Congress Must Ensure That Any Changes to LIFO and Advertising Deductibility in Tax Reform Do Not Negatively Impact Small Business

Issue

Limiting the use of LIFO and advertising deductibility would take working capital away from dealerships that could be used to maintain or create jobs. Previous tax reform proposals would repeal LIFO and significantly restrict the amount of advertising costs a dealership could deduct each year. The House Republican "Tax Blueprint" is the basis for tax reform legislation expected later this year. The Blueprint maintains LIFO but does not specify how inventory or LIFO reserves will be treated. The Blueprint is also silent on the tax treatment of advertising deductibility. Congress should maintain LIFO and advertising deductibility in comprehensive tax reform.

Background

LIFO repeal—LIFO (last in, first out) is a longstanding inventory accounting method used by businesses to help mitigate rising inventory costs. It allows companies to calculate their income by basing sales on the newest inventory for goods, such as vehicles and parts, which increase in price over time. As costs rise, LIFO is a more accurate way of measuring financial performance. Dealerships use LIFO to better match the cost of goods sold to the cost of replacing inventory, and its preservation is critical for inventory management to manage price increases.

In the 113th Congress, a Senate proposal would have required recapture of LIFO reserves in income evenly over eight years, and under a House bill (H.R. 1), LIFO reserves would have been recaptured in income over four years. The Blueprint maintains the LIFO accounting method but is silent on how inventory and LIFO reserves will be treated.

Advertising deductibility—Dealers utilize advertising extensively since it is an integral component of marketing vehicles and creating a competitive marketplace for consumers. A previous Senate proposal would have made 50 percent of the advertising expense deductible in the year the expense is incurred; the remainder would have been amortized over five years. Previous tax reform legislation (H.R. 1) also would have reduced the advertising deduction in the year incurred to 50 percent, with the remainder amortized over 10 years. While the Blueprint is silent on the treatment of advertising deductibility, Congress could attempt to limit advertising deductibility in tax reform legislation.

Key Points

- **As a majority of dealers use LIFO, restricting this accounting method would have a significant negative effect on small- business dealerships** that generally operate on thin margins and tight cash flow.
- For many small-business dealers**, limiting the use of LIFO would diminish their ability to maintain and create jobs.** In a recent survey, 39 percent of dealers stated that they "would have to lay off workers or eliminate positions" if LIFO were repealed.
- **Advertising has been an ordinary and necessary business expense, just like salaries, utilities and rent, for more than 100 years** and should remain fully deductible in the year incurred. There is no evidence to support reducing or delaying legitimate advertising deductions.

Status

Tax reform legislation from the Trump administration and congressional leaders is expected to be released in September. **NADA urges Congress to ensure that any changes to LIFO and advertising deductibility do not negatively impact small businesses.**

August 29, 2017