April 13, 2015

The Honorable John Thune
511 Dirksen Senate Office Building
Washington, D.C. 20510

The Honorable Ben Cardin
509 Hart Senate Office Building
Washington, D.C. 20510

Dear Senator Thune and Senator Cardin:

The National Association of Chemical Distributors (NACD) and its nearly 440 member companies are vital to the chemical supply chain providing products to over 750,000 end users. NACD members process, formulate, blend, re-package, warehouse, transport, and market chemical products. They make a delivery every six seconds while maintaining a safety record that is more than twice as good as all manufacturing combined. NACD members are leaders in health, safety, security, and environmental performance through implementation of Responsible Distribution.

Most NACD members are small businesses. The typical member is privately owned with less than $29 million in annual sales and fewer than 30 employees. Like numerous industry sector associations, many different parts of the tax code affect our members. There are two specific issues, however, that we wish to focus on in our comments to the Business Income Tax Working Group.

<u>Protecting Pass-Through Entities from Higher Effective Rates</u>

It is essential that, if the tax code is simplified, it also be comprehensive. Any tax reform proposal considered by Congress must include individual as well as corporate tax reform. The issue is of immense importance to the financial health of NACD's membership, and many of our members are pass-through entities.

Since many business deductions and credits are used by both corporate and pass-through businesses, their elimination in exchange for corporate-only rate reduction would result in a tax increase for a large number of chemical distributors who pay taxes as individuals. As Congress considers tax reform, it must also address the rate of those businesses that operate as pass-through entities. Under the individual code, pass-through entities face a top marginal rate of 39.6%, even higher than the 35% faced by C corporations.

Small businesses are job creators and play a critical role in this country's economic health. There are important non-tax business reasons for choosing to operate as a pass-through entity, including the flexibility it affords in setting up the business structure and financing. Thus, retaining the ability of small businesses to operate as pass-through entities is an important economic issue. While tax reform is a worthy goal, a subset of businesses should not face tax increases to accomplish this goal. This would negatively impact closely-held businesses struggling to compete.

Preserving the Last-In, First-Out Inventory Accounting Method

NACD supports retaining the last-in, first-out (LIFO) inventory method as part of any tax reform effort. A repeal of the LIFO method would reduce growth, reduce investment in property, and curtail employment. This issue is of great importance to many chemical distributors.

The LIFO accounting method assumes the inventory used to establish a value for "cost of goods sold" or CSG is from the last inventory acquired. The corollary of this statement is that the inventory defined on the balance sheet is the oldest inventory acquired. Many businesses have used this method for decades. LIFO allows businesses to exclude inflationary gains from holding inventories from taxable income. Similar to real property that is held and has appreciated in market value, however, this inventory appreciation is unrealized. LIFO allows a company to retain the working capital needed to be able to replace the same physical amount of goods that a company would normally carry with new stock. Put another way, the LIFO method of accounting allows chemical distributors to match their current sales revenues with current inventory replacement costs.

Further, the repeal of LIFO would be a retroactive tax. Companies currently using the accounting method would be subject to a one-time tax on their LIFO reserves and higher tax bills in the future. By creating a sizeable tax penalty for having chosen a particular accounting method sometimes decades earlier, eliminating LIFO would effectively be a retroactive tax. It would drain small businesses of a substantial amount of their accumulated net worth. Businesses bearing this retroactive tax would struggle to maintain employment and investment for an extensive period of time following the repeal of LIFO. This reduction of net worth would occur from taxes on inflation gains over differing lengths of time, depending on the company. During any phase-out period, many small businesses would be hesitant or unable to make new investments in facilities or equipment.

For these reasons, we ask the committee to protect pass-through entities from higher effective rates and preserve the LIFO accounting method. If you have questions regarding NACD's priorities for tax reform, please contact Laura Chambers, director of legislative affairs, at lchambers@nacd.com or (703) 527-7747.

Thank you for your attention to this important issue.

Sincerely,

Eric R. Byer
President