Outlaw business accounting methods that artificially lower corporate taxes: $98 billion over 10 years

The Idea: Corporations enjoy numerous financial benefits through the tax code. These include certain business accounting methods – such as the so-called "last-in, first-out" (LIFO) and "lower-of-cost-or-market" (LCM) methods. If Congress were to eliminate these loopholes, which allow corporations to lower their taxable income artificially, the country could save roughly $98 billion[14] over 10 years.

Crafted in the 1970s to help reduce corporate taxes during inflationary times, LIFO is an accounting technique used in managing inventory where the most recently produced items are recorded as being sold first, even if the older goods are usually sold first. Since inflation is usually driving up prices, newer goods cost more to produce than older goods. By subtracting these higher costs from their revenue, a company can artificially lower its profits, and thereby lower its tax liabilities.

Here's how Citizens for Tax Justice puts it:

> For example, we normally think of profit this way: You buy something for $30 and sell it for $50 and your profit is $20 (ignoring any other expenses). But corporations, notably oil companies, use an accounting method that doesn't fit this picture. They might buy oil for $30 a barrel, and when the price rises they might buy some more for $45 a barrel. But when they sell a barrel of oil for $50, they get to assume that they sold the very last barrel they bought, the one that cost $45. That means the profit they report to the IRS is $5 instead of $20.

The Rationale: Throughout the world, only Japan and the U.S. allow for the use of LIFO accounting methods; other options are "first-in, first-out" (FIFO) accounting or the average cost method. Over a 10-year period, this accounting trick costs the government at least $52 billion in lost revenue.

LCM is a similar accounting method but allows a company to choose between valuing its inventory using its historical cost (i.e. what it cost to acquire it, using either LIFO or FIFO) or its replacement cost (i.e. what it costs to get new inventory). If the replacement cost is lower than its historical cost, then the inventory has lost value. LCM lets a company choose to value its inventory at whichever is the lower of the two costs, thus artificially reducing its profits and tax liability. While this accounting trick costs the government less than LIFO in foregone revenue, its costs are not inconsequential.

Support for the idea: Several members of Congress have introduced legislation over the last two sessions, either to limit the use of LIFO and LCM or to repeal the loopholes. Rep. Earl Blumenauer (D-OR) introduced the "End Big Oil Tax Subsidies Act of 2011," which prohibited the use of LIFO by major oil companies. Reps. Gerald Connolly (D-VA), David Cicilline (D-RI), and Heath Shuler (D-NC) each introduced bills to repeal the LIFO accounting method. Rep. John Tierney (D-MA) introduced the "Tax Equity and Middle Class Fairness Act of 2011," which would repeal both LIFO and LCM.

Of the plans reviewed for this revenue project, the following support repealing LIFO, LCM, or both accounting methods: the Citizens for Tax Justice's *Policy Options to Raise Revenue by Eliminating or Reducing Tax Subsidies for Wealthy Individuals and Profitable Businesses*, Center for American Progress' *Budgeting for Growth and Prosperity*, and both President Obama's FY 2012 budget and *Living within Our Means and Investing in the Future*.

[14] *Reducing the Deficit: Spending and Revenue Options*, CBO, pg. 177.