What's News in Tax

Analysis that matters from Washington National Tax

Accounting for Tax Credits

November 16, 2022 (update of September 14, 2022 article)

by Katie Morgan, Ken Kazmierski, Jenna Summer, and Ashby Corum Washington National Tax

There are many different types of tax credits available to entities, including several credits that have been created, modified, or extended as a result of recent federal legislation enacted in the United States. This article summarizes some accounting considerations entities should keep in mind when evaluating the impact of tax credits.

Background

Credits that are claimed on income tax filings can take many different forms. Generally speaking, these credits can be classified as nonrefundable credits or refundable credits. Certain credits may be transferable. Some credits may have multiple requirements to generate the credit, generate an increased or bonus amount of credit, avoid a recapture of the credit or avoid incurring a penalty. Accordingly, consideration should be given as to the appropriate unit of account for evaluating the credit and whether it should be bifurcated into separate units of account. Correctly identifying the underlying characteristics of tax credits is critical to appropriately accounting for and reflecting these items within financial statements.

Refundable Credits

Refundable credits are credits that may be applied as a payment against tax with any excess being eligible to be refunded in full. Since an entity may obtain a refund despite being in a taxable loss position, the credit is not dependent on an entity's tax liability. Given the nature of these types of credits, while the claim may be filed or administered in connection with the income tax return, the tax credits are not considered within the scope of ASC 740 and are not recorded as an

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

adjustment to income tax expense (benefit). Instead, an entity should account for a refundable credit consistent with its policies on accounting for government grants. We believe an entity's intended manner of monetizing a refundable tax credit is not relevant to the determination that it is outside the scope of ASC 740. Accordingly, we believe a refundable tax credit, including when such refundable credit is also transferable, is outside the scope of ASC 740 even if an entity expects to apply the credit against an income tax liability.

US GAAP does not address the accounting for government grants received by a business entity that are outside the scope of ASC 740 and there is diversity in practice. Many companies have existing accounting policies analogizing to IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance* under IFRS® Accounting Standards. Other acceptable approaches may include analogizing to ASC 958-605, *Not-for-profit Entities – Revenue Recognition*, or ASC 450-30, *Gain Contingencies*.

Applying IAS 20 by Analogy

Under IAS 20, a company does not recognize the benefit of a government grant until it has *reasonable assurance* (which we understand the Securities and Exchange Commission (SEC) staff equates to *probable* under US GAAP) that it will comply with the relevant conditions and the grant will be received. Accordingly, an entity applying IAS 20 by analogy should not recognize the benefit of a refundable credit unless it is US GAAP *probable* of being sustained. *Probable* under US GAAP is a higher level of assurance than the *more likely than not* standard for evaluating uncertainty under ASC 740.

An entity recognizes the benefit of tax credits accounted for by applying IAS 20 in pretax income on a systematic basis in line with its recognition of the expenses that the grant is intended to compensate. For grants associated with assets, the benefit is typically recognized over the useful life of the asset. For grants associated with income, the benefit is often recognized as the tax credit arises as either an offset to the related costs or as other income.

IAS 20 permits two methods for presenting government grants related to assets. The first method presents the grant as deferred income on the balance sheet and in earnings as either income or a reduction in expense (typically depreciation expense). The second method presents the grant as a reduction of the financial statement carrying amount of the asset and recognizes the income over the life of the asset through reduced depreciation expense.

To the extent that a reduction in tax basis under the tax law occurs that is not equal to the asset-based grant, temporary differences may arise given the difference in the financial statement carrying amount and tax basis of the related asset (taking into consideration the amount, if any, reported as deferred income). Any temporary differences are assessed in accordance with ASC 740 to determine if deferred taxes are recognized. We believe entities generally should apply the simultaneous equation approach under ASC 740-10-25-51 to recognize deferred taxes, but there may be other acceptable approaches. Under the simultaneous equation approach, any tax effects of asset purchases that are not business combinations in which the amount paid differs from the tax basis of the asset shall not result in immediate income statement recognition. As such, the financial statement carrying amount of the asset is further adjusted for any deferred tax consequences; however, this results in a circular calculation. To

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

solve for the circularity, an entity applies the simultaneous equation,[1] which will provide the appropriate amount of deferred taxes to ultimately equal the applicable tax rate applied to the difference between the financial statement carrying amount and tax basis of the related asset.

To the extent a reduction in tax basis under the tax law is equal to the grant, regardless of which method is selected for balance sheet presentation, it is not expected that temporary differences will arise as the financial statement carrying amount, as adjusted for deferred income, if any, and tax basis of the asset are an equal amount. As such, when a reduction in tax basis is equal to the grant, no temporary difference or related deferred taxes may arise.

Applying ASC 958-605 by Analogy

While ASC 958-605 excludes transfers of assets from governmental entities to business entities, business entities are not prohibited from analogizing to this guidance in accounting for government grants. Income from 'conditional' contributions is recognized under ASC 958-605 when the conditions on which the contribution depends are substantially met. This is determined without considering the likelihood that the conditions will be met.

Applying ASC 450-30 by Analogy

ASC 450-30 provides that a contingency that might result in a gain usually should not be reflected in the financial statements because to do so might be to recognize revenue before its realization. An entity that applies ASC 450-30 by analogy does not recognize income related to the grant (in this case, the tax credit) until it is realized or realizable.

Disclosure Considerations

If an entity analogizes to either IAS 20 or ASC 958-605, it should consider disclosure requirements in accordance with ASC 832, *Government Assistance*, for annual periods beginning after December 15, 2021.[2] The disclosure requirements include the nature of the transactions, including the form of the assistance, the accounting policy used to account for the transaction, the line items on the balance sheet and income statement that are affected and the amounts applicable to each financial statement line item, and significant terms and conditions of the transactions.[3]

If an entity analogizes to ASC 450-30, it should consider disclosures related to a contingency that might result in a gain. However, adequate care shall be exercised to avoid misleading implications as to the likelihood of realization. Specific disclosures should be sufficiently specific to enable a reader to understand the scope of the contingencies affecting the entity.

---

[1] The simultaneous equation determines the appropriate deferred taxes by applying the preliminary temporary difference times the tax rate over one minus the tax rate.

[2] ASC 832 was codified through the issuance of ASU 2021-10, *Disclosures by Business Entities about Government Assistance*, to increase the transparency of government assistance within an entity's financial statements.

[3] ASC 832-10-50-2 and 50-3.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Nonrefundable, Nontransferable Credits

A nonrefundable, nontransferable credit may be applied against income taxes, however it contains no refund mechanism and is accordingly dependent on an entity having a tax liability to support realization. Therefore, these credits may generally be applied against an income tax liability with any excess credit, depending on the underlying provisions of the tax law governing the credit, resulting in potential carryback to prior tax years or carryforward to future tax years, and may expire if not utilized during the requisite carryforward period. A nonrefundable credit that may be applied against income taxes and that is not transferable is generally within the scope of ASC 740.

The terms and conditions of nonrefundable credits may need to be analyzed to assess how the credit should be accounted for within an entity's financial statements. Nonrefundable credits within the scope of ASC 740 are generally accounted for following the investment tax credit guidance discussed below or as an income tax benefit in the year the credit arises.

There may be situations in which tax credits are subject to recapture or a penalty if certain requirements are not met. When there is the potential for recapture or a penalty for credits within the scope of ASC 740, an entity must assess whether it expects to comply with the requirements. An entity derecognizes or remeasures the benefit of tax credits for which it does not expect to comply with the requirements to avoid recapture or incurring a penalty.

An investment tax credit is a nonrefundable credit for the acquisition of an asset that falls within the scope of ASC 740. An investment tax credit is granted in the form of a credit, rather than an exclusion or deduction from taxable income, may be based on a specified percentage cost of specified assets and may be used to reduce the amount of income taxes payable. In some instances, an investment tax credit may have provisions that result in a reduction to the tax basis of the property acquired. Acceptable accounting methods for investment tax credits are either the deferral method or the flow-through method, with the deferral method representing the preferable approach.[4]

Deferral Method of Accounting for Investment Tax Credits

When an entity elects the deferral method of accounting for investment tax credits, the related benefit is reflected in income over the life of the acquired property. If the investment tax credit arises on the tax return over multiple years, the amount reflected in income is based on an estimate of the total investment tax credit to be generated for the asset over the asset's life. The deferral of the benefit of the investment tax credit is presented either as a reduction of the financial statement carrying amount of the property or as deferred income.[5]

If the deferred benefit of an investment tax credit is presented as a reduction of the financial statement carrying amount of the related property, it is subsequently recognized as a reduction to either depreciation expense or income tax expense. This represents a policy election that should be consistently applied. Alternatively, if the deferred benefit of the investment tax credit is presented as

[4] ASC 740-10-25-46.

[5] ASC 740-10-45-27.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

deferred income, it is subsequently recognized (through amortization of the deferred income balance) as a reduction to income tax expense.

The benefit of an investment tax credit should be recognized ratably over either the productive life of the specific asset acquired that gave rise to the investment tax credit or the composite productive life of all depreciable assets that gave rise to the investment tax credit. The period over which the benefit is recognized is the same regardless of whether presenting the investment tax credit as a reduction of the financial statement carrying amount or as deferred income.

The amount of an investment tax credit recognized as a reduction of the financial statement carrying amount or as deferred income along with any tax basis reduction as a result of generating the credit may result in a temporary difference for which deferred taxes should be recognized. The difference between the financial statement carrying amount of the property and its tax basis after considering any adjustment to the tax basis of the property under applicable tax law may result in a deferred tax asset or liability. When the deferred tax asset or liability is established, an entity should apply an accounting policy election to recognize the related income tax expense (benefit) as either an immediate adjustment to income tax expense or a further adjustment to the financial statement carrying amount of the property. If an accounting policy election to recognize the income tax expense (benefit) is made as a further adjustment to the financial statement carrying amount of the property it will change the temporary difference and create a circular calculation. Similar to the guidance above, ASC 740-10-25-51 addresses the accounting for analogous types of temporary differences and provides that there shall be no immediate income statement recognition. This guidance requires the measurement of deferred taxes through the simultaneous equation that generates a corresponding adjustment to the financial statement carrying amount of the related asset. The resultant deferred tax amount should equal the tax effect of the difference between the net financial statement carrying amount and the tax basis of the property.

Flow-through Method of Accounting for Investment Tax Credits

When an entity uses the flow-through method of accounting for investment tax credits, the credit is recognized as a reduction in income tax expense in the year it arises. If the investment tax credit arises on the tax return over multiple years, the amount reflected in income is based on the amount that arises during the year. A deferred tax asset (net of valuation allowance) should be recognized for unused credits arising in the current year that are available to offset income taxes in future years. The entire tax benefit from the tax credit should be presented as an adjustment to income tax expense (benefit) and not as a reduction to operating expense. A credit arises in the year it becomes available to offset income taxes on the tax return.[6]

As with the accounting under the deferral method discussed above, deferred taxes are established for the difference between the financial statement carrying amount of the asset and its tax basis, if any, when the flow-through method is applied. This typically occurs when the investment tax credit results in

---

[6] ASC 740-10-25-46.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

a reduction of the tax basis of the property and results in the deferred tax amount associated with the taxable temporary difference recognized as an adjustment to income tax expense (benefit).

Disclosure Considerations

When an entity reports material investment tax credits, it must disclose the method of accounting followed and the amounts related to investment tax credits.[7] Further, the significant components of income tax expense attributable to continuing operations must be disclosed, including investment tax credits and government grants within the scope of ASC 740.[8] To the extent any unused income tax credits result in carryforwards to future tax years, the amounts and expiration dates are required to be disclosed.[9]

Nonrefundable, Transferable Credits

In some jurisdictions, nonrefundable credits may either offset the entity's income tax liability or be transferred to a third party. These are commonly referred to as transferable credits. While we believe there is more than one acceptable approach to account for these credits, we believe it is most appropriate for entities to account for nonrefundable, transferable credits within the scope of ASC 740. When doing so, we believe an entity may either consider or disregard expected transfers of the credits in assessing the realizability of the credits. When applying an ASC 740 approach, upon sale or transfer of the credit, an entity recognizes the sale proceeds and derecognize the carrying amount of the tax asset as adjustments to income tax expense (benefit); however, we also believe it is acceptable for entities to recognize the gain (loss) on the sale of the credits in pretax income (loss).

We also believe it is acceptable for entities to elect a policy to account for the nonrefundable, transferable credits like government grants. See the above *Refundable Credits* section for discussion on accounting for government grants.

A third approach is to account for nonrefundable, transferable credits based on the entity's intent. If an entity expects to use all or a portion of the credit to offset its income tax liability it would account for the portion of the credit expected to be utilized to satisfy income tax liabilities in accordance with ASC 740. Alternatively, if the entity expects to transfer all or a portion of the credit, it accounts for the portion expected to be transferred outside of ASC 740, like a government grant. Some companies have applied this approach historically for certain transferable credits. However, prior to concluding that use of the intent-based model is appropriate for recently enacted federal nonrefundable, transferable credits, we believe companies should consult with its accounting advisors, auditors, and potentially the SEC staff.

Accounting for the transfer of a credit

When a sale of a transferable credit occurs, an entity may need to assess the appropriate accounting guidance based upon its facts and circumstances. For example, if the credit is nonrefundable, it may be appropriate to consider the derecognition guidance in ASC 610-20, *Gains and Losses from the*

---

7 ASC 740-10-50-20.

8 ASC 740-10-50-9(c) and 50-9(d).

9 ASC 740-10-50-3(a).

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Derecognition of Nonfinancial Assets. Entities are reminded, however, that if they apply ASC 740 to the credits pre-sale, we believe it is most appropriate to present the gain or loss, if any, in income tax expense (benefit). Companies that consider the proceeds of the sale in applying ASC 740 before the sale occurs are less likely to recognize significant gains or losses in the period in which the sale occurs.

If the credit is refundable, ASC 860-20, *Sales of Financial Assets,* may apply.

An entity would also need to determine whether and how the credit's ongoing requirements, if any, could affect the recognition of the sale or the income from the sale.

Purchase of a credit

An entity that acquires a credit may do so at a price that differs from the amount of the credit obtained. Since the acquirer of a nonrefundable credit generally cannot transfer the credit again and can only utilize the credit to offset its income tax liability, it recognizes and measures the acquired credit based on the principles of ASC 740, with any excess of the amount of the deferred tax asset over the price of the acquisition reflected as a deferred credit that is amortized into income tax expense (benefit) in proportion to the reversal of the related deferred tax asset. The related deferred credit is generally included in determining the entity's estimated annual effective tax rate.

Illustration 1: Refundable Tax Credits

ABC Corporation operates in Country X and receives a credit on its income tax form that is treated as a payment such that the excess of the credit over the income tax liability for the year may be refunded in cash. The credit is equal to 30 percent of the basis of certain qualifying assets placed in service during the year. The grant is excludable from taxable income and ABC Corporation must reduce its tax basis in the property by 50 percent of the credit amount. ABC Corporation accounts for government grants by analogizing to IAS 20 and has a policy to present grants as a reduction of the financial statement carrying amount of the asset. ABC Corporation has a 21 precent statutory income tax rate.

On January 1, 20X4, ABC Corporation purchases $1 million of qualifying assets that will be depreciated for both financial statement and income tax purposes on a straight-line basis over a five-year period. Since the asset will generate a refundable tax credit, ABC Corporation concludes the credit is outside the scope of ASC 740 and accounts for the credit as a government grant in accordance with its existing accounting policies. At the time of the purchase, ABC Corporation has reasonable assurance it will generate the full 30 percent credit and expects to comply with any requirements to avoid recapture or penalties. ABC Corporation initially reflects the following entry upon acquisition of the related asset:

Account	Debit (credit)	Notes
Qualifying assets	700,000	Total acquisition of $1,000,000, less $300,000 credit
Grant receivable	300,000	$1,000,000 acquisition at 30 percent credit rate
Cash	(1,000,000)	

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

As the tax basis in the qualifying assets is reduced by 50 percent of the credit, the tax basis is adjusted to $850,000[10] which differs from the $700,000 initial financial statement carrying amount of the asset. Consequently, ABC Corporation measures the related deferred tax asset using a simultaneous equation that generates a corresponding adjustment to the financial statement carrying amount of the qualifying assets and the following entry is recorded:

Account	Debit (credit)	Notes
Deferred tax asset	39,873	($850,000 tax basis - $660.127 carrying amount) x 21 percent
Qualifying assets	(39,873)	$150,000 x 21 percent / (1-21 percent)

The tax basis of $850,000 less the adjusted financial statement carrying amount of $660,127 results in a deductible temporary difference of $189,873 and a related deferred tax asset of $39,873 when applying the 21 percent statutory income tax rate.

For the year ended December 31, 20X4, ABC Corporation has financial statement pretax income of $387,975, and taxable income of $350,000, with the $37,975 difference arising solely from the excess of tax depreciation expense over the financial statement amount for the qualifying assets. After 20X4 activity, the tax basis and financial statement carrying amount of the qualifying assets are $680,000 and $528,102, respectively, resulting in a deductible temporary difference of $151,898 and a resultant deferred tax asset of $31,898. The following entries are recognized to reflect current and deferred tax expense related to the 20X4 activity:

Account	Debit (credit)	Notes
Current tax expense	73,500	$350,000 taxable income x 21 percent
Income taxes payable	(73,500)	
Deferred tax expense	7,975	$31,898 end of year deferred tax asset less $39,873 beginning of year deferred tax asset
Deferred tax asset	(7,975)	

Illustration 2: Investment Tax Credits

ABC Corporation operates in Country X and receives an investment tax credit for 50 percent of the purchase price of certain qualifying assets. There is no limitation on how much of a given year’s income taxes payable may be offset by the credit and unused credits may be carried forward indefinitely, but

[10] $1 million cost of the qualifying assets less $150,000 basis reduction ($300,000 credit x 50 percent).

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

not refunded. No reduction in the tax basis of the qualifying assets is required under operation of the tax law.

On December 31, 20X3, ABC Corporation acquires and places in service a $100,000 qualifying asset that will be depreciated for both financial statement and tax purposes on a straight-line basis over five years. The qualifying asset qualifies for a $50,000 investment tax credit, which is fully utilized on the 20X3 tax return. ABC Corporation expects to comply with any requirements to avoid recapture or penalties, has a 21 percent statutory income tax rate and does not require a valuation allowance against its deferred tax assets. The following entries are based upon the following scenarios:

- Deferral method:(1) ABC Corporation elects the deferral method with an accounting policy to present the tax benefit as a reduction to the financial statement carrying amount of the asset, an accounting policy to record the corresponding deferred tax benefit from any initial basis difference as an immediate adjustment to income tax expense and a policy election to record the subsequent recognition of the deferred benefit as a reduction to income tax expense.
- Deferral method:(2) ABC Corporation elects the deferral method with an accounting policy to present the tax benefit as deferred income and an accounting policy to record the corresponding deferred tax benefit from any initial basis difference as an immediate adjustment to income tax expense.
- Deferral method:(3) ABC Corporation elects the deferral method with an accounting policy to present the tax benefit as a reduction to the financial statement carrying amount of the asset, an accounting policy to record the corresponding deferred tax benefit from any initial basis difference as a further adjustment to the financial statement carrying amount of the asset and a policy election to record the amortization of the investment tax credit as a reduction to depreciation expense.
- Flow-through method: ABC Corporation elects the flow-through method.

ABC Corporation initially records the following entries upon acquisition of the qualifying assets in 20X3:

	Debit (credit)			
Account	Deferral method (1)	Deferral method (2)	Deferral method (3)	Flow-through method
Qualifying Assets	100,000	100,000	100,000	100,000
Cash	(100,000)	(100,000)	(100,000)	(100,000)
Income taxes payable	50,000	50,000	50,000	50,000
Contra-asset	(50,000)	-	(50,000)	-
Deferred income	-	(50,000)	-	-
Current tax benefit	-	-	-	(50,000)

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

ABC recognizes deferred tax consequences for the difference between the financial statement carrying amount and tax basis of the qualifying assets and reflects the following entries in 20X3:

	Debit (credit)			
Account	Deferral method [1]	Deferral method [2]	Deferral method [3]	Flow-through method
Deferred tax asset	10,500	10,500	13,291[A]	-
Deferred tax benefit	(10,500)	(10,500)	-	-
Contra-asset	-	-	(13,291)	-

[A] $50,000 initial deductible temporary difference x (21 percent over (1-21 percent)) resulting in a net financial statement carrying amount of $36,709

For the year ended December 31, 20X4, ABC Corporation incurs the following:

	Debit (credit)			
Account	Deferral method [1]	Deferral method [2]	Deferral method [3]	Flow-through method
Pretax income before depreciation expense	60,000	60,000	60,000	60,000
Financial statement depreciation expense	20,000	20,000	7,342[A]	20,000
Pretax income	40,000	40,000	52,658	40,000
Tax depreciation expense	20,000	20,000	20,000	20,000
Net financial statement carrying amount at 12/31/20X4	40,000 [B]	80,000	29,367 [C]	80,000
Tax basis at 12/31/20X4	80,000	80,000	80,000	80,000
Deferred income amortization	-	10,000	-	-
Unamortized deferred income at 12/31/20X4	-	40,000	-	-
Deferred tax asset at 12/31/20X4	8,400	8,400	10,633	-

[A] $36,709 over five years
[B] $50,000 beginning net financial statement carrying amount, less $20,000 of financial statement depreciation, plus $10,000 amortization of investment tax credit contra asset
[C] $36,709 beginning net financial statement carrying amount, less $7,432 of financial statement depreciation expense

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

As a result of the 20X4 activity, ABC Corporation records the following entries:

	Debit (credit)			
Account	Deferral method [1]	Deferral method [2]	Deferral method [3]	Flow-through method
Current tax expense[A]	8,400	8,400	8,400	8,400
Income taxes payable	(8,400)	(8,400)	(8,400)	(8,400)
Deferred tax expense	2,100[B]	2,100[B]	2,658[D]	-
Deferred tax asset	(2,100)	(2,100)	(2,658)	-
Deferred income	-	10,000[C]	-	-
Contra-asset	10,000	-	-	-
Current tax benefit[E]	(10,000)	(10,000)	-	-

[A] $40,000 taxable income at 21 percent statutory income tax rate
[B] Change in beginning of year deferred tax asset of $10,500 and end of year deferred tax asset of $8,400
[C] Amortization of deferred income ($50,000 over five years) reflected as a reduction to income tax expense
[D] Change in the beginning of year deferred tax asset of $13,291 and the end of year deferred tax asset of $10,633
[E] The benefit of the amortization is commonly included in the current tax benefit caption, but is also disclosed in accordance with ASC 740-10-50-9(c)

ABC Corporation's activity for 20X4 can be summarized as follows:

Item	Deferral method [1]	Deferral method [2]	Deferral method [3]	Flow-through method
Pretax income	40,000	40,000	52,658	40,000
Income tax expense	500	500	11,058	8,400
Net income	39,500	39,500	41,600	31,600
Effective tax rate	1%	1%	21%	21%

Regardless of the methodology applied, assuming the income for 20X5 through 20X8 is the same as 20X4, ABC Corporation's activities provided $208,000 of net cash flow for the 20X3 to 20X8 period ($60,000 of pre-depreciation income x 5 years, plus the $50,000 tax credit, less $42,000 of income taxes incurred [$300,000 of pre-depreciation income less $100,000 of tax depreciation x 21 percent], less $100,000 for the cost of the asset) under all the scenarios. The $208,000 of net cash flow resulted in net income of $208,000 as follows:

- Deferral method [1] - $10,500 in 20X3, plus $39,500 x 5 in 20X4 – 20X8
- Deferral method [2] - $10,500 in 20X3, plus $39,500 x 5 in 20X4 – 20X8
- Deferral method [3] - $41,600 x 5 in 20X4 – 20X8
- Flow-through method - $50,000 in 20X3, plus $31,600 x 5 in 20X4 – 20X8

As demonstrated by the scenarios above, depending on an entity's accounting policy elections, multiple potential outcomes and accounting approaches may be appropriate.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Conclusion

When evaluating the accounting consequences of tax credits, an entity should determine the underlying characteristics of the credit, its desired accounting policies and if accounting policies have been previously established. Entities should also consider if any financial statement disclosures are necessary.

Related Content

KPMG Handbook: Accounting for income taxes

KPMG Handbook: Diverse accounting for energy tax credits

□□□□

The information in this article is not intended to be "written advice concerning one or more federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230 because the content is issued for general informational purposes only. The information contained in this article is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author or authors only, and does not necessarily represent the views or professional advice of KPMG LLP.

© 2022 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.