

THE LIFO COALITION

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

March 2, 2011

To All Members of the U.S. Senate and House of Representatives

The LIFO Coalition, representing businesses and trade associations of every size and industry sector who employ the last-in, first out (LIFO) inventory accounting method, strongly opposes the proposed repeal of the LIFO inventory accounting method, which was included in the President's Fiscal Year 2012 Budget and which has also been raised in the context of possible fundamental tax reform by the President's National Commission on Fiscal Responsibility and Reform.

The LIFO Coalition was organized in April 2006, when LIFO repeal was first proposed in the Senate as a revenue offset for unrelated policies. Since then, the Coalition has grown to include more than 120 members; trade associations representing every industry sector – manufacturing, wholesale distribution, and retailing – and companies both large and small.

LIFO is a well-accepted and long-standing method of accounting for inventory used by hundreds of thousands of businesses of all sizes to track their costs and accurately measure their income for tax and financial reporting purposes. The proposed repeal of LIFO would:

- Impose punitive taxes on businesses and force them to pull cash from on-going operations to pay a tax on “phantom” income;
- Subject LIFO taxpayers to serious unfairness by incorporating a degree of retroactivity unprecedented in the history of the Internal Revenue Code;
- Reverse long-standing tax policy that ensures companies are properly taxed on their real income; and
- Increase costs for businesses, resulting in job losses and decreased capital spending and investment

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What is LIFO?

LIFO is a textbook accounting method used by businesses which maintain inventory to clearly determine both ‘book’ income and tax liability. It has been an accepted and established accounting method in the United States for 70 years.

Businesses that use LIFO assume for accounting purposes that they sell first the inventory most recently acquired. Conversely, businesses that use first-in, first out (FIFO) assume that they first sell that inventory which they have held the longest. LIFO is considered a more accurate accounting method for industries that often experience rising inventory costs because it allows them to avoid the realization of phantom profits caused by inflation. FIFO is preferred by companies which sell in a flat or declining price market.

Put another way, both LIFO and FIFO assume that the less expensive inventory remains on hand for calculation of taxable income. Accordingly, the basic premise for a business choosing to use FIFO is the same as for a business adopting LIFO: ability to deduct the most expensive inventory costs. That is the way both are designed to work. By matching current costs against current revenues, these inventory regimes most accurately measure the net income (or loss) of a business, by reference to how much the business *spent* during the year.

Who Uses LIFO?

LIFO is used extensively by both publicly-traded and privately-held companies including automobile and equipment dealers, extractive industries, newspapers, manufacturers, wholesaler-distributors, retailers, and a wide range of other businesses. LIFO 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 and have built up sizeable LIFO reserves, i.e., the difference between the taxpayer’s basis in its inventory on the LIFO method compared with its inventory basis under FIFO.

Devastating Impact of Repeal

If LIFO were repealed, companies using LIFO would face two substantial business challenges. First, the overwhelming majority of the revenue raised from LIFO repeal would come not from the future elimination of its use, but from the retroactive “recapture” tax on accumulated LIFO reserves.

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But the LIFO reserve is an accounting entry -- there is no money in this so-called reserve. As a result, if LIFO were repealed, a company would be taxed as if it had sold its entire inventory even though it received no money from the sale. Obtaining the cash necessary to pay tax on this deemed sale could undermine a company's capital budget and force significant changes to ongoing operations. The taxation of LIFO reserves would be tantamount to a retroactive tax on the savings a company accrued over time from accelerated depreciation. In fact, the proposed repeal and recapture probably amounts to the most retroactive tax increase in the history of the tax code. The Administration's proposal would effectively repeal fully authorized deductions from income that were taken as many as 60 or 70 years ago.

Second, taxpayers operating a business in a market subject to rising prices would be forced, on a prospective basis, to begin paying income taxes on unrecognized phantom "profits" caused by inflation. If the economy returns to a period of significant inflation as many economists predict, and LIFO were repealed, many companies would find that the replacement cost of their inventory exceeds their after-tax income from the sale of those goods, obviously an unsustainable situation.

Thus, while repeal of LIFO might generate short-term revenue for the Federal treasury, the long-term damage to the economy would far out-weigh any short-term increase in revenue. Depending on the size of a company's LIFO reserve relative to its retained earnings, repeal could be devastating to individual businesses. In addition, based on the feedback LIFO Coalition members have received from their member companies, repeal of LIFO would have a huge, measurable negative impact on the overall economy as companies would be forced to lay off workers, stop providing health insurance or contributing to 401(k) plans, and cancel planned investments or hiring. For some companies -- especially small businesses -- repeal would force them out of business entirely because their LIFO reserve would exceed retained earnings or net worth -- in which case the business could be forced to liquidate and might still owe tax. Larger companies that may have the financial capacity to pay the tax would similarly be harmed by the resultant reduction in shareholder equity and stock price.

Tax Reform/Deficit Reduction Implications

As noted, LIFO repeal has been proposed not only in the President's budget submissions, but also as part of a comprehensive tax reform/deficit reduction proposal included in the report of the President's fiscal commission. LIFO repeal differs from the other provisions of the report, however, in that the revenue that would be obtained from repeal and recapture would come overwhelmingly from the proposal's retroactive application. The other tax expenditures are

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clearly intended to be repealed or reduced prospectively so that only future conduct will be affected by the repeal or reduction. On the other hand, the report leaves open the possibility that LIFO repeal will reach back to conduct that occurred many decades ago. For this reason alone, not to mention the other reasons discussed above, LIFO repeal should not be considered as an element of any comprehensive tax reform/deficit reduction effort.

We Urge You To Oppose LIFO Repeal

In sum, LIFO is a well-accepted method of accounting used by hundreds of thousands of businesses to track their inventory costs and accurately measure their income for tax and financial reporting purposes, and repeal would have a severe, unfair, and long-lasting negative impact on economic growth and job creation.

The LIFO Coalition urges you to oppose LIFO repeal in any context.

Sincerely,

A handwritten signature in black ink that reads "Jade West". The signature is written in a cursive, flowing style.

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

Enclosure:

LIFO Coalition Membership List

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Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Forest & Paper Association
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
Auto Team America
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
ExxonMobil
Far West Equipment Dealers Association
Financial Executives International
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
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 Petrochemical and Refiners Association
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
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