Corporations, simply makes no sense. Since only U.S. companies use LIFO, it is one of the very few provisions of U.S. tax law that gives companies that use it a competitive advantage against their foreign competitors. This is of great significance now with the U.S. corporate tax rate the highest among industrialized economies; and even if broad-based tax reform is enacted in the U.S. in the near term, it is highly unlikely that our business tax rate will be reduced to a rate lower than that of most of our competitors.

In light of the fact that the LIFO inventory method: (i) allows U.S.-based companies to better compete against foreign-based companies that are generally subject to lower effective tax rates, and (ii) is consistent with the United States' international trade obligations, it is essential that the LIFO inventory method be retained in the tax code, regardless of any tax reform effort.

CONCLUSION

LIFO is a 70-year-old, long-accepted inventory accounting method which, just like first-in, first-out (FIFO), allows a company to most closely match cost of goods sold with cost of purchasing replacement inventory to allow the company to stay in business. LIFO is neither a tax expenditure nor a tax preference under any rational definition of those terms. Repeal of the LIFO method would be an unprecedented retroactive tax increase that would cause economic harm, cost jobs, and put a significant number of companies out of business. The members of the LIFO Coalition strongly urge the members of the Ways and Means Committee not to consider repeal of the LIFO method in tax reform legislation.

The LIFO Coalition

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Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Forest & Paper Association
American Fuel and Petrochemical Manufacturers
American Gas Association
American International Automobile Dealers Association
American Petroleum Institute
American Road & Transportation Builders Association
American Supply Association
American Veterinary Distributors Association
American Watch Association
American Wholesale Marketers Association
Americans for Tax Reform
AMT-The Association for Manufacturing Technology
Associated Equipment Distributors
Association for High Technology Distribution
Association for Hose & Accessories Distribution
Association of Equipment Manufacturers
Automobile Dealers Association of Alabama
Automotive Aftermarket Industry Association
Brown Forman Corporation
Business Roundtable
Business Solutions Association
California Independent Grocers Association
Caterpillar Inc
Ceramic Tile Distributors Association
Connecticut Food Association
Copper & Brass Servicenter Association
Deep South Equipment Dealers Association
Deere & Company
East Central Ohio Food Dealers Association
Equipment Marketing & Distribution Association
Far West Equipment Dealers Association
Farm Equipment Manufacturers Association
Financial Executives International
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
Greater Boston Chamber of Commerce
Healthcare Distribution Management Association
Heating, Airconditioning & Refrigeration Distributors International
Illinois Food Retailers Association
Independent Lubricant Manufacturers Association
Industrial Fasteners Institute
Industrial Supply Association
International Foodservice Distributors Association
International Franchise Association
International Sanitary Supply Association
International Sealing Distribution Association
International Wood Products Association
Iowa Grocers Industry Association
Iowa Nebraska Equipment Dealers Association
Jewelers of America
Kansas Food Dealers Association
Kentucky Association of Convenience Stores
Kentucky Grocers Association
Louisiana Retailers Association
Manitowoc Company Inc (The)
Maryland Retailers Association
MDU Resources Group
Metals Service Center Institute
Mid-America Equipment Retailers Association
Midwest Equipment Dealers Association
Minnesota Grocers Association
Minnesota-South Dakota Equipment Dealers Association

Missouri Grocers Association
Missouri Retailers Association
Montana Equipment Dealers Association
Moss Adams LLP
NAMM-The International Music Products Association
National Association of Chemical Distributors
National Association of Convenience Stores
National Association of Electrical Distributors
National Association of Manufacturers
National Association of Shell Marketers
National Association of Sign Supply Distributors
National Association of Sporting Goods Wholesalers
National Association of Wholesaler-Distributors
National Auto Dealers Association
National Beer Wholesalers Association
National Electrical Manufacturers Association
National Federation of Independent Business
National Grocers Association
National Lumber and Building Material Dealers Association
National Paper Trade Alliance
National Roofing Contractors Association
National RV Dealers Association
Nebraska Grocery Industry Association
New Hampshire Grocers Association
New Jersey Food Council
North American Equipment Dealers Association
North American Horticultural Supply Association
North American Wholesale Lumber Association
Ohio Grocers Association
Ohio-Michigan Equipment Dealers Association
Paperboard Packaging Council
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Professional Beauty Association
Retail Grocers Association of Greater Kansas City
Retail Industry Leaders Association
Safety Equipment Distributors Association
SBE Council
Security Hardware Distributors Association
Society of Independent Gasoline Marketers of America
SouthEastern Equipment Dealers Association
Southern Equipment Dealers Association
SouthWestern Association
Souvenir Wholesale Distributors Association
SPI: The Plastics Industry Trade Association
State Chamber of Oklahoma
Textile Care Allied Trades Association
Tire Industry Association
U.S. Chamber of Commerce
Washington Food Industry Association
Wholesale Florist & Florist Supplier Association
Wine & Spirits Wholesalers of America
Wine Institute
Wisconsin Grocers Association, Inc.
Wood Machinery Manufacturers of America

THE LIFO COALITION

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THE ADMINISTRATION'S LIFO REPEAL PROPOSAL: HISTORICALLY UNPRECEDENTED RETROACTIVITY

A Brief Background on LIFO.

LIFO is an accounting method used by businesses which maintain inventory to clearly determine both "book" income and tax liability and has been an accepted and established accounting method in the United States for 70 years. LIFO and FIFO (first-in, first-out) in fact achieve the same purpose: most closely matching cost of goods sold with cost of purchasing replacement inventory. LIFO is used extensively by both publicly-traded and privately-held companies, manufacturers, extractive industries, wholesaler-distributors, retailers, newspapers, automobile and equipment dealers, and a wide range of other businesses. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. It is widely used by small businesses and is particularly important to businesses which have thin capitalization, small profit margins, and/or particular sensitivity to rising materials costs. Many of these companies have been on LIFO for decades, creating many years of LIFO reserves.

The Repeal Proposals.

The Obama Administration has continued to call for LIFO repeal in its annual Budget submissions to Congress, including the Fiscal Year 2013 Budget. The Administration's proposal would not, however, simply prohibit the use of the method prospectively. Rather, it would require each LIFO taxpayer to take into income over a 10-year period the full amount of the taxpayer's LIFO "reserve," which, as will be discussed more fully below, is equivalent to the amount of all deductions of the taxpayer attributable to the LIFO method ever since that method was first adopted by the taxpayer. In effect, therefore, it would retroactively repeal all of those deductions – in some cases deductions taken by the taxpayer as many as 50, 60 or 70 years ago. The extent of this retroactive reach by the government appears to be unprecedented in the history of the Internal Revenue Code.

The FY 2013 proposal has been scored by the Joint Committee on Taxation as generating approximately $74 billion in revenue for the federal treasury over 10 years. What is often not understood, however, is that by far the most significant portion of that revenue would come from the retroactive feature of the proposal just described. The adoption of that feature would be analogous to a repeal of the tax code's bonus and other accelerated depreciation provisions not only for future acquisitions of depreciable property, but also for all previous acquisitions for which tax savings had been enjoyed by the taxpayer under the provisions – i.e., the taxpayer would be required to pay back all of those tax savings retroactively. It is hard to imagine the Congress adopting an accelerated depreciation repeal so configured.

The purpose of the discussion that follows is to attempt to describe the mechanism by which this retroactivity would come about under the LIFO proposal and how that retroactivity would result in excessively harsh – it is fair to say punitive – treatment of taxpayers during already challenging times.

The LIFO "reserve" – What is it?

The retroactive repeal of decades-old deductions referred to above would result from the proposal's requirement that a LIFO taxpayer's LIFO "reserve" must be "recaptured" under the terms of the proposal. An understanding of this result may be facilitated by an explanation of the concept of a LIFO "reserve." To begin, the value of the LIFO method to a tax paying company is that, in periods of rising prices such as those typically experienced since the LIFO method was included in the tax code more than 70 years ago, the method allows the company to assume that the inventory sold during any given year is the company's higher-priced inventory – the "last in" – rather than the company's lower-priced inventory – the "first in" – which the company would be required to assume had been sold during the year if the company were on the alternative FIFO method. The company therefore is typically permitted to take a higher deduction under LIFO during a given year for the cost of the goods sold by the company in that year than would be permissible under FIFO.[1] The "reserve" the company is required to establish – which is not an actual accumulation of company funds, but rather a figure the company is simply required to compute and record – represents the difference between these two deduction amounts. The company is required to add each year to the reserve the difference between the amount of its cost-of-goods-sold deduction under LIFO and the amount of the deduction that would have been allowed to the company under FIFO. At any given time, therefore, the company's LIFO reserve is the cumulative amount over the years of these "incremental deductions" permissible under LIFO but not under FIFO. [2]

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[1] A taxpayer's cost of goods sold as a technical matter is not actually a deduction from gross income but is rather an element of gross income that reduces the gross income amount before adjustments and deductions are applied to that amount. Treas. Reg. § 1.61-3. Since that cost operates in a manner similar to a deduction, however, and is often referred to in common parlance as a deduction, this paper will refer to it as such.

[2] It is worth repeating that there *neither is nor ever was* any cash in a company's LIFO reserve. The tax savings the company received were invested back into the company to purchase replacement inventory, thus contributing to economic growth and job creation. With no actual cash in the reserve, repeal of LIFO

<u>"Recapture" of the reserve – Why it amounts to unprecedented retroactivity.</u>

A significant feature of the reserve requirement is that it provides a mechanism for the "recapture" – or the taking into income – by the taxpayer of the amount of the reserve in certain defined circumstances. When the reserve is taken into income, this has the effect of undoing, or retroactively repealing, the deductions that were responsible for the build-up of the reserve. The deductions that are repealed are, as noted, the amount by which the deductions allowed the taxpayer under LIFO exceed those that would have been allowed under FIFO. Recapturing the reserve effectively puts the taxpayer in the same position as if the taxpayer had been on FIFO all along and had never had the tax benefits of LIFO accounting.

The tax code currently provides that a taxpayer's LIFO reserve will be totally recaptured only under certain conditions. Principal among these is when the company undergoes a complete liquidation of its assets, including its inventories. LIFO taxpayers have long been aware that the very significant consequences of recapture would be triggered by any such action by the company. Taxpayers have *not* operated on the assumption, however, that such consequences would be triggered by an act of law, and that all of the deductions associated with their use of the LIFO method over the life of the company would be retroactively repealed by such legislation. Yet the Administration's proposal to recapture existing LIFO reserves over a 10-year time frame would produce just such a repeal. The taxpayers would be treated as if they had been on FIFO all along and would be deprived retroactively of all the tax benefits they had received – sometimes over the course of many decades – from their use of LIFO accounting.

Moreover, they would be required to pay back those tax benefits at a time when they have generated no cash to enable them to do so. While a company's liquidation of its inventories and other assets under current law typically can be expected to produce substantial amounts of cash with which to pay the resulting LIFO recapture tax bill, the proposed repeal will generate no cash whatever. Affected taxpayers, accordingly, will be forced to borrow very large sums of money, if indeed they can obtain such financing at all. The impact of such a significant and retroactive tax increase on economic recovery and job creation cannot be overstated.

<u>Retroactivity would be extremely unfair and extremely harsh to affected companies.</u>

The proposal is unfair because it departs so dramatically from the taxpayer expectations just described. As noted, existing law has long provided that reserves will be recaptured only under certain conditions, and it is now proposed to require recapture even in the absence of those conditions. The harshness of the proposal results from the magnitude of the reserves involved.

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would require affected companies to find or borrow the funds to pay the recapture tax. With 36- 40 % of U.S companies using LIFO, the resulting huge demand for credit to pay recapture taxes would in many circumstances have a damaging impact on credit availability and interest rates. A seriously adverse macroeconomic impact could also be expected, since available credit resources would be tapped not to help create jobs and grow the economy, but to transfer funds in payment of retroactive taxes.

Because the LIFO method has been authorized for more than 70 years, many companies have accumulated extraordinarily large reserves over time. In many cases these reserves are greater than the net worth of the company. The tax liability associated with taking those reserves into income, even over a 10-year period, would severely harm large numbers of businesses and would render many of them insolvent. Enacting the legislation in the midst of the nation's current adverse economic circumstances no doubt would add to the disruption by creating a serious chilling effect on competitiveness and job creation at a fragile time.[3] While the Administration's proposal would not trigger recapture until 2014, the prospect of these very large tax liabilities for affected companies inevitably would reduce available credit and investment capital for these companies immediately upon enactment of the proposal.

Conclusion.

For the reasons discussed, the Administration's and other similarly configured proposals to repeal LIFO should be strongly opposed. This discussion has focused solely on the problems associated with the retroactive effect of the Administration's proposal, which is perhaps that proposal's most undesirable feature. The proposal should be rejected, however, for other reasons as well. LIFO is an accepted and longstanding accounting method that remains as conceptually sound as it was when it was first approved by the Congress. There would be no justification for repealing the method, especially in the current economic and employment circumstances, even if the repeal were prospective only. The fact that the proposed repeal involves a degree of retroactivity not seen elsewhere in the tax code, however, provides sufficient reason by itself to reject the proposal.

[3] For thinly capitalized closely-held companies, the requirement to recapture a company's LIFO reserve would probably exhaust all working capital and, notwithstanding a 10-year spread of the tax on recapture, would prevent bank borrowing and might force insolvency and shut down of the company, thereby eliminating jobs.

THE LIFO COALITION

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REASONS WHY THE LIFO METHOD SHOULD NOT BE REPEALED IN THE CONTEXT OF BUSINESS TAX REFORM

I. Background

The LIFO Coalition has previously provided its views on why the LIFO inventory method, presently contained in section 472 of the Internal Revenue Code, is a proper method of accounting and should not be repealed as part of any general deficit reduction effort. These views were provided in connection with proposals by members of the Senate Finance Committee to repeal the LIFO inventory method in 2006 and in response to proposals by the Obama Administration to repeal the LIFO inventory method as part of the Administration's budget proposals for Fiscal Years 2010-2013. The LIFO Coalition also provided its views on the propriety of the LIFO inventory method in the context of deliberations concerning possible tax reform by the President's Economic Recovery Advisory Board and the President's Deficit Reduction Commission.

Tax reform is increasingly part of the tax debate today: it was actively discussed during the deliberations of the "Super Committee" in 2011, a number of proposals are being drafted by Members of Congress, Congressional tax-writing committees are conducting hearings on various aspects of reform, and consideration of broad-based reform is certain to be a major issue facing the 113th Congress next year. In this context, the theme that has been discussed by the Obama Administration and some members of Congress is that business tax expenditures should be curtailed in exchange for a reduction in the business income tax rates in an effort to broaden the tax base and promote tax reform in a revenue neutral environment.

It is important to note that while the President and some in Congress were originally discussing reform only of corporate taxes, Subchapter S corporations and other pass-through business entities pay taxes at individual and not corporate rates. Reforming the corporate tax code while leaving individual rates unchanged would have dire consequences for the approximately 30 million Subchapter S corporations, as will be addressed later in this document.

Since the LIFO inventory method is characterized as a tax expenditure in the list of tax expenditures prepared annually by the staff of the Joint Committee on Taxation ("JCT staff"), the propriety of retaining the LIFO inventory method in the Internal Revenue Code could well be considered in the context of comprehensive tax reform. However, in contrast to prior consideration of this subject, in the present circumstances, the use of the LIFO inventory method is not being singled out for possible elimination, but instead, the possible repeal of the LIFO inventory method is being considered together with other tax provisions that are included in the JCT staff list of tax expenditures relating to businesses.

It is the position of the LIFO Coalition that the LIFO inventory method should not be classified as a tax expenditure and should not be eliminated from the Internal Revenue Code either as part of any deficit reduction effort or in exchange for a reduction in income tax rates as part of a revenue neutral tax reform program. While the LIFO Coalition takes no position on the desirability of tax reform generally, the Coalition submits that the elimination of the use of the LIFO inventory method for federal income tax purposes, whether or not in the context of a tax reform effort that entails broadening the business tax base in exchange for a reduction in tax rates, would be extremely – in many cases irreversibly – damaging to users of the LIFO inventory method and cause lasting damage to the economy and job creation in the United States.

The reasons for the LIFO Coalition's position are set forth below.

II. Summary of Reasons for Opposition to Repeal of the LIFO Inventory Method in the Context of Corporate Tax Reform

1. If tax expenditures are going to be the main category of provisions that will be considered as offsets for reductions in business tax rates in the context of tax reform, the system of classifying tax provisions as tax expenditures needs to be reviewed and drastically revised. The present criteria for including particular tax provisions in the annual list of tax expenditures reported by JCT staff are neither logical nor internally consistent.

2. Whatever criteria are ultimately adopted for classifying tax provisions in the Internal Revenue Code as tax expenditures, the LIFO inventory method should not be classified as a tax expenditure. The LIFO inventory method is not a tax expenditure; it differs significantly from the other provisions now classified as tax expenditures in the JCT staff's annual list of tax expenditures.

3. The overwhelming majority of the revenue that would result from the repeal of the LIFO inventory method comes from the recovery of income taxes that were deferred in taxable years prior to the effective date of any repeal of the LIFO inventory method. Accordingly, in contrast to other tax expenditures that might be eliminated with prospective effect, the repeal of the LIFO inventory method would single out users of the LIFO inventory method for a unique *retroactive* increase in taxes.

4. Future tax rate reductions would in no way compensate companies for the damaging effects to their capital base resulting from the recapture of LIFO reserves into taxable income as a result of repeal of the LIFO inventory method. In addition, the damage to companies' capital base would not be eliminated by the allowance of an amortization period to recapture deferred taxes resulting from the repeal of the LIFO inventory method.

5. A majority of the businesses using the LIFO inventory method are smaller companies organized in the form of pass-through entities, such as partnerships or S corporations. The real owners of these entities are taxed at individual tax rates. Accordingly, any reduction in corporate income tax rates that might accompany a repeal of the LIFO inventory method and other tax expenditures employed by both non-corporate and corporate taxpayers would not provide any offsetting relief for pass-through entities. Should this option be pursued, the consequences for the small business community would be more devastating than any other alternative yet proposed.

6. Once companies' LIFO reserves are fully recovered through amortization into taxable income by reason of the repeal of the LIFO inventory method, the ongoing annual revenue savings from the elimination of the LIFO inventory method would not be significant. Thus, in contrast to other provisions listed as tax expenditures by JCT staff, the repeal of the LIFO inventory method represents primarily a "one-shot" boost to federal revenues and would not pay for business tax rate reductions in taxable years outside the budget horizon.

7. Some commentators have mentioned that the LIFO inventory method may be repealed in the near future without Congressional action because of the forthcoming adoption of International Financial Reporting Standards ("IFRS") in the U.S. IFRS does not recognize the LIFO inventory method and taxpayers using the LIFO inventory method for federal income tax purposes must use that same method for financial reporting purposes, which would not be permissible if IFRS were adopted in the U.S. However, the SEC Staff Report on IFRS released in July, 2012 makes it clear that convergence will not occur in the near term, if at all, as the timetable for an SEC decision has been indefinitely postponed. The Staff Report also makes clear that if convergence were to occur, it would most likely occur in a way that does not result in the elimination of the LIFO method for financial reporting purposes, thus avoiding a conflict between IFRS and the LIFO conformity requirement in sections 472(c) and (e) of the Internal Revenue Code.

8. Repeal of the LIFO inventory method will harm U.S.-based companies and benefit their foreign competitors. Since, as noted above, U.S. accounting standards ("U.S. GAAP") permit the use of the LIFO inventory method, but international accounting standards ("IFRS") do not permit the use of the LIFO inventory method, at present only U.S.-based companies are able to use the LIFO inventory method. As a result, if the LIFO inventory method is repealed, this action would raise taxes on U.S. companies, but not their foreign competitors. A compelling reason in support of retaining the LIFO inventory method is that it is one of the few tax incentives that enhances the competitiveness of U.S.-based companies in the global marketplace without violating the United States' international trade obligations.

Each of these points is discussed in detail below.

III. Detailed Reasons for Opposing the Repeal of the LIFO Inventory Method

1. The Present System for Classifying Tax Expenditures by JCT is Not Logical, Uniform or Fair

Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974 (the "1974 Budget Act") defines "tax expenditures" as:

> [T]hose revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability …

Pub. L. No. 93-344, 93d Cong., 2d Sess., § 202(d) (1974).

The legislative history of the 1974 Budget Act further provides:

> The term 'tax expenditures' means those Federal revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from the taxpayer's gross income, or which provide a special credit, a preferential rate of tax, or a deferral of tax liability representing a deviation from the normal tax structure for individuals and corporations.

S. Rep. No. 93-688, 93d Cong., 2d Sess. *reported in* 1974 U.S.C. Congressional & Administrative News 3504, 3532 (1974).

However, nowhere in the statute or legislative history of the 1974 Budget Act is there any description of what constitutes the "normal structure" of a tax law. There is no uniform definition of a "normal" income tax, so that deviations from such norm may be identified as tax expenditures. What is a special deduction, credit or preference may vary from one country's tax laws to the next. Thus, there is no consensus as to what constitutes a tax expenditure.

This conclusion is confirmed by the following acknowledgement from a 2010 publication of the Office of Management and Budget:

> A tax expenditure is an exception to baseline provisions of the tax structure that usually results in a reduction in the amount of tax owed. The 1974 Congressional Budget Act, which mandated the tax expenditure budget, did not specify the baseline provisions of the tax law. As noted previously, deciding whether provisions are exceptions, therefore, is a matter of judgment.

OMB, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2010,* at 298 (2010).

The LIFO inventory method is a perfect example of the imprecise nature of the concept of tax expenditures. While the LIFO inventory method has been part of the Internal Revenue Code since 1939, for over 33 years following the enactment of the 1974 Budget Act, the LIFO inventory method was not classified as a tax expenditure by JCT staff.

However, in 2008, the JCT staff performed a reexamination of the criteria for defining tax expenditures and JCT staff issued a revision to its criteria. See staff of the Joint Committee on Taxation, *A Reconsideration of Tax Expenditure Analysis* (JCX-37-08) (May 12, 2008). As a result of this reconsideration, JCT staff began classifying the LIFO inventory method as a tax expenditure starting with the 2008 taxable year. Staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 21 (Oct. 31, 2008).

The JCT staff's reexamination of the concept of tax expenditures in 2008 was not prompted by any change in the 1974 Budget Act. Instead, as part of this reexamination, the JCT staff on its own initiative simply invented a new class of tax expenditures that JCT staff labeled "Tax-Induced Structural Distortions." The JCT staff then included the LIFO inventory method in this new class of tax expenditures. The actions of JCT staff to include the LIFO inventory method in this new class of tax expenditures has had the effect of raising the profile of the LIFO inventory method and making it appear that this long-accepted method of inventory accounting that is permissible for GAAP is suddenly an exception from a "normal" income tax law.

The foregoing invention by JCT staff of a new category of tax expenditures and the inclusion of the LIFO inventory method in such category of tax expenditures is surprising for several reasons. First, the Office of Management and Budget (OMB) publishes its own list of tax expenditures and the estimated revenue effects resulting from the inclusion of such provisions in the income tax laws. However, the OMB has not classified the LIFO inventory method as a tax expenditure either prior to 2008 or subsequent thereto, even though the JCT staff now includes the LIFO inventory method in its list of tax expenditures. See Office of Management and Budget, *Analytical Perspectives, Budget of the U.S. Government, Fiscal Year 2013.* This inconsistency in classification between two branches of government is particularly significant considering that the OMB under the Obama Administration has proposed that Congress repeal the LIFO inventory method. Thus, even though the Obama Administration favors the repeal of the LIFO method, the Obama Administration does not classify the LIFO inventory method as a tax expenditure.

Second, in conducting its reexamination of tax expenditures, JCT staff was mindful of the criticism that would be attached to any effort to redefine tax expenditures in a way that was considered politically motivated. In this regard, JCT staff noted in its initial implementation of new criteria for defining tax expenditures:

> The concept of a normal tax baseline as the underpinning of tax expenditure analysis has evoked serious and continuous criticism, however, since its introduction in the late 1960s. Numerous tax academics and policy experts have rightly observed that the ideal "normal" tax system does not correspond to any generally accepted formal definition of net income. Instead, many observers view tax expenditure analysis, in the form envisioned by Stanley Surrey, as a thinly veiled agenda for a specific form of tax reform. Under this view, the normative tax system is not simply an analytical tool but is also an aspirational goal of the political process.
>
> Tax expenditure analysis cannot serve as an effective and neutral analytical tool if the premise of the analysis (the validity of the "normal" tax base) is not universally accepted. The "normal" tax is admittedly a commonsense extension (and cleansing) of current tax policies, and not a rigorous framework developed from first principles. As a result, the normal tax cannot be defended from criticism as a series of ultimately subjective or pragmatic choices, and its use as a baseline has diminished the utility of tax expenditure analysis.

Staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 5 (Oct. 31, 2008).

Notwithstanding its own admonitions to the contrary, the JCT staff embarked on what can only be perceived as a politically-motivated endeavor to create a new category of tax expenditures that it labeled "Tax-Induced Structural Distortions." JCT staff defines "Tax-Induced Structural Distortions" as follows:

> Tax-Induced Structural Distortions are structural elements of the Internal Revenue Code (not deviations from any clearly identifiable general tax rule and thus not Tax Subsidies) that materially affect economic decisions in a manner that imposes substantial economic efficiency costs.

Id. at 7.

The foregoing definition of a new category of tax expenditure bears no relationship to the definition of a tax expenditure contained in the 1974 Budget Act. The JCT staff makes no effort to reconcile its definition of tax expenditures with the definition in the 1974 Budget Act. Any doubts as to JCT staff's motivations for adding this new category of tax expenditures are reinforced by JCT staff's decision to include the lower of cost or market inventory method in this new category of tax expenditures at the same time that it added the LIFO inventory method to the list of tax expenditures.

The specific definition of "tax expenditures" in the 1974 Budget Act clearly requires that in order to be classified as a "tax expenditure," a tax provision must be reflected in a special provision in the tax statutes. However, the lower of cost or market inventory method has never been prescribed by statute. Thus, the inclusion of the lower of cost or market inventory valuation method in the JCT staff's list of tax expenditures is clearly inconsistent with the express terms of the 1974 Budget Act, which limits tax expenditures to provisions in a tax statute, not in income tax regulations.

The history of the lower of cost or market method is that the tax law in Code section 471, and its predecessors, dating back to 1918, simply contains a general authorization to the Secretary of Treasury to promulgate regulations stipulating which generally accepted inventory methods will be acceptable for federal income tax purposes. In 1918, the Treasury acted on this authorization to issue regulations accepting the use of the lower of cost or market method for federal income tax purposes. Moreover, apart from the fact that the lower of cost or market method is not a creature of statute, such method is part of the foundation of GAAP and has been an accepted method for federal income tax purposes for over 90 years. Such method was not classified as a tax expenditure by the JCT staff for over 33 years following the enactment of the 1974 Budget Act. However, in 2008, the lower of cost or market method suddenly appeared in JCT's annual list of tax expenditures.

JCT staff's analysis of tax expenditures is rife with such inconsistencies. While the lower of cost or market method, which is not even specifically authorized by statute, is classified by JCT staff as a tax expenditure, special *statutory* provisions such as the allowance of a reserve for inventory shrinkage in section 471(b) of the Code, the amortization of goodwill in section 197 of the Code and the amortization of business organizational expenses in section 248 of the Code are not classified as tax expenditures by JCT staff.

Moreover, if Congress had intended the definition of tax expenditures in the 1974 Budget Act to include methods of accounting that are authorized by regulation or other administrative action of the Treasury Department, rather than expressly by statute, then why hasn't JCT staff classified the progressive or rolling average inventory costing method permitted in Rev. Proc. 2008-43, 2008-2 C.B. 186, and the replacement cost method permitted in Rev. Proc. 2002-17, 2002-1 C.B. 676, and Rev. Proc. 2006-14, 2006-1 C.B. 350, as tax expenditures? Why isn't the retail inventory method authorized in Treas. Reg. § 1.471-8 classified as a tax expenditure? Why aren't all of the special inventory costing methods contained in the regulations under section 263A of the Code classified as tax expenditures?

The point of this exercise is not to cast aspersions on any of these other special methods of accounting for inventories, but rather to highlight the fact that a "normal" income tax law may accommodate a wide variation in accounting and inventory methods. What is special, or an exception from the norm, is an extremely vague standard. About the only conclusion one could draw from examining JCT staff's list of tax expenditures is that methods of accounting seem to be included in, or excluded from, the list of tax expenditures depending on the whim of JCT staff, rather than on the basis of a logical and consistent standard. In fact, an objective analysis of JCT staff's list of tax expenditures might lead an observer to conclude that whether a method of accounting is singled out for inclusion in JCT staff's list of tax expenditures depends more on whether the method is in or out of favor with JCT staff, rather than on the nature of the method itself.

In conclusion, if Congress is going to use JCT staff's list of tax expenditures as the starting point in looking for offsets to pay for a reduction in business tax rates, Congress needs to reevaluate the criteria being used by JCT staff to determine what provisions are and are not classified as tax expenditures.

2. Under Any Rational Classification System, the LIFO Method Should Not be Classified as a Tax Expenditure

If the criteria for classifying provisions in the federal income tax law as tax expenditures are developed in an objective and logical way, the LIFO inventory method would surely be excluded from classification as a tax expenditure. Under any type of rational income tax system, a reasonable method for distinguishing between merchandise that is sold and merchandise that remains in ending inventory would be absolutely indispensible. Moreover, a system for assigning costs to merchandise that is sold and to the merchandise that remains in ending inventory would also be essential.

One could argue that the "norm" for an income tax statute ought to be based on the specific identification and actual cost of the merchandise in ending inventory and the specific identification and actual cost of the merchandise that is sold, thus rendering any methods that deviate from such norm as tax expenditures. However, use of the specific identification method to identify merchandise in ending inventory or the tracking of the actual cost of merchandise in ending inventory are not possible in most cases. Most merchandise within a product category is homogenous in nature and tracking the actual cost of such merchandise is not feasible. Accordingly, any rational income tax system must permit the use of cost flow assumptions. Moreover, such cost flow assumptions need to be adaptable to accommodate the software systems commonly in use under modern computer technology.

There are presently in use for federal income tax purposes four different cost flow assumptions apart from the specific identification method: (1) the first-in, first-out method or "FIFO"; (2) the last-in, first-out method or "LIFO"; (3) the average cost method; and (4) the replacement cost method. Each of these methods reflects a reasonable, but significantly different, cost flow assumption. When prices of merchandise are rising, the LIFO method, followed by the replacement cost method, produces the largest cost of goods sold and the lowest amount of taxable income of the four methods. In contrast, when prices of merchandise are declining, the FIFO method, followed by the average cost method, produces the largest cost of goods sold and the lowest amount of taxable income of the four methods. When prices of merchandise are relatively stable, all four methods yield approximately the same result. Nevertheless, while all four cost flow assumptions are now permitted for tax purposes, only the LIFO inventory method is singled out for inclusion in JCT staff's list of tax expenditures. Moreover, for totally inexplicable reasons, the specific identification method for homogeneous merchandise is also listed as a tax expenditure, albeit with minimum revenue loss associated with such method.

In a 2010 study conducted by the Congressional Research Service (CRS) and published by the Senate Budget Committee, CRS offered several reasons for the inclusion of the LIFO inventory method in JCT staff's list of tax expenditures. See S. Rep. No. 111-58, TAX EXPENDITURES Compendium of Background Material on Individual Provisions, prepared by Congressional Research Service, 111th Cong., 2d Sess. 517-19 (Dec. 2010). In most respects, these reasons mirror those offered in JCT staff's initial classification of the LIFO inventory method as a tax expenditure in staff of the Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012*, 21 (Oct. 31, 2008).

First, CRS notes that while the specific identification method would be the norm for valuing inventory (while ignoring the fact that this method is listed as a tax expenditure), due to its impracticality in the case of homogeneous merchandise, CRS asserts that the FIFO inventory method should be considered the norm based on the expectation that companies would sell their oldest merchandise first. Second, CRS contends that all of the cost flow assumptions permit taxpayers to reduce their tax burden for the difference between the sales price and cost of the merchandise, but the FIFO inventory method comes closest to valuing inventory at its market value, whereas the LIFO inventory method permits inventory to be valued at a level below its market value. Finally, CRS asserts that the use of the LIFO inventory method facilitates tax planning opportunities that are not available to taxpayers using the FIFO inventory method. As examples, the CRS suggests that firms expecting a high tax liability may be able to purchase additional inventory at year end to increase costs and reduce taxable income, whereas firms expecting losses may reduce taxable income by shrinking inventory.

The reasons offered by the CRS are completely invalid and in some instances demonstrate a complete lack of understanding of how the inventory rules in general and the LIFO inventory method in particular operate. For example, the first reason that CRS offers to support the classification of the LIFO inventory method as a tax expenditure is that the method does not mirror the expected pattern of sales of merchandise by companies. However, in the case of homogeneous merchandise, there is no evidence that companies necessarily sell their oldest merchandise first. Moreover, the CRS' reasoning is internally inconsistent, as the CRS notes in its own study that "[a]llowing specific identification permits firms to select higher cost items and minimize taxable income."

The second reason that CRS offers as support for treating the LIFO inventory method as a tax expenditure is that the FIFO inventory method comes closest to valuing inventory at its fair market value, whereas the use of the LIFO inventory method permits companies to value their inventory at below its fair market value. However, no inventory system values inventory at its market value except for a "mark-to-market" system, such as is required by section 475 of the Code for securities dealers. Moreover, CRS cites nothing to support its unstated premise that valuing inventory at market value is a desirable goal that would be part of any normal income tax system. In fact, the "realization" concept, which is a cornerstone of the U.S. income tax system, is flatly inconsistent with the concept of valuing inventory at its market value. Moreover, one should not confuse offering prices for merchandise with its fair market value. The fact that a company offers its merchandise for sale at a particular price does not insure that a customer will actually buy the merchandise at that selling price or at any other price at which the merchandise is offered for sale. In fact, no one can say what is the fair market value of merchandise in inventory until someone actually buys the merchandise.

The final reason that the CRS offers for treating the LIFO inventory method as a tax expenditure confirms that the CRS does not understand how the LIFO inventory method operates. CRS suggests that companies expecting a high tax liability may purchase inventory at year end to lower their tax liability, whereas companies expecting losses can reduce their taxable income by shrinking inventory.

Taking CRS' first point, under any inventory system, the cost of purchases near year end that are included in ending inventory offset each other and have a neutral effect on taxable income except where the additional purchases are valued at less than their cost. However, under the LIFO inventory method, purchases of merchandise at the end of a taxable year are typically included in an increment in a taxpayer's LIFO inventory, which would be valued at the current-year cost of the purchased merchandise and thus would have no impact on taxable income. Alternatively, if decrement in LIFO inventory would otherwise be expected, taxpayers would not purchase additional inventory to *reduce* taxable income, as CRS claims. Moreover, the tax law is replete with provisions and court decisions that prevent taxpayers from engaging in tax-motivated purchases of LIFO inventory to manipulate their income. Thus, the CRS' concerns in this regard are totally misplaced.

The main reason in support of the LIFO inventory method is that if a company is to remain a going concern, the company must replenish or replace the inventory that it sells. If prices of merchandise are increasing and a company must pay an income tax based on the *historical* cost of the merchandise that is sold, but must pay for replacement merchandise at its higher *replacement* cost, the capital for such replenishment is eroded by the income tax that the company must pay on the inflationary increase in the cost of its inventory. Most merchants would not consider themselves enriched simply because they have the same quantity of inventory as in the previous year, but the inventory is now valued at a higher replacement cost. The LIFO method enables companies to finance the replacement of inventory that is sold by using the increased after-tax profit that results from employing the LIFO inventory method.

The CRS responds to this argument with two criticisms, neither of which is persuasive. First, the CRS argues that the LIFO inventory method defers or excludes *real* gains from income. However, the CRS fails to explain or justify its definition of *real* gains. The CRS illustrates its contention by focusing on the substantial increase in oil prices that occurred during the first half of 2008. In fact, most observers would regard the increase in oil prices that occurred during the first half of 2008 as a temporary aberration, in light of the sharp drop in oil prices that occurred thereafter. The LIFO method is designed to defer taxes on permanent increases in the replacement cost of merchandise that must be reinvested in a business in order for that business to remain a going concern. Moreover, the LIFO inventory method is an annual system that measures the change in the price of merchandise from one year end to the next year end. Temporary fluctuations in prices of merchandise within a year, such as the situation illustrated by CRS, have no real effect on companies' income tax liabilities when the LIFO inventory method is employed.

CRS' second argument against permitting the continued use of the LIFO inventory method is that the LIFO inventory method represents a form of indexation of inventories for inflation, a concept that CRS argues the federal income tax law does not permit for any other type of property. However, the CRS overlooks the role that the allowance of accelerated depreciation and MACRS depreciation periods play in the case of depreciable plant and equipment. While the allowance of accelerated depreciation and shorter MACRS depreciation periods may not represent indexation in form for capital equipment, these methods produce the same overall effect as indexation for capital investment. See Viard, "Why LIFO Repeal is not the Way to Go," TAX NOTES, 574 (Nov. 6, 2006).

Most merchandising companies' two largest investments that are necessary to remain a going concern are investment in plant and equipment and investment in inventory. Thus, it is appropriate to compare the tax treatment of these two investments. As Mr. Viard so eloquently explains in the above-cited article, the LIFO method of valuing inventories and the allowance of accelerated depreciation for plant and equipment may be viewed as equivalent tax treatment in substance, if not in form, of these two major asset classes.

In conclusion, the criticisms leveled at the LIFO inventory method by CRS in its recent study are not valid and should be rejected when considering the subject of tax reform.

3. The Repeal of the LIFO Inventory Method Would Represent a Unique Retroactive Tax Increase on Companies Using the LIFO Method

In marked contrast to the other provisions listed as tax expenditures in JCT staff's annual study, the repeal of the LIFO inventory method would have a retroactive effect on users that would be unique in the annals of tax reform. Since any legislation to eliminate tax expenditures, including the LIFO inventory method, that might be enacted as an offset to lower income tax rates would undoubtedly have a prospective effective date, one might question how this form of legislation could be retroactive in effect insofar as the legislation might apply to the repeal of the LIFO inventory method.

To answer this question requires a brief explanation of how the LIFO inventory method works. Each year that a company employs the LIFO inventory method for federal income tax purposes, the taxpayer starts out by valuing the portion of its ending inventory equal in quantity to the quantity of merchandise in its beginning inventory at the original cost of the merchandise in beginning inventory. To the extent the quantity of merchandise in the ending inventory exceeds the quantity of merchandise in the beginning inventory, that increase or increment in quantity of merchandise is valued at its current-year cost. Over time, the effect of this methodology is to value the ending inventory at the historical cost of the merchandise when additional quantities of merchandise were first added to the company's ending inventory.

In addition to valuing its ending inventory under the LIFO inventory method, as described in the preceding paragraph, a company using the LIFO inventory method must also maintain a parallel record of what its inventory value would be each year if the company had used the FIFO inventory method. The cumulative difference between the value of a company's inventory based on the LIFO inventory method and the FIFO inventory method is referred to as a company's "LIFO reserve." Thus, the LIFO reserve represents the cumulative reduction in a company's ending inventory (and hence taxable income) that resulted from the use of the LIFO inventory method instead of the FIFO inventory method.

However, the term "LIFO reserve" is misleading in the sense that it does not represent actual funds set aside by a company to pay back the tax deferral reflected in the company's LIFO reserve. Instead, the LIFO reserve is merely a memorandum account that tracks the cumulative difference between the value of the company's inventory using the LIFO and FIFO inventory methods.

In the past, all of the legislative proposals to repeal the LIFO inventory method have included as a key feature the requirement that a company repay all of its cumulative prior tax savings from the use of the LIFO inventory method by including the amount of its LIFO reserve in taxable income when the use of the LIFO method is discontinued. Under some tax reform proposals, relief is provided in the form of an amortization of the amount of the recapture of the company's LIFO reserve over a period of years, such as 10 years.

Thus, the effect of the repeal of the LIFO inventory method would not be limited to the future use of the LIFO inventory method, but companies would have to pay back all of the historical tax savings that they enjoyed from the use of the LIFO method over the entire history of the company. As noted above, the LIFO inventory method has been part of the federal income tax law since 1939, so that for some companies, the LIFO reserve was built up over a period of more than 70 years.

There is no other provision listed as a tax expenditure by JCT staff which, if repealed, would entail this type and degree of retroactivity. For example, if the use of accelerated depreciation and shorter MACRS depreciation periods were repealed to offset a reduction in business income tax rates, no one would suggest that taxpayers repay the tax savings that they enjoyed in all prior years by virtue of having claimed depreciation deductions on productive property for federal income tax purposes that exceeded straight line depreciation over the physical useful life of the productive property.

Moreover, it is unlikely that there is any other type of tax provision which could have the potential for this degree of retroactivity. The longest lived type of depreciable property has a MACRS depreciation period of 39.5 years, whereas most property is depreciated over a much shorter life. In theory, a company's LIFO reserve could have been built up over 70 years. In practice, the lion's share of companies adopted the LIFO inventory method in the early 1970s, meaning that for the typical company the LIFO reserve is at least 40 years old.

Based on inflation over this length of time, the typical company's LIFO inventory is valued at less than half of its FIFO value and its LIFO reserve could easily exceed the company's net worth. The income tax liability associated with recapturing this amount of LIFO reserve into taxable income would severely harm most companies and potentially bankrupt many of them. As noted above, the savings represented by a company's LIFO reserve is not sitting in a liquid investment awaiting the repayment; instead, the savings is reinvested annually in the company's inventory. In this sense, a company's LIFO reserve is different from a depreciation reserve that reflects tax savings which companies are expected to set aside in order to be available to replace plant and equipment that becomes obsolete. The tax saving from a company's LIFO reserve has already been spent because the saving is continually reinvested in replacement inventory.

These circumstances might cause an observer to wonder why anyone proposing the repeal of the LIFO inventory method would require the recapture of a company's LIFO reserve. The answer to that question is: "That's where the money is." The overwhelming share of the revenue raised by the repeal of the LIFO inventory method results from the recapture of companies' LIFO reserves. As an offset to reduced business tax rates, it's not worth repealing the LIFO inventory method if such repeal is not accompanied by a recapture of companies' LIFO reserves.

Therein lies the dilemma; the LIFO inventory method is the only tax expenditure listed by JCT staff that needs to be repealed retroactively in order to raise the type of money needed to finance a significant reduction in income tax rates. For that reason, tax reformers will not relinquish retroactivity as part of the proposed repeal of the LIFO inventory method, but for that same reason, tax reform should not include the repeal of the LIFO inventory method.

4. Neither a Reduction in Business Tax Rates, Nor Amortization of the Recapture of LIFO Reserves, Would Eliminate the Damaging Effect of Recapture of a Company's LIFO Reserve

The premise of proponents of the idea of repealing the LIFO inventory method as part of business tax reform is that the additional income triggered by the requirement to recapture a company's LIFO reserve would be offset by the reduction in future income tax rates and the amortization of the recapture of the LIFO reserve over a period of years. Both of these premises do not withstand analysis.

First, with respect to the offset for reduced business tax rates, as noted above, the size of a company's LIFO reserve, particularly if the company has used the LIFO inventory method for an extended period of time, is likely to dwarf the future tax savings resulting from the reduction in tax rates. If one multiplies the annual inflation rate over the past several decades on a compounded basis by the amount of a company's inventory each year, it is not difficult to see how a company's cumulative LIFO reserve might exceed the company's entire taxable income for a taxable year, if not the company's entire net worth. No realistic amount of rate reduction will significantly ameliorate the size of that additional tax burden. Thus, while the impact of the ongoing disallowance of the LIFO method on future years' taxable income might be offset by future tax rate reductions, the tax burden of recapture of a company's entire LIFO reserve on top of the loss in the annual benefit from the LIFO inventory method cannot possibly be offset by future annual tax rate reductions.

Second, the fact that a LIFO repeal proposal permits amortization of the amount of recapture of a company's LIFO reserve will not materially ease the tax burden that accompanies the recapture of a company's LIFO reserve. Apart from the size of the typical company's LIFO reserve, the main reason why amortization would not materially ease a company's tax burden is because of the way that the LIFO inventory method operates. Companies using the LIFO inventory method do not expect to recapture their LIFO reserve, except as a result of transactions that generate cash to pay the resulting recapture tax.

The LIFO inventory method is designed to indefinitely defer the tax on any inflationary gain in the value of inventories that remains reinvested in replacement merchandise. As noted in the preceding section, as long as actual deflation does not occur, if a company's ending inventory equals or exceeds its beginning inventory in real quantity terms, a company's LIFO reserve will either increase in amount or remain steady and, accordingly, will not be recaptured into taxable income.

Recapture of a company's LIFO reserve into taxable income ordinarily occurs only when a company experiences a permanent decline in the level of its inventories. In such circumstances, cash is freed up from the sale of inventory that is not replenished, so that repayment of the prior tax savings from the use of the LIFO inventory method at such time is both logical and appropriate.

In contrast, if a company must repay the tax savings from the prior use of the LIFO inventory method at a time when the company's inventory is not declining in real quantity terms, such as by reason of the repeal of the LIFO inventory method, cash will not be readily available from the sale of inventory to pay the increased tax burden caused by the recapture of LIFO reserves. In such circumstances, amortization over a period of years of the tax burden resulting from recapture of LIFO reserves is not a sufficient offset to enable a company to finance its increased tax burden because the tax savings from the prior use of the LIFO inventory method remain invested in the company's inventory in these circumstances. Thus, a company would be faced with the choice of either shrinking its business or financing its inventory through additional borrowings, assuming that credit is available.

Accordingly recapture of a company's LIFO reserve in a setting where inventories are not reduced is a recipe for disaster. Companies will be forced to either shrink in size or go out of business in order to pay the tax on the recapture of LIFO reserves. Business tax rate reductions and amortization of the LIFO reserve recapture amount will not eliminate the significant additional tax burden placed on companies by the repeal of the LIFO inventory method.

5. **Many Companies Using The LIFO Inventory Method Do Not Operate In Corporate Form And Would Not Benefit If Only Corporate Tax Rate Reductions Are Considered To Offset The Repeal of The LIFO Inventory Method And Other Tax Expenditures Employed By Both Non-Corporate And Corporate Taxpayers**

The use of the LIFO inventory method is not restricted to large, publicly-held corporations; the method is available to all taxpayers with inventories. See S. Rep. No. 648, 76th Cong., 1st Sess., 1939-2 C.B. 524, 528. Moreover, as the CRS notes in its study of tax expenditures, apart from its use in certain basic manufacturing industries such as petroleum, chemicals and metals, the LIFO inventory method is most prevalent in industries such as motor vehicles (i.e., dealers), food and beverage production and retailing, and general merchandise retailing. See S. Rep. No. 111-58, TAX EXPENDITURES Compendium of Background

Material on Individual Provisions, prepared by Congressional Research Service, 111th Cong., 2d Sess. 517, 518 (Dec. 2010).

In fact, as the membership of the LIFO Coalition underscores, LIFO is used by a far broader range of businesses and industries than CRS identified. (A copy of the membership list of the Coalition is appended to this document.) According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories. Clearly, repeal of LIFO would not be removal of a narrowly-used tax deduction or preference and would have wide-spread consequences. (You can access the GA Tech study here: http://www.savelifo.org/pdf-2011/GA%20Tech%20Study%20Consequences%20of%20the%20Elimination%20of%20LIFO.pdf.)

Many of the businesses operating in these industries, as well as other industries where the use of the LIFO inventory method is prevalent are relatively small businesses. The use of the LIFO inventory method by small businesses is manifested in the composition of the membership of The LIFO Coalition. The lion's share of the trade associations that make up the core of the membership of The LIFO Coalition represent small businesses that employ the LIFO inventory method.

Many, if not most, of these small businesses are organized in non-corporate form. For example, many of the businesses that employ the LIFO inventory method are organized as pass-through entities and are taxed either as S corporations or partnerships. Businesses organized as S corporations or partnerships are not taxed at the entity level at the rate of tax imposed on corporations. Instead, the individual owners of these businesses are taxed at individual tax rates.

Accordingly, the main premise of one type of tax reform that has been discussed, which is to broaden the tax base for corporations while lowering the rate of tax on corporations, would simply be inapplicable to many users of the LIFO inventory method . Repealing that method in exchange for a reduction in corporate tax rates which does not benefit a user of the LIFO inventory method would impose an enormous burden on small businesses not taxed as corporations and would undoubtedly lead to a significant number of business failures.

As noted above, The LIFO Coalition submits that even for corporate taxpayers, tax reform that entails a reduction in corporate tax rates in exchange for the repeal of the LIFO method and other provisions listed as tax expenditures by JCT staff, will not make corporations whole, given the size of the typical LIFO reserve relative to a company's net worth. For non-corporate businesses, repeal of the LIFO inventory method in exchange for rate reductions that benefit only corporate entities would be an unmitigated disaster in financial terms. It's hard to conceive of another tax provision the repeal of which would destroy more businesses and eliminate more jobs than the a repeal of the LIFO inventory method so constructed.

6. The Repeal of the LIFO Inventory Method Will Not Pay for Lower Business Tax Rates in the Long Term

As noted above, the vast majority of the revenue raised from the repeal of the LIFO inventory method comes from the recapture of companies' existing LIFO reserves. A much smaller portion of the revenue that would be raised from the repeal of the LIFO inventory method would come from the ongoing effects of the elimination of the LIFO inventory method.

This disparity in revenue sources derives from the fact that for companies that have used the LIFO inventory method for many years (which is the case for most companies using LIFO), the amount of the company's LIFO reserve is usually a significant multiple of the annual increase in the company's LIFO reserve. Thus, for example, assuming relatively uniform inflation rates over time of between three to five percent and relatively constant inventory levels over the period of usage of the LIFO inventory method, one would expect that the annual revenue gain from the repeal of the LIFO inventory method for a company that employed the LIFO inventory method for 40 years would be small fraction of the company's cumulative LIFO reserve.

In addition, the rate of inflation in the United States for the past few years has been relatively modest. In contrast, the inflation rate in the United States over the past forty years has greatly exceeded the recent rate of inflation. Accordingly, a company's cumulative LIFO reserve is likely to greatly exceed the result of multiplying the current inflation rate by the number of years that the LIFO method has been employed and multiplying that amount by the average cost of inventory at the company.

One additional reason why projected future savings from the repeal of the LIFO inventory method is comparatively modest is the fact that companies have been reducing the levels of inventory that they maintain by relying on computerized order and record keeping systems, such as just-in-time inventory systems, in order to minimize the capital tied up in inventory. Accordingly, future revenue projections do not take into account much growth in the levels of LIFO inventories.

The conclusion that consideration of all of these factors leads to is that once current LIFO reserves are fully included in taxable income through amortization over some period of time, ongoing revenue savings from the repeal of the LIFO inventory method will not be available in significant enough amounts to balance out the long-term costs of business tax rate reductions. This is in marked contrast to other tax expenditures listed by JCT staff which display consistent or increasing revenue gains resulting from their repeal. This point is masked in the Obama Administration's proposal to eliminate the LIFO inventory method because the projected revenue gains from the proposal are shown through only the budget time horizon of ten years.

Accordingly, the repeal of the LIFO inventory method would prove to be a highly temporary and unreliable source of significant revenue after the amortization of companies' LIFO reserves is completed.

7. The Likelihood of Convergence with IFRS Has Significantly Diminished and Should Not Affect or Influence Decisions about the Retention of the LIFO Inventory Method

One final reason that some have offered in support of repeal of the LIFO inventory method is that the Securities and Exchange Commission (SEC) is giving serious consideration to requiring SEC registrants to issue their financial statements in compliance with IFRS. Because it is based primarily on European accounting standards where the LIFO method is not widely used, IFRS does not permit the use of the LIFO inventory method in reporting net income for financial reporting purposes. However, section 472(c) and (e)(2) of the Internal Revenue Code require as a condition for companies to use the LIFO inventory method for federal income tax purposes that they use no method other than the LIFO method in reporting their net income for financial reporting purposes.

Accordingly, if the use of IFRS were to be required for SEC registrants, those companies might be barred from continuing to use the LIFO inventory method for federal income tax purposes. Thus, the argument was made that the LIFO method may well be eliminated as a practical matter in the near future and Congress should take action before this happens in order to take credit for the revenue gain that would result from the repeal of the LIFO inventory method.

However, this reasoning is flawed, was premature, and is rendered moot by the indefinite postponement of a decision by the SEC on the adoption of IFRS. On July 13, 2012, the SEC released its Staff Report on convergence, which makes no recommendation to the Commissioners on the adoption of IFRS in any form or time frame and contains the following introductory statement:

> The Commission believes it is important to make clear that publication of the Staff Report at this time does not imply—and should not be construed to imply—that the Commission has made any policy decision as to whether International Financial Reporting Standards should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented.

Further, the Report references LIFO several times, describing it as one of the "fundamental differences" between U.S. GAAP and IFRS, concluding that "In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), and any attempt by the SEC or others to resolve these differences in a time period even as long as five to seven years may prove to be difficult." See *"Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers Final Staff Report" at 14*.

Even if the SEC were to eventually move to the adoption of the international accounting standards, it is increasingly unlikely that they will do so by fully moving from GAAP to IFRS as originally intended. Rather, an endorsement method of adoption is more likely, by which US GAAP will continue to used, FASB will retain an active role in devising and implementing accounting standards, and IFRS will be incorporated into GAAP. Under such an endorsement process, local deviations from IFRS, such as the use of LIFO, could be accommodated.

The SEC Staff Report referenced above makes this point very clearly:

> [T]he staff focused on other methods of potential incorporation, such as an endorsement mechanism or continued convergence of accounting standards issued by the Financial Accounting Standards Board ("FASB") and the IASB … As noted in the 2010 Progress Report, very few jurisdictions provide for the use of standards issued by the IASB without measures to ensure the suitability of those standards. Rather, most jurisdictions generally rely on some mechanism to incorporate IFRS into their domestic reporting system. Mechanisms range from converging a jurisdiction's standards to IFRS without necessarily incorporating IFRS fully into its national framework, to various forms of endorsement approaches whereby IFRSs are incorporated into the national framework on a standard-by-standard basis, if the newly issued IFRS standard passes some prescribed threshold

In addition, wholly apart from the uncertain timing and scope of any decision concerning the possible adoption of IFRS in the U.S., any requirement that U.S. companies follow IFRS and discontinue using the LIFO inventory method in computing net income in the body of their financial statements would not automatically result in the termination of the use of the LIFO inventory method for federal income tax purposes. Under the Internal Revenue Code, the Treasury has broad discretion to permit the continued use of the LIFO inventory method in these circumstances. Accordingly, it does not necessarily follow that adoption of IFRS in the U.S. will result in the termination of the LIFO method for tax purposes.

In sum, the possibility of changes in the financial accounting world should not be allowed to influence any decision by the Congress on whether to repeal the LIFO inventory method for tax purposes. Any such decision should be based solely on the merits of LIFO repeal, rather than on any assessment of what actions an agency such as the SEC may take in the future. The SEC Staff Report demonstrates quite convincingly that actions of this sort basically defy prediction.

8. Repeal of the LIFO Inventory Method will Harm U.S.-Based Companies and Benefit their Foreign Competitors.

Under the U.S. worldwide system of taxation, U.S.-based companies face both a high U.S. statutory tax rate and remain subject to tax on their foreign earnings when repatriated to the United States. It is well established that these factors contribute to U.S.-based companies that operate worldwide bearing effective tax rates that are among the highest in the world. *See, e.g.,* Chen and Mintz, "New Estimates of Effective Corporate Tax Rates on Business Investment," Cato Institute (Feb. 1, 2011) reported in TAX NOTES TODAY, 2011 TNT 37-17 (Feb. 24, 2011). Chen and Mintz note that the effective U.S. tax rate on corporations was 34.6 percent in 2010, which was the highest rate in the Organization for Economic Cooperation and Development and the fifth highest rate among 83 countries in the world. Moreover, this study is not just based on statutory tax rates, but takes into account such tax provisions as accelerated depreciation and inventory allowances:

> This bulletin presents estimates of effective corporate tax rates on new capital investment for 83 countries. "Effective" tax rates take into account statutory rates plus tax-base items that affect taxes paid on new investment, such as depreciation deductions, inventory allowances, and interest deductions.

Id.

One can infer from the Chen and Mintz study that the detrimental impact of such high effective tax rates on the competitiveness of U.S.-based companies is mitigated to a limited degree by the LIFO inventory method. As noted above, only U.S. companies use the LIFO inventory method, which allows them to better compete against foreign-based companies who are generally subject to lower effective tax rates, but cannot use the LIFO inventory method under international accounting standards.

As the Congress and the Administration consider how to revise the tax code to encourage the competitiveness of U.S.-based companies, the United States must be mindful that any export subsidies it considers must be consistent with the United States' international trade obligations, particularly those imposed by the World Trade Organization (WTO). Indeed, a number of prior export subsidies, such as the foreign sales corporation and extraterritorial income regimes, have been found to violate these obligations and were required to be repealed. The LIFO inventory method, by contrast, has not been subject to challenge by the WTO and, therefore, remains a permissible means to encourage U.S.-based companies to manufacture and export domestic products in the global marketplace.

In light of the fact that the LIFO inventory method: (i) allows U.S.-based companies to better compete against foreign-based companies that are generally subject to lower effective tax rates, and (ii) is consistent with the United States' international trade obligations, it is essential that the LIFO inventory method be retained in the tax code, regardless of any tax reform effort. Moreover, as the Chen and Mintz study confirms, repeal of the LIFO inventory method, along with other tax expenditures, in exchange for lower business statutory tax rates, will still leave corporations with an effective tax rate that is among the highest in the world.

IV. Conclusion

In the final analysis, repeal of the LIFO inventory method, in the context of business tax reform that involves base broadening in exchange for lower statutory tax rates, will not accomplish the goal of lowering the *effective* tax rate on businesses. Repeal of the LIFO inventory method will not enhance the competitiveness of U.S. businesses in the worldwide marketplace and, in fact, will damage the capital position of businesses in many industries that rely on the LIFO inventory method to finance their replacement of inventory in an inflationary environment. Finally, even if individual tax rates are reduced for businesses operating in non-corporate form, such as pass-through entities, repeal of the LIFO inventory method will severely damage such businesses, which are the life-blood of job creation in the United States. Moreover, without such rate reductions, the effect of the repeal of the LIFO method on small businesses would be devastating.

THE LIFO COALITION

1325 G Street N.W., Suite 1000, Washington, DC 20005 TEL: 202-872-0885

June 6, 2012

Mr. Jeffrey D. Zeints
Acting Director
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Zeints:

On January 27th, a bi-partisan group of 22 Members of the House of Representatives sent a letter to President Obama urging that LIFO repeal not be included in the Administration's Fiscal Year 2013 Budget. On April 2nd, you responded to the letter from the Members of Congress on behalf of the Obama Administration.

The LIFO Coalition, a coalition of more than 120 business organizations and trade associations, was provided a copy of both the letter to the President and your response on his behalf.

The Coalition has prepared a detailed response to the points you raised in your letter to the Members of Congress.

Please find enclosed the LIFO Coalition's response to your letter with a list of the members of the coalition, a copy of your letter to the Members of Congress, and a copy of their original letter to the President.

Sincerely,

Jade West

Jade West, Senior Vice President-Government Relations
National Association of Wholesaler-Distributors
Executive Secretariat, The LIFO Coalition

Enclosures:
1. *Coalition response and membership list (pages 2-10)*
2. *OMB Letter to Members of Congress (page 11-12)*
3. *Members of Congress letter to the President (pages 13-15)*

cc: Honorable Timothy F. Geithner
Secretary
U.S. Department of the Treasury

THE LIFO COALITION

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June 2012

LIFO Coalition Response to the Administration's Proposal to Repeal the

Last-in, First-out (LIFO) Inventory Method

Executive Summary

LIFO has been permitted in the tax code since 1939, is an accepted general accounting principle, and is used by millions of companies in a wide range of industries. Repeal of LIFO would have a major damaging impact on the U.S. economy and job creation, particularly among small and mid-sized businesses, and most of the revenue that would be generated by LIFO repeal would be from the "recapture tax" – an unprecedented retroactive tax increase.

In January, a bi-partisan group of 22 Members of Congress sent a letter to President Obama urging the Administration to exclude repeal of LIFO from its Fiscal Year 2013 Budget. On April 2nd, the Office of Management and Budget (OMB) responded to the Congressional letter, rejecting their request and defending the proposal to repeal LIFO on three separate grounds.

The LIFO Coalition believes that the three arguments outlined by OMB for the Administration's proposal fail to justify repeal of the LIFO method.

OMB: *The LIFO inventory method provides unwarranted deferral of income taxes for taxpayers experiencing increasing costs in their inventories.*

Coalition response: The LIFO method simply recognizes the reality that inflationary gains should not be taxed until the benefits from those gains are permanently withdrawn from the business. In order for a business selling merchandise to remain in operation, that business must consistently reinvest the profits that it earns from the sale of merchandise in order to replenish the merchandise that has been sold. When costs increase due to inflation, the business must invest an ever increasing amount of capital simply to maintain the status quo. If the business must pay taxes currently on that inflationary income, it would have to either acquire additional capital in order to maintain existing inventory levels, or shrink the level of operations and thereby reduce employment, so as to be able to afford the additional taxes.

OMB: *LIFO repeal would simplify the Internal Revenue Code by eliminating a complex and burdensome accounting method that has been the source of tax controversies.*

Coalition response: Any complexities or burdens under the LIFO method have generally been eliminated. When LIFO was initially adopted by Congress over 70 years ago, there were a number of complexities and uncertainties about the way that the LIFO method operated. However, approximately 30 years ago, the IRS made a concerted effort to simplify the most complicated aspect of LIFO usage, permitting taxpayers to use standardized industry-wide statistics to compute the inflation in their inventories. The adoption of this method transformed the LIFO calculation process into a relatively formulaic process.
In fact, the Administration's default method, first-in, first-out (FIFO), is the basis for LIFO calculations. Moreover, FIFO and LIFO serve the same function – most closely matching the cost of goods sold with the cost of replacement inventory – so eliminating LIFO would force companies which use it into a disadvantaged position vis a vis companies for which FIFO is the more economically appropriate method.

OMB: The *LIFO Method is an Impediment to the Adoption of IFRS in the U.S.*

Coalition response: The presence of LIFO as a proper method of inventory valuation is not having the slightest effect on the adoption of IFRS in the U.S. All recent news reports indicate that the SEC is leaning towards an "endorsement" model under which the U.S. would continue to evaluate what accounting principles would be acceptable for use in the financial statements of U.S. issuers. Moreover, numerous articles in the financial press have highlighted far more serious differences between IFRS and U.S. GAAP than the treatment of the LIFO method. Finally, if an initial decision is made by the SEC to require or permit IFRS to be used by U.S. issuers of financial statements, such a decision will simply be the beginning of a long process whereby the two sets of accounting rules will be brought into closer alignment, and that evolutionary process does not mean that the LIFO method will necessarily be prohibited for financial reporting purposes in the U.S.

Conclusion: ***The LIFO Coalition believes that the Administration has failed to make an effective case for LIFO repeal, and that the additional federal revenue that repeal would generate would be more than offset by the economic harm that repeal would cause. The negative impact of LIFO repeal would be felt by companies of all sizes and in a wide range of industries. The prospective and retroactive tax increases imposed by LIFO repeal will take valuable resources away from business operations, investment and job creation and can be expected to result in the decline or failure of many currently viable companies. We strongly urge policy makers to reject efforts to repeal this long-standing and widely accepted accounting method.***

THE LIFO COALITION

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June 2012

LIFO Coalition Response to the Administration's Proposal to Repeal the

Last-in, First-out (LIFO) Inventory Method

Background: On January 27, 2012, a bi-partisan group of 22 Members of Congress sent a letter to President Obama urging the Administration to exclude from its Fiscal Year 2013 Budget Proposal a proposal to repeal the last-in, first-out (LIFO) inventory method, which had been included in prior budget proposals. The Administration ultimately rejected this request and included in its Fiscal Year 2013 Budget Proposal a proposal to repeal the LIFO inventory method for federal income tax purposes.

On April 2, 2012, Jeffrey Zients, Acting Director, Office of Management and Budget (OMB), responded to the January 27, 2012, Congressional letter and explained the Administration's decision. In the letter, OMB defended the Administration's decision to propose the repeal of the LIFO inventory method on three separate grounds –

1. The LIFO inventory method provides unwarranted deferral of income taxes for taxpayers experiencing increasing costs in their inventories;

2. The repeal of the LIFO method would simplify the Internal Revenue Code by eliminating a complex and burdensome accounting method that has been the source of tax controversies in the past; and

3. The repeal of the LIFO method would remove an impediment to the adoption of International Financial Reporting Standards (IFRS) in the United States by the Securities and Exchange Commission (SEC).

The LIFO Coalition (the Coalition), which represents trade associations and businesses of every size and industry sector that employ the LIFO method, was organized in April 2006, when LIFO repeal was first proposed in the Senate as a revenue offset to fund unrelated policies. Since then, the Coalition has grown to include more than 120 members including trade associations representing a wide swath of American industry – including manufacturing, wholesale distribution and retailing – and companies of all sizes. The Coalition's mission is to preserve the option of companies to value their inventories pursuant to the LIFO method for federal income tax purposes. A list of the Coalition members is attached to this document, and can be found at http://www.savelifo.org/pdf/LIFOMemberList.pdf

Coalition's Position: As discussed in more detail below, the LIFO Coalition believes that the three arguments outlined by OMB for the Administration's proposal do not justify repeal of the LIFO method.

1. The LIFO Method as an Unwarranted Deferral of Taxes

OMB's assertion that the LIFO method results in an unwarranted deferral of income taxes ignores the fact that the LIFO method has been included in the Internal Revenue Code (the Code) as a permissible method of inventory valuation for federal income tax purposes since 1939. Moreover, the LIFO method has been a part of generally accepted accounting principles (GAAP) in the United States for more than 70 years.

In fact, the LIFO method is widely used as an inventory valuation method for both tax and financial reporting purposes in a wide range of industries. According to two separate recent studies, one by Georgia Institute of Technology and the other by the American Institute of Certified Public Accountants, LIFO is used by between 36% and 40% of businesses in every industry sector that maintains inventories.

Accordingly, the LIFO method is not an unintended loophole or, in any sense, a tax expenditure. The LIFO method is based on sound economic principles and operates on the economic theory that in order for a business selling merchandise to remain in operation, the business must consistently reinvest the profits it earns from the sale of merchandise to replenish the merchandise that has been sold and/or the raw materials that are used in the production process. As a result, unless the business chooses to either reduce the level of its operations or terminate its business altogether, the profits from the business must be permanently reinvested in merchandise offered for sale by the business or raw materials used for production.

When a business operates in this type of environment and costs increase due to inflation, the capital investment in the business is placed in an even more precarious state. Thus, a business must reinvest the same amount of capital that financed the original quantity of merchandise necessary to maintain the operations of the business and invest an ever increasing amount of capital simply to maintain the status quo. While in some abstract sense one might view the business as having "realized" additional income due to the effect of inflation on the sales prices of the merchandise, the additional income resulting from that increased sales revenue must remain permanently invested in the capital of the business to preserve the ongoing business' operations. If the business must pay taxes currently on that inflationary income, the business will be unable to preserve its ongoing operations without either locating additional capital or shrinking the size of its operations.

As a matter of tax policy, the LIFO method recognizes that inflationary gains should not be taxed until the benefits from those gains are permanently withdrawn from the business. Under the LIFO method, the inflation element in a business' profits is taxed only when that profit is permanently withdrawn from the business through reductions in inventory levels. The tax law deals with inflation in a number of different ways, depending on the type of property involved. In the case of machinery and equipment, accelerated depreciation methods and shorter recovery periods than the physical life of the machinery and equipment enables a business to replace the machinery and equipment that wears out with more costly machinery and equipment. In the case of capital assets, preferential rates for capital gains are designed, in part, to compensate for the fact that a portion of the gain taxed is due to the effects of inflation. Similarly, the LIFO method addresses the effects of inflation on business inventories.

LIFO is a necessary and appropriate inventory valuation method under any economic circumstances. However, given the present business environment and the fragility of the economic recovery, eliminating the LIFO inventory method at this time would be particularly inadvisable. If adopted, this proposal would require businesses to either acquire additional capital to maintain their existing inventory levels or shrink the level of operations and reduce employment to afford the additional taxes that would accrue on inflation-induced profits.

In conclusion, the LIFO method addresses the effects of inflation on inventory and does not constitute a tax loophole or subsidy. The method has a sound economic underpinning and should be preserved to enable businesses to reinvest their profit in inventory that becomes more costly due to inflation.

2. The Repeal of LIFO Would Facilitate Simplification of the Tax Law

The Coalition also disagrees with OMB's argument that the LIFO method is complex and repeal would simplify U.S. tax laws.

When the LIFO method was initially adopted by Congress over 70 years ago, there were a number of complexities and uncertainties about how the LIFO method operated. Over the past seven decades, however, a series of court decisions and Internal Revenue Service (IRS) rulings have addressed these issues.

One of the most complex aspects of the LIFO method was the computation procedure that a taxpayer must use to compute inflation, i.e., a taxpayer's method of computing its LIFO price index. Approximately 30 years ago, IRS issued regulations to simplify this aspect of the LIFO calculations. These rules, issued in 1981, allow taxpayers to elect to use standardized, industry-wide statistics as a basis for computing the inflation. This simplified index method is referred to as the Inventory Price Index Computation (IPIC) and these regulations were further refined almost ten years ago. The adoption of this method transformed the LIFO calculation process into a relatively formulaic process, and the use of this simplified method is widespread among taxpayers that use LIFO.

As a result, there are very few remaining complexities and uncertainties under the LIFO method. In fact, very few rulings issued by the IRS deal with the LIFO method. Similarly, there have been very few court decisions in the last ten years involving the operation of the LIFO method.

The LIFO Coalition submits that, at this point, the LIFO method has ceased to be a particularly complex and/or controversial provision. In fact, the Administration's default method, first-in, first-out (FIFO) is the basis for LIFO calculations. Consequently, eliminating LIFO would not eliminate any perceived complexities. Moreover, since FIFO and LIFO serve the same function – most closely matching the cost of goods sold with the cost of replacement inventory – eliminating LIFO would place current LIFO companies at a competitive disadvantage as compared to companies for which FIFO is the more economically appropriate method. (In this regard, the Coalition continues to have concerns that the Administration's approach remains critical of deferrals associated with the use of LIFO when corresponding deferral opportunities are also integral to the FIFO method.)

3. The LIFO Method is an Impediment to the Adoption of IFRS in the U.S.

Similarly, the Coalition does not agree with the Administration that the presence of the LIFO method in the U.S. tax law, together with the effect of the financial conformity requirement for LIFO users, is an impediment to the adoption of International Financial Reporting Standards (IFRS) in the United States. The OMB reasoning is premised on the fact that the LIFO method is prohibited by IFRS for financial reporting purposes. At the same time, the "conformity requirement" in the Code requires companies that use LIFO for tax purposes to use LIFO for financial reporting. Specifically, OMB is concerned that the Securities and Exchange Commission (SEC) will be reluctant to adopt IFRS for issuers of financial statements regulated by the SEC because that will force users of IFRS to discontinue the use of LIFO for tax purposes.

In reality, however, the presence of LIFO as a proper method of inventory valuation for tax purposes, together with the LIFO conformity requirement, is not having any effect on the adoption of IFRS in the United States. Based on news reports, the SEC is leaning towards an "endorsement" model for the adoption of IFRS in the United States. Under an "endorsement" model, the Financial Accounting Standards Board (FASB), which currently sets the standards for Generally Accepted Accounting Principles (GAAP) in the United States, would retain its authoritative role in evaluating what accounting principles would be acceptable for use in the financial statements of U.S. issuers. Thus, rather than adopting IFRS on a wholesale basis, FASB would evaluate each accounting principle adopted by IFRS to determine its suitability for U.S. GAAP. If the accounting principle that is part of IFRS is deemed suitable for U.S. GAAP purposes, FASB would endorse that principle and accept it as part of U.S. GAAP. In contrast, if FASB determined that a particular accounting principle that is part of IFRS was not suitable for U.S. GAAP, the FASB would decline to endorse that principle and the FASB would adopt its own separate accounting standard for U.S. GAAP.

It is important to note that the LIFO method was not widely used in Europe and, as a result, the LIFO method was not included in the list of acceptable inventory valuation methods under IFRS. However, that does not mean that the FASB would reach the same conclusion for U.S. GAAP. In light of the long-standing acceptance and broad usage of the LIFO method in the United States, FASB could conclude the LIFO method should continue to be acceptable under U.S. GAAP, notwithstanding IFRS. In any event, it is premature at this point to predict what the FASB would do on this issue.

Moreover, the presence of the LIFO method and the LIFO conformity requirement in the Code does not prevent the adoption of IFRS for U.S. financial reporting purposes. As noted in numerous articles in the financial press, there are far more serious differences between IFRS and U.S. GAAP than the treatment of the LIFO method. If an initial decision is made by the SEC to require or permit IFRS to be used by U.S. issuers of financial statements, the decision will be the beginning of a long process of aligning two sets of accounting rules.

4. Repeal of LIFO Would be an Unprecedented Retroactive Tax Increase

Finally, the Coalition does not agree with the Administration that a ten-year amortization period for the recovery of the effects of discontinuing the LIFO method in any sense makes the LIFO repeal proposal acceptable.

It is important to note that the impact of LIFO repeal is not prospective only. Under the proposal, taxpayers also would be required to recapture into taxable income the entire benefit that a taxpayer received from the use of the LIFO method over the taxpayer's entire lifetime, i.e., the LIFO reserve. In fact, most of the revenue generated by this proposal comes from its retroactive effect.

The LIFO Coalition is not aware of any other serious revenue raising proposal that has this type of retroactive effect. For example, no proposal for the elimination of accelerated depreciation or the research credit or the mortgage interest deduction includes a requirement that taxpayers pay back the taxes that they saved from the prior use of these methods. No proposal to increase tax rates on dividends and/or capital gains ever suggests that taxpayers pay back the benefits of reduced rates on those types of income for past years. The proposal to repeal the LIFO method is the only serious tax proposal that The LIFO Coalition is aware of that has a retroactive effect of the magnitude that is contemplated. Accordingly, while a ten-year amortization of the effect of repeal of the LIFO method might otherwise seem reasonable, it in no way compensates for the double-barreled effect of repeal of LIFO for the future combined with repayment of the benefits of LIFO from the past.

Conclusion

As outlined above, the Coalition believes that the Administration has failed to make an effective case for LIFO repeal, and that the additional federal revenue that repeal would generate would be more than offset by the economic harm that repeal would cause. The negative impact of LIFO repeal would be felt by companies of all sizes and in a wide range of industries. The prospective and retroactive tax increases imposed by LIFO repeal will take valuable resources away from business operations, investment and job creation and can be expected to result in the decline or failure of many currently viable companies. We strongly urge policy makers to reject efforts to repeal this long-standing and widely accepted accounting method.

THE LIFO COALITION

1325 G Street N.W., Suite 1000, Washington, DC 20005 ▪ TEL: 202-872-0885

Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Forest & Paper Association
American Fuel and Petrochemical Manufacturers
American Gas Association
American International Automobile Dealers Association
American Petroleum Institute
American Road & Transportation Builders Association
American Supply Association
American Veterinary Distributors Association
American Watch Association
American Wholesale Marketers Association
Americans for Tax Reform
AMT-The Association for Manufacturing Technology
Associated Equipment Distributors
Association for High Technology Distribution
Association for Hose & Accessories Distribution
Association of Equipment Manufacturers
Automobile Dealers Association of Alabama
Automotive Aftermarket Industry Association
Brown Forman Corporation
Business Roundtable
Business Solutions Association
California Independent Grocers Association
Caterpillar Inc
Ceramic Tile Distributors Association
Connecticut Food Association
Copper & Brass Servicenter Association
Deep South Equipment Dealers Association
Deere & Company
East Central Ohio Food Dealers Association
Equipment Marketing & Distribution Association
Far West Equipment Dealers Association
Farm Equipment Manufacturers Association
Financial Executives International
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
Greater Boston Chamber of Commerce
Healthcare Distribution Management Association
Heating, Airconditioning & Refrigeration Distributors International
Illinois Food Retailers Association
Independent Lubricant Manufacturers Association
Industrial Fasteners Institute
Industrial Supply Association
International Foodservice Distributors Association
International Franchise Association
International Sanitary Supply Association
International Sealing Distribution Association
International Wood Products Association
Iowa Grocers Industry Association
Iowa Nebraska Equipment Dealers Association
Jewelers of America
Kansas Food Dealers Association
Kentucky Association of Convenience Stores
Kentucky Grocers Association
Louisiana Retailers Association
Manitowoc Company Inc (The)
Maryland Retailers Association
MDU Resources Group
Metals Service Center Institute
Mid-America Equipment Retailers Association
Midwest Equipment Dealers Association
Minnesota Grocers Association
Minnesota-South Dakota Equipment Dealers Association
Missouri Grocers Association
Missouri Retailers Association

Montana Equipment Dealers Association
Moss Adams LLP
NAMM-The International Music Products Association
National Association of Chemical Distributors
National Association of Convenience Stores
National Association of Electrical Distributors
National Association of Manufacturers
National Association of Shell Marketers
National Association of Sign Supply Distributors
National Association of Sporting Goods Wholesalers
National Association of Wholesaler-Distributors
National Auto Dealers Association
National Beer Wholesalers Association
National Electrical Manufacturers Association
National Federation of Independent Business
National Grocers Association
National Lumber and Building Material Dealers Association
National Paper Trade Alliance
National Roofing Contractors Association
National RV Dealers Association
Nebraska Grocery Industry Association
New Hampshire Grocers Association
New Jersey Food Council
North American Equipment Dealers Association
North American Horticultural Supply Association
North American Wholesale Lumber Association
Ohio Grocers Association
Ohio-Michigan Equipment Dealers Association
Paperboard Packaging Council
Pet Industry Distributors Association
Petroleum Equipment Institute
Power Transmission Distributors Association
Printing Industries of America
Professional Beauty Association
Retail Grocers Association of Greater Kansas City
Retail Industry Leaders Association
Safety Equipment Distributors Association
SBE Council
Security Hardware Distributors Association
Society of Independent Gasoline Marketers of America
SouthEastern Equipment Dealers Association
Southern Equipment Dealers Association
SouthWestern Association
Souvenir Wholesale Distributors Association
SPI: The Plastics Industry Trade Association
State Chamber of Oklahoma
Textile Care Allied Trades Association
Tire Industry Association
U.S. Chamber of Commerce
Washington Food Industry Association
Wholesale Florist & Florist Supplier Association
Wine & Spirits Wholesalers of America
Wine Institute
Wisconsin Grocers Association, Inc.
Wood Machinery Manufacturers of America

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

April 2, 2012

The Honorable
U.S. House of Representatives
Washington, DC 20515

Dear Representative

Thank you for your letter to the President concerning the Fiscal Year 2013 Budget proposal to repeal the Last In, First Out (LIFO) accounting method. I am responding on his behalf. The Administration is committed to a balanced approach to deficit reduction, and proposed in the Budget a number of measures to close special tax provisions such as LIFO accounting.

In the Administration's view, the repeal of the LIFO method of accounting would eliminate a tax deferral opportunity available to taxpayers that hold inventories with increasing costs. In addition, LIFO repeal would simplify the Internal Revenue Code by removing a complex and burdensome accounting method that has been the source of controversy between taxpayers and the Internal Revenue Service.

International Financial Reporting Standards do not permit the use of the LIFO method, and their adoption by the Securities and Exchange Commission would cause violations of the current LIFO book/tax conformity requirement. Repealing LIFO would remove this possible impediment to the implementation of these standards in the United States.

The Administration's proposal would repeal the use of the LIFO inventory accounting method for Federal income tax purposes. Taxpayers that currently use the LIFO method would be required to write up their beginning LIFO inventory to its First In, First Out value in the first taxable year beginning after December 31, 2013. However, this one-time increase in gross income would be taken into account ratably over 10 years, beginning with the first taxable year beginning after December 31, 2013.

Thank you again for expressing your concerns about the LIFO proposal in the FY 2013 Budget.

Sincerely,

Jeffrey D. Zients
Acting Director

Identical Letter Sent to:

The Honorable Geoff Davis
The Honorable John Yarmuth
The Honorable Mike Thompson
The Honorable Pat Tiberi
The Honorable Richard Neal
The Honorable Peter Roskam
The Honorable Ron Kind
The Honorable Vern Buchanan
The Honorable Bill Pascrell, Jr.
The Honorable Erik Paulsen
The Honorable Aaron Schock
The Honorable Ben Chandler
The Honorable Jim Metheson
The Honorable Mike McIntyre
The Honorable Michael H. Michaud
The Honorable Jim Costa
The Honorable Dan Boren
The Honorable Cynthia Lummis
The Honorable Randy Neugebauer
The Honorable Colin Peterson
The Honorable Reid Ribble
The Honorable Cedric Richmond

Congress of the United States
Washington, DC 20515

January 27, 2012

President Barack Obama
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

As you draft your Fiscal Year 2013 Budget Proposal, we urge you not to include the repeal of the Last In, First Out (LIFO) accounting method. Repealing LIFO is more likely to exacerbate than solve our fiscal problems.

The well-established LIFO method of accounting has been expressly permitted by the tax code for more than seventy years. It is widely used by thousands of both public and privately-held businesses. LIFO allows a business to track their costs, minimize artificial inflation gains, accurately reflect replacement costs, and more precisely measure their income for tax and financial reporting purposes. According to a 2008 study by Georgia Tech, "approximately 36% of U.S. companies use LIFO for at least a portion of their inventories."

The repeal of LIFO and resulting retroactive tax increase would have a devastating impact on businesses that rely on this accounting method. The overall taxes owed by companies would increase by billions of dollars. For many businesses, this would significantly reduce available capital for investments in equipment or the hiring of new employees. In some cases it could even threaten the job security of current employees. While our economy is still recovering from a very severe economic recession, it would be unwise to significantly impair the cash flow of many businesses.

Businesses that rely on LIFO include hundreds of publicly-traded companies in the US and countless privately-owned businesses. Industries affected range from metals, paper, chemicals, and petroleum refining to auto parts, beverages, distilleries, groceries, textiles, building materials and industrial equipment. Repeal would impact manufacturers, wholesaler-distributors, and retailers; makers and sellers of virtually all products produced, sold and consumed in the United States. The impact of LIFO repeal would surely be felt in our Congressional Districts and every corner of America.

We hope that the Fiscal Year 2013 Budget will not include LIFO repeal. We believe that retaining LIFO will help struggling companies and small businesses across the nation remain valuable assets to our economy and globally competitive.

Again, thank you for listening to our concerns about these issues as you work on drafting your budget.

Sincerely,

Rep. Geoff Davis Member of Congress	Rep. Mike Thompson Member of Congress
Rep. Pat Tiberi Member of Congress	Rep. Richard Neal Member of Congress
Rep. Peter Roskam Member of Congress	Rep. Ron Kind Member of Congress
Rep. Vern Buchanan Member of Congress	Rep. Bill Pascrell Member of Congress
Rep. Erik Paulsen Member of Congress	Rep. Aaron Schock Member of Congress
Rep. Ben Chandler Member of Congress	Rep. Jim Matheson Member of Congress
Rep. Mike McIntyre Member of Congress	Rep. Mike Michaud Member of Congress

Rep. Jim Costa
Member of Congress

Rep. Dan Boren
Member of Congress

Rep. Cynthia Lummis
Member of Congress

Rep. Randy Neugebauer
Member of Congress

Rep. Colin Peterson
Member of Congress

Rep. Reid Ribble
Member of Congress

Rep. Cedric Richmond
Member of Congress

Rep. John Yarmuth
Member of Congress