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Accounting for Tax Credits Under the CHIPS Act and the Inflation Reduction Act — Interim Reporting Considerations

Executive Summary

The Creating Helpful Incentives to Produce Semiconductors and Science Act of 2022 (the “CHIPS Act”) and the Inflation Reduction Act of 2022 (the IRA), both signed into law in August 2022, have a number of tax-related provisions, including a plethora of clean energy tax incentives in the form of tax credits, some of which include a direct-pay option, transferability provisions, or both.

The direct-pay option would allow an entity to elect to treat the tax credits as a direct payment against its income tax liability and claim a refund for any resulting overpayment (e.g., receive a refund of such tax credits in the absence of any income tax liability).

The transferability provision, on the other hand, would allow an “eligible taxpayer” to elect to transfer (i.e., sell) the tax credit, or some portion thereof, to an unrelated entity. If an entity does not have sufficient taxable income to use all or a portion of the income tax credit or if using the credit might take multiple tax years, the entity might achieve a better economic benefit by selling the credit.

See Deloitte’s August 12, 2022, [Tax Alert](#) for further details and observations related to each energy credit available under the IRA. The CHIPS Act includes a manufacturing investment tax credit under Section 48D that allows for the direct-pay election.

First-Quarter Impact — Action Required

As discussed below, there are multiple accounting approaches to accounting for refundable and transferable credits. Accordingly, it is critical for entities to determine which approach to use, make the appropriate accounting policy determinations, and factor such determinations into their first-quarter close process, if material.

Refundable Credits

If an entity can elect to treat a credit as a direct payment of tax and receive a refund of such a payment in the absence of any taxable income (i.e., the entity is otherwise in a taxable loss position), we believe that the tax credit represents a refundable credit that would be outside the scope of ASC 740.¹

Because there is no specific, authoritative U.S. GAAP guidance on recognizing and measuring government assistance received by business entities, entities have used different approaches for recognition and measurement and multiple models may be acceptable with respect to the timing and amount of government assistance reflected in an entity's financial statements.

See the [Government Grant Model — Refundable and Transferable Credits](#) section for further details regarding the accounting for refundable credits under a government grant model (e.g., IAS 20,² ASC 958-605, or ASC 450-30 framework).

Transferable Credits

Regardless of intent, we believe that a transferable credit should remain within the scope of ASC 740 if it (1) can be used only to reduce an income tax liability either for the entity that generated it or the entity to which it is transferred and (2) would never be refundable by the government. While we believe that it is most appropriate to account for the credits under ASC 740, on the basis of feedback received from the FASB staff, we believe that it would also be acceptable for an entity to account for the transferable credits in a manner similar to refundable credits (i.e., which are not within the scope of ASC 740) since the company generating the credit does not need taxable income to monetize the credit.

See the [Government Grant Model — Refundable and Transferable Credits](#) section for further details regarding the accounting for refundable credits under a government grant model (e.g., IAS 20, ASC 958-605, or ASC 450-30 framework).

Transferable Credits — ASC 740 Accounting

If an entity elects to account for the credit in accordance with ASC 740, the entity that generated the credit would recognize and measure it in accordance with the recognition and measurement criteria of ASC 740. More specifically, to the extent that the income tax credit does not reduce income taxes currently payable, the entity would recognize a deferred tax asset (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. Under this approach, an entity would exclude the expected proceeds, including any discount on the sale of the credits, when assessing the measurement of the DTA, with the gain or loss on sale recognized in pretax earnings.

We understand, however, on the basis of a technical inquiry with the FASB staff, that it would be most appropriate to reflect any proceeds and resulting gain/loss on the sale as a component of the tax provision. Under this approach, and on the basis of the same FASB staff inquiry, we understand that the valuation allowance could be determined by either (1) factoring the expected sales proceeds into the assessment of the realizability of the related DTA or (2) not factoring in the expected sales when assessing the realizability of the related

¹ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's ["Titles of Topics and Subtopics in the FASB Accounting Standards Codification."](#)

² International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

DTA. We believe that if the expected sales proceeds are factored into the assessment of the realizability of the DTA, the DTA (net of valuation allowance) would be recognized in an amount equal to the amount expected to be realized (i.e., the expected sales proceeds). Any difference between the expected sales proceeds and the actual sales proceeds would be recognized as a component of income tax expense.

If the expected sales proceeds are not factored into the assessment, an entity would exclude the expected proceeds, including any discount on the sale of the credits, when assessing the realizability of the DTA, with the gain or loss on sale recognized at the time of sale as a component of income tax expense.

In accordance with ASC 740-270-30-8, an entity's annual effective tax rate (AETR) should "reflect anticipated investment tax credits, foreign tax rates, percentage depletion, capital gains rates, and other available tax planning alternatives." Accordingly, regardless of the policy elections described above, we generally believe that the effects of the credits, including gains and losses projected to occur during the year, if reasonably estimable, would be included in an entity's annual AETR (i.e., reasonably estimable gains/losses that will affect pretax earnings for the year would be included in the denominator, and the reasonably estimable net realizable amount of the tax credits, including gains/losses that will affect the income tax provision, would be included in the numerator).

See [Appendix A](#) for a decision tree summarizing the accounting impacts of the elections discussed above.

Government Grant Model — Refundable and Transferable Credits

As described above, ASC 740 would not apply to refundable credits (i.e., those with a direct-pay option available) or transferable tax credits for which an entity makes a policy choice of accounting for the credits outside the scope of ASC 740; therefore, entities often account for such credits under a government grant model. ASC 958-605 explicitly excludes government grants given to for-profit entities from its scope, although some entities analogize to this guidance.

In the absence of explicit guidance in U.S. GAAP for business entities, ASC 105 provides a hierarchy for entities to use in determining the relevant accounting framework for the types of transactions that are not directly addressed in sources of authoritative U.S. GAAP. According to ASC 105-10-05-2, an entity should "first consider [U.S. GAAP] for similar transactions" before considering "nonauthoritative guidance from other sources," such as IFRS® Accounting Standards.

When selecting the appropriate accounting model to apply to a government grant, a business entity should consider the specific facts and circumstances of the grant. If the entity has a preexisting accounting policy related to accounting for similar government grants, it should generally apply that policy. However, if the entity does not have a preexisting accounting policy or the grant is not similar to grants it has received in the past, it should carefully consider applying a model that would faithfully depict the nature and substance of the government grant.

We believe that in the absence of either directly applicable or analogous U.S. GAAP, it may be appropriate to apply IAS 20, which has been widely used in practice by business entities to account for government grants under U.S. GAAP.

Further, the issuance of ASC 832 has confirmed the acceptability of applying the ASC 958-605 accounting framework for recognition and measurement of grants received by for-profit businesses under U.S. GAAP. This view is consistent with past statements the FASB staff has made indicating that business entities were not precluded from applying that recognition and measurement guidance by analogy when appropriate. Therefore, a business entity may conclude that it is acceptable to apply ASC 958-605 by analogy because of the lack of U.S.

GAAP guidance addressing the accounting for for-profit businesses, particularly if the grant received by the business entity is similar to one received by a not-for-profit entity. Note that, under the ASC 958-605 framework, all required barriers must be overcome before the entity that receives the grant can recognize it; that is, an entity cannot recognize the grant simply because it expects to overcome the barriers when applying this framework.

Note that ASC 832 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 (i.e., a grant model under IAS 20 or ASC 958-605). We believe that entities applying a government grant model should provide the disclosures required by ASC 832.



Connecting the Dots

While we believe that business entities have widely applied IAS 20 in practice when accounting for government grants, it may also be acceptable to apply ASC 450-30 since we are aware that some business entities may have applied a gain contingency model to certain grants by analogy. Under this model, income from a conditional grant is viewed as akin to a gain contingency; therefore, recognition of the grant in the income statement is deferred until all uncertainties are resolved and the income is “realized” or “realizable.” That is, an entity must meet all the conditions required for receiving the grant before recognizing income. For example, a grant that requires the entity to sell a manufactured product to a qualifying buyer should not be recognized until the sale transaction occurs. Such a deferral may be required even if (1) the government has already funded the grant, (2) the entity incurred the costs that the funds were intended to defray, and (3) the remaining terms subject to compliance are within the entity’s control or virtually certain to be met. That is, under a gain contingency model, it would not be appropriate for an entity to consider the probability of complying with the requirements of the government grant in determining when to recognize income from the grant. Therefore, for many grants, the recognition of income under ASC 450-30 would most likely be later than the recognition of income under IAS 20.

IAS 20 Accounting Framework

An entity that elects an IAS 20 framework to account for government grants should consider that such grants cannot be recognized (even if payment is received up front) until there is reasonable assurance that the entity will (1) comply with the conditions associated with the grant and (2) receive the grant. While “reasonable assurance” is not defined in IAS 20, for a business entity that is subject to U.S. GAAP, we believe that reasonable assurance is generally the same threshold as “probable” as defined in ASC 450-20 (i.e., “likely to occur”).

When an entity has met the reasonable assurance threshold, it applies IAS 20 by recognizing the government grant in its income statement on a “systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.” To help an entity meet this objective, IAS 20 provides guidance on two broad classes of government grants: (1) grants related to long-lived assets (capital grants) and (2) grants related to income (income grants).

Capital Grants

A capital grant is a grant received by an entity with conditions tied to the acquisition or construction of long-lived assets. An entity may elect an accounting policy of initially recognizing such a grant as either deferred income or a reduction in the asset's carrying amount. If the entity classifies the grant as deferred income, it will recognize the grant in the income statement over the useful life of the depreciable asset that it is associated with (e.g., as an offset against depreciation expense). If the entity classifies the grant as a reduction in the asset's carrying amount, the associated asset will have a lower carrying value and a lower amount of depreciation over time. Further, with respect to nondepreciable assets, paragraph 18 of IAS 20 observes the following:

Grants related to non-depreciable assets may also require the fulfilment of certain obligations and would then be recognised in profit or loss over the periods that bear the cost of meeting the obligations. As an example, a grant of land may be conditional upon the erection of a building on the site and it may be appropriate to recognise the grant in profit or loss over the life of the building.

Income Grants

An income grant is a grant that is not related to long-lived assets. An entity may present the receipt of such a grant in the income statement either as (1) a credit to income (within or outside operating income) or (2) a reduction in the related expense that the grant is intended to defray. As discussed above, the main objective of the accounting for government grants under IAS 20 is for an entity to recognize a grant in the same period or periods in which it recognizes the corresponding costs in the income statement. Therefore, an entity should assess the specific compliance requirements that it must meet to receive or retain any funds from the government.

Example

Entity A is eligible to receive nonrefundable, transferable advanced manufacturing production credits under Section 45X of the IRA for the production and sale of certain clean energy components. Production of the clean energy components occurs in December 20X3, and A determines, in accordance with IAS 20, that it is reasonably assured to meet the requirements of Section 45X after production of the inventory is completed by December 31, 20X3. During December 20X3, A produces 100 kg of clean energy components for \$120 and is eligible to receive an \$87 tax credit on such production. Entity A determines that the fair value of the tax credit is \$70. On January 31, 20X4, A sells the produced inventory to a customer for \$150 and recognizes revenue at a point in time related to the sale of such inventory. Entity A sells the tax credit for \$75 on March 31, 20X4. The following are examples of journal entries that would be acceptable under an IAS 20 model (income grant) for the production of clean energy components, the generation of tax credits, and the sale of the tax credits:

IAS 20 Offsetting Cost Approach

December 20X3:

Entity A incurs a cost of \$120 to produce clean energy components:

Inventory	120	
Cash or payable		120

Entity A determines it can recognize the grant in accordance with IAS 20:

Asset*	70	
Inventory		70

January 31, 20X4:

Entity A sells the inventory produced to a customer for \$150:

Cost of sales	50	
Inventory		50
Accounts receivable	150	
Revenue		150

March 31, 20X4:

Entity A sells the transferable credit received to a third party for \$75:

Cash	75	
Asset		70
Gain on sale**		5

* Note that A's determination of the nature of the asset (e.g., intangible, other asset) will be based on its specific facts and circumstances.

** Note that A's determination of the classification within the income statement will be based on its specific facts and circumstances.

IAS 20 Deferred Income Approach**December 31, 20X3:**

Entity A incurs a cost of \$120 to produce clean energy components:

Inventory	120	
Cash or payable		120

Entity A determines it can recognize the grant in accordance with IAS 20:

Asset*	70	
Deferred credit		70

January 31, 20X4:

Entity A sells the inventory produced to a customer for \$150:

Cost of sales	120	
Inventory		120
Deferred credit	70	
Government grant income		70
Accounts receivable	150	
Revenue		150

March 31, 20X4:

Entity A sells the transferable credit received to a third party for \$75:

Cash	75	
Asset		70
Gain on sale**		5

* Note that A's determination of the nature of the asset (e.g., intangible, other asset) will be based on its specific facts and circumstances.

** Note that A's determination of the classification within the income statement will be based on its specific facts and circumstances.

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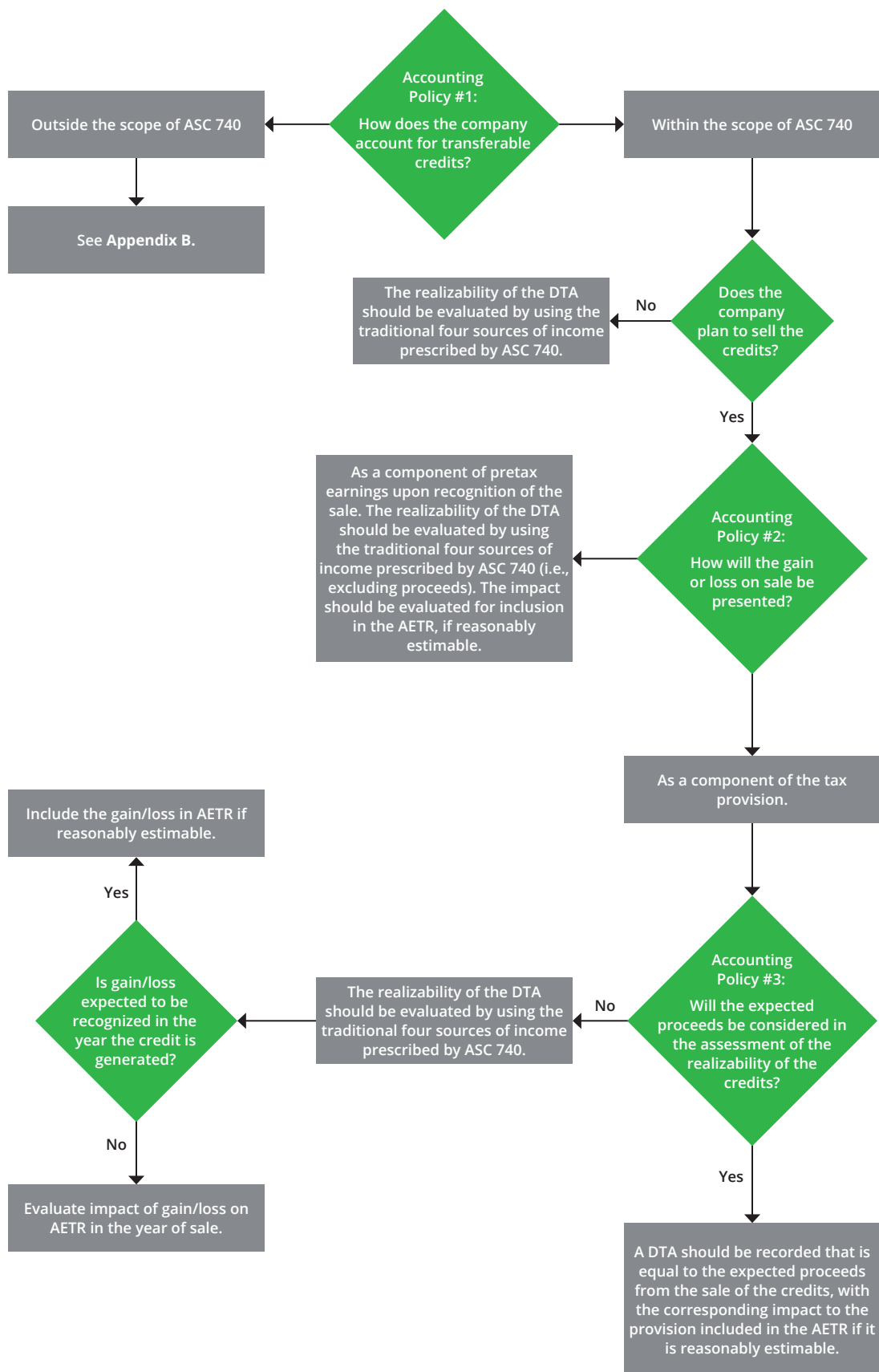
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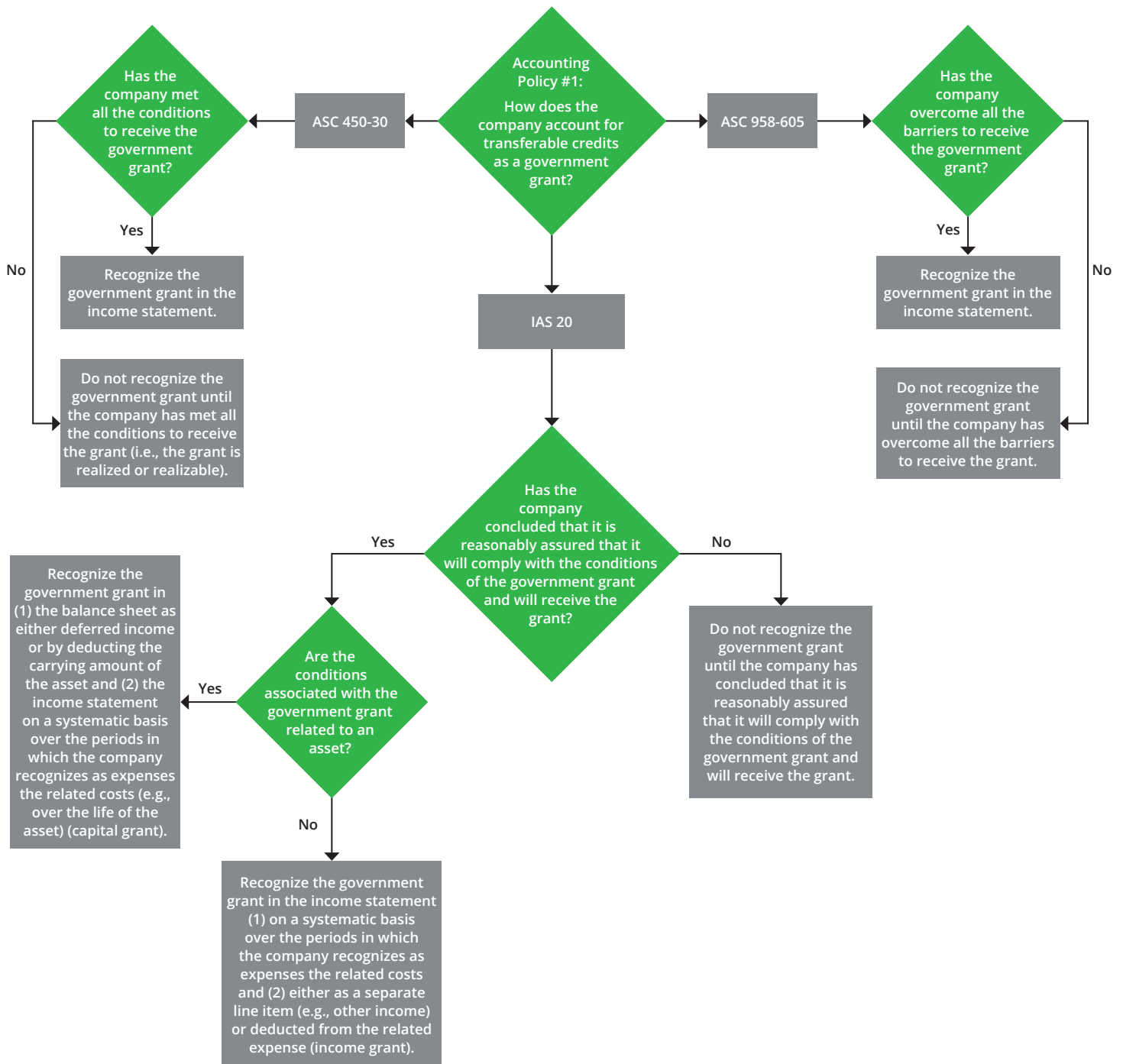
Appendix A

The decision tree below summarizes the accounting impacts of the elections discussed above.



Appendix B

The decision tree below summarizes the accounting impacts of the elections discussed above for a government grant model.



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