



PROTECT LIFO

LIFO (which stands for “last in, first out”) is an inventory accounting method used by companies in a range of inventory-intensive industry since the 1930s to manage inflation’s impact. LIFO takes into account the greater costs of replacing inventory, providing a more accurate measure of the financial condition of the business and the income to which tax should apply.

LIFO is an accounting method, not a tax loophole. When inventory costs are rising, using the LIFO method will mean less tax liability in a given year than under the FIFO (“first in, first out”) method. However, if prices fall, the taxpayer would repay the LIFO benefit through greater tax liability. Moreover, taxpayers may not change between LIFO and FIFO without Internal Revenue Service (IRS) approval, thus once a company elects to use the LIFO method, it assumes the risk of artificially increased tax liability if inventory costs should fall.

President Obama again supports repealing LIFO in his 2012 budget proposal. LIFO repeal also surfaced during the National Commission on Fiscal Responsibility and Reform’s 2010 deliberations and will likely come up again during discussions over corporate tax reform.

LIFO repeal would have a devastating impact on both large and small companies alike - particularly members of the equipment industry, which has been one of the hardest hit sectors of the economy.

Congress must protect the use of LIFO as a tax and accounting method.

- AED estimates that 40 percent of its members use LIFO, that they collectively have \$2.8 billion in combined LIFO reserves, and that repeal would cost equipment distributors more than \$900 million.
- Repealing LIFO would force companies currently using this method to report their LIFO reserves as income. The result would be a massive and unprecedented retroactive tax increase for large and small businesses across the country, causing job losses and decreased capital spending and investment.
- Prospectively, LIFO repeal would force companies to pay income taxes on 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 If the economy returns to a period of significant inflation, as many economists predict, and LIFO were repealed, many companies would find that the replacement cost of their inventory exceeds their after-tax income from the sale of those goods — an obviously unsustainable situation.