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ACCOUNTING INTERPRETATIONS FOR THE INVESTMENT CREDIT

Several Accounting Interpretations of the investment credit will be published in the April issue of The Journal of Accountancy in view of Treasury releases dated Dec. 21, 1971 and Jan. 10, 1972 explaining the investment credit provisions of the Revenue Act of 1971 and specifying Dec. 10, 1971 as the effective date for the accounting requirements for the Act. The Interpretations summarized below apply to all financial statements prepared in accordance with GAAP.

Change in Accounting Method (APB Opinion No. 20) -- Under the Act, a taxpayer has a one-time "free choice" to select a different method to account for the investment credit in financial reports subject to the jurisdiction of or made to a federal agency. Once adopted, a method may not be changed without Treasury consent.

"Old" Investment Credits -- The accounting method used for credits previously reported for years ending before Dec. 10, 1971 should be continued for those credits in financial statements issued after Dec. 9, 1971 even though the taxpayer elects to use a different method to account for 1971 Act credits. In view of the Treasury releases, the "old" credit is considered terminated as of Dec. 9, 1971 and par. 16, APB Opinion No. 20 applies. Adopting a different method for 1971 Act credits is like adopting a different amortiziation method for new assets (See par. 24, APB Opinion No. 20).

"New" Credits Allowable before December 10, 1971 -- A credit arising under the 1971 Act but allowable in a taxable year ending before Dec. 10, 1971 may be accounted for either by the method used in prior years or by a different method, which should be continued in following years for future credits.

Carrybacks and Carryforwards -- The credit may be recognized by including it in the "with and without" computation described in par. 36, APB Opinion No. 11, although it is a tax carryback or carryforward. Thus, when different methods are used in different years and carrybacks or carryforwards are involved, the method applicable to a particular credit is the method used for the year in which the credit is recognized in the financial statements.

A credit arising in a taxable year ending after Dec. 9, 1971 but carried back to a prior year or a credit arising under prior Acts but allowable after Dec. 9, 1971 and not previously reported should be accounted for by the "free choice" method.

The Treasury releases do not apply to credits reported in annual income statements for years ending before Dec. 10, 1971 although they are carryforwards for tax purposes. They should be accounted for in the normal manner when realized.

Consistency Exception in Auditor's Report -- A change in method of accounting for the investment credit calls for a consistency exception if it has a material effect in the current year. A "free choice" change should be disclosed as specified by par. 24 of APB Opinion No. 20.

(continued)

Investment Credit is Prior Period Adjustment -- An investment credit arising under the 1971 Act and allowable in a taxable year ending before Dec. 10, 1971 is considered to be an event of that fiscal year. If the financial statements have not yet been issued, they should include the credit (this is a type 1 subsequent event under SAP No. 47). If the financial statements have already been issued, the credit will be a prior period adjustment.

Tax Credit Disclosure -- An Accounting Interpretation issued in Feb. 1972 on disclosure of the investment credit is modified as to disclosure of method. The method of accounting should be disclosed in all reports for taxable years ending after Dec. 9, 1971 even though the amount is not material. If more than one method is used (for example, the deferral method for "old" credits and the flow-through method for "new" credits), all methods should be disclosed. The amounts may be omitted only if they are clearly insignificant.

Acceptable Accounting Methods -- The Jan. 10 Treasury release interpreted the Act as permitting only the flow-through or deferral methods to account for credits allowable for taxable years ending after Dec. 9, 1971. Under flow-through, the credit is a reduction of tax expense in the year it is recognized in the financial statements. Under the deferral method, the credit is amortized over the period and by the method the asset is depreciated for financial reporting purposes. The period may be the specific life of each asset or the composite life of all assets, but the recapture period of the credit is not acceptable.

A financing institution may include the credit as part of the proceeds from leased property accounted for by the financing method and include it in determining the yield from the "loan." It may account for the credit on property purchased for its own use by either the flow-through or deferral method.

A lessee's amortization period under the deferral method for the investment credit passed through for leased property not capitalized is the term of the lease, including renewal options reasonably expected to be exercised.

Investment Credit in Consolidation -- A single method of accounting for the investment credit should be adopted under the one-time "free choice" by a parent company and its subsidiaries in consolidated financial statements (including subsidiaries carried on the equity method) and other financial reports.

FRANCHISE TAXES BASED ON INCOME -- ACCOUNTING INTERPRETATION

The Ohio corporation franchise/income tax enacted Dec. 20, 1971 is considered to be composed of two elements for accounting purposes. To the extent the tax is based on stockholders' equity, it is a franchise tax to be accrued in the year to which the privilege relates. Any additional tax due, based on income, is an income tax to be accrued in the year the income was earned. If 1971 financial statements already have been issued, any additional tax, based on income, for years ending in 1971 will be a prior period adjustment.

"LEVERAGED" LEASE ACCOUNTING -- ACCOUNTING INTERPRETATION

Financing institutions enter into "leveraged" leases and rapidly recover their equity yield on a cash-flow basis (subject to income tax payments in later years) although the lease provides a low rate of return on total investment over its life. The deferred method should be followed for interperiod tax allocation in recognizing income from these leases and income taxes should not be directly or indirectly discounted.