US tax legislation: IRA and CHIPS

US GAAP and IFRS® Accounting Standards

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Tax changes are here

In August 2022, President Joseph R. Biden signed into law two pieces of legislation with significant tax implications:

- H.R. 5376, commonly referred to as the Inflation Reduction Act of 2022 ('IRA'); and
- H.R. 4346, commonly referred to as the CHIPS and Science Act of 2022 ('CHIPS').

The IRA introduces a new 15% corporate alternative minimum tax ('AMT') and includes a substantial package of energy and climate-related provisions, among other revenue raisers and incentives. CHIPS adds a one-time investment tax credit equal to 25% of a company's investment in facilities that manufacture semiconductors or semiconductor manufacturing equipment.

Although no changes have been made to US federal corporate statutory tax rates, a number of provisions in the new laws may affect companies' forecasts of future income tax liabilities and the realizability of deferred tax assets.

The new laws also introduce mechanisms for monetizing some credits that are novel to US federal tax law – including elections for 'direct pay' and third-party transfer. The IRA also allows for increased and bonus credits if a company meets certain criteria.

Preliminary guidance subject to update

This guide includes preliminary guidance on considerations under US GAAP and IFRS® Accounting Standards. This preliminary guidance is based on our current understanding of the IRA and CHIPS. 'Handbook' and 'Example' paragraph numbers indicated throughout refer to KPMG Handbook, Accounting for income taxes. 'Insights' paragraph numbers indicated throughout refer to KPMG Insights into IFRS.

We will continue to analyze how the authoritative accounting guidance applies to some of the provisions. We will update our views as additional information becomes available, practice develops, and further research and analysis is completed. New and updated guidance is noted throughout this guide.

1. Corporate AMT

Although the IRA does not raise the corporate statutory tax rate, it does introduce a new AMT. Corporate AMT is a 15% minimum tax levied on certain large corporations – generally, those with three-year average adjusted financial statement income ('AFSI') of $1 billion or more. Under the new law, a company's minimum tax is equal to the amount by which:

- the tentative minimum tax (15% of AFSI reduced by AMT foreign tax credits) exceeds
- the company's regular tax for the year (including any Base Erosion and Anti-Abuse Tax ('BEAT') liability, but before the consideration of general business credits).

AFSI generally starts with the net income or loss of the taxpayer as reported on its applicable financial statement with certain modifications, including an add-back for certain federal and foreign taxes and the ability to use tax depreciation instead of book depreciation. An applicable financial statement includes a corporation's Form 10-K filed with the SEC, certain audited financial statements, and certain other similar financial statements filed with a federal agency.

Companies may claim a credit against regular tax in future years for Corporate AMT previously paid, but the credit cannot reduce that future year's tax liability below the computed minimum tax for that year.

The Corporate AMT is effective for tax years beginning after December 31, 2022.

General considerations under US GAAP

Like the legacy AMT regime, we believe companies should account for the incremental tax owed under Corporate AMT as incurred and continue to measure their deferred taxes at regular tax rates – at enactment and going forward. [Handbook 3.069–3.072]

Valuation allowance

For deferred tax assets related to AMT credit carryforwards, Topic 740 requires that a company's expectation of its AMT status be considered when evaluating its valuation allowance for those carryforwards. This is necessary because a company, depending on its facts and circumstances, could be subject to the AMT in perpetuity. In that case, it is often difficult for a company to conclude that all or some of the benefits of the AMT credit carryforwards are more likely than not to be realized when it is relying on future taxable income exclusive of reversing temporary differences. [Handbook 4.115, Example 4.23]

For deferred tax assets other than AMT credit carryforwards, we believe a company may elect to either consider or disregard its Corporate AMT status when evaluating its deferred tax assets under the regular tax system. For example, a company that forecasts reducing its regular tax with an existing net operating loss carryforward in a year that it is subject to the Corporate AMT may not benefit at all from that deferred tax asset if it anticipates always being an

AMT taxpayer. If that company elects to consider its Corporate AMT status, it would recognize a valuation allowance on the deferred tax asset. If a company elects to disregard its Corporate AMT status, it would not recognize a valuation allowance if it is more likely than not it will have sufficient taxable income under the regular tax system to realize the deferred tax asset.

In another example, a company may have general business credit carryforwards (e.g. energy credits, new markets credits, affordable housing credits, research credits) that are not more likely than not to be realized under the regular tax system. However, the company can demonstrate that it is more likely than not to realize those carryforwards under the Corporate AMT system.

- If the company elects to consider its Corporate AMT status, it would release its existing valuation allowance on the deferred tax assets.
- If the company elects to disregard its Corporate AMT status, it would retain its existing valuation allowance.

If a company elects to consider its Corporate AMT status in its valuation allowance assessment, any changes to the valuation allowance are recognized in the period that includes the August 16, 2022 enactment date. The election to consider (or disregard) Corporate AMT status when evaluating the realizability of deferred tax assets under the regular tax system is an accounting policy choice that must be consistently applied. Companies should also provide transparent disclosure of their policy election, if material. [Handbook 4.116]

Accounting policy changes

Corporate AMT's reliance on AFSI may prompt some companies to analyze how different pretax accounting policy elections might change AFSI and their potential corporate AMT liabilities.

Companies considering a voluntary change in accounting policy should evaluate preferability. Preferability is determined on the merits of the accounting principle – i.e. whether it is an improvement in financial reporting. Preferability cannot be justified on the basis of the income tax effect alone (see section 3.3 of KPMG Handbook, Accounting changes and error corrections).

General considerations under IFRS Accounting Standards (added Feb. 3, 2023)

Like US GAAP, it appears that deferred taxes should be measured based on the regular statutory rate, and a company should account for the incremental tax owed under the Corporate AMT system as it is incurred. [IAS 12.47, 51, Insights 3.13.380, 3.13.390, 3.13.470, 3.13.480]

Like US GAAP, a company should consider whether Corporate AMT credit carryforwards will be realized and whether a related deferred tax asset should be recognized.

Unlike US GAAP, it appears that a company should consider whether it will be subject to the Corporate AMT when assessing to what extent deductible temporary differences and unused tax losses under the regular tax will be realized in the future. [IAS 12.47, 51]

If a company's projections of future taxable profits indicate that a certain amount of deductible temporary differences and unused tax losses will not be realized because the company expects to be subject to the Corporate AMT, it should take that into account when accounting for the deferred tax assets consistent with its expected manner of recovery. This does not imply applying the Corporate AMT rate when measuring deferred taxes. [Insights 3.13.380, 3.13.390, 3.13.470, 3.13.480]

Any changes in the amount of deductible temporary differences and unused tax losses that can be realized should be recognized in the period that includes the August 16, 2022 enactment date.

What questions should you be asking?

- Based on current forecasts, is the Corporate AMT likely to affect us? If so, is it only in certain years or regularly?
- What's the expected effect on our forecasted effective tax rate and cash taxes?
- What changes might we need to make to our internal processes and controls to properly calculate and record Corporate AMT?
- What pretax accounting policy elections have we made (or do we expect to make) that may have a significant effect on AFSI?

2. Excise tax on stock repurchases

The IRA imposes a 1% excise tax on repurchases of stock by certain publicly traded corporations. The amount on which the tax is imposed is reduced by the value of any stock issued by such corporation during the tax year. How the excise tax works in practice will likely require further interpretation from the Treasury Department.

General considerations under US GAAP

The excise tax is determined on a non-income-based measure and is therefore not accounted for as an income tax.

Excise tax as direct cost

We believe companies will generally account for the excise tax as a direct cost of a repurchase. A company follows the balance sheet classification of the stock being repurchased to determine the geography of the excise tax imposed.

- Direct costs associated with acquiring permanent equity-classified stock are generally considered in the cost of acquiring the treasury stock – i.e. included in equity. See section 5.8 of KPMG Handbook, Debt and equity financing.
- Direct costs associated with acquiring temporary equity-classified stock likewise are generally considered in the cost of acquiring the stock. However, these costs may reduce net income available to common shareholders for purposes of computing earnings per share – e.g. if the stock is a preferred instrument or a common instrument with a non-fair value redemption feature. See sections 3.3 and 5.3 of KPMG Handbook, Earnings per share.
- Direct costs associated with extinguishing mandatorily redeemable stock classified as liabilities are included as part of the extinguishment gain or loss in pretax income. See section 4.10 of KPMG Handbook, Debt and equity financing.

A company recognizes these direct costs in the period(s) that includes a repurchase and subsequently adjusts those costs for any reductions in the period that includes a stock issuance. A company that has net stock issuances at the reporting date does not recognize an asset because that future benefit can be realized only if future repurchases equal or exceed the total issuances in the same tax year.

There may be situations in which a company completes multiple repurchase transactions and the related charges for excise tax affect both pretax income and equity. In this case, if an adjustment must be made to the total excise tax due to issuances, we believe companies should select a reasonable and consistent policy for allocating that adjustment.

For example, a company could attribute the credits:

- pro rata based on the proportion of excise tax in pretax income and equity; or
- first to the first repurchase of the tax year, next to the second repurchase and so on.

There may be other acceptable approaches for allocating the adjustment. We believe a company should disclose its accounting policy if material.

General considerations under IFRS Accounting Standards (added Feb. 3, 2023)

Like US GAAP, taxes that are not based on taxable profits are not in the scope of IAS 12. [IAS 12.2, 5, Insights 3.13.20–40]

Like US GAAP, qualifying costs directly related to an equity transaction – e.g. issuing or buying back the company's own shares – are debited directly to equity. [IAS 32.33–35, 37, Insights 7.3.440]

Like US GAAP, costs incurred on extinguishment of a financial liability are recognized as part of the gain or loss.

Unlike US GAAP, there is no temporary equity classification under IFRS Accounting Standards. [IAS 32.11, 15–27, IFRS 9.5.1.1, 3.3.1–3.3.3]

What questions should you be asking?

- What is the total amount we have authorized under our current buyback program and the estimated costs under the new excise tax?
- Do we have flexibility in our buyback program or are there other strategies available to consider as alternatives to achieving our capital objectives?

3. New options for monetizing certain credits

One of the more fundamental changes to the energy space is the introduction of the transferability election through which companies can sell certain tax credits to third parties. Companies that make the election can transfer all or a portion of certain tax credits to unrelated parties in exchange for cash consideration that would be excluded from the selling taxpayer's taxable income.

In addition, the IRA introduces a direct pay election under which the credit is considered a direct payment of tax and is refundable. Direct pay is available to:

- credit eligible projects owned by certain tax-exempt and government entities; and
- other companies only for specific credits – i.e. carbon capture and sequestration, clean hydrogen production and the advanced manufacturing production tax credit.

CHIPS also includes a direct pay election for its semiconductor manufacturing facility investment credit.

3.1 Nonrefundable, nontransferable credits

The benefits of nonrefundable, nontransferable tax credits are realizable only if the company has an income tax liability. Until enactment of the new legislation, most energy tax credits (both production tax credits, or PTCs, and investment tax credits, or ITCs), have been both nonrefundable and nontransferable.

The IRA adds new, and modifies existing, PTC and ITC programs for green energy projects. Many of the new credit regimes include a base credit and an increased credit. To claim the increased credits, a company must satisfy:

- a prevailing wage requirement for the period that extends from the beginning of construction through the end of a specified compliance period (which depends on the type of credit); and
- an apprenticeship requirement over just the construction period.

There are also PTC and ITC bonus credits available for projects that meet the domestic content requirement. This rule generally requires companies to ensure that facilities are composed of steel, iron and other products manufactured in the United States.

We believe nonrefundable, nontransferable tax credits (base, increased and bonus credits) are in the scope of Topic 740.

General considerations under US GAAP

Base PTCs

Nonrefundable base PTCs are recognized in the year they arise (i.e. the year in which they become available to offset a company's income tax liability). This is typically the period in which the related production occurs (if the recognition and measurement principles in Topic 740 are met). [Handbook 10.127–10.132]

Base ITCs

Companies have a policy choice when accounting for nonrefundable ITCs – they can apply the flow-through method or the deferral method. Topic 740 states that the deferral method is preferable. [Handbook 10.127–10.132]

A company using the flow-through method recognizes the ITC benefit in the period it arises, like a PTC benefit. If a temporary difference arises (e.g. because the tax law also reduces the tax basis of the qualifying property), companies generally recognize the related deferred tax asset or liability by adjusting income tax expense (benefit).

A company using the deferral method initially defers the ITC benefit and recognizes it over the productive life of the qualifying property. After electing the deferral method, we believe there are several more policy elections, including:

- an option to reduce the carrying amount of the asset (contra-asset) or recognize deferred income (liability) by the amount of the ITC benefit;

- an option to recognize the deferred taxes on temporary differences arising from initially deferring the ITC benefit by further reducing the carrying amount of the asset (using the simultaneous equation) or immediately recognizing income tax expense (benefit); and
- an option to present the income statement effects of derecognizing the deferred ITC benefit over the productive life of the qualifying property as depreciation expense or income tax expense (benefit), if the deferred ITC benefit is initially treated as a reduction of the asset's carrying amount.

The policy choices should be consistently applied, as discussed in Topic 250 (accounting changes); see section 3.3 of KPMG Handbook, Accounting changes and error corrections.

Tax equity investments

There are additional considerations for companies that make an investment in a noncontrolling equity interest in a flow-through entity that generates income tax credits (see section 4.3 of KPMG Handbook, Equity method of accounting).

The FASB has decided to issue an ASU which will allow such investors to apply the proportional amortization method to all qualifying investments made under any nonrefundable tax credit program if certain criteria are met. Under this method, a noncontrolling investor amortizes the cost of its investment through income tax expense or benefit as an offset to the nonrefundable tax credits and other tax benefits (e.g. tax depreciation) that it receives from the project entity. This method is currently available only for investors in qualified affordable housing projects. It is unclear at this time how many energy tax credit structures will qualify for this method. See KPMG Defining Issues, Simplified accounting for tax equity investments.

See additional discussion and illustrative examples of the accounting for tax credits (for owners of qualifying projects and noncontrolling investors) in KPMG publication, Energy tax credits.

Although the same general principles to account for the tax credits apply for companies that sponsor and consolidate tax credit structures, the pretax accounting for the noncontrolling investment is often very complex (see section 7.5 of KPMG Handbook, Consolidation).

Increased and bonus credit considerations

Certain tax credits have a prevailing wage requirement that extends beyond the period the credit arises. Like nonrefundable base PTCs, nonrefundable increased and bonus PTCs are recognized in the year they arise – i.e. the year in which they become available to offset a company's income tax liability. Increased and bonus ITCs are also recognized in the year they arise if a company is applying the flow-through method.

If a company is applying the deferral method for ITCs, the benefits of the increased and bonus credits are initially deferred on the balance sheet in the year they arise, and then are recognized in pretax income or income tax expense (benefit) over the productive life of the asset.

Companies apply the recognition and measurement guidance for accounting for uncertainty in income taxes when evaluating whether the credit is available on the tax return. In making that determination, a company evaluates whether it is more likely than not to sustain the benefit of the credits based on the technical merits of the position. Meeting the more-likely-than-not threshold is a positive assertion by management that the company is entitled to some level of economic benefit based on the conditions and information that is available at the reporting date.

To make this positive assertion, we believe a company would need to: [Handbook 10.127b]

- demonstrate that it has met the more-likely-than-not recognition threshold based on its compliance with the requirements under the tax law at the reporting date; and
- expect to continue to comply with the requirements during the compliance period. [Handbook 3.019–3.025]

A company reevaluates its position that it is entitled to the credits when new information becomes available. If a company concludes that the position is no longer more likely than not to be sustained based on new information (or a different amount represents the largest amount of benefit that is greater than 50% likely of being realized), or if it no longer expects to comply with the requirements, it derecognizes (or remeasures) the benefits of the position. [Handbook 10.127b, 3.026–3.033, 3.048–3.050]

General considerations under IFRS Accounting Standards **(added Feb. 3, 2023)**

Unlike US GAAP, IFRS Accounting Standards do not specifically address the accounting for ITCs. As a result, companies need to choose an accounting approach, to be applied consistently, that best reflects the economic substance of the credit. This determination requires judgement in light of all relevant facts and circumstances. If the substance of the credit is similar to a tax allowance (e.g. its benefits are determined or limited on the basis of the company's income tax liability), it is more appropriate to apply IAS 12, Income Taxes, by analogy. If the substance of the credit is similar to a government grant, then it is more appropriate to apply IAS 20, Accounting for Government Grants and Disclosure of Government Assistance, under IFRS Accounting Standards by analogy.

It appears that nonrefundable, nontransferable credits are akin to tax allowances. Although the amount of the incentive is independent of taxable profit, the related benefits are limited on the basis of the taxpayer's income tax liability (i.e. they are only realizable if the company has taxable income sufficient to offset the credit amount). Therefore, we believe that generally it is appropriate to account for these credits by applying IAS 12.

What questions should you be asking?

- Is our current policy election for flow-through vs deferral recognition methods still appropriate?
- If we do not have any existing ITCs, what is the most appropriate accounting policy election for our company?
- Do these credits have any increased or bonus amounts associated with them that we need to consider separately?
- Do we expect to meet the prevailing wage, apprenticeship and domestic content requirements?
- What processes and controls would we need to implement to track compliance with the requirements to generate and retain the increased or bonus credits?
- How may the credits affect our forecasts of future income tax liabilities?

3.2 Refundable credits

Both the IRA and CHIPS introduce a direct pay mechanism for certain credits and certain taxpayers. The direct pay election allows taxpayers to elect to treat the credit as a direct payment of tax, which allows them to receive a cash payment if the taxpayer does not incur any income tax liability.

For some of these refundable credits, there are also increased and bonus credits available to companies meeting certain criteria – e.g. the prevailing wage requirement, the apprenticeship requirement and the domestic content requirement (see section 3.1). Increased and bonus credits arise in the same period as the base credits, but require companies to meet certain criteria during a specified compliance period to avoid incurring a penalty.

General considerations under US GAAP

We believe tax credits are like government grants to the extent they are refundable through the direct pay election, regardless of whether a company expects to elect direct pay. Although the direct pay claim is filed in connection with the income tax return, the amount eligible for refund is not limited by the taxpayer's taxable income or income tax liability – e.g. a taxpayer may receive the refund despite being in a taxable loss position. As a result, those amounts are not income taxes and are outside the scope of Topic 740. [Handbook 9.167c, Example 9.41]

US GAAP currently provides no specific guidance on how business entities should account for government grants and there is diversity in practice. In our experience, many companies have an existing policy to analogize to IAS 20 under IFRS Accounting Standards. Other acceptable approaches include analogizing to Subtopic 958-605 (not-for-profit grants) or Subtopic 450-30 (gain contingencies).

If a company analogizes to IAS 20 or Subtopic 958-605, it provides disclosures under Topic 832 (government assistance) in its financial statements for annual periods beginning after December 15, 2021.

The FASB has a project on its research agenda to consider incorporating the recognition, measurement and presentation guidance on accounting for government grants in IAS 20 into US GAAP. To obtain feedback from stakeholders on how to proceed with the project, the FASB issued an Invitation to Comment. The comment period ended September 12, 2022. See KPMG web article for additional discussion.

IAS 20

Under IAS 20, a company does not recognize a government grant until it has reasonable assurance (which we understand the SEC staff equates to probable under US GAAP) that (1) it will comply with the relevant conditions and (2) the grant will be received.

Judgment may be required when evaluating whether the IAS 20 criteria are met. This is the case for the new law's refundable increased and bonus credits in particular, given that:

- companies will be assessing their ability to comply with the new prevailing wage, apprenticeship and domestic content requirements for the first time; and
- the procedural and other aspects of the program are likely to be unclear until clarifying regulations are issued.

If conditions (1) and (2) of IAS 20 are met, a company recognizes the grant on its balance sheet. The company then recognizes the benefits of the grant in pretax income on a systematic basis in line with its recognition of the costs that the grant is intended to compensate.

The measurement and presentation of government grants may depend on the nature of the grant and the company's accounting policies.

For grants related to assets, a company can elect to either:

- deduct the grant from the cost of the asset (net presentation) and recognize it through reduced depreciation expense; or
- present the grant separately as deferred income to be amortized as income or as a reduction in expense (typically depreciation expense) over the useful life of the asset (gross presentation).

Temporary differences may arise under either approach – e.g. if the tax law only provides a partial reduction of the tax basis of the qualifying property. In that case, companies need to recognize the related deferred taxes.

We believe a company should generally recognize those deferred taxes using the simultaneous equation approach (see KPMG Handbook, Accounting for income taxes, from paragraph 10.001) but there may be other acceptable approaches.

For grants related to income, a company is able to elect to present the benefit as:

- an offset to the related costs; or
- other income.

The accounting for government grants under IAS 20, from the perspective of a preparer of US GAAP financial statements, is discussed in KPMG Handbook, The US CARES Act, IFRS® compared to US GAAP.

Subtopic 958-605

The guidance on contributions in Subtopic 958-605 excludes transfers of assets from governmental entities to business entities. However, the FASB staff has noted that business entities are not prohibited from analogizing to that guidance to account for government grants. Income from 'conditional' contributions is recognized under Subtopic 958-605 when the conditions on which the contribution depends are substantially met.

Conditional contributions are those that include:

- one or more barriers that must be overcome before the recipient is entitled to the benefit; and
- a right of return.

A company does not consider the likelihood that the conditions will be met when determining whether barriers exist.

Determining whether the conditions necessary to avoid penalties associated with the increased and bonus credits are 'barriers' and, if so, when they are 'substantially met' may require judgment. Applying the guidance in Subtopic 958-605 could result in a company deferring the recognition of the benefit until the compliance period has lapsed.

Subtopic 450-30

Some companies have applied Subtopic 450-30 (gain contingencies) by analogy to account for government grants. Under this approach, a company does not recognize income related to the grant (i.e. the tax credit) until it is realized or realizable.

Financial statement presentation

US GAAP currently provides no specific guidance on how a company should classify the right to a government grant on the balance sheet. We believe companies should generally recognize a refundable credit as:

- a reduction of US federal income taxes payable if it expects to realize the benefit through a reduction of its income tax liability;
- an 'other receivable' or 'other asset' if it expects to receive cash for the excess of the credit amount over its US federal income tax liability; or
- income taxes refundable, if it expects to apply the refundable credit as a payment against future US federal income taxes.

We believe it would be inappropriate to reduce the income taxes payable balance of another tax-paying component for the credit. This is because the 'right of setoff' conditions in Subtopic 210-20 are not met.

A company that uses the indirect method for preparing the statement of cash flows under Topic 230 discloses the amount of income taxes paid. We believe this amount is net of refundable credits that were actually used in the period to reduce the amount of cash paid for income taxes – i.e. the portion of credits refunded in cash (or to be refunded) do not reduce 'income taxes paid'.

As discussed above, for refundable credits relating to assets, we believe a company can choose to deduct the amount from the cost of the asset or present it separately as deferred income. When those credits are refunded in cash, we believe classification generally aligns with the chosen balance sheet presentation as follows.

- Cash received for credits presented as a contra-asset is an investing cash inflow.

- Cash received for credits presented as deferred income is an operating cash inflow.

For refundable credits relating to income, we believe the cash received is generally an operating cash flow.

Policy elections made in connection with accounting for the IRA and CHIPS should be consistent with prior policy elections for similar types of government grants. See section 23.3 of KPMG Handbook, Statement of cash flows.

General considerations under IFRS Accounting Standards (added Feb. 3, 2023)

Unlike US GAAP, IFRS Accounting Standards specifically provide guidance on the accounting for government grants. It appears that the IRA's refundable credits meet the definition of government grants in IAS 20 and should be accounted for under that standard. [Insights 4.3.10.10–10.15]

Like a company electing to apply IAS 20 by analogy under US GAAP, a company recognizes the benefits of the credits in pre-tax income over the periods in which it recognizes the related costs. [Insights 3.13.710.20]

Unlike US GAAP, which does not have direct guidance on the accounting for government grants by for-profit businesses, IAS 20 is the authoritative guidance under IFRS Accounting Standards. Therefore, applying standards other than IAS 20 to the IRA's refundable credits would not be appropriate. [Insights 3.13.700.10]

Unlike US GAAP, if a temporary difference arises on the initial recognition of assets and liabilities (e.g. because the tax basis of construction in progress does not equal its financial statement carrying amount), companies do not recognize deferred taxes if they qualify for the initial recognition exemption. [IAS 12.15, 24]

However, recognition of deferred taxes may depend on the amount of the tax basis adjustment and a company's chosen balance sheet presentation under IAS 20 for the credits. Consider the following examples regarding the initial recognition of assets and liabilities. [IAS 12.33, IE.B.7, Insights 3.13.210.10–240.170]

- A company that reduces the financial statement carrying amount of the asset or recognizes deferred income for the full amount of the credit, but whose tax basis in the asset has been reduced for only 50% of the credit, will not recognize deferred taxes if it qualifies for the initial recognition exemption.
- A company that reduces the financial statement carrying amount of the asset for the full amount of the credit and whose tax basis in the asset has been reduced by the same amount will not recognize deferred taxes because no temporary difference will exist.
- A company that recognizes deferred income for the full amount of the credit and whose tax basis in the asset has been reduced by the same amount will recognize deferred taxes for the temporary differences associated with the

asset and the deferred income. This is the case because under the recent amendments to IAS 12, the initial recognition exemption does not apply if, at initial recognition of the assets and liabilities, equal and offsetting temporary differences arise. The amendments to IAS 12 are effective for annual periods beginning on or after January 1, 2023. [Insights 3.13.213.10–213.20]

What questions should you be asking?

- What do we expect the effect on our effective tax rate to be if the benefits of these credits move to pretax income?
- Have we previously established policies for accounting for government grants? If yes, have we correctly considered the cash flow statement impacts of our established policies?
- What processes and controls would we need to implement to track compliance with the requirements to qualify for bonus credits?
- How may the credits affect our forecasts of future income tax liabilities?
- Have we considered the additional disclosure requirements in Topic 832?

3.3 Transferable credits

For the first time at the federal level, certain credits are transferable. The IRA allows companies to transfer certain credits (or portions of credits) to another unrelated taxpayer in exchange for cash. The resulting payment will be excluded from the selling taxpayer's taxable income.

Each credit can only be transferred once, and the acquiring taxpayer can use the credit to offset its income taxes. We expect the buying taxpayer to generally purchase the credit at a discount to its full redeemable value.

General considerations under US GAAP

Accounting for refundable, transferable credits

We believe refundable tax credits are like government grants, even if they are also transferable. This is because the taxpayer can realize the benefit regardless of whether it has an income tax liability. US GAAP currently provides no specific guidance on how business entities should account for government grants and there is diversity in practice. In our experience, many companies have an existing policy to analogize to IAS 20 (government grants), Subtopic 958-605 (not-for-profit grants) or Subtopic 450-30 (gain contingencies) (see section 3.2).

Accounting for nonrefundable, transferable credits

US GAAP does not specifically address how the transferability feature in nonrefundable IRA credits affects the accounting for those credits. Based on discussions with the FASB staff, we believe there is more than one acceptable approach.

Topic 740

We believe it is most appropriate for companies to:

- apply Topic 740 to the IRA's nonrefundable, transferable credits (see section 3.1). In applying Topic 740, we believe a company may either consider or disregard expected transfers of the credits in assessing their realizability.
- If sold, recognize the sale proceeds and derecognize the carrying amount of the tax asset (i.e. the gain or loss) as adjustments to income tax expense or benefit.

We also believe it is acceptable for companies to recognize the gain or loss on sale of the credits in pretax income or loss.

Other approaches

In addition, we believe it is acceptable for companies to elect a policy to account for the credits like government grants. However, companies making this election should consider how future standard-setting on the accounting for government grants could impact their accounting. Section 3.2 addresses the current accounting for government grants and the related FASB project.

A third approach is an intent-based model whereby a company accounts for the credit based on how it expects to monetize the credit. Under this approach:

- if a company expects to use a credit to offset its income tax liability, it accounts for the credit under Topic 740 (see section 3.1); or
- if a company expects to transfer a credit, it accounts for the credit outside of income taxes, like a government grant (see section 3.2).

Some companies have applied this approach historically for other transferable credits. However, before concluding that use of the intent-based model is appropriate for the IRA's nonrefundable, transferable credits, we believe companies should consult with their accounting advisors, auditors and potentially the SEC staff. [Handbook 9.167bd]

Accounting for the transfer of the credit

When a company sells a transferable credit, it will need to determine the appropriate accounting guidance to apply to the sale based on the facts and circumstances. For example, if the credit is nonrefundable, it may be appropriate to consider the derecognition guidance in Subtopic 610-20 (sales of nonfinancial assets). However, if the credit is refundable, Topic 860 (transfers of financial assets) may apply. A company will also need to consider whether and how the ongoing requirements associated with increased and bonus credits affect the recognition of the sale or the income from the sale of those credits.

Accounting for the purchase of the credit

A company that acquires a credit may do so at a price that is discounted from the credit amount. Because the acquirer can use it only to offset its income tax liability, it recognizes and measures the acquired credit based on the principles of Topic 740. The difference between the purchase price and the Topic 740 measurement is recognized as a deferred credit. The deferred credit is recognized in income tax expense in proportion to the reversal of the associated deferred tax asset. Reversal of the deferred credit is generally included in determining the company's estimated annual effective tax rate if the related tax credit is expected to be used to offset a company's current year income tax liability. [Handbook 10.007, Example 10.3]

Example

A company purchases a $100 credit for $94 in Q2 2023.

At purchase, the company forecasts use of the entire credit on its 2023 tax return. Therefore, in Q2 the company recognizes the following:

- $100 credit as a reduction of its 2023 current income taxes payable; and
- $6 discount as a decrease to its estimated annual income tax expense for purposes of computing its estimated annual effective tax rate.

If the company instead expects to use only $50 of the credit in 2023, it recognizes the following:

- $50 of the credit as a reduction of its 2023 current income taxes payable;

- $50 of the credit as an increase to deferred tax assets;
- $3 of the discount (half, in proportion to half of the credit) as a decrease to its estimated annual income tax expense for purposes of computing its estimated annual effective tax rate; and
- $3 of the discount as a deferred credit that will be recognized in income tax expense in proportion to the reversal of the $50 deferred tax asset.

General considerations under IFRS Accounting Standards **(added Feb. 3, 2023)**

Accounting for refundable, transferable credits

Unlike US GAAP, IFRS Accounting Standards specifically provide guidance on the accounting for government grants. It appears that the IRA's refundable credits are government grants and should be accounted for under IAS 20, regardless of whether the credits are transferable. [Insights 4.3.10.10–10.15]

Accounting for nonrefundable, transferable credits

Unlike US GAAP, IFRS Accounting Standards do not specifically address the accounting for ITCs. As a result, companies need to choose an accounting approach, to be applied consistently, that best reflects the economic substance of the credits. This determination requires judgement in light of all relevant facts and circumstances.

It appears that in determining the economic substance of the nonrefundable, transferable credits for purposes of developing an accounting policy, a company may consider, among other factors, whether it generally expects to realize the benefits of the credits through reducing its taxable income or by transferring the credits to a third party.

If a company concludes that the economic substance of these credits is similar to a tax allowance, then we believe that it is appropriate to account for them by applying IAS 12. If a company concludes that the economic substance of these credits is similar to a government grant, then we believe that it is appropriate to account for them by applying IAS 20. Once the accounting policy is developed, a company should apply it consistently from period to period to all nonrefundable, transferable credits, regardless of how the benefits of the credits are actually realized at subsequent reporting dates – i.e. whether they reduce taxable income or are transferred to a third party.

Because US GAAP allows several policy choices, differences may arise in practice.

What questions should you be asking?

- Should we elect to sell or use our transferable credits? Do we expect taxable income in the near future to use the tax credits or is it worth it to sell, potentially at a discount?
- How does our selection of an accounting policy affect our company's performance measures?
- What effect could our transfer decision have on our Corporate AMT status?

KPMG resources

Delivering guidance and insights, KPMG Financial Reporting View is ready to inform your decision making. Stay up to date with our resources on the IRA and CHIPS.

Biden Administration tax legislation

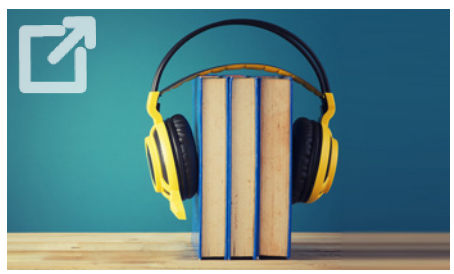
Our collection of resources to help you stay informed about the significant changes to the US tax landscape.

The CHIPS and Science Act of 2022

Read more about the 25% advanced investment tax credit for certain investments in semiconductor manufacturing.

Inflation Reduction Act of 2022

Read our analysis and observations on the significant law changes related to tax, climate change, energy and healthcare.



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Acknowledgments

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