Accounting for tax credits generated by pass-through entities

March 18, 2024

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Recent legislation has introduced or modified several tax credits available to entities in the United States, including introducing both refundable and nonrefundable, transferable credits at the federal level for the first time. Pass-through entities, such as entities taxed as partnerships, are one of the more popular methods to structure projects that generate tax credits. This article summarizes certain accounting considerations entities should keep in mind when evaluating the impact of tax credits generated by pass-through entities.

Background

Entities typically generate tax credits either directly through participation in certain activities or ownership of qualifying property, or indirectly through ownership of interests in pass-through entities. For tax credits that are generated directly, entities consider whether the tax credit is refundable or nonrefundable and whether it is transferrable or nontransferable to determine the appropriate accounting model to apply. However, for tax credits that are generated indirectly through investments in pass-through entities, the appropriate accounting model for the investment may be dependent on the accounting policies of the investor.

Developers of projects that generate tax credits, commonly referred to as sponsors, may seek to monetize the tax credits by partnering with entities that may utilize the income tax benefits, commonly referred to as tax equity investors. These arrangements generally result in tax equity investors making investments in a pass-through entity that will generate tax credits and tax deductions that are passed through to the tax equity investors. The tax equity investors receive a return from the investment through allocated tax credits and losses, cash distributions and redemptions. In the arrangement, the sponsor of the project typically retains a greater percentage of the pass-through entity's recognized net assets.

In other situations, investors may have an investment in a pass-through entity that happens to generate significant tax credits, without being formed with a primary objective of monetizing tax credits.

This article recounts the accounting for refundable and nonrefundable, transferable tax credits generated directly by taxable entities, then focuses on the accounting by pass-through entities that generate such credits and the investors in those entities that under the consolidation guidance in ASC 810, *Consolidation* and the equity method in accordance with ASC 323, *Investments — Equity Method and Joint Ventures.*

Accounting for tax credits directly generated

Accounting for transferable credits generated directly by a taxable entity

U.S. GAAP does not specifically address how the transferability feature in nonrefundable credits affects the accounting for those credits; consequently, based upon discussions with the Financial Accounting Standards Board staff, we believe there is more than one acceptable approach.

We believe it is most appropriate for entities to apply ASC 740, *Income Taxes*, in accounting for nonrefundable, transferable credits by which an entity either recognizes the credit in income tax expense (benefit) in the year the credit arises or over the productive life of the underlying asset to which the credit relates, depending on the nature of the credit. In applying ASC 740, we believe an entity may either consider or disregard expected transfers of the credits in assessing the realizability of any deferred tax assets for nonrefundable, transferable credits as part of the valuation allowance analysis.

However, another acceptable accounting approach for nonrefundable, transferable credits is to apply a government grant approach. While there is diversity in practice in accounting for government grants, many entities analogize to one of three primary accounting models:

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- **Grant model**, based on IAS 20, Accounting for Government Grants and Disclosure of Government Assistance under IFRS® Accounting Standards;
- **Contribution model**, based on ASC 958-605, Not-for-Profit Entities – Revenue Recognition; or
- **Gain contingency model**, based on ASC 450-30, Gain Contingencies.[1]

The remainder of this article is written assuming an entity uses the grant model, analogizing to IAS 20, which we have observed is generally the more commonly applied policy on accounting for government grants by for-profit entities.

Refundable credits, whether transferable or not, are government grants and therefore should be accounted for consistent with an entity's policy on accounting for government grants.

Refer to the KPMG Tax credits handbook for additional discussion on accounting for transferable credits.

Accounting for nonrefundable, transferable and refundable credits generated directly by a pass-through entity

The accounting approaches discussed above for taxable entities are generally available to pass-through entities that directly generate tax credits; however, there can be meaningful differences in how they are applied due to the different nature of taxable entities and pass-through entities.

If a pass-through entity applies ASC 740 to nonrefundable, transferable credits that are generated directly through participation in certain activities or ownership of qualifying property, the entity remains nontaxable under the tax law and its taxable income and losses continue to flow through to its partners. Accordingly, we believe any tax credits generated by a pass-through entity that applies ASC 740 should be attributed to its owners with no deferred tax asset recognized in the pass-through entity's separate financial statements. If such pass-through entity applying ASC 740 generates tax credits that are sold, we believe the pass-through entity would present any sale proceeds directly in equity as received, unless the pass-through entity has an obligation to distribute the proceeds to the investor, in which case it would recognize a liability until paid to the investor. We do not believe a pass-through entity applying ASC 740 to nonrefundable, transferable credits would recognize any amounts related to the credits in income. If such pass-through entity allocates the credit to its investors, then we believe there would be no accounting at the pass-through entity.

When a pass-through entity applies the grant model tax credits that it directly generated, we believe the entity would present the benefit of the credits in pretax income, following its policy on accounting for government grants. We believe this accounting model should apply regardless of whether the pass-through entity expects to sell the credits or allocate them to its owners. However, when measuring the amount of the benefit under the grant model, we believe the pass-through entity should consider its intent to sell the credit or allocate it to its investors. If the pass-through entity expects to allocate the credit to its investors, we believe the benefit should be measured at its full undiscounted amount. Alternatively, if such pass-through entity expects to sell the credit to a third party, then we believe the benefit should be measured at fair value or a nominal value of zero. [2]

From a balance sheet perspective, we believe a pass-through entity should recognize an asset if it meets the recognition criteria under IAS 20. That is, when it has reasonable assurance that (1) it will comply with

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[1] See section 2.2 of the KPMG *Tax Credits* handbook (May 2023) for further discussion on accounting for tax credits as government grants.

[2] Although IAS 20 includes a policy choice to use a nominal value, we believe entities should consult with accounting advisors, auditors and potentially the SEC staff before concluding that it is appropriate to measure the credit at a nominal value of zero.

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the grant's relevant conditions and (2) the grant will be received.[3] This asset would be derecognized with an offsetting adjustment to equity upon (1) receiving consideration for the credits, such as under a direct pay mechanism, (2) selling the credits or (3) allocating the credits to its owners.

Accounting for tax credits indirectly generated through an investment in a pass-through entity

Accounting by an investor with a consolidated pass-through entity

We believe the financial statements of an investor (parent), when it consolidates a pass-through entity that generates credits, has the same accounting policy choices for tax credits available to them as an entity that directly generates tax credits. In situations where accounting policy elections are available, such as for nonrefundable, transferable credits, we believe an investor and its consolidated pass-through entity should apply the same policies.

When ASC 740 is applied by an investor (parent) and its consolidated pass-through entity, we believe the income tax assets recognized should be limited to the income tax amounts that would be allocated to the investor based on the operating agreement of the pass-through entity. To the extent a nonrefundable, transferable credit is sold by the consolidated pass-through entity, the portion of the sale proceeds attributable to noncontrolling interest holders would be recognized in equity (as an increase to noncontrolling interests), if there is no obligation to distribute the proceeds.

When a grant model is applied, we believe an income statement benefit should be measured at the full amount of credits generated if recovered through a direct pay mechanism or if allocated to investors. If the credit is expected to be monetized by being sold, we believe the initial income recognized would be measured at either fair value or a nominal value of zero.[4] We believe the offsetting entry for the portion of the credits allocated to the noncontrolling interest holders should be made directly to noncontrolling interests.

Accounting by an investor with an equity method pass-through entity

U.S. GAAP does not address the accounting for tax credits generated by non-consolidated investments except when the proportional amortization method (PAM) is elected and applied in accordance with ASC 323-740. Depending on the facts and circumstances, investments in tax credit structures that are not consolidated might be accounted for using the equity method under ASC 323, ASC 321, *Investments in equity securities* or the PAM. This section focuses on investments in tax credit structures accounted for using the equity method under ASC 323 that do not apply the PAM.

There may be situations where the investor's accounting policy for nonrefundable, transferable credits differs from the pass-through entity's accounting policy. For example, the investor may account for such tax credits as government grants whereas the pass-through entity accounts for the credits under ASC 740 in its separate financial statements. Conversely, the investor may account for such tax credits under ASC 740

[3] We understand the SEC staff equates reasonable assurance to probable (likely to occur) under U.S. GAAP.

[4] Although IAS 20 includes a policy choice to use a nominal value, we believe entities should consult with accounting advisors, auditors and potentially the SEC staff before concluding that it is appropriate to measure the credit at a nominal value of zero.

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whereas the pass-through entity accounts for the credits as government grants in its separate financial statements.

Although an investor typically does not adjust an equity method investee's accounting policies, we believe a tax equity investor uses its own policy elections (rather than the pass-through entity's policy elections) when accounting for tax credits generated by the pass-through entity.[5] Therefore, an equity method investor may need to *adjust* the financial statements of the pass-through entity when measuring its equity method earnings from the investment to align the amounts with the investor's policies. As such, it is imperative that equity method investors obtain an understanding of the specific accounting policy selected by the pass-through entity and the amount of benefit from the nonrefundable, transferable credit that was recognized in the pass-through entity's separate financial statements.

In circumstances in which the equity method investor applies a government grant policy, we believe the investor should account for the credit within its overall equity method earnings. However, other approaches may be acceptable (for instance, accounting for the transferable tax credits as a separate unit of account). Regardless of which approach is used, a tax credit investor must understand the pass-through entity's accounting policy for transferable credits to avoid double counting the benefit.

Refer to the KPMG Tax credits handbook for additional discussion on accounting by investors in tax credit structures.

Example

The accounting for the generation of nonrefundable, transferable credits by a pass-through entity, along with the investors' accounting are illustrated below. The illustrations all share the following assumptions.

Background

Hydro LLC (Hydro) is a limited liability company treated as a partnership for income tax purposes. Hydro is generating hydropower in Country X. Country X provides a production tax credit (PTC) equal to 20% of qualified hydropower production.

The PTC is a nonrefundable, transferable credit. Under the provisions of the tax law in Country X, Hydro may either sell the PTC to a third party or may allocate it to Hydro's investors at which point the PTC would be nonrefundable and nontransferable to the investors.

ABC Corp (ABC) is an investor in Hydro. Based on the terms of Hydro's operating agreement, ABC has an economic entitlement to 20% of Hydro's income, gain, loss, deduction, and tax credits. However, due to ABC's ability to control Hydro in accordance with ASC 810, *Consolidation,* it consolidates Hydro for financial reporting purposes.

DEF Corp (DEF) is also an investor in Hydro. DEF is entitled to 80% of Hydro's income, gain, loss, deduction, and tax credits. DEF accounts for its investment in Hydro using the equity method in accordance with ASC 323, *Investments – Equity Method and Joint Ventures*.

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[5] Question 4.2.10 of KPMG's *Equity Method* handbook discusses other situations in which an investor adjusts the investee's financial statements to conform accounting principles.

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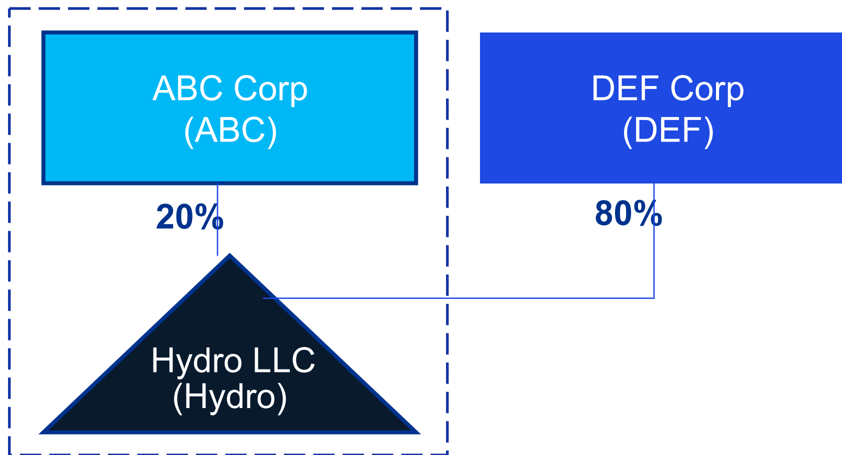

Entities included in ABC's consolidated financial statements

Other information

During Year 1, Hydro produces $50 million in qualifying hydropower energy and generates a PTC equal to 20%, or $10 million. As a pass-through entity for Country X income tax purposes, Hydro incurs no income tax liability.

Illustrations

The following illustrations demonstrate the considerations involved in accounting for nonrefundable, transferable credits based on a variety of scenarios and highlight the results of different means of monetizing the PTC and different accounting policies for assessing the realizability of the PTC. Each illustration assumes that Hydro, ABC, and DEF have elected the same accounting policy with respect to the accounting for the credit (either ASC 740 or the IAS 20 grant model). As Hydro does not have any special allocations, the illustrations assume there is no shift in ABC's and DEF's claim on the net assets of Hydro as a result of allocating tax credits. The illustrations do not reflect deferred taxes the investors would reflect related to temporary differences associated with its respective investment in Hydro.

Illustration	Overall Policy	Monetization	Realizability Policy
Illustration 1	IAS 20	Sell	N/A
Illustration 2	IAS 20	Allocate	N/A
Illustration 3	ASC 740	Sell	Disregard transfer
Illustration 4	ASC 740	Sell	Consider transfer
Illustration 5	ASC 740	Allocate	Disregard transfer
Illustration 6	ASC 740	Allocate	Consider transfer

In the IAS 20 illustrations below, assume Hydro and ABC have a policy to present government grant income as other income and measure nonmonetary government grants it expects to sell at fair value.

In the ASC 740 illustrations below, assume ABC has a policy to recognize any gain or loss on disposal within income taxes.

In each illustration, the accounting in Hydro's separate financial statements, ABC's consolidated financial statements, and DEF's financial statements is provided. If DEF and Hydro were to have different accounting

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policies for the tax credits, we believe DEF should adjust its share of the Hydro's reported amounts as if Hydro used the DEF's accounting policies for tax credits.

Illustration 1: IAS 20 accounting policy, PTC monetized by selling

In Year 1, assume Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million).

Year 1

The entities record the following journal entries in Year 1.

Hydro separate	*Debit*	*Credit*
Other asset[1] Other income *To recognize the PTC as Hydro meets the conditions of the grant[3].*	9,200,000	 9,200,000
ABC consolidated	*Debit*	*Credit*
Other asset[1] Other income *To recognize the PTC as the consolidated entity meets the conditions of the grant.*	9,200,000	 9,200,000
Net income attributable to noncontrolling interests[2] Noncontrolling interest *To recognize the amount of other income that is attributable to noncontrolling interest (DEF).*	7,360,000	 7,360,000
DEF	*Debit*	*Credit*
Investment in Hydro[2] Equity in earnings *To account for DEF's share of Hydro's earnings from the PTC.*	7,360,000	 7,360,000
Notes: 1. Estimated fair value of the PTC generated. 2. Estimated fair value of the PTC generated x DEF's 80% interest. 3. The timing of recognition is determined by the application of IAS 20 which requires analysis. Refer to KPMG's *Tax Credits* Handbook for discussion of the requirements of IAS 20.		

Year 2

Hydro sells the PTC in Year 2 for $9.3 million and the entities record the following journal entries in Year 2.

Hydro separate	*Debit*	*Credit*

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	Debit	Credit
Cash[1]	9,300,000	
Other income[2]		100,000
Other asset		9,200,000
To account for the sale of the PTC, including the related gain on the sale.		
ABC consolidated	*Debit*	*Credit*
Cash[1]	9,300,000	
Other income[2]		100,000
Other asset		9,200,000
To account for the sale of the PTC, including the related gain on the sale.		
Net income attributable to noncontrolling interests[3]	80,000	
Noncontrolling interest		80,000
To recognize the amount of other income that is attributable to noncontrolling interest (DEF)		
DEF	*Debit*	*Credit*
Investment in Hydro[3]	80,000	
Equity in earnings		80,000
To account for DEF's share of Hydro's earnings from the gain on sale of the PTC		

Notes:

1. Actual proceeds on sale of the PTC.
2. Gain on sale of the PTC calculated as the difference between the carrying value of the PTC of $9.2 million and the proceeds from the sale of the PTC of $9.3 million. ASC 610-20, *Gains and Losses from the Derecognition of Nonfinancial Assets,* is applied to determine when control of the PTC transfers and the sale occurs Refer to KPMG's *Tax Credits* Handbook for additional discussion on accounting for the sale of tax credits.
3. Gain on the sale of the PTC x DEF's 80% interest.

Illustration 2: IAS 20 accounting policy, PTC monetization changes to allocating to investors

In Year 1, Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million).

Year 1

The entities record the following journal entries in Year 1, which are the same as Illustration 1.

Hydro separate	*Debit*	*Credit*
Other asset[1]	9,200,000	
Other income		9,200,000

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To recognize the PTC as Hydro meets the conditions of the grant[3].		
ABC consolidated	*Debit*	*Credit*
Other asset[1]	9,200,000	
Other income		9,200,000
To recognize the PTC as the consolidated entity meets the conditions of the grant.		
Net income attributable to noncontrolling interests[2]	7,360,000	
Noncontrolling interest		7,360,000
To recognize the amount of other income that is attributable to noncontrolling interest (DEF).		
DEF	*Debit*	*Credit*
Investment in Hydro[2]	7,360,000	
Equity in earnings		7,360,000
To account for DEF's share of Hydro's earnings from the PTC.		

Notes:

1. Estimated fair value of the PTC generated.
2. Estimated fair value of the PTC generated x DEF's 80% interest.
3. The timing of recognition is determined by the application of IAS 20 which requires analysis. Refer to KPMG's *Tax Credits* Handbook for discussion of the requirements of IAS 20.

Year 2

Hydro decides to allocate the PTC to the investors in Year 2 rather than sell the PTC as initially expected. ABC and DEF can utilize any PTC allocated to them in the year the PTC is generated. The entities record the following journal entries in Year 2.

Hydro separate	*Debit*	*Credit*
Other asset	800,000	
Other income[1]		800,000
To remeasure the asset upon management changing its intent to allocate the credits.		
Equity	10,000,000	
Other asset		10,000,000
To derecognize the other asset upon the allocation of the PTC.		
ABC consolidated	*Debit*	*Credit*
Other asset	800,000	
Other income[1]		800,000

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	Debit	Credit
To remeasure the asset upon management changing its intent to allocate the credits.		
Net income attributable to noncontrolling interests[4]	640,000	
Noncontrolling interest		640,000
To record the amount of other income that is attributable to noncontrolling interest (DEF).		
Income taxes payable[2]	2,000,000	
Noncontrolling interest[3]	8,000,000	
Other asset		10,000,000
To account for the allocation of the PTC.		
DEF	*Debit*	*Credit*
Investment in Hydro[4]	640,000	
Equity in earnings		640,000
To account for DEF's share of Hydro's earnings from remeasuring the PTC.		
Income taxes payable[3]	8,000,000	
Investment in Hydro		8,000,000
To account for DEF's share of Hydro's PTC as a result of Hydro's allocation of the PTC upon the allocation decision made in Year 2.		

Notes:

1. The difference between the carrying value of the other asset of $9.2 million and the PTC generated of $10 million.
2. The PTC allocated to ABC (20% of the $10 million).
3. The PTC allocated to DEF (80% of the $10 million), which is essentially accounted for as a distribution received from an equity method investee.
4. The amount of other income recognized of $800,000 x DEF's 80% interest.

Illustration 3: ASC 740 accounting policy, PTC monetized by selling, ABC and DEF only consider its respective profitability in assessing the realizability of the PTC and disregards estimated proceeds from the transfer of the PTC

In Year 1, Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million). ABC and DEF are able to utilize any PTC allocated to it in the year generated.

Year 1

The entities record the following journal entries in Year 1 (if any).

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Hydro separate	Debit	Credit
No entry is recorded as Hydro has not sold the PTC.		

ABC consolidated	Debit	Credit
Deferred tax asset[1]	2,000,000	
Deferred tax benefit[2]		2,000,000
To recognize ABC's share of the PTC generated by Hydro .		

DEF	Debit	Credit
Deferred tax asset[3]	8,000,000	
Deferred tax benefit[4]		8,000,000
To recognize DEF's share of the PTC generated by Hydro.		

Notes:

1. The PTC allocable to ABC (20% of the $10 million). Note no valuation allowance is necessary as ABC would be able to realize the deferred tax asset based solely on its profitability.
2. The benefit is based on the PTC ABC could utilize.
3. The PTC allocable to DEF (80% of the $10 million). Note no valuation allowance is necessary as DEF would be able to realize the deferred tax asset based solely on its profitability.
4. The benefit is based on the PTC that DEF could utilize.

Year 2

Hydro sells the PTC in Year 2 for $9.3 million and the entities record the following journal entries in Year 2.

Hydro separate	Debit	Credit
Cash[1]	9,300,000	
Equity[2]		9,300,000
To account for the sale of the PTC.		

ABC consolidated	Debit	Credit
Cash	9,300,000	
Deferred tax expense[3]	140,000	
Deferred tax asset		2,000,000
Noncontrolling interest[4]		7,440,000
To account for the sale of the PTC[6].		

DEF	Debit	Credit

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	Debit	Credit
Investment in Hydro[5]	7,440,000	
Deferred tax expense	560,000	
Deferred tax asset		8,000,000
To account for the sale of the PTC[6].		

Notes:

1. Actual proceeds on sale.
2. We believe a pass-through entity using ASC 740 should present the proceeds in equity.
3. Actual proceeds on sale of $9.3 million x 20% attributable to ABC less the deferred tax asset of $2 million.
4. 80% of proceeds attributable to other investors.
5. 80% of proceeds attributable to DEF. This example assumes the proceeds were not distributed nor were they required to be distributed to the investors by Hydro.
6. ASC 610-20, *Gains and Losses from the Derecognition of Nonfinancial Assets,* is applied to determine when control of the PTC transfers and the sale occurs Refer to KPMG's Tax Credits Handbook for additional discussion on accounting for the sale of tax credits.

Illustration 4: ASC 740 accounting policy, PTC monetized by selling, ABC and DEF consider a potential transfer in assessing the realizability of the transferable PTC

In Year 1, Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million).

Year 1

The entities record the following journal entries in Year 1 (if any).

Hydro separate	*Debit*	*Credit*
No entry is recorded as Hydro has not sold the PTC.		
ABC consolidated	*Debit*	*Credit*
Deferred tax asset[1]	2,000,000	
Valuation allowance		160,000
Deferred tax benefit[2]		1,840,000
To recognize ABC's share of the PTC generated by Hydro.		
DEF	*Debit*	*Credit*
Deferred tax asset[3]	8,000,000	
Valuation allowance		640,000
Deferred tax benefit[4]		7,360,000
To recognize DEF's share of the PTC generated by Hydro.		

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Notes:

1. The PTC allocable to ABC (20% of the $10 million).
2. The benefit is based on ABC's share of the estimated amount that would be realized in a sale because a sale is the expected manner of monetizing the PTC ($2 million x 92%).
3. The PTC allocable to DEF (80% of the $10 million)
4. The benefit is based on DEF's share of the estimated amount that would be realized in a sale as such represents the expected manner of monetizing the PTC ($8 million x 92%).

Year 2

Hydro sells the PTC in Year 2 for $9.3 million and the entities record the following journal entries in Year 2.

Hydro separate	*Debit*	*Credit*
Cash[1]	9,300,000	
Equity[2]		9,300,000
To account for the sale of the PTC.		
ABC consolidated	*Debit*	*Credit*
Valuation allowance[3]	20,000	
Deferred tax benefit		20,000
To remeasure the valuation allowance based on estimates of final sales proceeds.		
Cash	9,300,000	
Valuation allowance[4]	140,000	
Deferred tax asset		2,000,000
Noncontrolling interest[5]		7,440,000
To account for the sale of the PTC.		
DEF	*Debit*	*Credit*
Valuation allowance[6]	80,000	
Deferred tax benefit		80,000
To remeasure the valuation allowance based on estimates of final sales proceeds		
Investment in Hydro[7]	7,440,000	
Valuation allowance	560,000	
Deferred tax asset		8,000,000
To reverse the Year 1 entry upon sale of the PTC.		

Notes:

1. Actual proceeds on sale.
2. We believe a pass-through entity using ASC 740 should present a gain or loss on sale in equity.

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3. Difference between the originally established valuation allowance of $160,000 ($2 million – ($2 million x 92%)) based on estimated proceeds and the valuation allowance of $140,000 ($2 million – ($2 million x 93%)) as remeasured for actual proceeds.
4. Reversal of the existing valuation allowance.
5. 80% of proceeds attributable to other investors.
6. Difference between the originally established valuation allowance of $640,000 ($8 million – ($8 million x 92%)) based on estimated proceeds and the valuation allowance of $560,000 ($8 million - ($8 million x 93%)) as remeasured for actual proceeds
7. 80% of proceeds attributable to DEF. This example assumes the proceeds were not distributed nor were they required to be distributed to the investors by Hydro.

Illustration 5: ASC 740 accounting policy, PTC monetized by allocating to investors, ABC and DEF only consider its respective profitability in assessing the realizability of the PTC and disregards estimated proceeds from the transfer of the PTC

In Year 1, Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million). ABC and DEF can utilize any PTC allocated to them in the year generated.

Year 1

The entities record the following journal entries in Year 1 (if any).

Hydro separate	*Debit*	*Credit*
No entry is recorded as Hydro has not sold the PTC.		
ABC consolidated	*Debit*	*Credit*
Deferred tax asset[1]	2,000,000	
Deferred tax benefit[2]		2,000,000
To recognize ABC's share of the PTC generated by Hydro.		
DEF	*Debit*	*Credit*
Deferred tax asset[3]	8,000,000	
Deferred tax benefit[4]		8,000,000
To recognize DEF's share of the PTC generated by Hydro.		

Notes:

1. The PTC allocable to ABC (20% of the $10 million). Note no valuation allowance is necessary as ABC would be able to realize the deferred tax asset based solely on its profitability.
2. The benefit is based on the PTC ABC could utilize.

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3. The PTC allocable to ABC (80% of the $10 million). Note no valuation allowance is necessary as DEF would be able to realize the deferred tax asset based solely on its profitability.
4. The benefit is based on the PTC that DEF could utilize

Year 2

Hydro allocates the PTC in Year 2 to its investors and the entities record the following journal entries in Year 2.

Hydro separate	*Debit*	*Credit*
Hydro does not record any amounts in its separate financial statements.		
ABC consolidated	*Debit*	*Credit*
Deferred tax expense	2,000,000	
Deferred tax asset		2,000,000
To reverse the Year 1 deferred tax entries upon the change in expectation in Year 2 to utilize the PTC.		
Income taxes payable[1]	2,000,000	
Current tax benefit		2,000,000
To account for the utilization of the PTC on the Year 1 tax return upon the change in expectation in Year 2 to allocating the PTC.		
DEF	*Debit*	*Credit*
Deferred tax expense	8,000,000	
Deferred tax asset		8,000,000
To reverse the Year 1 deferred tax entries upon the change in expectation in Year 2 to utilize the PTC		
Income taxes payable[2]	8,000,000	
Current tax benefit		8,000,000
To account for the utilization of the PTC on the Year 1 tax return upon the change in expectation in Year 2 to allocating the PTC.		

Notes:
1. The PTC allocated to ABC (20% of the $10 million).
2. The PTC allocated to DEF (80% of the $10 million).

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Illustration 6: ASC 740 accounting policy, PTC monetized by allocating to investors, ABC and DEF consider a potential transfer in assessing the realizability of the transferable PTC

In Year 1, Hydro initially expects to sell the PTC and estimates it can be sold for 92% of the face value ($9.2 million).

Year 1

The entities record the following journal entries in Year 1 (if any).

Hydro separate	*Debit*	*Credit*
No entry is recorded as Hydro has not sold the PTC.		
ABC consolidated	*Debit*	*Credit*
Deferred tax asset[1]	2,000,000	
Valuation allowance		160,000
Deferred tax benefit[2]		1,840,000
Tor recognize ABC's share of the PTC generated by Hydro.		
DEF	*Debit*	*Credit*
Deferred tax asset[3]	8,000,000	
Valuation allowance		640,000
Deferred tax benefit[4]		7,360,000
To record DEF's share of the PTC generated by Hydro.		

Notes:

1. The PTC allocable to ABC (20% of the $10 million).
2. The benefit is based on ABC's share of the estimated amount that would be realized in a sale because a sale is the expected manner of monetizing the PTC ($2 million x 92%).
3. The PTC allocable to DEF (80% of the $10 million).
4. The benefit is based on DEF's share of the estimated amount that would be realized in a sale because a sale is the expected manner of monetizing the PTC ($8 million x 92%

Year 2

Hydro allocates the PTC in Year 2 to its investors. ABC and DEF can utilize any PTC allocated to them in the year generated. The entities record the following journal entries in Year 2.

Hydro separate	*Debit*	*Credit*
Hydro does not record any amounts in its separate financial statements.		

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ABC consolidated	Debit	Credit
Valuation allowance Deferred tax expense Deferred tax asset *To reverse the Year 1 deferred tax entries upon the change in expectation in Year 2 to utilize the PTC.*	160,000 1,840,000	 2,000,000
Income taxes payable[1] Current tax benefit *To account for the utilization of the PTC on the Year 1 tax return upon the change in expectation in Year 2 to allocating the PTC.*	2,000,000	 2,000,000
DEF	*Debit*	*Credit*
Valuation allowance Deferred tax expense Deferred tax asset *To reverse the Year 1 deferred tax entries upon the change in expectation in Year 2 to utilize the PTC.*	640,000 7,360,000	 8,000,000
Income taxes payable[2] Current tax benefit *To account for the utilization of the PTC on the Year 1 tax return upon the change in expectation in Year 2 to allocating the PTC.*	8,000,000	 8,000,000

Notes:

1. The PTC allocated to ABC (20% of the $10 million).
2. The PTC allocated to DEF (80% of the $10 million).

What does it all mean?

What happens to the financial statements with different permutations of the policy elections and methods of monetizing the credits? The following table summarizes the outcomes in the illustrations provided. The illustrations were for a PTC; different outcomes may have occurred if the credits had been investment tax credits.

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Ref	Policy choice 1: Overall policy	Method of Monetization	Policy choice 2: Realizability Policy	Outcome to Hydro	Outcome to ABC	Outcome to DEF
III 1	IAS 20[6]	Sell	N/A	Asset and other income principally recognized in Year 1	Asset and other income principally recognized in Year 1	Investment in Hydro and equity in earnings principally recognized in Year 1
III 2	IAS 20	Allocate	N/A	Asset and other income principally recognized in Year 1	Asset and other income principally recognized in Year 1	Investment in Hydro and equity in earnings principally recognized in Year 1
III 3	ASC 740	Sell	Disregard transfer	Asset and equity recognized in Year 2	Attributable deferred tax benefit recognized in Year 1	Attributable deferred tax benefit recognized in Year 1.
III 4	ASC 740	Sell	Consider transfer	Asset and equity recognized in Year 2	Attributable deferred tax benefit and valuation allowance recognized in Year 1	Attributable deferred tax benefit and valuation allowance recognized in Year 1
III 5	ASC 740	Allocate	Disregard transfer	No recognition	Attributable deferred tax benefit recognized in Year 1	Attributable deferred tax benefit recognized in Year 1
III 6	ASC 740	Allocate	Consider transfer	No recognition	Attributable deferred tax benefit and valuation allowance recognized in Year 1	Attributable deferred tax benefit and valuation allowance recognized in Year 1

Conclusion

As demonstrated by the illustrations above, an entity's accounting policy elections can produce varied outcomes and require the analysis and application of different accounting guidance. When evaluating the accounting consequences of tax credits, an entity should understand the underlying characteristics of the credit and whether accounting policies for the tax credit (or credits with similar characteristics) have been previously established. Entities should also make any required financial statement disclosures, including those required by ASC 832, *Government Assistance* and ASC 740, *Income Taxes*. Further, ASC 235, *Notes to Financial Statements*, requires disclosure of policy choices among acceptable alternatives.

[6] The illustrations presenting an overall policy of IAS 20 assumed Hydro and ABC have a policy to measure nonmonetary government grants at fair value. If a policy had been applied to initially measure the grants at a nominal value of zero, different outcomes would have occurred.

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Acknowledgements

This publication has been produced by KPMG's Washington National Tax. We would like to acknowledge members of KPMG's Department of Professional Practice of KPMG LLP in the United States for the time they committed to this publication: Meredith Canady, Teresa Dimattia, Matt Drucker, Nick Tricarichi, and Jennifer Yruma.

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