Deloitte.

Deloitte Tax LLP | August 16, 2022 (Last updated November 8, 2022)

Emerging ASC 740 Issues – Recent Tax Legislation

Tax Alert

Overview

Two recent pieces of tax legislation have significant tax-related provisions. The CHIPS Act of 2022 (the "CHIPS Act"), (P.L. 117-167) 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"), (P.L. 117-169), 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*.

Effective Date Considerations (Added September 29, 2022)

As further discussed below, many of the impacts of the new legislation are effective for financial reporting periods and tax years beginning on or after January 1, 2023. Accordingly, the legislation is expected to have limited effects on financial reporting periods ending on or before December 31, 2022, except for potential valuation allowance impacts for perpetual corporate AMT taxpayers or potential adjustments to an entity's annual effective tax rate (AETR) related to certain credits.[1] However, SEC filers should consider disclosing, when material, the anticipated current and future impact of the newly enacted laws on the results of operations, financial position, liquidity, and capital resources in Management Discussion & Analysis (MD&A) as part of their 2022 quarterly and annual filings.

Accounting Considerations

The discussions and guidance in this Tax Alert reflect our current views, which are subject to change on the basis of additional input received or further developments in practice.

Issues

Corporate Alternative Minimum Tax (Updated September 29, 2022)

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 which would then be assessed for realization.

We believe that similar accounting will be applied 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 law is actually effective (*i.e.*, beginning in an entity's first reporting period and tax year that begins after December 31, 2022). More specifically, an entity that expects to owe corporate AMT for tax years beginning after December 31, 2022, would recognize an increase in current tax payable for such years 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). The resulting tax effects would be considered in determining the entity's annual effective tax rate in such future years.

Potential interaction with valuation allowance assessment

While deferred taxes will continue to be measured at the regular tax rate, the introduction of corporate AMT will have an effect on existing deferred tax assets in the regular tax system if an entity expects to be perpetually pay corporate AMT (*e.g.*, while a NOL for an entity that is expected to perpetually pay corporate AMT might result in a reduction in tax under the regular system, the NOL may not be available for corporate AMT purposes and the entity might pay corporate AMT tax on the income sheltered by the NOL in the regular tax system). When assessing the realizability of DTAs in the regular system for perpetual corporate AMT taxpayers, we believe two acceptable approaches exist.[2]

Under the first approach, the entity would assess the realizability of its deferred tax assets[3] based on all available information. If, for example, the expected tax benefit of an NOL is less than the reported amount because the utilization of the NOL will result in incremental corporate AMT, a valuation allowance would be required to reflect the actual amount of tax benefit that will be realized with respect to the NOL. Alternatively, the entity could assess the realizability of its deferred tax assets based solely on the regular tax system without taking into account amounts due under the corporate AMT system (*i.e.*, any incremental impact of the corporate AMT would be accounted for in the period the corporate AMT is incurred).

An illustration of these approaches for a perpetual corporate AMT taxpayer is as follows:

Assumptions:

- Entity A had $1,000 of pre-2018 NOL carryforwards and no corporate AMT credit or NOL carryforward.
- Entity A expects sufficient future income to fully utilize its pre-2018 NOL carryforward.

- Entity A expects to perpetually be a corporate AMT taxpayer and, accordingly, will need to record a full valuation allowance against any corporate AMT credit carryforwards that arise in future years.
- For simplicity, assume no other permanent or temporary differences or attributes.

	Regular Tax	Corporate AMT
Future pre-NOL AFSI & taxable income **A**	$1,000	$1,000
NOL deduction	(1,000)	0
Taxable income/AFSI **B**	$0	$1,000
Tax rate **C**	21%	15%
Taxes payable with NOL c/f **(B x C)**	$0	$150
Taxes payable without NOL c/f **(A x C)**	$210	$150

Approach 1 – The utilization of the NOL reduces the regular tax liability of $210 down to the corporate AMT liability of $150. As a result, the NOL only results in a reduction of future cash outflows of $60, necessitating a $150 valuation allowance against the $210 NOL DTA.

Approach 2 – The $150 incremental cost of corporate AMT would be accounted for in the period in which it arises, and no valuation allowance would be recorded against the $210 NOL DTA as there is sufficient regular taxable income expected in future years.

Entities that elect to follow the first approach would need to consider whether the impact of the new corporate AMT will require an adjustment to their valuation allowance against their deferred tax assets; any such adjustment would be recorded in the period of enactment (*i.e.*, August 2022). In addition, the IRA allows entities to reduce their corporate AMT tax liability by certain general business credits. Entities following the first approach that have a valuation allowance because of an inability to use such credits in the regular tax system would need to consider whether such credits may now be realizable as a result of 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. 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 (Updated November 8, 2022)

The IRA also adds a transferability provision for a number of "eligible credits". 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. 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.

Regardless of intent, 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 transferred and would never be refundable by the government, we believe that the credit should remain within the scope of ASC 740[4]. In such situations, the entity that generated the credit would 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. While we believe such an assessment would generally 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), we understand based on a technical inquiry with the FASB staff that it would also be acceptable to consider the expected sales proceeds when assessing realizability.

If the entity were to subsequently sell the income tax credit, we understand based on the same FASB staff technical inquiry that it would be most appropriate to reflect any proceeds and resulting gain/loss on the sale as a component of the tax provision. Alternatively, we believe the sale could 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 of the DTA for the income tax credit that was recognized in accordance with the guidance in ASC 740 on recognition and measurement.[5]

Transferee Considerations: The entity that purchases a transferable credit should generally record a deferred tax asset for the amount of tax credits purchased and a deferred credit for the difference between the amount paid and the deferred tax asset recognized in accordance with ASC 740 (such deferred credit does not represent a deferred tax liability). The deferred credit will be reversed and recognized as an income tax benefit in proportion to the deferred tax expense recognized on realization of the associated deferred tax asset (*i.e.*, as the credits are utilized on the tax return).

Stock Buyback Tax (Updated September 29, 2022)

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 specifically address the accounting for taxes paid in connection with the repurchase of stock. Given the lack of U.S. GAAP on the issue, entities may consider the guidance in AICPA Technical Questions and Answers 4110.09 – *Costs Incurred to Acquire Treasury Stock*. TPA 4110.09 indicates that direct and incremental legal and accounting costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock. Therefore, it is acceptable to account for an excise tax obligation that results from the repurchase of common stock classified within permanent equity as a cost of

the treasury stock transaction. Any reductions in such excise tax obligation arising from share issuances would also be recognized as part of the original treasury stock transaction regardless of the nature of such share issuances. Additional considerations are necessary when the excise tax obligation arises from redemptions of preferred stock. Such excise tax obligations would be recognized as a cost of redeeming the preferred stock. The accounting for redemptions of preferred stock differs depending on the classification of the preferred stock as permanent equity, temporary equity, or a liability. A systematic and rationale allocation approach would be required to account for the effect of share issuances on the excise tax obligation when an entity has repurchases of both common stock and preferred stock during a taxable period.

Disclosure Considerations (Added September 29, 2022)

While ASC 740 does not explicitly require disclosure of new tax laws, if an entity is required to reassess its valuation allowance on existing tax attributes or make a significant adjustment to its AETR affecting its resulting interim income tax provision in the period of enactment, the entity should consider the footnote disclosure requirements in ASC-740-270-50-1 in its interim financial statements, which states:

> The reasons for significant variations in the customary relationship between income tax expense and pretax accounting income shall be disclosed in the interim period financial statements if they are not otherwise apparent from the financial statements or from the nature of the entity's business.

ASU 2021-10, *Disclosures by Business Entities About Government Assistance*, requires business entities to provide certain disclosures when they (1) have received government assistance and (2) use a grant or contribution accounting model by analogy to other accounting guidance (*e.g.*, a grant model under IAS 20 or ASC 958-605). Such ASU is effective for all entities for fiscal years beginning after December 15, 2021. Entities that account for credits that are outside the scope of ASC 740 should consider these requirements. See Deloitte's Head's Up, *FASB Provides Guidance on Disclosures Regarding Government Assistance* (December 3, 2021).

SEC Regulation S-K, Item 303(a) requires entities to provide certain forward-looking information related to “material events and uncertainties known to management that would cause reported financial information not to be necessarily indicative of future operating results or of future financial condition.” Accordingly, entities should consider disclosing, when material, the anticipated current and future impact of the newly enacted laws on their results of operations, financial position, liquidity, and capital resources. In addition, entities should consider providing disclosures in the critical accounting estimates section of MD&A to the extent that the changes could materially affect existing assumptions used in estimating tax-related balances.

Footnotes

[1]The IRA extended a number of existing tax credits. To the extent an entity will now receive an increased (or decreased) current-year benefit for a tax credit that is within the scope of ASC 740, it should recognize such benefit, to the extent reliably estimable, in the period of enactment, generally through an adjustment to its annual effective tax rate. Further, noncalendar year-end entities will need to assess whether they would be eligible to receive and, if so, would anticipate generating new tax credits subsequent to December 31, 2022, but prior to their noncalendar year-end. Such credits, if estimable, would likewise be recognized in the period of enactment — generally through an adjustment of its annual effective tax rate.
[2]An entity would need to make a policy choice, which would then be consistently applied.

[3]Related to deductible temporary differences or attributes.
[4]While we believe accounting for the credits within the scope of ASC 740 is most appropriate, consistent with feedback received from the FASB staff, we believe it would also be acceptable for a company to account for the transferable credits in a manner similar to refundable credits as the company generating the credit does not need taxable income in order to monetize the credit.
[5]If an entity's policy is to reflect gain or loss in pretax earnings it would not be appropriate to consider the expected proceeds when assessing realizability of the related DTA.

Deloitte.com | Unsubscribe | Manage email preferences | Legal | Privacy

30 Rockefeller Plaza
New York, NY 10112-0015
United States

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see www.deloitte.com/us/about for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2022 Deloitte Development LLC. All rights reserved.