

Accounting for the Inflation Reduction Act and the CHIPS Act

What's inside

Accounting for tax law changes.....1

Key provisions of the IRA.....1

 Corporate alternative minimum tax.....1

 Excise tax on corporate stock repurchases.....3

 Climate and clean energy provisions.....4

Key provisions of the CHIPS Act...6

 Advanced manufacturing investment tax credit.....6

What's next6

At a glance

On August 16, President Biden signed the Inflation Reduction Act (the IRA) into law, which includes implementation of a new alternative minimum tax, an excise tax on stock buybacks, and significant tax incentives for energy and climate initiatives, among other provisions.

On August 9, President Biden signed the Creating Helpful Incentives to Produce Semiconductors (CHIPS) Act into law, which includes an advanced manufacturing investment tax credit, among other provisions.

This *In depth* does not include a comprehensive discussion of all aspects of the IRA or CHIPS Act. Instead, it is focused only on the provisions of each law that may have accounting implications. We will expand this *In depth* for additional topics as needed and update it as interpretations evolve.

The section on the excise tax on corporate stock repurchases was updated on August 31. The section on the corporate alternative minimum tax was updated on September 28. The section on the accounting for the climate and clean energy provisions was updated on November 7 to reflect consideration shared by the FASB staff.

Accounting for tax law changes

Under US GAAP, changes in income tax rates and law are accounted for in the period of enactment. For US federal purposes, the enactment date for US GAAP is the date the President signs the bill into law.

Although some entities may determine that certain provisions in the IRA require accounting in the period of enactment, the majority of the provisions in the IRA with accounting implications will impact financial statements prospectively. The only aspect of the CHIPS Act that is expected to have an accounting impact will not require any accounting in the period of enactment.

Key provisions of the IRA

Corporate alternative minimum tax (updated September 28)

The corporate alternative minimum tax (CAMT) imposes a minimum tax on the adjusted financial statement income (AFSI) for “applicable corporations” with average annual AFSI over a three-year period in excess of \$1 billion. A



corporation that is a member of a foreign-parented multinational group, as defined, must include the AFSI (with certain modifications) of all members of the group in applying the \$1 billion test, but would only be subject to CAMT if the three-year average AFSI of its US members, US trades or business of foreign group members that are not subsidiaries of US members, and foreign subsidiaries of US members exceeds \$100 million.

AFSI can generally be described as net income adjusted for certain items. Adjustments include:

- replacing book income, cost, or expense related to a covered benefit plan (e.g., fair value adjustments related to a defined benefit plan) with income or deductions for those covered benefit plans as determined under the tax law,
- replacing the entity's book depreciation for certain property, plant, and equipment with its depreciation as calculated under the tax law, and
- disregarding federal income taxes.

The IRA imposes a tentative minimum tax equal to the excess of 15% of the applicable corporation's AFSI over the CAMT foreign tax credit (CAMT FTC) for the tax year. The CAMT is only due if a taxpayer's tentative minimum tax exceeds its regular tax plus base erosion and anti-abuse tax (BEAT).

Entities that pay tax under the CAMT will receive a tax credit (CAMT credit carryforward) for the tax paid in excess of the amount computed on the basis of the regular tax plus BEAT. The CAMT credit carryforward can be claimed against regular tax in future years (where regular tax plus BEAT exceeds tentative minimum tax) and has no expiration period.

This provision is effective for tax years beginning after December 31, 2022.

Tax accounting implications

Prior to US tax reform in 2017, the US had an AMT regime that was explicitly addressed in US GAAP. When there is both a regular tax system and an alternative minimum tax system with the ability to generate a credit against regular tax liabilities in future years, ASC 740 requires deferred taxes to be measured using the regular tax rate even if the company anticipates remaining subject to the AMT system for the foreseeable future (see ASC 740-10-30-10 through 30-11 and ASC 740-10-55-31 through 55-33). Further, ASC 740 provides that a deferred tax asset should be recognized for the AMT credit carryforward. Finally, the guidance also requires companies to consider the realization of the AMT credit carryforward deferred tax asset similar to any other deferred tax asset.

A company that expects to be a perpetual CAMT taxpayer may not realize the full benefit of its regular deferred tax assets (i.e., deferred tax assets excluding the CAMT carryforward). We understand that the FASB staff believes that the codification does not contain guidance that specifically addresses whether a company should anticipate future years' CAMT in its valuation allowance assessment for its regular deferred tax assets. As a result, the FASB staff believes that a company should make a policy election as to whether to consider the impact of its expectation of future years' CAMT on its valuation assessment for its regular deferred tax assets. The accounting policy election should be applied consistently and accompanied by transparent disclosure.

Excise tax on corporate stock repurchases (updated August 31)

The IRA imposes a nondeductible 1% excise tax on a publicly traded corporation for the net value of certain stock that the corporation repurchases during the tax year.

The value of repurchases subject to the tax is reduced by the value of any stock issued by the corporation during the tax year, including stock issued or provided to the employees of the corporation or employees of a specified affiliate of the corporation during the tax year, whether or not such stock is issued or provided in response to the exercise of an option to purchase such stock. Additional exceptions are noted in the law.

The provision includes special rules for foreign-parented domestic corporations that would treat a repurchase of stock by certain affiliates of a publicly traded foreign corporation (including domestic corporations, domestic partnerships, and foreign partnerships with domestic partners) as if it were a repurchase by a publicly traded US corporation.

This provision would apply to repurchases of stock after December 31, 2022.

Accounting implications

Taxes that are not based on income are outside the scope of ASC 740. Because the excise tax is levied on the gross amount (i.e., the tax basis excludes any expenditures or other adjustments), the effects of the excise tax are not expected to be included in an entity's income tax provision under ASC 740.

US GAAP does not contain explicit guidance for taxes that are not subject to ASC 740, but most transactional taxes – excise taxes, sales taxes, value-added taxes, etc. – are reflected as an additional cost of the underlying pre-tax transaction that gives rise to the tax. Under US GAAP, many stock repurchases are accounted for as equity transactions with no income statement consequence, although certain equity transactions may have income statement consequences and not all shares of stock are classified as equity instruments for accounting purposes. As a result, the US GAAP accounting treatment for a stock buyback transaction may be relevant in determining the appropriate accounting for the excise tax.

We believe that an acceptable approach would be to consider the excise tax as a direct and incremental cost that is associated with the transaction that created it. Under this approach, if a company incurs an excise tax as a result of an open market purchase of equity-classified common stock that is accounted for as a treasury stock transaction, we believe that it would be appropriate to record the excise tax incurred as part of the cost basis of the treasury stock repurchased and to record a corresponding liability for amounts due. We believe that this amount would be calculated without consideration of potential future transactions that may result in a reduction of the excise tax.

Under this approach, any excise tax reductions generated by a subsequent issuance of shares would be reflected as an adjustment to the excise taxes previously recorded during the relevant period. Thus, if later in the same relevant period, the company issues common shares to settle a warrant that was recorded at fair value with changes in fair value reflected in earnings, we

believe that any reduction to the originally accrued excise tax as a result of this issuance of shares should be reported as an adjustment to the cost of the prior treasury stock repurchase. We generally do not believe that it would be appropriate to recognize a reduction to an excise tax liability in earnings that was originally included in the cost basis of an equity transaction.

We also do not believe that it would be appropriate to record an asset if at any point during the relevant period, the company has generated a net surplus of share issuances that might offset potential future excise taxes. For example, if the first transaction in the relevant period that may affect the company's ultimate excise tax liability is a share issuance, we do not believe that a company should record a receivable. In this situation, the company does not have a right to a cash payment from the taxing authority simply by issuing shares. The realization of any excise tax benefit from this share issuance is contingent on future share repurchases. If the company later enters into a share repurchase transaction that would otherwise be subject to the excise tax absent the existence of the share issuances, we believe it would be appropriate at that time to recognize the net excise tax generated by that issuance as a cost of the transaction, considering any unutilized offsetting benefits from previous transactions.

The application of this model may be complex when there are multiple transactions impacted by the excise tax that were accounted for under different accounting models (e.g., recorded in equity, in earnings, or as a deemed dividend). In these situations, companies will need to apply judgment on how to record the effect of offsetting impacts using a consistent model.

Climate and clean energy provisions

The IRA includes significant extensions, expansions, and enhancements of numerous energy-related tax credits and also creates new credits in multiple categories, including advanced manufacturing production credits and credits for clean production of electricity, fuel, hydrogen, and nuclear power.

Certain of the credits have a "direct-pay election" which allows an eligible taxpayer to receive a current benefit from the credit without taxable income or a tax liability. What constitutes an "eligible taxpayer" varies depending on the credit, but for most of the credits, the population of taxpayers eligible for the direct-pay option is fairly narrow and limited generally to tax exempt and governmental entities as well as rural electric cooperatives.

The law also provides an election to transfer (i.e., sell) certain credits to another taxpayer. The transfer may be for all or a portion of a credit, but any credit may only be transferred once. The cash received in exchange for the credits transferred is not includable in taxable income of the transferor nor deductible to the transferee. For most of the credits, the population of entities that can elect to transfer the credit is broader than the population of entities that could elect the direct-pay option, which may cause the transfer election to be more common.

The provisions with respect to the impacted credits have various effective dates. The option for direct-pay and transferability of credits will apply to taxable years beginning after December 31, 2022.

Accounting implications

The application of the ASC 740 income tax accounting model is warranted if a particular credit or incentive can be claimed on the income tax return and can be realized only through the existence of taxable income. When a company is able to receive the benefit of a credit regardless of whether it has income taxes payable or taxable income, we believe the benefit should be accounted for outside of the income tax model. This would apply to credits with a direct-pay option.

When credits are not accounted for under the income tax model in ASC 740, a reporting entity will need to determine the appropriate accounting framework to apply. The direct-pay provisions make many of these credits akin to a government grant or subsidy. Although the FASB has an active project on its agenda on the accounting for government assistance, there is currently no US GAAP that explicitly addresses the accounting by business entities for government assistance. As a result, reporting entities generally analogize to either ASC 958-605, *Not-for-profit entities—Revenue recognition*, or IAS 20, *Accounting for Government Grants and Disclosures of Government Assistance*.

In practice, most for-profit business entities apply an IAS 20 approach to the recognition of government assistance. When applying the IAS 20 accounting model to tax credits in the IRA, a reporting entity will need to identify, understand, and evaluate all conditions of the credits for which it may be eligible to determine when the credit should be recognized in the financial statements as well as to determine the appropriate amounts to recognize.

Income statement classification of the income from a tax credit will vary depending on the facts and circumstances that give rise to the credit and will sometimes be reported as other income while at other times it may be reported as a reduction to the related expenditures that generated the credit. See section 10 in our [In depth](#) on accounting for COVID-19 and market volatility for additional details on the accounting for government assistance.

ASC 740 does not directly address how to account for transferable credits that may be used by a reporting entity as a reduction of income tax payable on its income tax return or that may be sold to another taxpayer. As it relates to the specific credit transferability provisions introduced by the IRA, we understand that the FASB staff believes it is most appropriate to account for such credits as part of the provision for income taxes under ASC 740, regardless of whether the reporting entity that receives the credit claims the credit on its tax return or if that entity sells the credit to another taxpayer. The FASB staff further believes that if a credit is sold, it is most appropriate for any difference between the notional amount of the credit originally received and the proceeds from sale to be recorded in the income tax provision. Because there is no directly applicable GAAP, the FASB staff acknowledges that other views may be acceptable, such as accounting for transferable credits similar to refundable or direct-pay credits by accounting for the entire credit outside of the tax line.

If a reporting entity accounts for transferable credits, including any difference between the proceeds and the notional value of the credits, as part of the income tax provision, it would be appropriate for the reporting entity to consider any expected sale of the credits as a source of realization in its valuation allowance assessment.

Key provision of the CHIPS Act

Advanced manufacturing investment tax credit

The CHIPS Act provides a credit of 25% of an eligible taxpayer's qualified investment in an advanced manufacturing facility. Similar to certain of the energy credits in the IRA, a taxpayer may make an irrevocable election to treat the credit as a payment against tax, thus electing the direct-pay option.

The credit will be subject to recapture for taxpayers that dispose of the property prior to five years after the credit was generated.

The credit applies to qualified property placed in service after December 31, 2022, for which construction begins before January 1, 2027.

Tax accounting implications

As described under the IRA credit provisions, because this credit is refundable to the taxpayer even if the taxpayer does not have taxable income or a tax liability, it is more akin to a government grant and should therefore be accounted for outside of the income tax provision.

What's next

We expect that certain provisions of these tax laws will be the subject of further guidance from Treasury in the months ahead. Entities should monitor developments in the law and assess any potential accounting impacts as the guidance continues to evolve.

To have a deeper discussion, contact:

Jennifer Spang

Partner

Email: jennifer.a.spang@pwc.com

Matt McCann

Partner

Email: matthew.j.mccann@pwc.com

Kassie Bauman

Managing director

Email: kathleen.bauman@pwc.com

Nicole Siroonian

Senior manager

Email: nicole.l.siroonian@pwc.com

For more PwC accounting and reporting content, visit us at viewpoint.pwc.com. On the go? Take our podcast series with you at the [Viewpoint podcasts page](#).