THE LIFO COALITION

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MEMORANDUM

TO: **The LIFO Coalition**

FROM: **Les Schneider**
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Tax Counsel to The LIFO Coalition

RE: **Evaluation of Bloomberg Government Study – LIFO and the Domestic Production Deduction: Deserving of the Tax Axe?**

Background

On November 25, 2012, Bloomberg Government published a study which attempts to measure the extent of LIFO usage and the concentration of LIFO benefits in various industries and to quantify the impact of LIFO repeal on companies that use it.

The LIFO Coalition

The LIFO Coalition (the Coalition), organized in April 2006, has more than 120 members including trade associations representing manufacturing, wholesale distribution, and retail industries, as well as companies of every size and industry sector that employ the LIFO method. A list of the Coalition members is attached to this document, and can be found at http://www.savelifo.org/pdf/LIFOMemberList.pdf

Purpose of the Response to the Bloomberg Study

The Coalition believes that the Bloomberg study does not take certain issues into consideration, and that a response from the Coalition, representing hundreds of thousands of LIFO users, is necessary and appropriate to identify specific issues regarding LIFO usage which are not addressed in the Bloomberg study, and/or which we believe need additional analysis.

Executive Summary

The Study Bases its Analyses of the Impact of LIFO Repeal on the Published Financial Statements of a Relatively Small Number of Publicly-Traded Companies, Primarily in the Oil and Gas Industry; Thereby leaving the impression that the Preponderance of Cumulative LIFO Reserves are Held by, and the Impact of Repeal Would be Largely Confined to, these Companies

LIFO usage is widespread among privately-held companies in many industries outside oil and gas. In fact, the conformity rule – requiring a company which uses LIFO for tax purposes to also use LIFO in its financial statements – results in lower reported earnings and is a deterrent to LIFO use for publicly-traded companies.

It should also be noted that even within the oil and gas industry it is not oil and gas production, but refining and petrochemicals, that primarily benefit from the use of LIFO.

Further, the impact of repeal would be much more acute on smaller companies that do not have the same access to the capital markets as large oil and gas companies.

The Study Relies on the Published Financial Information of the Companies to Project the U.S. Federal Income Tax Impact of LIFO Repeal

The data in these published financial statements is potentially seriously flawed and may not represent U.S. tax consequences of repeal. For example:

- a company's reported reserve could include the LIFO reserves of a foreign affiliate, and therefore overstate the impact of repeal;
- if a company has acquired another company that used LIFO prior to the acquisition, the reported LIFO reserve could understate the LIFO reserve maintained for federal income tax purposes;
- companies may maintain different LIFO inventory methods for tax and financial reporting, and this disparity could fluctuate in either direction.

The Study Does Not Address the Impact of Repeal on Pass-Through Companies

The impact of LIFO repeal on the large number of pass-through entities which use it is not addressed in the Bloomberg study. Moreover, pass-throughs are taxed at individual income tax rates – rates which have just been increased – and repeal of LIFO in the context of corporate tax reform would deny the use of LIFO to pass-through entities with no benefit of reduced tax rates.

The Study Does Not Address the Issue of the High Effective Tax Rate on Inventory

While noting that inventory is among the highest taxed asset classes, the Study does not draw concrete conclusions with respect to the high effective tax rate imposed on inventory. For example, the Study does not:

- note that inventories are the most important component of a company in a manufacturing or merchandising type of business;
- address the impact of inflation on the capital base of a company that must maintain a particular level of investment in inventory;
- acknowledge that the LIFO method is necessary to help finance the capital investment in inventory during inflationary periods;
- evaluate what alternative sources of capital would be available to companies, and at what cost, if the LIFO method were not permitted.

The Study Suggests that the Benefit of LIFO Usage is Intended to be Temporary and Therefore Repeal May be Justified, an Analysis with which the Coalition Disagrees

LIFO usage was never intended to be temporary.

In periods of inflation, a company must reinvest a portion of the profits from the sale of products in the purchase of replacement inventory in order to remain in business; therefore a company's LIFO reserve will continue to build up as long as it maintains inventory and prices continue to rise. There is nothing temporary in this usage.

There are only two occasions when a company is required to repay the prior benefits of LIFO usage, and in neither case would the events regularly occur: when the replacement cost of inventory declines, and when the company reduces its inventory levels.

To repay the benefits of prior LIFO usage when a company is not experiencing deflation or reducing inventory levels, a company would need to simultaneously finance both the purchase of replacement inventory at higher costs and the repayment of prior benefits.

This dual effect would impose a significant burden on companies; the suggestion some proponents of LIFO repeal have made that a spreading out of the repayment of the benefits of the prior use of the LIFO method somehow makes the forced repayment palatable is simply wrong.

The typical LIFO user never viewed the LIFO method as temporary; the LIFO user assumed it would retain benefits for as long as the LIFO user remained in business, and therefore the LIFO user set aside no cash for the repayment of prior LIFO benefits.

To be now told that the benefits were temporary would require a company to repay benefits properly accrued over as many as 50 or 60 years, as if it had never been on LIFO to begin with. This would be an unfair, unexpected and punitive tax increase.

The tax increase would also be "retroactive." The Administration's LIFO-repeal recapture provisions unquestionably reach back to the tax treatment of a company's income in prior years and change that treatment dramatically. The provisions also unquestionably share the two principal characteristics of retroactive tax provisions that make such provisions so objectionable – a change of the rules in the middle of the game, and a total departure from reasonable taxpayer expectations.

For all of these reasons, the Coalition disputes any suggestion that LIFO was intended as a temporary measure or that the proposed LIFO-repeal recapture provisions would not be a retroactive tax increase.

<u>Potential Adoption of IFRS is not a Valid Reason for LIFO Repeal as an SEC Staff Paper Released Last Summer Clearly Demonstrates</u>

When potential repeal of LIFO was first discussed, it appeared that the SEC might adopt the International Financial Reporting Standards ("IFRS"), which do not allow the use of LIFO; the likely adoption of IFRS made repeal of LIFO seem inevitable.

U.S. adoption of IFRS is now unlikely, as a report released last July by the SEC Office of the Chief Accountant made clear: ". . . *In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO),* <u>*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" (emphasis added).*</u>

Moreover, under the SEC's current approach to convergence, it is unclear whether the general prohibition against the use of LIFO in IFRS would ever be adopted as part of U.S. accounting principles.

<u>The Complexity of LIFO Does Not Explain its Concentration in Specific Industries and is Not a Valid Reason for Repeal</u>

The most complex part of LIFO calculations, the measurement of inflation in a company's inventory, was simplified more than a decade ago by the Treasury Department. That system, called IPIC, is both simple and widely-used.

Further, we respectfully disagree with the Bloomberg Study's assessment that concentration in usage of LIFO in certain industries is based on the complexity of the method. LIFO usage is concentrated in industries that experience high inflation in the price of their products – serving the purpose for which it was intended. High inflation and therefore high LIFO usage are found in retail, distribution and manufacture of pharmaceuticals, industrial and farm equipment, consumer products, metals, beer, wine, liquor and cigarettes …to name a few.

<u>Conclusions</u>

The unfortunately common portrayal of LIFO as a benefit primarily for the oil and gas industry is a serious misrepresentation of the use of the LIFO method. The Coalition believes that consideration of LIFO repeal should be based on an accurate assessment of the extent of LIFO usage, an adequate knowledge of how the LIFO method operates and what the impact would be on companies if the LIFO method were repealed.

The Coalition notes that the Bloomberg study does not advocate repeal of LIFO.

Detailed Analysis of Bloomberg Study

I. Background

On November 25, 2012, Bloomberg Government published a study entitled "LIFO and the Domestic Production Deduction: Deserving of the Tax Axe?" written by Patrick Driessen ("the Bloomberg Study"). The first part of the Bloomberg Study undertakes to measure the extent of usage of the LIFO inventory method by companies in the United States and the concentration in LIFO benefits among various industries. The Bloomberg Study also attempts to quantify the cash flow impact on companies that currently use the LIFO method, if the right to use the LIFO method to value inventories for federal income tax purposes were repealed. The second part of the Study summarizes the arguments for and against LIFO repeal and reaches the conclusion that repeal of the LIFO method might not be a suitable policy goal, depending on the resolution of a number of additional considerations.

This memorandum has been prepared at the request of The LIFO Coalition (the 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.

I serve as Tax Counsel to The LIFO Coalition. I am a tax attorney and certified public accountant who specializes in the taxation of inventories. I have written a three-volume treatise entitled "Federal Income Taxation of Inventories" and I am a leading practitioner and lecturer on the subject of the LIFO inventory method.

The purpose of this memorandum is to evaluate the portion of the Bloomberg Study that addresses the desirability of the potential repeal of the LIFO method as a partial source of funding for corporate tax reform. I have been asked by The LIFO Coalition to evaluate the author's analysis and the reasonableness of the author's conclusions with respect to the possible repeal of the LIFO method for federal income tax purposes. While the author of the Bloomberg Study makes no explicit recommendation with regard to the potential elimination of the LIFO method, I find that the author's analysis is incomplete and we believe does not adequately evaluate the significant detrimental impact that the repeal of the LIFO method would have on a wide range of companies in a number of different industries besides oil and gas.. This memorandum is designed to address various aspects of the author's analysis and the author's ultimate conclusions.

1. Impact of LIFO Repeal Based on Financial Statement Information

One of the most important factual premises of the Bloomberg Study, which, in my opinion, leads to an incorrect conclusion with respect to the impact of LIFO repeal, is the premise that six energy companies (primarily integrated oil and gas companies) account for 84 percent of the cumulative LIFO reserves recorded by the top 20 companies in the United States and that over 80 percent of the cumulative LIFO reserves recorded by publicly-held companies is earned by companies in the oil and gas industry. The inevitable, and incorrect, conclusion from the assumption is that the major impact of the potential repeal of the LIFO method would be confined mainly to a few large oil and gas companies.

Many commentators on this subject have drawn inaccurate conclusions about the extent of LIFO usage and the likely impact of the repeal of the LIFO method for federal income tax purposes based on information disclosed in companies' published financial statements. By way of background, publicly-held corporations are required to disclose in a footnote to their financial statements the amount of the company's LIFO reserve, which is a measure of the impact on the company's net income if the LIFO method were terminated and the FIFO method were instead employed for financial reporting purposes. Thus, these commentators have drawn the seemingly logical conclusion that if one multiplies by the 35 percent corporate tax rate the amount of the LIFO reserve shown in a company's published financial statements, one obtains a reasonable measure of the impact on that company of repealing the LIFO method for federal income tax purposes.

However, this analytical approach ignores the fact that the amount shown as the LIFO reserve in a company's financial statements is based purely on the application of financial accounting principles. There are a considerable number of reasons why the amount shown as a company's LIFO reserve in its financial statements might vary significantly (either higher or lower) than the company's actual LIFO reserve for federal income tax purposes. Thus, the use of financial accounting information to make projections as to the tax impact of the potential repeal of the LIFO method is very likely to produce misleading results.

For example, a company's LIFO reserve shown in its financial statements might overstate the impact of the potential repeal of the LIFO method for federal income tax purposes because the amount shown as the company's LIFO reserve in its financial statements could reflect the use of the LIFO method on a world-wide basis for financial reporting purposes. That is in fact the case for a number of the companies listed in the Bloomberg Study as having the 20 largest LIFO reserves in their published financial statements. However, the federal income tax effect of repeal of the LIFO method would be limited to U.S. companies and would not take into account the use of the LIFO method by foreign affiliates of a U.S. company.

In contrast, if a company has undertaken one or more acquisitions of other companies that used the LIFO method prior to the acquisition or a company has undergone a corporate restructuring, it is entirely possible that the LIFO reserve shown in the company's financial statements materially understates the company's LIFO reserve maintained for federal income tax purposes. Those situations have undoubtedly occurred in a number of the companies listed in the Bloomberg Study.

Finally, and most significantly, companies have since 1982 been permitted to maintain different LIFO inventory methods for tax and financial reporting purposes, without being considered in violation of the LIFO conformity requirement. The use of disparate LIFO methods for financial reporting and federal income tax purposes is particularly significant with the widespread adoption by companies using the LIFO method of the inventory price index computation ("IPIC") method for federal income tax purposes, since that method is not permitted to be used for financial reporting purposes. This disparity in the amount of a company's LIFO reserve for financial and tax reporting could fluctuate in either direction.

For all of the foregoing reasons, the amount shown in a company's financial statements as the amount of its cumulative LIFO reserve could present an extremely misleading picture of the impact of the potential repeal of the LIFO method for federal income tax purposes. Thus, reliance on published financial information to project the federal income tax impact of the possible repeal of the LIFO method is subject to challenge on the grounds that it involves the use of potentially flawed data.

2. Concentration in Use of LIFO by Industry

Another flaw in an analysis that relies on published financial information is the conclusion that LIFO repeal would mainly affect large oil and gas companies. This is an argument that some proponents of LIFO repeal in Congress have offered in support of their position.

One need only examine the membership of The LIFO Coalition to obtain an idea of the range of companies and the types of industries that would be affected by the repeal of the LIFO method: manufacturing, wholesale distribution, and retailing firms of all sizes and business structures. These companies operate in a number of industries outside of the oil and gas industry. Moreover, the conclusion that the companies with the largest LIFO reserves would necessarily be the most adversely affected by LIFO repeal is not completely accurate. The impact of LIFO repeal would be much more acute on those companies that do not have the same access to the capital markets as large oil and gas companies.

As the Bloomberg Study correctly notes, any taxpayer that uses the LIFO method for tax purposes must also use that method in its financial statements. Since the use of LIFO for financial reporting purposes results in lower reported earnings during periods of inflation, the LIFO conformity requirement in the Internal Revenue Code undoubtedly operates as a deterrent to the use of the LIFO method for tax purposes. This deterrent effect is much more significant among publicly-held companies that publish their financial information, because company-by-company comparisons of financial earnings within the same industry are frequently made by analysts in evaluating the relative performance of companies.

Contrary to the picture often painted by commentators writng about LIFO, its usage is much more broadly based and the repeal of the LIFO method would affect a much wider range of industries and a much broader class of companies than just large oil and gas companies. Further, as discussed below, small companies may not gain the offsetting benefit of reduced tax rates in exchange for giving up the benefit of the LIFO method.

Moreover, not only is it notable that it is not only the oil and gas industry that benefits from LIFO, but even within the oil and gas industry it is not oil and gas production, but rather it is refiners and petrochemical producers that primarily benefit from the use of LIFO. Oil and gas in the ground is not inventory and is not eligible to be valued on the LIFO method. Moreover, due to ongoing structural changes in the oil and gas industry over the past several years, many refining businesses are now stand alone companies with no oil and gas production, and pay much higher prices for crude oil than the cost of extracting the crude oil from the ground. Further, many petrochemical operations formerly owned by integrated oil companies are now either part of separate downstream companies, have been sold to chemical companies or are not entirely 100% owned. So the notion that LIFO largely benefits only big integrated oil companies is indeed very much incorrect.

In addition, the suggestion that because a particular industry shows a concentration of large LIFO reserves, that means that the industry has disproportionately benefitted from the use of LIFO is likewise incorrect. As an example, oil and gas refining is a business with notoriously thin margins. In many cases in the past, refiners have been unable to pass through dramatic increases in the cost of purchased crude oil in the form of higher selling prices for gasoline and other refined products. As a result, refiners are squeezed from both ends during periods of high inflation and depend on the use of LIFO as a lifeline to maintain the heavy reinvestment in inventory that is necessary in order to replenish their stocks so as to remain in business.

3. Impact of LIFO Repeal on Pass-Throughs

Another very serious problem with concentrating on the size of a company's LIFO reserve that is shown in published financial information for a study of LIFO usage is the resultant overlooking of the impact of LIFO repeal on pass-through entities. The use of published financial information concerning LIFO usage completely ignores the widespread use of LIFO among smaller companies, many of which are organized as pass-through entities, such as S corporations and partnerships.

Pass-through entities are taxed at individual income tax rates, not corporate tax rates. Individual tax rates have not been reduced; in fact, they have recently been increased. Moreover, proponents of LIFO repeal have not indicated that the revenue generated from such repeal would go toward funding reduced tax rates for entities that are taxed at the individual rate.

Many LIFO analyses overlook these facts. Why would it be fair to pass-through entities to repeal tax benefits that they enjoy in the name of corporate tax reform and corporate tax rate reductions, when those pass-through entities will not obtain the offsetting benefit of reduced tax rates that would accompany corporate tax reform?

4. High Effective Tax Rate on Inventory

To its credit, the Bloomberg Study does point out that the Obama Administration's own analysis of the relative tax burdens imposed on various classes of assets held by companies shows that inventory is among the highest taxed asset classes. Joint Report by the White House and the Department of the Treasury, THE PRESIDENT'S FRAMEWORK FOR BUSINESS TAX REFORM. Appendix II, Table A2, at 22 (Feb. 2012). In fact the Obama Administration's own analysis shows that the inventory asset class is the *highest* taxed asset class.

However, as in the case of the Obama Administration's own Joint Report on tax reform, the author of the Bloomberg Study does not draw any concrete conclusions with respect to the high effective tax rate imposed on inventory. For example, inventories are the most important component of a company that is operating in a manufacturing or merchandising type of business. In addition, it would be appropriate to comment on the impact of inflation on the capital base of a company that must maintain a particular level of investment in inventory in order to remain in business. An analysis of a company's cash flow is a not a good substitute for a capital flow analysis.

In other words, the Obama Administration's Joint Report on tax reform simply fails to examine the validity of the premise that the LIFO method is necessary to help finance the capital investment in inventory during inflationary periods, or to evaluate what alternative sources of capital would be available to companies and at what cost, if the LIFO method were not permitted. Such an analysis should be the centerpiece of any thorough examination of the financial impact on companies of repealing the LIFO method.

5. The Benefit of LIFO Usage is not Temporary

The author of the Bloomberg Study draws some significance from the notion that the tax benefits derived from the LIFO method are intended to be temporary and this should somehow make LIFO repeal more palatable to LIFO users, particularly if the recapture of LIFO benefits is spread over a number of years. It is difficult to know where the idea originated that the benefits from using the LIFO method were intended to be temporary and that this fact justifies the repeal of the LIFO method. It is simply wrong.

To respond to the claim that LIFO was intended to produce only a temporary benefit to users of the method, it is necessary to review the underlying rationale for the LIFO method. In periods of rising prices (i.e., inflation), a portion of a company's profit from the sale of its products is not available to be withdrawn from the business when its products are sold because that profit must be reinvested in replacement products in order for the company to remain in business and to have additional products available to sell to customers. For this reason, a company's LIFO reserve continues to build up the longer the company remains in business, so long as the company maintains or increases its level of inventory and as long as prices for the company's inventory continue to increase.

Based on the foregoing rationale for the LIFO method, the method is designed so that there are only two occasions when a company continuing to use the LIFO method is required to repay the benefits obtained in prior years from the use of the LIFO method. The first potential occasion is when there is an actual decline in the prices paid for the inventory (i.e., deflation). In that situation, the rationale for the deferral of taxes as a result of the use of the LIFO method is absent; a company would be able to withdraw profits from the sale of its products without lacking the investment capital to purchase replacement products in order to remain in business. Accordingly, the LIFO method operates in a fashion that automatically requires the pay back of a portion of a company's LIFO reserve if the company experiences deflation.

The second occasion when a company is required to repay the benefits that it reaped in prior years from the use of the LIFO method is when the company reduces its inventory levels and does not have the same amount of capital invested in its inventory. In that case, it is fair to require repayment of the benefits obtained from the use of the LIFO method in prior years to the extent an amount of capital has been freed up through the company's reduction in its levels of inventory.

Those are the only two occasions when, under the company's LIFO method, the benefits reaped from the prior use of the LIFO method are repaid. Nowhere in the literature associated with the development of the LIFO method is there the suggestion that either of these two events are expected to regularly recur, so that a company's LIFO benefits would be temporary. In particular, unless a company is planning to go out of business, one does not normally expect a company's inventory levels to shrink. Moreover, in modern times, while there have been brief periods where there has been actual deflation in the prices of commodities, at least in some industries, the true operating experience of most companies is that inflation is ongoing, albeit at sometimes higher and at sometimes lower rates.

To require companies to repay the benefits from the prior use of the LIFO method when they are not experiencing actual deflation or when they are not shrinking their business and reducing inventory levels would have a double-barreled effect on companies' pool of capital. First, companies would need to find another source to finance replacement of inventory at ever higher costs, while at the same time being required to pay back all of the prior benefits that the company derived from the use of the LIFO method.

This dual effect would impose a significant burden on those companies, and a spreading out of the repayment of the benefits of the prior use of the LIFO method would in no way make the forced repayment palatable.

The real-world reactions of corporate LIFO-users are relevant here. The typical corporate member of The LIFO Coalition has never viewed the LIFO method as temporary. To the contrary, that typical corporation (i) chose LIFO because of the benefits the method provided; (ii) accumulated those benefits from year to year; and (iii) most importantly, reasonably assumed it would retain those benefits for as long as the company remained in business. Its business planning was based on that assumption. It set aside no cash for the purpose of funding a massive tax liability associated with the recapture of its LIFO reserve, since neither the law, the government, nor anyone else ever suggested that any such precaution was necessary.

Thus, to be told now that these benefits were temporary, that the company must disgorge all the benefits it ever received from LIFO over the years (perhaps as many as 50 or 60 years), and that the company must be treated effectively as if it were never on LIFO to begin with would be, to say the least, totally unexpected and unfair. It would also be "retroactive." The Administration's LIFO-repeal recapture provisions unquestionably reach back to the tax treatment of a company's income in prior years and change that treatment dramatically. They also unquestionably share the two principal characteristics of retroactive tax provisions that make such provisions so objectionable –

a change of the rules in the middle of the game, and a total departure from reasonable taxpayer expectations.

The main rebuttal to the retroactivity argument offered by the Administration is that many accounting method changes are accompanied by an adjustment (i.e., section 481(a)) that places the taxpayer in the same economic position as if the taxpayer had always used the new method of accounting. However, this argument is flawed. A section 481(a) adjustment does not work very well for changes in accounting methods that involve extremely long deferral periods, such as LIFO. In addition, if a section 481(a) adjustment is such a conventional mechanism for handling accounting method changes, why is no one that advocates the repeal of accelerated depreciation as a trade-off for lower corporate rates suggesting that accelerated depreciation should be repealed for property placed in service in prior years, but accompanied by a section 481(a) adjustment? It is difficult to justify a harsher treatment for the repeal of LIFO.

For all of these reasons, we firmly disagree with any suggestion that LIFO usage was intended to be temporary or that proposed LIFO-repeal recapture provisions would not be retroactive.

6. The Potential Adoption of IFRS is not a Valid Reason for LIFO Repeal

It is perhaps unfortunate timing that when the potential repeal of the LIFO method was first being considered at the beginning of the first Obama Administration, it appeared that U.S. tax laws and financial accounting rules were on a collision course. Under International Financial Reporting Standards ("IFRS"), the LIFO method is prohibited for financial reporting, whereas, as noted above, for U.S. federal income tax purposes, a company *must* use the LIFO method in its financial reports if the company is to be eligible to use the LIFO method for federal income tax purposes (i.e., "LIFO conformity requirement").

When the Obama Administration first reconsidered the rationale for the LIFO method in its annual tax and budget proposals, it appeared as if the Securities and Exchange Commission ("SEC") was going to adopt IFRS on a wholesale basis throughout the U.S., without any modifications for U.S. registrants. As a result, it seemed inevitable that the LIFO method would be repealed for federal income tax purposes through the back door mechanism of the LIFO conformity requirement in the Internal Revenue Code. As a result, the Obama Administration reasoned that if its budget proposals offered an extended spread period for the repayment of the tax savings from the prior use of the LIFO method in exchange for the affirmative repeal of the LIFO method (i.e., without waiting for the adoption of IFRS), this trade-off might actually be appealing to companies.

However, as is now readily apparent, the SEC is not hastening to adopt IFRS for U.S. registrants. The "Final Staff Report" on the "Work Plan for Consideration of Incorporating [IFRS] into the Financial Reporting System for U.S. Issuers" released last July by the SEC Office of the Chief Accountant makes that clear:

> *"Finally, in some cases, although the standards' objectives may appear to be similar, the underlying guidance diverges, resulting in differences that are more fundamental in nature. The following represents some of the more significant areas that were noted by the Staff. In some cases, the resolution of these differences will be individually challenging (e.g., removal of, or any change to, LIFO), <u>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 (emphasis added).</u>*

Moreover, the SEC has indicated that even if closer conformity between U.S. accounting principles and IFRS is a desirable goal, the SEC does not want the U.S.' financial accounting standard setter, the Financial Accounting Standards Board ("FASB"), to dissolve and abdicate its responsibility for overseeing financial accounting principles in the U.S. to the IASB, through the wholesale adoption of IFRS in the U.S. As a result, it appears increasingly likely that in a long, drawn-out process, the FASB will examine each principle embodied in IFRS and decide for itself whether to approve that principle for adoption in the U.S. or instead adopt a U.S. version of the principle. Under that type of approach to converging U.S. financial accounting principles with IFRS, it is unclear whether the general prohibition against the use of LIFO in IFRS would ever be adopted as part of U.S. accounting principles.

Accordingly, what was probably the main impetus for including LIFO repeal in the Obama Administration's original budget proposals has now largely been eliminated, and this rationale for LIFO repeal is clearly no longer valid. While we concur with the Bloomberg Study's question of the general relevance of IFRS to the issue of LIFO repeal for federal income tax purposes, the Staff Report released last summer significantly strengthens that conclusion.

7. The Complexity of LIFO is not a Valid Reason for its Repeal

Another argument that has been offered for the repeal of the LIFO method for tax purposes is the method's alleged complexity. The author of the Bloomberg Study also mentions the complexity of the LIFO method in explaining its perceived limited use and concentration in certain industries. Again, developments within the operation of the LIFO method mitigate that argument

In this regard, it is important to note that the most complex part of LIFO calculations is the measurement of inflation in a company's inventory. This is the step in the calculation process referred to as calculating the LIFO price index. More than ten years ago, the Treasury Department developed a simplified method for calculating a company's LIFO price indexes. This simplified method is referred to as the IPIC method. This is not the more limited simplified dollar-value LIFO method referred to in the Bloomberg Study as Section 474 of the Internal Revenue Code.

Under the IPIC method, the user of the LIFO method simply adopts as its own LIFO price index the inflation reported in industry-wide studies published monthly by the U.S. Government's Bureau of Labor Statistics. The IPIC methodology is quite simple and is widely used.

With the widespread adoption of the IPIC method, the number of issues and controversies concerning the operation of the LIFO method has been drastically reduced. The time that the Internal Revenue Service spends auditing companies' use of the LIFO method has also been greatly reduced as a result of the widespread adoption of the IPIC method. Accordingly, justifying the repeal of the LIFO method on the grounds that the method is complex and consumes an inordinate amount of tax resources is completely unfair.

In addition, the complexity of the LIFO method has nothing whatever to do with the concentration in usage of LIFO among certain industries. The reason that the LIFO method is not used uniformly among the various industries is based on the very reason for the existence of the LIFO method – to ameliorate the harsh effects of inflation on inventories. Since different industries have experienced different levels of inflation, the response by industry naturally varies with regard to the adoption of LIFO.

For example, companies in the oil and gas industry have experienced very high levels of inflation over the years, although this experience is clearly sporadic and has occurred in spurts geared to world events. That is why many oil and gas companies use the LIFO method. However, this inflation experience is by no means limited to the oil and gas industry. Companies in retail, distribution and manufacture of pharmaceuticals, industrial and farm equipment, consumer products, metals, beer, wine, liquor and cigarettes have all experienced high levels of inflation during various periods in recent history and, as a result, LIFO usage in these industries is very high as well.

Conclusions

We appreciate the Bloomberg author's attention to the LIFO issue, and note that he has written on the subject before. We also recognize and appreciate that his analysis was not in the context of a call for LIFO repeal.

We do, however, believe that the Coalition can add material content to any analysis of the LIFO method, and in particular want to stress that while this Bloomberg study focuses on the use of LIFO in the oil and gas industry, its use is widespread in a wide variety of industries, and among smaller pass-through entities which would be far more negatively impacted by repeal than the larger companies with greater access to capital.

In conclusion, while some may argue that the subject of possible LIFO repeal is a legitimate one for policy makers to consider in the context of fundamental tax reform for both corporations and pass-through entities, any such consideration, should it occur, should be based on an accurate assessment of the extent of LIFO usage and a comprehensive knowledge of how the LIFO method operates and what the impact would be on companies if the LIFO method were repealed.

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
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 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