1971

Proposed APB opinion : Accounting for investment tax credits;Accounting for investment tax credits

American Institute of Certified Public Accountants. Accounting Principles Board

Ref. No. 1056

EXPOSURE DRAFT

OCTOBER 22, 1971

Proposed APB Opinion

Accounting for Investment Tax Credits

This proposed Opinion was drafted on the basis of the bill (HR 10947) passed by the House October 6 and will require that benefits arising from investment tax credits be accounted for as reductions of income tax expense over the periods in which the cost of the related property is charged to income. In taking final action, the Board will, of course, take into consideration any changes in relevant provisions of the law as finally enacted that differ substantially from those provisions in the House bill.

Issued by the Accounting Principles Board of the
American Institute of Certified Public Accountants
for Comment from Persons Interested in Financial Reporting

Comments should be received by November 30, 1971 and addressed to Richard C. Lytle, Administrative Director, APB at the Institute's Offices, 666 Fifth Avenue, N.Y., N.Y. 10019

INTRODUCTION

1. The United States Internal Revenue Code from time to time has provided for selective tax benefits as incentives to accomplish desired objectives, such as stimulating investment in certain types of property. This Opinion states the views of the Accounting Principles Board on the appropriate accounting for investment tax credits (job development credits).

2. This Opinion supersedes APB Opinion No. 2, *Accounting for the "Investment Credit"*, except the Addendum thereto, and APB Opinion No. 4 (Amending No. 2), *Accounting for the "Investment Credit"*, and paragraph 4 of APB Opinion No. 11 *Accounting for Income Taxes*. This Opinion should be applied to regulated companies in accordance with the provisions of the Addendum to APB Opinion No. 2.

DISCUSSION

3. Under the United States Internal Revenue Code the investment tax credit resulting from expenditures for qualifying property is claimed as a credit against income taxes otherwise payable. Thus, for income tax purposes, benefits arising from investment tax credits depend on two conditions: (1) an investment in qualifying property and (2) the existence of taxable income. Two principal methods have been followed in accounting for benefits arising from investment tax credits:

a. The "flow through" method reduces income tax expense for the periods in which expenditures create tax benefits. This method is premised on the view that realization of the benefit of the investment tax credit is effected by the generation of taxable income and that realization does not depend on, or relate to, future productive use of the related property (so long as the property is held for the qualifying period for income tax purposes) or to revenues earned during subsequent periods. Under this method the investment tax credit is viewed as a selective tax reduction in the periods taxes otherwise payable are reduced by the credit. Thus, the tax credit is not considered to be a reduction of the cost of the property acquired.

b. The "deferral" method defers the benefit arising from the investment tax credit and amortizes that benefit as a reduction of income tax expense over the periods in which the cost of the related property is charged to income. Under this method the investment tax credit is viewed in substance as a reduction of, or offset to, the cost of the property that results in the credit. The tax credit is not viewed as resulting in a reduction of income tax expense prior to the time the cost of the related asset is charged to income. Thus, the tax benefit follows the accounting for the related asset and is reflected in income proportionately as the cost of the asset is charged to income.

OPINION

4. The Board concludes that benefits arising from investment tax credits should be accounted for as reductions of income tax expense over the periods in which the cost of the related property is charged to income, as discussed in paragraph 3b.[1] The Board believes that this conclusion will result in a more meaningful presentation of the economic facts to investors and other users of financial statements. Amortization of the tax benefits deferred should be proportional to the amortization of the related expenditures.

5. Investment tax credits should be recognized as deferred investment tax credits only to the extent that the benefits (a) have been utilized as offsets against income taxes payable, (b)

---

[1] In certain circumstances the benefit related to an investment tax credit may be realized in a financing transaction (usually by a lending institution) as an element of the "yield" on the financing. The benefits of such tax credits may be recognized over the appropriate term of the financing transaction.

If the investment tax credit serves to reduce income taxes otherwise payable by a lessee of property, the benefits should reduce income tax expense over the periods in which the related charge is made to income.

would have been utilized as offsets against income taxes otherwise payable except for the effect of timing differences, (see paragraph 36 of APB Opinion No. 11) or (c) having not been so utilized or applied, are subject to unusual circumstances so that utilization is assured beyond any reasonable doubt at the time the credits arise. The benefits recognized under (a), (b), or (c) should be amortized to income tax expense in accordance with the provisions of paragraph 4.

6. If legislation were to be enacted providing that the depreciable tax basis of any property qualifying for investment tax credit be reduced to the extent of the credit, the amount of such reduction would have an effect similar to a timing difference (APB Opinion No. 11) and should be so treated. The balance of the tax reduction arising from the investment tax credit should be amortized in accordance with the provisions of paragraphs 4 and 7.

7. Investment tax credits may be unused because of the absence of taxable income or because of limitations provided in the Internal Revenue Code. Benefits of investment tax credit carryforwards should not be recognized as deferred credits except as set forth in paragraph 5. When unused investment tax credit carryforwards are recognized in a period subsequent to the period in which the related expenditure was made, the benefits should be recorded as deferred credits and amortized to the current and future periods as the remaining cost of the related property is depreciated.

8. The amount of benefits of investment tax credits that enter into the provision for income taxes and into the amounts of taxes payable in a period should be disclosed. Amounts of benefits of investment tax credits not utilized in the reduction of taxes payable (together with expiration dates) and that portion of those amounts recognized because of the effect of timing differences or because utilization is assured beyond any reasonable doubt should be disclosed (paragraph 5b and c).

9. The conclusions of this Opinion should be applied in all situations unless the results of application would be clearly immaterial in relation to the income tax provision, net income, and the trend of earnings.

10. This Opinion shall be effective for all benefits of investment tax credits arising under legislation enacted subsequent to December 31, 1970 as a part of the United States Internal Revenue Code. Similar benefits arising under taxation laws of other countries should be accounted for in a manner consistent with the concepts of this Opinion.

NOTES

Opinions of the Accounting Principles Board present the conclusions of at least two-thirds of the members of the Board, which is the senior technical body of the Institute authorized to issue pronouncements on accounting principles.

Board Opinions are considered appropriate in all circumstances covered but need not be applied to immaterial items.

Covering all possible conditions and circumstances in an Opinion of the Accounting Principles Board is usually impracticable. The substance of transactions and the principles, guides, rules, and criteria described in Opinions should control the accounting for transactions not expressly covered.

Unless otherwise stated, Opinions of the Board are not intended to be retroactive.

Council of the Institute has resolved that Institute members should disclose departures from Board Opinions in their reports as independent auditors when the effect of the departures on the financial statements is material or see to it that such departures are disclosed in notes to the financial statements and, where practicable, should disclose their effects on the financial statements (Special Bulletin, *Disclosure of Departures from Opinions of the Accounting Principles Board,* October 1964). Members of the Institute must assume the burden of justifying any such departures.