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Deloitte Tax LLP | August 16, 2022

# Emerging ASC 740 Issues – Recent Tax Legislation

Tax Alert

## Overview

This month has seen two pieces of legislation that have significant tax-related provisions. The CHIPS Act of 2022 (the "CHIPS Act"), (H.R. 4346) creates a new advanced manufacturing investment credit under new Internal Revenue Code section 48D and was signed into law by President Biden on August 9, 2022. The Inflation Reduction Act (the "IRA"), (H.R. 5376), signed into law by President Biden on August 16, 2022, has a number of tax-related provisions, including (i) a 15-percent book minimum tax ("corporate AMT") on "adjusted financial statement income" (AFSI) of applicable corporations, *see* Tax Alert dated August 10, 2022: *US International Tax Alert - Corporate AMT Included in Inflation Reduction Act of 2022*; (ii) a plethora of clean energy tax incentives in the form of tax credits, some of which include a direct-pay option or transferability provisions, *see* Tax Alert dated August 12, 2022: *Clean energy credits and incentives in the Inflation Reduction Act of 2022 – details and observations*, and (iii) a 1-percent excise tax on certain corporate stock buybacks, *see* Tax Alert dated August 12, 2022: *Excise tax on repurchases of stock*.

Below are our current thoughts on the ASC 740 considerations with respect to each of the significant tax-related provisions. We expect these items to be the subject of further discussion and debate within the profession and, accordingly, **the views presented are "tentative" and subject to change**.

## Issues

### Corporate Alternative Minimum Tax

The corporate AMT has many similarities to the since repealed, pre-2018 U.S. alternative minimum tax system applicable to corporations. ASC 740 addressed that tax law and provided that "[i]n the U.S. federal tax jurisdiction, the applicable tax rate [for measuring U.S. federal deferred taxes] is the regular tax rate" and a deferred tax asset (DTA) would be recognized for alternative minimum tax credit carryforwards available under the bill if realization is more likely than not.

While we are continuing to analyze the tax, similar accounting may apply to the corporate AMT. Accordingly, under this approach, no remeasurement of

existing deferred tax assets and liabilities would be needed in the period of enactment. Rather, the tax effects of the corporate AMT (*i.e.*, increase in tax payable and related credit) would only be reflected in an entity's financial statements after the bill is actually effective (*i.e.*, beginning in 2023). More specifically, in each interim and annual period that an entity expects to owe corporate AMT it would recognize an increase in current tax expense along with a deferred tax asset for AMT credit carryforwards that would then need to be assessed for realization (*i.e.*, assessed for a valuation allowance).

**Potential interaction with valuation allowance assessment**

While deferred taxes will continue to be measured at the regular tax rate, the introduction of corporate AMT may also impact the assessment of the realizability of an entity's existing deferred tax assets. The interaction of the regular and corporate AMT tax systems on existing deferred tax assets is still being assessed, but could potentially lead to adjustments in the period of enactment (and/or subsequent periods) for entities that expect to be perpetually subject to the corporate AMT.

## Refundable Credits

The CHIPS Act allows for a direct pay election whereby a taxpayer may elect to treat the amount of section 48D tax credits they are entitled to as a direct payment against tax. A similar provision exists for a number of "applicable credits" contained in the IRA (*i.e.*, sections 30C, 45, 45Q, 45U, 45V, 45W, 45X, 45Y, 45Z, 48, 48C and 48E). As discussed in *section 2.7, Refundable Tax Credits* of our *Roadmap – Income Taxes (Nov. 2021),* if an entity has the ability to elect to treat the credit as a direct payment of tax and receive a refund of such payment even in the absence of any taxable income (*i.e.*, the entity is otherwise in a loss), we believe the tax credit represents a refundable credit that would be accounted for outside the scope of ASC 740.

U.S. GAAP has no specific authoritative guidance on the recognition and measurement of government assistance received by business entities. Accordingly, diversity in practice exists and multiple models under U.S. GAAP with respect to accounting for government assistance may be acceptable. For more information on the models entities generally apply by analogy to recognize and measure government grants, *see* *Deloitte's Heads Up, Volume 27, Issue 8* (last updated September 18, 2020), issued in the context of the CARES Act.

## Transferable Credits

The IRA also adds a transferability provision for a number of "eligible credits" (*i.e*., sections 30C, 45, 45Q, 45U, 45V, 45X 45Y, 45Z, 48, 48C and 48E). The transferability provision would allow an "eligible taxpayer" to elect to transfer (*i.e.*, sell) the credit, or some portion thereof, to an unrelated taxpayer.

As discussed in *section 2.7.1, Selling Income Tax Credits to Monetize Them* of our *Roadmap – Income Taxes (Nov. 2021)*, if the credit can be used only to reduce an income tax liability either of the entity that generated it or the entity to which it is sold and would never be refundable by the government, we believe that the credit would remain within the scope of ASC 740. In situations in which an entity does not have sufficient taxable income to use all or a portion of the income tax credit or in which using it might take multiple tax years, the entity might achieve a better economic benefit (*i.e.*, present value benefit) by selling the credit. In such situations, the entity that generated the credit would initially recognize and measure it in accordance with the recognition and measurement criteria of ASC 740. To the extent that the income tax credit does not reduce income taxes currently payable, the entity would recognize a DTA for the carryforward and assess it for realizability in a manner consistent with the sources of income cited in ASC 740-10-30-18. In

this regard, such assessment would be predicated upon the normal course of business (*i.e.*, an entity would not factor in its ability to sell the underlying credit as a basis for realizing the related DTA).

If the entity were to subsequently sell the income tax credit, such sale would be treated no differently than the sale of any other asset, with gain or loss recognized in pretax earnings for any difference between the proceeds received and the recorded carrying value (*i.e.*, the DTA for the income tax credit recognized in accordance with the guidance in ASC 740 on recognition and measurement).

We are aware of diversity in practice with respect to the accounting treatment for transferable credits and further discussion on this topic is expected.

## Stock Buyback Tax

The IRA adds new section 4501 that would impose a 1-percent excise tax on stock repurchases by publicly traded companies starting in 2023. Specifically, under the new section 4501, a covered corporation would be subject to a tax equal to 1 percent of (1) the fair market value of any stock of the corporation that is repurchased by such corporation (or certain affiliates) during any taxable year, with limited exceptions, less (2) the fair market value of any stock issued by the covered corporation (or certain affiliates) during the taxable year (including compensatory stock issuances). The 1-percent excise tax may also be imposed on acquisitions of stock in certain mergers or acquisitions involving covered corporations.

Because the tax is not based on a measure of income, the excise tax is not an income tax and therefore is not within the scope of ASC 740. U.S. GAAP does not, however, address the accounting for taxes paid in connection with the repurchase of stock. On the surface, such taxes may represent direct and incremental costs of repurchasing stock and therefore would be accounted for within equity. However, because the total tax obligation may be affected by other transactions involving an entity's own stock (*e.g.*, the impact of new share issuances), the ability to directly correlate the tax to an individual stock buyback is not as straightforward as it may seem on the surface. Additionally, the scope of the transactions subject to the tax is unclear (*e.g.*, it is unclear whether the tax would apply to repurchases of preferred stock including mandatorily redeemable preferred stock that is classified as a liability). Accordingly, further discussion on the accounting for this tax is expected.

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