

THE LIFO COALITION

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July 17, 2017

Honorable Orrin G. Hatch
Chairman, Senate Finance Committee
United States Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Chairman Hatch:

I am writing on behalf of the LIFO Coalition in response to your request for input in creating a simpler tax system that is conducive to economic growth.

The LIFO Coalition 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, representing trade associations and businesses of every size and industry sector that employ the LIFO method of inventory accounting. In all, hundreds of thousands of American businesses use the LIFO method to accurately measure the value of their inventories. A list of the Coalition members is attached to this document.

The LIFO Coalition supports the continued availability of the LIFO method of inventory accounting in any tax reform plan. We believe the use of the LIFO method is consistent with the generally agreed-upon principles of tax reform, including economic growth, job creation, increased competitiveness and certainty for businesses. While we are aware that no legislative proposal to repeal LIFO has been introduced in this Congress, there have been several proposals in recent Congresses that would repeal or significantly modify the LIFO accounting method for tax purposes. Members of the LIFO Coalition are staunchly concerned about such changes and the deleterious effect they would have on businesses using the LIFO method.

Currently, businesses cannot deduct the cost of inventories until they are sold. However, difficulties in the identification of fungible goods make keeping track of physical inventory impractical, which led to the development of inventory costing conventions that are used both in financial reports and for tax purpose. Businesses, including wholesalers, retailers and manufacturers, use the inventory method that most accurately reflects income. Depending on the nature of the business, they generally choose from three cost flow assumptions: first-in, first-out (FIFO); last-in, first-out (LIFO); and weighted-average cost.

The FIFO method is best suited for companies facing falling prices, such as in the hi-tech and semiconductor industries. Average costs are used in industries with erratic and fluctuating prices. Finally, LIFO is used by companies facing rising prices for their products. LIFO and FIFO serve the same purpose for the businesses that use those methods: most closely matching the cost of goods sold with the cost of replacement inventory.

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In periods of rising prices, the premise of LIFO is that a company will require a portion of its nominal profit from the sale of its inventory to be reinvested in replacement goods in order to remain in business. By assigning the latest price paid for goods to the cost of the goods that were sold, the LIFO method enables companies to utilize the portion of their nominal profit from the sale of goods that would otherwise go to pay income taxes to instead be used to finance the purchase or production of replacement goods at the higher prices caused by inflation in the marketplace. Were it not for the LIFO method, such companies would be taxed on the inflationary component of their profit and they would lack the capital to just maintain the status quo, let alone expand, by acquiring or producing replacement inventory.

It is especially important to focus on the fact that proposals to repeal the LIFO method have included as a principal element a one-time tax on LIFO reserves. In fact, the lion's share of the revenue raised from the repeal of LIFO comes from this one-time "recapture tax" on the reserves that companies have built over their lifetimes, some for many decades. The effect of this recapture tax is akin to requiring companies that have used the LIFO method in accordance with the law to now recalculate their taxes for every year the companies have lawfully used the LIFO method and to pay tax on the cumulative benefit companies received from the use of LIFO.

This recapture tax on LIFO reserves would be an unprecedented retroactive tax increase imposed on businesses that have complied in good faith with the strict rules of this longstanding tax provision, and that reasonably thought they could continue to rely on these rules as long as they were on LIFO. Under current law this recapture tax is paid when the company reduces its inventory levels, experiences deflation, or goes out of business; actions which generate cash flow with which to pay the tax. The recapture tax in a LIFO repeal proposal would force a business to pay taxes on the deferred benefits from LIFO with no corresponding sales or cash flow to cover them. No other provision in the Internal Revenue Service code has been targeted in this fashion – LIFO should not be singled out for disparate treatment.

It would be hardship enough if that tax were imposed on money set aside by these companies. However, the term "LIFO reserve" is misleading, because whatever tax savings have accrued to a company from the use of LIFO have been reinvested in replacement inventory and funds are not sitting in the sidelines in the company's bank account. Accordingly, taxing a company's LIFO reserve would force a company to either find a significant alternative source of capital to both pay the recapture tax and replace the inventory that has been sold, or failing in that exercise, to sell all of its inventory and go out of business.

In view of the foregoing, repealing LIFO would disproportionately affect small and medium-size businesses that lack alternative sources of capital from which to both pay the tax on the inflationary component of their profits and remain in business by purchasing or producing replacement inventory. Thus, these job creators and community centers that tax reform is intended to assist would instead be harmed.

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Furthermore, LIFO repeal would damage the economy at large, by shuttering businesses, slowing hiring and shrinking the tax base. Such a tax would have the opposite effect that tax reformers set out to achieve. According to the Tax Foundation, a recapture tax included in a LIFO repeal proposal would result in the loss of 50,300 jobs in the short run and “hit cash-strapped companies particularly hard.” Moreover, according to the organization's Taxes and Growth Model, prospective repeal of LIFO “would reduce GDP by \$11.6 billion per year and end up reducing federal revenue by \$518 million each year.”

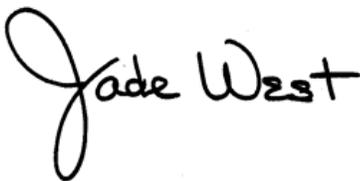
Even government regulators recognize the damage to the economy that repealing LIFO would wreak. In 2009 the Small Business Administration Office of Advocacy stated in a letter to the President’s Economic Recovery Advisory Board, “Ultimately, eliminating the ability to use LIFO would result in a tax increase for small businesses that could ultimately force many small businesses to close.”

We understand that comprehensive tax reform is a complicated and politically challenging task, and commend the committee for undertaking it. We understand that the committee is seeking sources of revenue to make tax reform revenue neutral, and we commend that as well.

However, as the economic data demonstrates, repealing LIFO would only hurt those businesses, entrepreneurs and communities that tax reform is intended to help, without contributing to the goals of tax reform.

With these realities in mind, the LIFO Coalition urges you to continue to allow the use of the LIFO method of inventory in any tax reform legislation you propose.

Sincerely,

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

Jade West

Executive Secretariat, The LIFO Coalition

Senior Vice President-Government Relations, National Association of Wholesaler-Distributors

Attachment

THE LIFO COALITION

Aeronautical Repair Station Association
Alabama Grocers Association
American Apparel & Footwear Association
American Chemistry Council
American Foundry Society
American Fuel & Petrochemical Manufacturers
American Gas Association
American International Automobile Dealers Association
American Iron & Steel Institute
American Petroleum Institute
American Road & Transportation Builders Association
American Supply Association
American Veterinary Distributors Association
American Watch Association
Americans for Tax Reform
AmerisourceBergen
AMT-The Association for Manufacturing Technology
Associated Equipment Distributors
Association for High Technology Distribution
Association for Hose & Accessories Distribution
Association of Equipment Manufacturers
Auto Care Association
Automobile Dealers Association of Alabama
Automobile Dealers Association of North Dakota
Brown Forman Corporation
Business Roundtable
Business Solutions Association
California Independent Grocers Association
Cardinal Health
Caterpillar Inc
Ceramic Tile Distributors Association
Connecticut Food Association
Convenience Distribution Association
Copper & Brass Fabricators Council
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
Food Industry Alliance of New York State
Food Marketing Institute
Forging Industry Association
Gases and Welding Distributors Association
Greater Boston Chamber of Commerce
Health Industry Distributors Association
Healthcare Distribution Alliance
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
Marine Retailers Association of the Americas
Maryland Retailers Association
McKesson Corporation
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 Automobile 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 Marine Manufacturers Association
National Paper Trade Alliance
National Roofing Contractors Association
National RV Dealers Association
National Stone Sand & Gravel Association
Nebraska Grocery Industry Association
New Hampshire Grocers Association
New Jersey Food Council
North American Equipment Dealers Association
North American Wholesale Lumber Association
North Dakota Implement Dealers Association
Ohio Equipment Distributors Association
Ohio Grocers Association
Ohio-Michigan Equipment Dealers Association
Paperboard Packaging Council
Pet Industry Distributors Association
Petroleum Equipment Institute
Petroleum Marketers Association of America
Power Transmission Distributors Association
Printing Industries of America
Professional Beauty Association
Retail Grocers Association of Greater Kansas City
Retail Industry Leaders Association
SBE Council
Security Hardware Distributors Association
Service Station Dealers of America and Allied Trades
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
Western Equipment Dealers Association
Wholesale Florist & Florist Supplier Association
Wine & Spirits Wholesalers of America
Wine Institute
Wisconsin Grocers Association, Inc.
Wood Machinery Manufacturers of America