

# THE LIFO COALITION

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March 17, 2010

## *To Members of the U.S. Senate Committees on the Budget and Finance and Members of the U.S. House of Representatives Committees on the Budget and Ways and Means*

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 budget submission to Congress.

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

### **What is LIFO?**

LIFO is a textbook 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.

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, on the other hand, 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.

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## **Who Uses LIFO?**

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. 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, creating many years of LIFO reserves.

## **Devastating Impact of Repeal**

If LIFO were repealed, LIFO users 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 “recapture” tax on accumulated LIFO reserves. However, the accumulated LIFO reserve is nothing more than a measure of the difference between the taxpayer’s basis in its inventory on the LIFO method compared with the FIFO method. There is no money in this so-called reserve.

Put another way, under LIFO repeal, a company would be taxed as though it had sold all its assets, would have gotten no money from the sale, but would be taxed as if it had. Obtaining the cash necessary to pay tax on this deemed sale could undermine capital budgets 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.

Second, taxpayers operating a business in a market prone to rising prices will prospectively be forced to begin paying income taxes on unrecognized phantom inflation-caused “profits.” If the economy sees a return of significant inflation as many economists predict, repeal of LIFO would result in many companies having the replacement cost of their inventory exceed 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, we firmly believe that the long-term damage to the economy that would result would far out-weigh any short term increase in revenue. Depending on the size of the LIFO reserve relative to its retained earnings, LIFO repeal could be devastating to a company. 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 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: the LIFO reserve could exceed retained earnings or net worth, in which case the business probably would liquidate, and might still owe tax. And larger companies which may have the financial capacity to pay the tax would similarly be harmed by the resultant reduction in shareholder equity and stock price.

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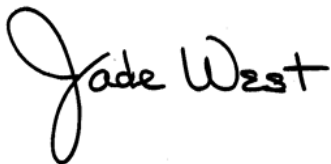
**We Urge You To Oppose LIFO Repeal**

LIFO is not an arcane provision of the tax code used by a select few businesses. It is a well-accepted method of accounting used by hundreds of thousands of businesses to track their costs and accurately measure their income for tax and financial reporting purposes. LIFO repeal would result in:

- a punitive tax on business that would force businesses to generate sufficient cash to pay tax on deemed income;
- bad tax policy that would prevent companies from being properly taxed on their real income; and
- bad economic policy that, even in a good economy, would result in job losses and decreased capital spending and investment.

The LIFO Coalition urges you to oppose LIFO repeal.

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  
Executive Secretariat, The LIFO Coalition

Attachment:

*LIFO Coalition Membership List*

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# THE LIFO COALITION

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  
The Manitowoc Company, Inc.  
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  
Outdoor Power Equipment Aftermarket 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  
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