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Accounting for Transferable Tax Credits

Overview

Entities can generate tax credits by engaging in various specific activities, including investing in or producing certain clean energy products. A tax credit is a benefit that can reduce income taxes payable on a dollar-for-dollar basis. In some jurisdictions, certain tax credits, or some portion thereof, can be transferred (i.e., sold) to unrelated third-party taxpayers. Entities may elect to sell these transferable credits because they have determined that they will achieve a better economic benefit (e.g., present value benefit) by doing so.

In recent years, the number and types of available tax credits have increased significantly, particularly in the United States. The CHIPS Act and the Inflation Reduction Act, which were signed into law in August 2022, introduced a number of tax-related provisions. These include a plethora of clean energy tax incentives in the form of tax credits, some of which contain a transferability provision, a direct-pay option (e.g., allowing 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), or both.

Given the recent increase in the availability of transferable credits, questions have arisen related to the applicable accounting treatment for both an entity that generates such credits and an entity that purchases them.

We believe that regardless of its intent, if an entity generates transferable credits, those credits should remain within the scope of ASC 740¹ if they (1) can be used only to reduce an income tax liability either for the entity that generated such liability or the entity to which it is transferred and (2) would never be refundable by the government. While we believe

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

that accounting for the credits under ASC 740 would be the most appropriate treatment, on the basis of feedback received from the FASB staff, we understand that it would also be acceptable for an entity to account for transferable credits outside the scope of ASC 740 since the entity generating the credits does not need taxable income to monetize them.

Entities that do not account for transferable credits in accordance with ASC 740 may consider such credits to be a form of government assistance. Because there has been no specific, authoritative U.S. GAAP guidance on recognizing and measuring government assistance received by business entities,² different approaches have been used for such recognition and measurement, and multiple models may be acceptable related to the timing and amount of government assistance reflected in an entity's financial statements. See the [Accounting for Transferable Credits Under the Government Grant Model](#) section for further details related to using a government grant model to account for transferable credits outside the scope of ASC 740 (e.g., the framework in IAS 20,³ ASC 958-605, or ASC 450-30).

A transferable credit generally may be transferred only one time (e.g., as discussed in Internal Revenue Code Section 6418), and the entity that purchases it can only use the credit to reduce its own income tax liability. Therefore, the purchaser would account for the transferable credit under ASC 740. See the [Accounting for the Purchase of Transferable Credits](#) section for further details.

The accounting considerations discussed in this publication apply to taxable entities. Additional considerations may apply to nontaxable entities (e.g., partnerships) that buy or sell transferable tax credits. Consultation with appropriate accounting advisers is encouraged.

Transferor's Accounting

As discussed above, entities have used two acceptable approaches in practice to account for the initial recognition of transferable tax credits (i.e., the initial accounting for the transferor). That is, they have accounted for such credits (1) under ASC 740 or (2) as a government grant. Entities should select one method as an accounting policy and apply it consistently. Each approach is discussed below.

Accounting for Transferable Credits Under ASC 740

If an entity has elected to account for transferable credits in accordance with ASC 740, the entity that generates the credits would apply the recognition and measurement criteria in ASC 740.⁴ An entity will initially recognize the transferable credit after all the applicable requirements of the tax law are met. If an entity plans to retain the credit for its own use, the entity will record a deferred tax asset (DTA), which is then assessed for realizability.

If, on the other hand, an entity intends to subsequently transfer a credit to a third party, it must make accounting policy elections regarding where it will classify the gain or loss in the income statement and whether it will consider anticipated sales proceeds when assessing the realizability of the DTA. As part of a technical inquiry, the FASB staff communicated that the most appropriate method would be to reflect any gain or loss resulting from the sale of the credit as a component of the tax provision. An entity that chooses to recognize gain or loss within the tax provision must make another election regarding whether to factor the expected sales proceeds of the credit into the assessment of the realizability of the DTA. When an entity includes the expected sales proceeds in the assessment of the DTA, it would initially recognize

² The FASB has issued a [proposed Accounting Standards Update](#) (ASU) that would codify the accounting for government grants under U.S. GAAP. See the [Government Grants Project](#) discussion for more information.

³ International Accounting Standard (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

⁴ While transferable credits can take the form of an investment tax credit (ITC) or a non-ITC, there is an additional layer of complexity associated with transferable tax credits that are considered ITCs. This is because ASC 740 permits entities to make a policy choice between the "flow-through" and "deferral" methods with respect to the initial recognition of an ITC. If an ITC is expected to be sold instead of used by the generator and an entity plans to use the deferral method, we suggest that the entity consult with its accounting advisers regarding the treatment of the transferable ITC.

the DTA (net of the valuation allowance) in an amount equal to the amount expected to be realized (i.e., the expected sales proceeds). It would then recognize any difference between the expected and actual sales proceeds as a component of income tax expense in the period the transfer occurs. An entity that elects not to include the expected proceeds in its assessment of the DTA should assess realizability by using the traditional four sources of taxable income.

As an alternative to the above approach, an entity may elect to recognize any gain or loss as a component of pretax earnings. Under this policy election, the entity should initially recognize a DTA and assess it for realizability in a manner consistent with the sources of income cited in ASC 740-10-30-18 (i.e., excluding any expected sales proceeds). That is, if an entity's policy is to reflect the gain or loss in pretax earnings, it would not be appropriate for the entity to consider the expected sales proceeds when assessing realizability of the related DTA.

See [Appendix A](#) for a decision tree that summarizes the impacts of accounting for transferable credits under ASC 740.

Example 1

Transferor A develops a small wind electric system, and construction begins January 1, 20X5. Construction is completed January 1, 20X6, on which date the system is placed into service. Transferor A incurred \$2,000 of costs, which it capitalized during 20X5, and is eligible to receive a 6 percent nonrefundable transferable tax credit (i.e., a \$120 transferable credit) on its investment once the system is placed into service. The asset's useful life is 10 years.

Because A does not expect to have taxable income for the next few years, it determined that it would be beneficial to sell the transferable credit. On the date the system was placed into service, A estimated that it would receive \$110 in proceeds.

Transferor A determined that it would account for the transferable credit under ASC 740 by using the flow-through method. When assessing the realizability of the credits in its DTA, A considered the expected proceeds and elects to account for the gain or loss on the sale as a component of the tax provision.

On January 1, 20X7, A enters into an agreement with Purchaser B to sell the \$120 credit for \$113, which is \$3 more than A had expected. Control of the credit was transferred on this date.

Below are the resulting journal entries. For simplicity, any impact associated with a statutory reduction in the tax basis is ignored.

20X5

PP&E	2,000	
Cash		2,000
To record the costs to construct the small wind electric system.		

20X6

DTA	120	
Valuation allowance		10
Income tax expense		110
To record the transferable credit.		

Example 1 (continued)

20X7

Cash	113	
Valuation allowance	10	
Income tax expense		3
DTA		120
To record the sale of the transferable credit.		

Accounting for Transferable Credits Under the Government Grant Model

An entity that elects to account for transferable credits as government grants must apply its accounting policy election on the treatment of other forms of grants to such credits. In practice, entities have often analogized to IAS 20 when accounting for government grants, but some have analogized to ASC 450-30 or ASC 958-605 (even though government grants to for-profit entities are specifically excluded from its scope).⁵

The paragraphs below address how an entity should account for transferable credits by analogizing to IAS 20, which entities commonly apply in practice to account for such credits that are outside the scope of ASC 740. Further, as noted in the [Government Grants Project](#) section, there are many similarities between IAS 20 and the FASB's proposed ASU on the recognition, measurement, and presentation of government grants.

As indicated in paragraph 23 of IAS 20, transferable credits recognized by analogy to IAS 20 are considered nonmonetary assets. Under this guidance, such credits would typically be measured at fair value (but note that entities may also initially measure an asset grant at a nominal value⁶). The transferable credit would be initially recognized when there is "reasonable assurance" that the entity will comply with the grant's conditions and that the grant will be received (i.e., earned). The "reasonable assurance" threshold under IFRS® Accounting Standards is not defined; however, when entities apply this framework under U.S. GAAP, practice often defines the term in a manner similar to the "probable" threshold under ASC 450-20. After determining that a grant is recognizable, an entity must assess whether the grant is related to an asset or to income.

A grant related to an asset received by an entity has conditions that are tied to the acquisition or construction of long-lived assets or inventory. 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 associated with it (e.g., as an offset against depreciation expense) or when the inventory is disposed of. 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 or the carrying amount of the inventory will be lower. An entity must use judgment to determine how to classify the transferable credit because the facts and circumstances will dictate whether classification as

⁵ While grants to for-profit entities are excluded from the scope of ASC 958-605, [ASU 2021-10](#) added ASC 832-10-15-4, which states that the guidance in ASC 832 applies to entities that analogize to grant or contribution models such as those addressed in IAS 20 or ASC 958-605. Further, paragraph BC17 in ASU 2021-10 acknowledges that business entities may apply IAS 20 or ASC 958-605 by analogy to grants of government entities. The same paragraph acknowledges that transactions with government entities may also be accounted for in accordance with other GAAP.

⁶ Paragraph 23 of IAS 20 allows entities to record nonmonetary government grants and the assets at a nominal amount as an alternative to recording them at their fair value. In such a case, since both the asset and the grant would be recorded at or near \$0, nothing (or nearly nothing) would be recorded on the balance sheet for either the asset or the grant.

an intangible asset or another asset, or some other classification, is appropriate. Further, with respect to nondepreciable assets, paragraph 18 of IAS 20 specifies 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.

An income grant is a grant that is not related to assets. Under IAS 20, an entity may present the receipt of such a grant in the income statement either as (1) a credit to income or (2) a reduction in the related expense that the grant is intended to defray. 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 requirements that it must meet to receive or retain any grant from the government.

See [Appendix B](#) for a decision tree that summarizes the impacts of accounting for transferable credits under the government grant model (i.e., outside the scope of ASC 740).

Example 2

Assume the same facts as in [Example 1](#), except that Transferor A has elected to use the government grant model. The fair value of the grant is equal to the amount that A expects to receive from selling the credit. Transferor A also obtains reasonable assurance related to meeting the conditions associated with the grant and the likelihood that it will receive such grant on January 1, 20X6.

Below are A's journal entries (1) if it elected to deduct the grant from the carrying amount of the asset and (2) under the deferred income approach, assuming that A recorded the grant separately within other income.

Reduced Carrying Value Approach

20X5

PP&E	2,000	
Cash		2,000
To record the costs to construct the small wind electric system.		

20X6

Other assets — grant asset	110	
PP&E		110
To record the transferable credit when the small wind electric system is placed into service.		

Depreciation expense	189	
Accumulated depreciation		189
To record depreciation expense each year — PP&E of \$1,890 is divided by the useful life of 10 years.		

20X7

Cash	113	
Gain on sale of credit		3
Other assets — grant asset		110
To record the sale of the transferable credit.		

Example 2 (continued)**Deferred Income Approach****20X5**

PP&E	2,000	
Cash		2,000
To record the costs to construct the small wind electric system.		

20X6

Other assets — grant asset	110	
Deferred income		110
To record the transferable credit when the small wind electric system is placed into service.		

Depreciation expense	200	
Accumulated depreciation		200
To record depreciation expense each year — PP&E of \$2,000 is divided by the useful life of 10 years.		

Deferred income	11	
Other income		11
To record income — deferred income of \$110 is divided by the useful life of 10 years.		

20X7

Cash	113	
Gain on sale of credit		3
Other assets — grant asset		110
To record the sale of the transferable credit.		

Insurance

When a buyer acquires transferable credits, it typically assumes any validity risk associated with them. That is, the buyer would be responsible for any additional tax liabilities (including interest and penalties) if any purchased credits are deemed to be wholly or partially invalidated by the Internal Revenue Service (IRS). A seller (i.e., the transferor) may or may not indemnify the buyer against such risks. For example, a transferor may agree to refund amounts to the buyer if a sold credit is later invalidated by the IRS. Alternatively, the transferor may purchase an insurance policy on behalf of the buyer under which a third-party insurance company will compensate the buyer if the IRS determines that a purchased credit is invalid.

If a transferor is obligated to purchase insurance in connection with the sale of transferable credits to avoid being primarily responsible for losses resulting from the invalidation of credits, the transferor would be expected to treat the policy as a separate unit of account. That is, the proceeds from the sale of the credits to the buyer might need to be allocated to both (1) the credits and (2) the obligation to provide insurance. Further, the transferor must determine whether it is the principal or an agent for the sale of the insurance policy (if the policy is being purchased on behalf of the buyer).

If the insurance policy is purchased by the seller but names the purchaser as the insured party, the seller would need to consider whether its role was to arrange for the insurance to be provided directly to the buyer (as an agent). If so, the seller would account for the policy on a net basis; that is, the seller would allocate the proceeds paid by the buyer to both the insurance and the credit and would reflect the cost of the insurance as a reduction to the proceeds received from the sale.

If the insurance policy represents insurance of the seller's own risk and no payout would be subsequently passed along to the buyer, or if the buyer is the named beneficiary (but the seller is still primarily responsible to the buyer for any losses resulting from the invalidation of credits), we believe that the seller typically would conclude that it should separately record the cost of the insurance policy as an expense. That is, none of the proceeds received or receivable in connection with the sale of the credits would be allocated to the insurance policy.

Other Indemnification

When a transferor indemnifies a buyer against credit invalidation risk (irrespective of whether the transferor has insured its risk), the entity should determine whether to account for the conditional obligation to pay amounts to the buyer as a guarantee within the scope of ASC 460. If the conditional obligation to repay amounts to the buyer is not a guarantee within the scope of ASC 460, such obligation would give rise to variable consideration and, as a result, the seller could record a refund liability (reflecting its conditional obligation to refund consideration to the buyer). This would affect the gain or loss recorded on the sale of the credits.

Transfer of Control

Selling a transferable credit will typically result in the derecognition of the credit from the entity's balance sheet, and the presentation of any gain or loss on the income statement will depend on the entity's accounting policy elections discussed above. The sale of a transferable credit is not explicitly discussed in ASC 740 or other GAAP, but ASC 610-20 applies to the gains or losses recognized upon the sale and derecognition of nonfinancial assets. ASC 610-20-15-2 states, in part, that the scope of ASC 610-20 specifically includes intangible assets:

Except as described in paragraph 610-20-15-4, the guidance in this Subtopic applies to gains or losses recognized upon the derecognition of nonfinancial assets and in substance nonfinancial assets. Nonfinancial assets within the scope of this Subtopic include intangible assets, land, buildings, or materials and supplies and may have a zero carrying value.

When an entity applies IAS 20 by analogy, we believe that it is appropriate for the entity to consider a transferable credit to be a nonmonetary asset (which is similar to a nonfinancial asset) and, therefore, to apply ASC 610-20 when derecognizing such credit. ASC 610-20-25-5 through 25-7 provide guidance on when an entity should derecognize a nonfinancial asset. Such guidance states that an entity must first determine that the contract with the other party meets the criteria in ASC 606-10-25-1 and identify all distinct nonfinancial assets within the sale. We believe that an entity should carefully consider whether any conditions precedent to the close of the sale, which would otherwise make the transfer and sale agreement cancellable, have been satisfied. That is, for the criteria in ASC 606-10-25-1 to be met, the agreement must be noncancellable. An entity then derecognizes the nonfinancial asset when control transfers to the purchasers in accordance with ASC 606-10-25-30, which addresses an entity's satisfaction of a performance obligation at a point in time.

Note that to transfer control of a credit, an entity must first have control of such credit. That is, the relevant credit must have already been generated and the selling entity must have the present ability to direct the use of and obtain the benefit from it. The entity must also consider whether it has met the applicable criteria for recognizing (i.e., earning) the credit under either ASC 740 or the government grant model (depending on its policy election). Therefore, if an entity has not recognized the transferable credit (i.e., since the entity does not control it), no

credit could be sold and therefore no gain or loss would be recorded. If an entity receives cash proceeds for the sale of credits that have not yet been recognized, we believe that a liability (e.g., a deposit liability) should be recorded for any cash consideration received until the recognition (and derecognition) criteria have been met.

When derecognizing transferable credits, an entity may need to use significant judgment to determine when control has been transferred to the purchaser. In accordance with ASC 606-10-25-25, “[c]ontrol of an asset refers to the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset.” ASC 606-10-25-30 provides the following five indicators of when control of an asset transfers:

- “The entity has a present right to payment for the asset.”
- “The customer has legal title to the asset.”
- “The entity has transferred physical possession of the asset.”
- “The customer has the significant risks and rewards of ownership of the asset.”
- “The customer has accepted the asset.”

To transfer a tax credit, the seller first generates the credit and completes a prefiling to obtain a registration number from the IRS. The seller identifies a transferee (i.e., a buyer) and gives such entity all the documentation it needs, including the credit’s registration number, to claim the credit on its tax return. Both the seller and buyer of the credit must then complete a transfer election statement, which describes the terms of the credit and requires each entity to provide certain representations. Finally, the entities will file their tax returns and attach their transfer election statements.

The process used to transfer a tax credit may be different from the approach undertaken to transfer other nonfinancial assets and in-substance nonfinancial assets. In practice, certain of the indicators in ASC 606-10-25-30 are more complex to analyze than others, and they may be more relevant for a sale of a transferable credit. Each indicator is discussed below.

Present Right to Payment — ASC 606-10-25-30(a)

While it is important to analyze a present right to payment for the transferable credit, the possession of such right is often not sufficient evidence that control of the transferable credit has passed on to the purchaser. This is because the entity may be entitled to payment before the purchaser is able to direct the use of and obtain the benefit from the credit. The point in time at which an entity has a present right to payment may differ between transfers and depends on when during the sale process the entities agree that payment should occur. However, if an entity does not have a present right to payment, this may be an indicator that the control of the credit has not transferred.

Legal Title — ASC 606-10-25-30(b)

Legal title to an asset is typically evidence of an ownership claim for that asset. For transferable credits, claim of ownership may be demonstrated by the presentation of a fully executed transfer election statement. Because of the nature of such credits, the ownership claim may not transfer upon the contract’s signing; instead, it would transfer upon the completion of the transfer election statement by both parties to the transaction.

Entities will need to carefully evaluate whether the transfer of a claim of ownership is sufficient evidence that control has transferred. This is because control refers to the ability to direct the use of and obtain the benefit from an asset. For a transferable credit, the benefit to the buyer is ultimately its ability to satisfy a tax obligation to the federal government. Accordingly, although transfer election forms may have been provided to a buyer, both transferors and purchasers still must consider whether they must perform other activities to complete the transfer and allow the purchaser to realize the benefit (e.g., file tax returns with the election

statement attached). If the remaining activities are deemed administrative and perfunctory, a transferor may conclude that control of a tax credit has transferred before the final activities necessary for the buyer to realize the benefit have been performed.

Physical Possession —ASC 606-10-25-30(c)

Physical possession of the transferable credit is not a relevant indicator since transferable credits are intangible assets.

Risks and Rewards — ASC 606-10-25-30(d)

Since there are numerous points at which a transferor may relinquish control during the sale process, it is important to consider whether any risks or rewards remain with the transferor. Rewards of ownership of a tax credit are typically transferred to the customer upon execution of the transfer election statement and when any remaining seller activities are deemed perfunctory. These are the points in time at which the purchaser can claim the credit and obtain the benefit (i.e., a reduction of taxes owed). Determining when the purchaser has obtained the risks of ownership of the asset can be more complex. As discussed further in the [Purchaser's Accounting](#) section, sellers may indemnify the buyer if a recapture event or other disallowance occurs. A recapture event generally arises when a disposition of an asset that resulted in a tax credit occurs within a period prescribed by the IRS or other taxing jurisdiction. A recapture event causes repayment of some or all of the tax credit to the government in the tax year of the disposition. If an indemnity clause is included in the agreement between the transferor and purchaser, the transferor would be required to pay the purchaser the amount of the credit that was repaid to the government.

Indemnity clauses could result in the transferor's retention of some level of risk related to the credits sold. Such risk could include having to meet ongoing requirements for the credit to remain valid. An entity would need to consider any such retained risk when determining whether and, if so, when control of the credits has transferred to the buyer. However, if the remaining risks associated with the validity or realizability of the credits are insignificant (e.g., there is a remote likelihood that a credit would be invalidated), a transferor's indemnification might not affect whether control of the credits has transferred.

Customer Acceptance — ASC 606-10-25-30(e)

A purchaser may receive the registration number of the credit and any other documentation it needs to claim the credit, but this does not necessarily mean that the entity has accepted the credit. An entity must carefully consider the terms of the contract between the purchaser and seller to determine whether other conditions must be satisfied (e.g., buyer due diligence) before transferred credits are deemed accepted by the purchaser. The entity should also carefully consider any of the purchaser's rights related to obtaining a refund of consideration transferred.

As noted above, an entity may need to use significant judgment to determine when control of the transferable credit is relinquished by the seller and obtained by the purchaser. Given the complexity involved, we encourage entities to consult with their accounting advisers.

Government Grants Project

On November 19, 2024, the FASB issued a proposed ASU that would add guidance to ASC 832 on the recognition, measurement, and presentation of government grants. In the absence of such guidance, many companies have analogized to other guidance, including IAS 20 or ASC 958-605, when accounting for such grants. In developing the proposed ASU's recognition and measurement framework, the FASB largely leveraged the guidance in IAS 20.

Unlike IAS 20, the FASB's proposed guidance in ASC 832 excludes grants of intangibles. Accordingly, it is uncertain whether entities would be able to account for transferable credits by analogizing to the proposed guidance or whether the FASB intended a different outcome (i.e., all nonrefundable transferable credits would be accounted for under ASC 740 rather than by using a government grant model). A possible outcome of the proposed ASU would be a requirement to treat transferable tax credits as monetary grants, in which case entities would no longer be allowed to record the grants at a nominal amount since the grants would have to be recorded at fair value. Alternatively, entities could still be allowed to analogize to IAS 20 for these credits. Entities that generate transferable credits will need to assess the final ASU, when issued, and consult with their accounting advisers regarding the treatment of transferable credits.

Purchaser's Accounting

Accounting for the Purchase of Transferable Credits

As discussed above, a transferable credit generally may be transferred only one time. In such instances, the entity that purchases the transferable credit can only use it to reduce its own income tax liability and would therefore account for the credit under ASC 740.

When a tax credit is transferred, the purchase price may often be at a discount from the credit amount. An entity that purchases a transferable credit should generally record a DTA for the amount of tax credits purchased and a deferred credit for the amount of the discount (i.e., the difference between the amount paid and the DTA recognized in accordance with ASC 740). Such deferred credit does not represent a deferred tax liability, and the DTA would be assessed for realizability under ASC 740 in a manner similar to any other DTA. The deferred credit will be reversed and recognized as an income tax benefit in proportion to the deferred tax expense recognized upon utilization of the associated DTA (i.e., as the credits are used on the tax return). The example below illustrates this guidance.

Example 3

Assume that Company A is a calendar-year-end entity. During the year ended December 31, 20X1, A purchased \$2,000 of tax credits from Company B for \$1,800 in cash. Under the tax law, the credits can only be transferred once. Company A expects to use \$1,000 of the tax credits in its tax return for 20X1 and the remaining \$1,000 of credits in its tax return for 20X2.

Before considering the utilization of the credits, assume that A had recorded an income tax liability of \$1,000 and \$5,000 for the years ended December 31, 20X1 and 20X2, respectively. Thus, the utilization of the \$1,000 of tax credits in each year is expected to reduce A's current tax liability to zero in 20X1 and to \$4,000 in 20X2. Below are the journal entries that A would record in 20X1 and 20X2.

Year Ended December 31, 20X1

To recognize the initial purchase of the credits:

DTA	2,000	
Deferred credit		200
Cash		1,800

Example 3 (continued)

To recognize the expected utilization of the credits in A's 20X1 tax return and the corresponding reversal of the deferred credit:

Deferred tax expense	1,000	
DTA		1,000
Current taxes payable	1,000	
Current tax expense		1,000
Deferred credit	100	
Tax expense		100

Year Ended December 31, 20X2

To recognize the expected utilization of the credits in A's 20X2 tax return and the corresponding reversal of the deferred credit:

Deferred tax expense	1,000	
DTA		1,000
Current taxes payable	1,000	
Current tax expense		1,000
Deferred credit	100	
Tax expense		100

The purchaser of transferable credits can only recognize the credits when the more-likely-than-not recognition criteria in ASC 740 are met. Because ASC 740 does not provide explicit guidance on the timing of recognition for purchased transferable credits, the purchaser may consider the factors discussed above regarding the transfer of control under ASC 610-20 when assessing whether control of the asset has been transferred from the transferor to the purchaser. This would include consideration of the specific terms of the contract associated with the purchased credits as well as timing of the execution of the related transfer election statements. See the [Transfer of Control](#) section above for additional considerations. If amounts are paid for credits before the recognition criteria are met, we would expect such amounts to be reflected as a prepaid asset or a deposit. Given the complex judgment that entities must apply in assessing the timing of the transfer of control, consultation with appropriate accounting advisers is encouraged.

Transaction Costs

An entity that purchases transferable credits may incur transaction costs, including other direct costs, in connection with such purchase. While Case F in ASC 740-10-55-199 through 55-201 addresses the purchase of future tax benefits (e.g., transferable credits), such guidance does not explicitly discuss the accounting for transaction costs incurred in connection with the purchase. Rather, ASC 740-10-55-201 simply states that a deferred credit should be recorded for the difference between the gross amount of the credit and the "purchase price." Given the lack of explicit guidance, we believe that there are two acceptable views on determining the "purchase price" (and hence the accounting for transaction costs):

- *View 1* — Transaction costs are treated as additional consideration paid for the credits, in a manner similar to how transaction costs are accounted for as part of the cost of an asset acquisition. This reduces the amount of the deferred credit that is recorded upon purchase, thus decreasing the amount of income tax benefit that would otherwise have been recorded upon reversal of the deferred credit. Under no circumstances, however, should the purchased credit be recorded at an amount greater than the gross amount of the credit.

- *View 2* — Transaction costs are treated separately from the purchase of the credits and are expensed as incurred within pretax income, in a manner similar to existing practice for other ancillary costs paid to entities other than taxing authorities (e.g., preparation and consulting costs) that are outside the scope of ASC 740.

Credit Insurance and Seller Indemnification

The purchaser of a transferable credit often obtains the risks of ownership from the transferor (e.g., the purchaser would assume the risk of underpaying taxes if the credits are invalidated by the IRS). To mitigate this risk, the seller may purchase credit insurance on behalf of the buyer and name the buyer as the insured party. Alternatively, the seller may include indemnification clauses that protect the buyer from credit recapture.

When sellers provide buyers with insurance from a third party, buyers should treat the receipt of the credit and the receipt of the insurance policy separately. For the insurance portion of the transaction, an entity should look to ASC 720-20, which provides guidance on the scope of insurance contracts. ASC 720-20-25-2 refers the insured entity to ASC 944-20-15, which provides guidance on whether the risk associated with a loss has transferred to the insurer from the buyer. If an entity determines that the risk has transferred and the purchased policy qualifies as insurance under U.S. GAAP, the entity will record expenses in accordance with ASC 720-20. Most insurance related to tax credits addresses risk associated with the validity of the credit that has already been generated. Because the risk is related to events or conditions that have already occurred, the associated insurance would be considered retroactive since there is no future event that governs whether a credit is valid. As a result, the cost of the policy would be expensed upon initial recognition. Additional considerations may be necessary if the insurance policy addresses future invalidation events (e.g., credit recapture due to an invalidation event triggered by the seller after the sale of the credits).

Subsequently, if a recapture event or other disallowance results in a loss for the purchaser, the purchaser should increase its income taxes payable and record an associated expense within the income tax provision. Any insurance recovery and resulting receivable would be separately accounted for and recorded in accordance with ASC 410-30 or the entity's accounting policies on insurance recoveries.

If the seller indemnifies the purchaser in the sale of a transferable tax credit and a recapture event or another disallowance subsequently occurs, we believe that the buyer should record a liability and corresponding income tax expense. This is similar to a seller's treatment in situations in which the seller provided an insurance policy to the buyer.

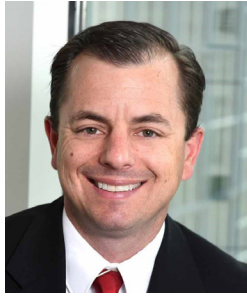
Rather than recording a recovery from the seller as a benefit in the income tax provision, an entity should account for the recovery separately as a gain within income from operations. This includes repayments by the insurer or the seller that provided the purchaser with the indemnification.

Other Resources

For additional information, see the following Deloitte publications:

- [Financial Reporting Alert](#) on the accounting for tax credits under the CHIPS Act and the Inflation Reduction Act.
- [Heads Up](#) on the FASB's proposed ASU on the recognition, measurement, and presentation of government grants.
- [Income Taxes Roadmap](#), which includes a comprehensive discussion of income tax credits.

Contacts



Chris Chiriatti
Audit & Assurance
Managing Director
Deloitte & Touche LLP
+1 203 761 3039
cchiriatti@deloitte.com



Matt Himmelman
Audit & Assurance
Partner
Deloitte & Touche LLP
+1 714 436 7277
mhimmelman@deloitte.com



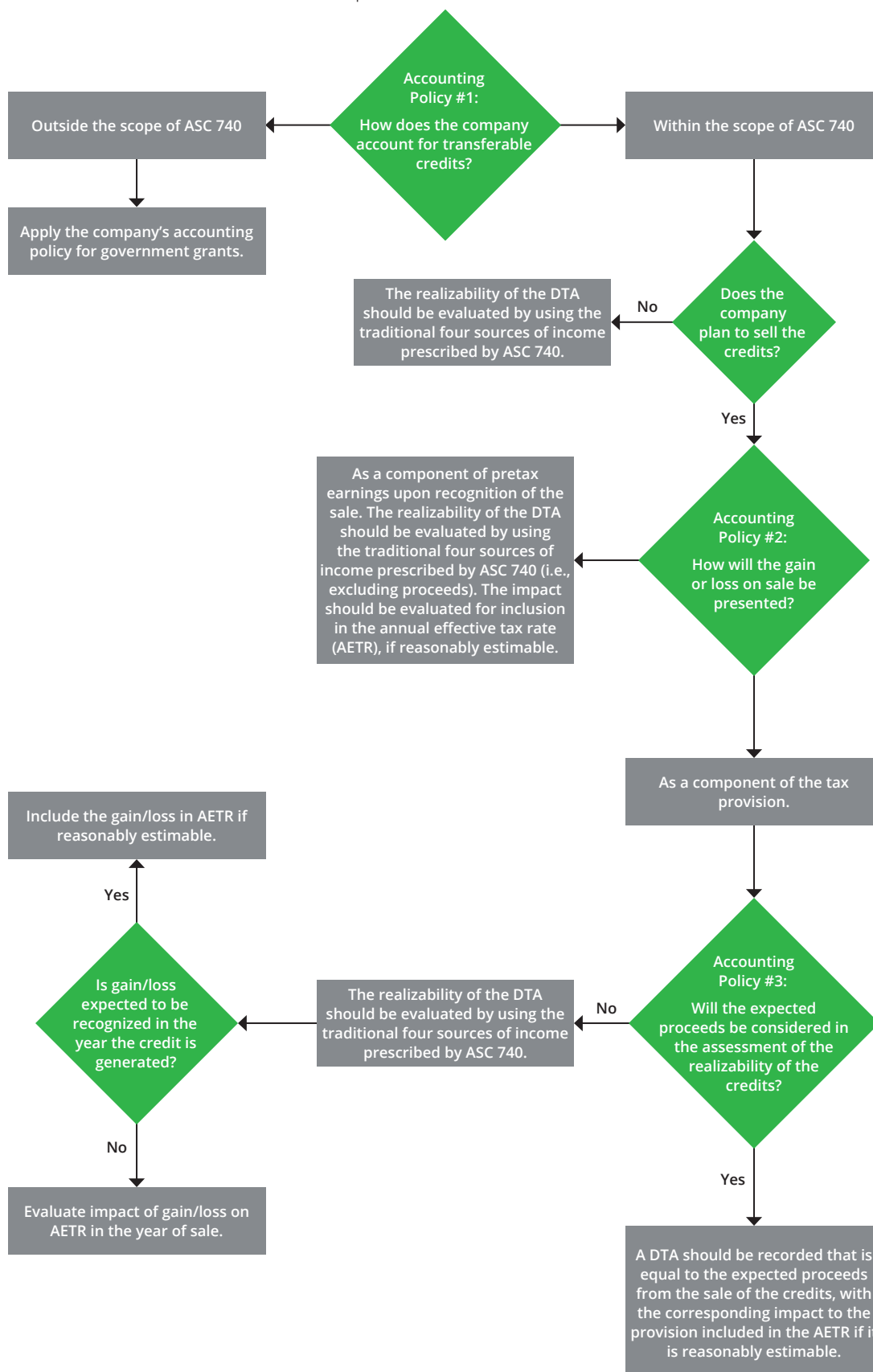
Tim Burns
Audit & Assurance
Senior Manager
Deloitte & Touche LLP
+1 862 505 9673
tiburns@deloitte.com



Michael Parducci
Audit & Assurance
Senior Manager
Deloitte & Touche LLP
+1 425 466 7474
mparducci@deloitte.com

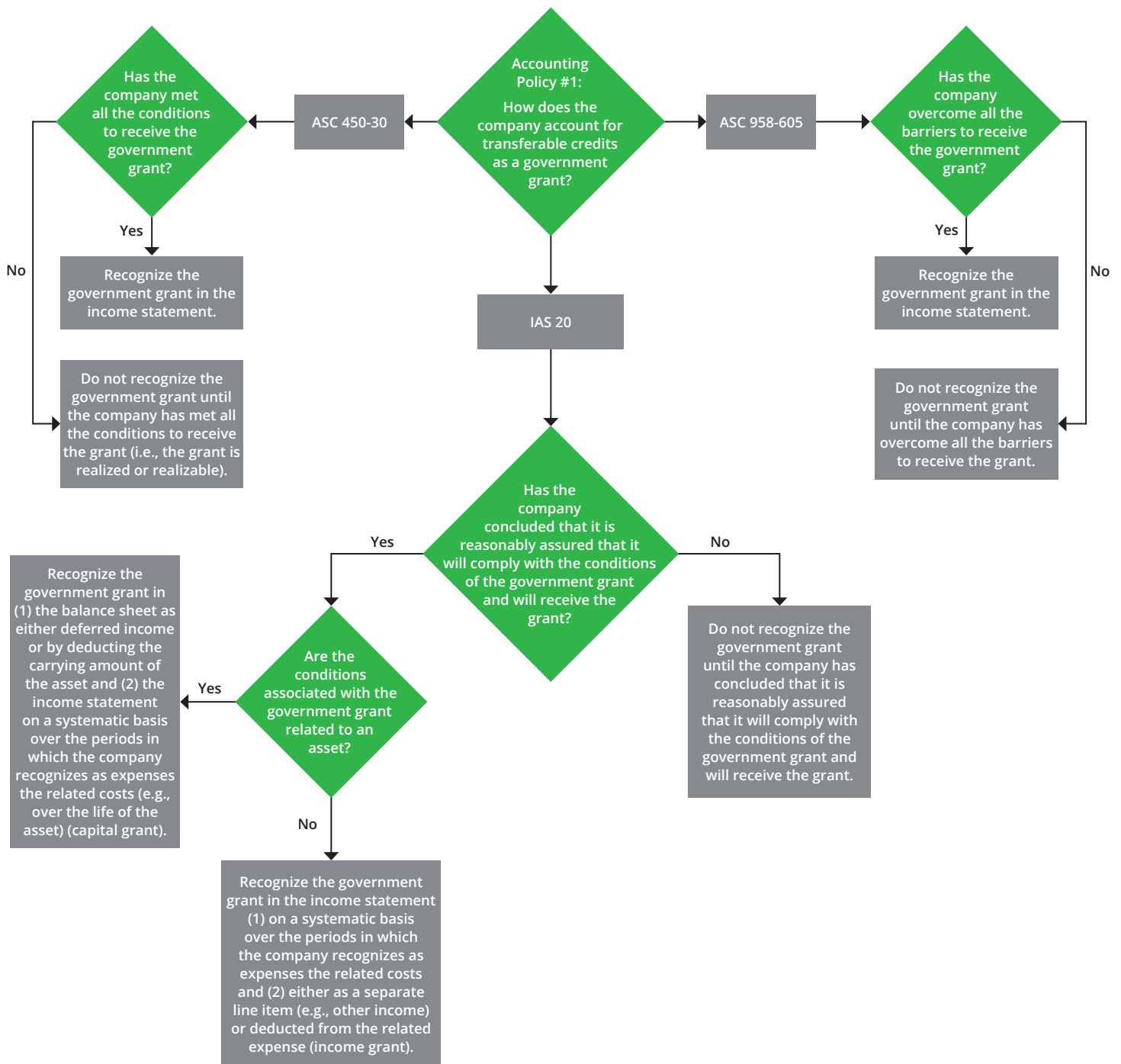
Appendix A — Decision Tree: Accounting Under ASC 740

The decision tree below summarizes the accounting impacts of an entity's elections related to the initial recognition of transferable tax credits accounted for within the scope of ASC 740.



Appendix B — Decision Tree: Accounting Under the Government Grant Model

The decision tree below summarizes the accounting impacts of an entity's elections related to the initial recognition of transferable tax credits accounted for under the government grant model (i.e., outside the scope of ASC 740).



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