THE LIFO COALITION

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February 25, 2021

Mark J. Mazur, Deputy Assistant Secretary for Tax Policy
Office of Tax Policy
Department of the Treasury
1500 Pennsylvania Ave, NW
Washington, DC 20220

Hon. Charles P. Rettig
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

William M. Paul, Acting Chief Counsel and Deputy Chief Counsel (Technical)
Office of the Chief Counsel
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Section 473 Relief for Businesses Using LIFO

Gentlemen:

I am writing on behalf of the LIFO Coalition to request that the Department of the Treasury provide relief under IRC § 473 for certain businesses using the Last-In, First-Out inventory accounting method whose inventory supplies have been disrupted by the COVID-19 pandemic.

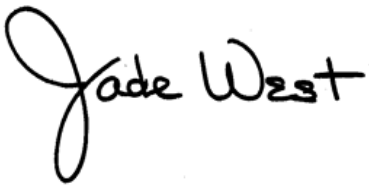
The LIFO Coalition (the Coalition), organized in April 2006, has more than 130 members including trade associations representing manufacturing, wholesale distribution, and retail industries, as well as companies of every size and industry sector that employ the LIFO method. A list of the Coalition members is attached to this document, and can be found at http://savelifo.org/about-lifo-coalition/.

LIFO Coalition members from a cross-section of industries have informed me that they have experienced a decrease in closing inventory as a direct result of global trade interruptions arising from the pandemic. Specifically, government actions to contain the spread of the virus have caused major trade interruptions that have made it impossible for a broad range of U.S. companies to acquire sufficient replacement inventory. Under LIFO rules, a decline in the value of LIFO inventory could trigger a recapture tax.

IRC § 473, "Qualified Liquidations of LIFO Inventories," addresses this issue and authorizes the Secretary to provide relief from the recapture tax if "any embargo, international boycott, or other major foreign trade interruption, has made difficult or impossible" the obtaining of replacement inventory for "any class of goods for any class of taxpayers." This relief is accomplished through the publication of a notice of determination in the *Federal Register* identifying the class(es) of goods and class(es) of taxpayers that are affected and the period of time to replace such inventory. Without § 473 relief, these COVID-related global trade interruptions will result in unanticipated and potentially significant tax liabilities for many U.S. LIFO companies at a time when they are still recovering from the impact of the pandemic.

On behalf of the LIFO Coalition and its impacted members, I would respectfully request that the Secretary publish in the *Federal Register* the required notice of determination providing relief for each class of goods and class of taxpayers that has experienced a qualified inventory interruption. I will be happy to provide contact information for impacted Coalition members if needed.

Sincerely,



Jade C. West
Chief Government Relations Officer, National Association of Wholesaler-Distributors
Executive Secretariat, The LIFO Coalition

April 27, 2021

Mr. John Moriarty
Associate Chief Counsel
Income Tax & Accounting
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

Re: Request for Relief under Section 473

Dear Mr. Moriarty:

The American Institute of CPAs (AICPA) commends the continued efforts of the Department of the Treasury ("Treasury") and the Internal Revenue Service (IRS) to issue timely guidance related to the Tax Cuts and Jobs Act (TCJA or the "Act")[1] and the Coronavirus Aid, Relief and Economic Security Act (CARES Act).[2] The AICPA recognizes and appreciates that the government is continuing to work on numerous urgent matters related to the Coronavirus Disease 2019 pandemic ("Coronavirus" or "COVID-19"). However, additional relief is needed as part of these ongoing efforts.

Specifically, the AICPA requests relief under section 473[3] ("Section 473 Relief") for taxpayers that: (i) account for their inventory under the last-in, first-out (LIFO) accounting method; and (ii) experienced a decrease in their closing inventories caused by government actions in response to COVID-19. Section 473 authorizes Treasury and the IRS to permit taxpayers to reduce the unanticipated income from a qualified liquidation of LIFO inventories by replacing the inventory over a three-year period. Absent this relief, many fiscal and calendar year taxpayers will realize significant and unexpected tax liabilities for the 2020 taxable year.

Overview

Section 473 provides detailed and specific rules that govern the class of eligible taxpayers and the mechanics of the available election for qualified liquidations of LIFO inventories.[4] The government actions and restrictions implemented in 2020 to mitigate the global health crisis and curtail the COVID-19 pandemic caused major disruptions to foreign trade, affecting the integrated supply chains upon which our global economy relies.[5] These disruptions made it difficult, and in some cases impossible, for taxpayers to maintain inventories at normal levels, resulting in an

[1] P.L. 115-97.
[2] P.L. 116-136.
[3] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended, or to the Treasury Regulations promulgated thereunder.
[4] The National Automobile Dealers Association (NADA) has also written a letter to Treasury and the IRS requesting relief under section 473 for the 2020 taxable year. For historical background regarding the enactment of section 473, including the legislative history, see the NADA letter (Request for Expedited Section 473 Relief for Certain Franchised Automobile and Truck Dealers), 2020 Tax Notes 228-9 (November 20, 2020).
[5] *See* section 473(c)(2) (qualified inventory interruption).

involuntary liquidation of LIFO layers for taxpayers that use the LIFO method to account for inventories. Congress enacted section 473 to provide relief to taxpayers in circumstances such as these.

Recommendations

The AICPA recommends that Treasury and the IRS determine that the foreign trade interruptions resulting from government actions to contain the spread of COVID-19 is a "qualified inventory interruption"[6] and issue the required notice (the "Notice")[7] granting Section 473 Relief to taxpayers that experienced a qualified liquidation of LIFO inventory.

The Notice should state the following:

- A taxpayer may elect relief under section 473 if the taxpayer experienced a qualified liquidation[8] for a liquidation year.[9]

- The election is made by attaching an election statement to its timely filed (including any extension) original federal income tax return for the first taxable year following the liquidation year (i.e., the first taxable year of the replacement period), unless the taxpayer is electing the safe harbor method described below.

- The election statement must include representations that: (i) the taxpayer is making an irrevocable election under section 473; (ii) the taxpayer experienced a liquidation in its LIFO inventory during the liquidation year; and (iii) the liquidation was attributable to the qualified inventory interruption described in the Notice.

- A qualified liquidation year includes taxable years ended March 31, 2020 through taxable years ending June 30, 2021.

- The applicable replacement period is the three taxable years following the liquidation year.

The AICPA recommends issuing the Notice immediately followed by additional guidance to provide a safe harbor method under which a taxpayer would:

- Disregard the liquidation for the liquidation year and would retain the LIFO layers related to the opening inventory of the liquidation year. Under this safe harbor method, the taxpayer would not recognize income attributable to the liquidation of these LIFO layers if the taxpayer completely replaces the inventory by the end of the replacement period.

[6] Under section 473(c)(2)(A).
[7] *See* section 473(c)(2).
[8] Section 473(c)(1).
[9] Section 473(d)(1).

- Attach an election statement to its timely filed (including any extension) original federal income tax return for the liquidation year. This election statement must include the representations listed above and a statement that the taxpayer is electing the section 473 safe harbor method.

- In cases where a taxpayer previously filed its federal income tax return for an eligible liquidation year, provide that the taxpayer may make a late election to use the section 473 safe harbor method by filing an amended return for the eligible liquidation year within 90 days of the date the guidance is published in the Federal Register, or by filing Form 3115 for its 2021 taxable year. A partnership that already has filed its return shall be permitted to file an amended return for the liquidation year reflecting the late election rather than an administrative adjustment request (AAR), similar to the relief provided in Rev. Proc. 2020-23, or by filing Form 3115 for its 2021 taxable year.

Analysis

Government Actions to Contain COVID-19

A "qualified inventory interruption" occurs when:

> "the Secretary, after consultation with the appropriate Federal officers, determines that (i) any embargo, international boycott, or other major foreign trade interruption has made it difficult or impossible to replace any class of goods for any class of taxpayers during the liquidation year, and (ii) the application of this section to that class of goods and taxpayers is necessary to carry out the purpose of this section."[10]

To prevent the spread of COVID-19, governments across Asia, Europe, Africa, and the Americas implemented restrictive measures that prevented taxpayers from conducting normal business operations. These measures included stay-at-home orders, travel restrictions, closure of factories and non-essential businesses, and reduced capacity limitations upon the reopening of businesses. The measures were implemented beginning in January 2020 in Asia, and in March 2020 in Europe and the Americas and continue, to an extent, into 2021.

The various government restrictions enacted in 2020 to prevent the spread of COVID-19 severely limited manufacturing capacity and caused major interruptions in foreign trade and the integrated global supply chain. These restrictions cascaded into the overall supply chains of U.S. taxpayers, making it difficult or impossible for many taxpayers to replace their inventories for taxable years ended March 31, 2020, and this problem is expected to continue at least through taxable years ending June 30, 2021.

The inability by many U.S. taxpayers to replace inventory due to major foreign trade interruptions caused by government restrictions related to COVID-19 meets the definition of a "qualified inventory interruption" under section 473(c)(2). For affected taxpayers, the liquidation of LIFO

[10] Section 473(c)(2).

inventory is predominantly attributable to the foreign trade and supply chain disruptions caused by these government restrictions. The relief would permit qualified taxpayers to restore their inventories to normal levels over a three-year replacement period, mitigating substantial and unexpected increases to taxable income due to involuntary liquidations of LIFO inventories caused by government actions necessitated by global public health concerns due to the COVID-19 pandemic.

Burdensome Impact on Taxpayers

The government restrictions described above are likely to result in significant tax costs to taxpayers with LIFO inventories due to artificial and permanent increases in income through an involuntary liquidation of LIFO layers. The decline in inventory and involuntary liquidation of LIFO layers result in an acceleration event of lower costs from prior years included in costs of goods sold in the liquidation year. This acceleration event, in turn, triggers an artificial increase in taxable income that would not have occurred but for the government actions that resulted in major foreign trade interruptions. Many taxpayers are struggling with the economic effects of government restrictions related to COVID-19 and may not have cash available to pay the taxes resulting from this unexpected involuntary liquidation of LIFO inventory.

Without Section 473 Relief, when the taxpayer restores the inventory to its normal level, the liquidated LIFO layers will be replaced with an increment valued at current-year costs. Thus, the income resulting from the involuntary liquidation of the LIFO inventory will not reverse in the following years, in effect, creating a long-term increase in taxable income for these taxpayers.

Under section 473(b), if a taxpayer replaces the liquidated inventory during a replacement year, the taxpayer would be entitled to decrease the gross income for the liquidation year by an amount equal to the excess of: (i) the aggregate replacement cost of the liquidated goods replaced during the replacement year, over (ii) the aggregate cost of the goods reflected in the opening inventory of the liquidation year. Therefore, the income resulting from a qualified liquidation would be reversed if the taxpayer completely replaces the liquidated inventory during the replacement period because the taxpayer subsequently would reduce the gross income for the liquidation year. However, under this approach, the taxpayer must recognize the income resulting from the qualified liquidation in the liquidation year and then file one or more amended tax returns to reduce the gross income for the liquidation year. Thus, taxpayers would incur the financial burden of paying additional taxes related to the income resulting from the qualified liquidation for the liquidation year, for which it may not have sufficient cash, and the administrative burden of filing up to three amended tax returns for the liquidation year.

A safe harbor method under which a taxpayer disregards the qualified liquidation for the liquidation year if the taxpayer completely replaces the inventory by the end of the replacement period alleviates the burden of paying additional taxes on the related income and obtaining Section 473 Relief by filing amended tax returns.

The AICPA plans to submit further comments providing details of this safe harbor method, including examples. Until this guidance providing the safe harbor method is published, the Notice

described above granting taxpayers Section 473 Relief would provide that any taxpayer electing Section 473 Relief by filing the Section 473 election statement with its federal income tax return for the liquidation year may elect to disregard the liquidation for the liquidation year and retain the LIFO layers related to the opening inventory of the liquidation year. As a result, the taxpayer would not recognize income attributable to the liquidation of these LIFO layers in the liquidation year.

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The AICPA is the world's largest member association representing the accounting profession, with more than 431,000 members in the United States and worldwide, and a history of serving the public interest since 1887. Our members advise clients on federal, state and international tax matters and prepare income and other tax returns for millions of Americans. Our members provide services to individuals, not-for-profit organizations, small and medium-sized businesses, as well as America's largest businesses.

We appreciate your consideration of our recommendations and welcome the opportunity to further discuss our comments. If you have any questions, please contact Connie Cunningham, Chair, AICPA Tax Methods and Periods Technical Resource Panel, at (310) 557-8544, or CCCunningham@bdo.com; Alexander Scott, Senior Manager — AICPA Tax Policy & Advocacy, at (202) 434-9204, or Alexander.Scott@aicpa-cima.com; or me at (612) 397-3071 or chris.hesse@CLAconnect.com.

Sincerely,

Christopher W. Hesse, CPA
Chair, AICPA Tax Executive Committee

cc: The Honorable Charles P. Rettig, Commissioner, Internal Revenue Service
Mr. Mark Mazur, Acting Assistant Secretary for Tax Policy, Department of the Treasury
Mr. William Paul, Acting Chief Counsel, Internal Revenue Service
Mr. Krishna P. Vallabhaneni, Tax Legislative Counsel, Department of the Treasury
Ms. Wendy Friese, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury
Mr. Timothy Powell, Tax Policy Advisor, Office of Tax Legislative Counsel, Department of the Treasury