Statement of the Oklahoma Automobile Dealers Association
Submitted For the Hearing Entitled
"State of the American Economy: The Heartland"
Before the House Committee on Ways and Means
March 7, 2023

Chairman Smith and Ranking Member Neal, thank you for the opportunity to submit testimony for the record in support of H.R. 700, bipartisan legislation that would provide much-needed relief for dealers using the Last In, First Out accounting method which were impacted by supply chain shortages.

The majority of franchised auto dealerships in Oklahoma are family-owned and operated small businesses, playing a vital role in their local economies by providing career opportunities and generating significant tax revenue. Many dealers in Oklahoma that use Last In, First Out (LIFO) accounting were hit by massive tax bills due to the unprecedented semiconductor and vehicle production shortages experienced during the global pandemic. With no way to replenish vehicle inventory, dealers using LIFO have faced major unanticipated tax liability due to circumstances beyond their control. Small family-owned dealerships on LIFO have been disproportionately harmed.

H.R. 700 the "Supply Chain Disruptions Relief Act" would allow businesses using LIFO extended time to replace vehicle inventories due to the unforeseen and uncontrollable vehicle supply chain and pandemic conditions. **The Oklahoma Automobile Dealers Association (OADA), which has represented franchised new automobile dealers in Oklahoma since 1917, supports passage of the "Supply Chain Disruptions Relief Act."**

Franchised auto dealers especially benefit small and rural towns in Oklahoma. In some small communities, the franchised dealer is one of the largest private employers. An auto dealership is not owned by the manufacturer; the dealer is independent and self-financed with their own capital. Here in Oklahoma, there are 270 franchised new car dealerships that are generally family owned and operated and many have served their local communities for decades. Most of the dealerships on LIFO are pass-through entities and all are closely held businesses. (Public company auto retailers do <u>not</u> use LIFO.)

Businesses using LIFO must maintain a minimum level of inventory at year-end or risk recognizing excess gains that result in LIFO recapture.[1] Supply chain disruptions during the pandemic made it

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[1]**What is LIFO, and why is it a threat?** Last in, first out is a widely used accounting method to track the costs of inventory that has been employed in the U.S. since before World War II. It can be beneficial to retailers of large-ticket items whose costs normally increase over time. About half of all franchised dealerships in the country use LIFO to track at least some part of their inventories: new vehicles, used vehicles and parts. The new-vehicle calculation is at issue.

How it works: LIFO presumes for accounting purposes that when a vehicle is sold from inventory, it was the last vehicle — and therefore the most expensive on a wholesale basis — placed into inventory, regardless of when it actually arrived or its actual wholesale cost. As long as inventories are stable, LIFO defers income tax by lowering the profit margin between the wholesale cost and revenue received. It creates a pool of the deferred income — referred to as the LIFO reserve and which is calculated every year — that must eventually be accounted for and taxed. Normally, this clearing of a dealership's LIFO pool, which could virtually impossible for auto dealers to maintain inventory. Dealerships with older reserves are generally family stores that have been on LIFO for many years and have been impacted more severely than newer larger dealerships.

Fortunately, Congress has anticipated this sort of scenario. Under existing law, temporary relief under LIFO is available for businesses that cannot maintain minimum inventory levels through no fault of their own, such as a major foreign trade interruption. Our national trade association, the National Automobile Dealers Association (NADA), petitioned Treasury in 2020 to use this authority. Despite broad bipartisan support for Treasury's use of its authority, Treasury declined as it believed additional legislative authority was needed.

The "Supply Chain Disruptions Relief Act" (H.R. 700/S. 443), which the Treasury Department helped draft, would determine that the requirements under existing law have been met for new vehicles due to pandemic-related foreign trade interruptions which created inventory shortfalls. Given the lingering supply chain disruptions, the bill extends the period to replenish inventory and compute LIFO reserve/recapture to the end of 2025 to allow vehicle production to normalize.[2]

Oklahoma small business dealers have noted the real-life impacts of LIFO recapture – these taxes are on top of other taxable income – which have resulted in deferred investments such as putting facility upgrades on hold, facility remodeling and reduced profit sharing for employees.

Washington can address this situation by passing H.R. 700 to clarify that under existing law businesses facing a major foreign trade interruption have additional time to replenish new vehicle inventory. This would help small businesses in Oklahoma invest in their business and employees and stay competitive.

These undue pandemic-related tax burdens also come at a time when major auto manufacturers have announced aggressive plans to electrify their fleet and dealers are being required to make substantial investments to sell and service electric vehicles. Installing electric chargers, purchasing special equipment, parts and tools and investing in training sales and service personnel can be

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stretch back decades, would occur when the dealership either switches to first in, first out accounting, changes hands or closes, when all its assets are accounted for and taxed.

What is the issue? Historically low levels of new-vehicle inventories in 2021 caused by COVID-19-related production issues meant that many dealers sold all or nearly all of their new vehicles, greatly reducing their LIFO reserve pools and making that long-deferred income suddenly taxable at the federal and potentially state level as regular income. Small dealerships especially are facing massive increases in their 2022 income tax bills as a result, though midsize and larger retailers on LIFO are affected as well.

What is being sought? Dealer groups, manufacturers, accountants and members of Congress have petitioned the U.S. Department of Treasury to invoke a never-before-used section of the federal tax code that would give dealers up to 3 years to restore their inventories to more normal levels. Doing so would not forgive the tax due; it would just pause the reckoning until inventory levels are restored. *Source: Automotive News "Why the inventory crunch has car dealers seeking U.S. relief from big tax bills." February 14, 2022*

[2] NADA also supports the "Supply Chain Disruptions Relief Act" (H.R. 700/S. 443), See NADA's one page issue brief attached and for more information see nada.org/lifo.

costly for an individual business. For example, a Level 3 charger can cost anywhere from $100,000 to $200,000, a significant commitment for a small business.

Passage of H.R. 700 would help provide continued investments in jobs in local and rural communities in Oklahoma as dealers are vital contributors to our state's economy. Dealers in Oklahoma average 52 employees per store and statewide dealerships are responsible for over 25,000 total jobs. The average annual earnings per dealership employee in Oklahoma is $72,345. Additionally, our dealers pay $1.2 billion annually in Oklahoma state sales tax. Significantly, dealers help the community by supporting civic and charitable organizations and other local businesses that help stimulate local economies. These investments and tax revenue provided by dealerships help keep local and rural communities vibrant.

Conclusion

OADA respectfully urges the U.S. House of Representatives to swiftly pass H.R 700, the "Supply Chain Disruptions Relief Act," to address this unprecedented supply chain issue that has severely impacted vehicle inventory and the auto industry. The bill is identical to the bills from last Congress which received overwhelming bipartisan support[3] and passed the Senate without opposition on Dec. 22, 2022. The Treasury Department has also expressed interest in working cooperatively with Congress for a legislative solution. Small businesses, local workers and rural communities would benefit from the timely passage of this important legislation. Thank you for your consideration.

Attachment: NADA – "Support Pandemic-Related 'Supply Chain Disruptions Relief Act" (H.R. 700/S.443) Bipartisan LIFO Relief Needed Due to a Major Foreign Trade Interruption of Auto Production.

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[3] Last Congress, H.R. 7382 had 174 cosponsors (96R, 78D), and S. 4105 had 59 cosponsors (35R, 23D, 1I).

Support Pandemic-Related "Supply Chain Disruptions Relief Act" (H.R. 700/S. 443)
Bipartisan LIFO Relief Needed Due to a Major Foreign Trade Interruption of Auto Production

ISSUE

Vehicle assembly plants around the globe ceased or slowed production during the pandemic, drastically reducing new vehicle inventory. The shortfall worsened with the worldwide shortage of semiconductors, which are increasingly essential to vehicle production. With no way to replenish vehicle inventory, dealers using the last-in, first-out (LIFO) method of accounting are facing major unanticipated tax liability due to circumstances beyond their control. The Treasury Department has existing authority to allow LIFO relief to businesses if a "major foreign trade interruption" makes inventory replacement difficult. Despite broad bipartisan support for Treasury's use of its authority, Treasury has declined as it believes additional legislative authority is needed. The "Supply Chain Disruptions Relief Act" (H.R. 700/S. 443) would determine that the requirements under existing law have been met for new vehicles due to pandemic-related foreign trade interruptions which created inventory shortfalls. The reintroduced legislation is identical to the bills from last Congress which received overwhelming bipartisan support and passed the Senate without opposition. **Congress should pass "Supply Chain Disruptions Relief Act" to allow businesses on LIFO extended time to replace vehicle inventories as pandemic-related global disruptions and reduced auto production made it nearly impossible to replenish new vehicle supply.**

BACKGROUND

In 1980, Congress provided the Treasury Department authority (Sec. 473 of the Internal Revenue Code) to grant temporary LIFO relief to businesses if a "major foreign trade interruption" makes inventory replacement difficult or impossible. As the pandemic slowed or stopped production at vehicle assembly plants and suppliers across the globe, dramatic supply constraints helped create the lowest dealer inventory levels in 50 years. To reduce LIFO recapture tax liability, dealers must generally restock inventory by year's end as shortfalls can be taxed as ordinary income. Dealers on LIFO, however, were powerless to replenish inventories, resulting in large, unanticipated tax liabilities for many small business dealers.

The "Supply Chain Disruptions Relief Act," provides a congressional finding that the conditions necessary to grant LIFO relief under existing law have been met. The Alliance for Automotive Innovation and a White House Fact Sheet have documented that automakers could not complete the final assembly of sufficient vehicles, and dealers were unable to sufficiently replace inventory, due to pandemic-related foreign trade interruptions, including a severe shortage of critical semiconductor chips. The bill would allow dealers to delay the recognition of income triggered by LIFO recapture for tax years 2020 and 2021. Given the lingering supply chain disruptions, the bill extends the period to replenish inventory and compute LIFO reserve/recapture to the end of 2025 to allow vehicle production to normalize.

KEY POINTS

- As a result of supply chain disruptions beyond the dealers' control, LIFO recapture will trigger significant, unexpected tax liability, imposing massive tax bills on small businesses that could otherwise be used to invest in workers, EV infrastructure, and replenishing vehicle inventory as it becomes more available.
- The Treasury Department has indicated its support and interest in working cooperatively with Congress for a legislative solution to this unprecedented supply chain issue that severely impacted vehicle inventory and the auto industry.
- The "Supply Chain Disruptions Relief Act," is technical and noncontroversial legislation that is identical to the bills from last Congress which received overwhelming bipartisan support

STATUS

On Feb. 1, Reps. Jodey Arrington (R-Texas) and Dan Kildee (D-Mich.) reintroduced the "Supply Chain Disruptions Relief Act" in the House, and Sens. Sherrod Brown (D-Ohio) and Tim Scott (R-S.C.) reintroduced the Senate version on Feb. 15 along with 48 Senators. Last Congress, the Senate bill, which had 60 cosponsors, passed the Senate unanimously on Dec. 22. The previous House bill had 175 House cosponsors, but time ran out before the bill's consideration at the end of the Congress. **Members are urged to pass the "Supply Chain Disruptions Relief Act," to provide relief to businesses facing difficulty replacing vehicle inventory due to the unprecedented supply chain shortages.**

February 16, 2023