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# Technical Line

## Accounting for the effects of the Inflation Reduction Act and the CHIPS and Science Act

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### What you need to know

- President Biden signed into law the Inflation Reduction Act of 2022 on 16 August 2022 and the CHIPS and Science Act of 2022 on 9 August 2022. These laws implement new tax provisions and provide for various incentives and tax credits.
- The Inflation Reduction Act creates a 15% corporate alternative minimum tax on profits of corporations whose average annual adjusted financial statement income for any consecutive three-tax-year period preceding the tax year exceeds $1 billion and is effective for tax years beginning after 31 December 2022.
- Companies will not need to remeasure deferred tax balances for the tax accounting effects of the corporate alternative minimum tax; however, they may need to reassess their valuation allowances for certain affected deferred tax assets in the period that includes the enactment date.
- The Inflation Reduction Act creates an excise tax of 1% on stock repurchases by publicly traded US corporations, effective for repurchases after 31 December 2022.
- Companies eligible to receive assistance under the new laws should determine whether the credits are in the scope of the income tax or other accounting standards and consider the disclosure requirements for government assistance.

## Overview

President Biden signed into law the Inflation Reduction Act of 2022 (the IRA) on 16 August 2022. The Act includes climate and energy provisions, extends the enhanced Affordable Care Act (ACA) subsidies, increases Internal Revenue Service (IRS) enforcement funding and allows Medicare

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to negotiate prescription drug prices. The IRA introduces a 15% corporate alternative minimum tax (CAMT) for corporations whose average annual adjusted financial statement income (AFSI) for any consecutive three-tax-year period preceding the tax year exceeds $1 billion and a 1% excise tax on stock repurchases made by publicly traded US corporations.

President Biden also signed into law the CHIPS and Science Act of 2022 (CHIPS Act) on 9 August 2022. The CHIPS Act includes $280 billion in spending that aims to build a domestic supply chain for semiconductor chips in the face of foreign competition, while also funding scientific and technological research to keep US industries competitive. The CHIPS Act provides funding for subsidies and loans to semiconductor manufacturers and a 25% investment tax credit for investments in semiconductor manufacturing, including investments in specialized tooling equipment required in the semiconductor manufacturing process.

## Key provisions of the IRA

Companies need to consider the accounting and disclosure implications of the IRA, which, among other provisions:

- Creates a 15% CAMT on a corporation's AFSI. The CAMT applies to any corporation (other than an S corporation, regulated investment company or real estate investment trust) whose average annual AFSI for any consecutive three-tax-year period preceding the tax year exceeds $1 billion. The CAMT is effective for tax years beginning after 31 December 2022.
- Establishes a 1% excise tax on stock repurchases made by publicly traded US corporations. The excise tax is effective for stock repurchases after 31 December 2022.

In addition, eligible companies may need to consider the accounting and disclosure requirements related to government assistance provided under both the IRA and the CHIPS Act. Companies will need to determine the nature of the government assistance they receive to determine the appropriate accounting guidance to be applied.

## Overview of the new corporate alternative minimum tax

The CAMT applies to an "applicable corporation," which is defined as any corporation (other than an S corporation, a regulated investment company or a real estate investment trust) with average annual AFSI exceeding $1 billion over any consecutive three-tax-year period before the current tax year. Once a corporation is an applicable corporation, it remains an applicable corporation, even if its average AFSI is less than $1 billion, unless an exception applies.

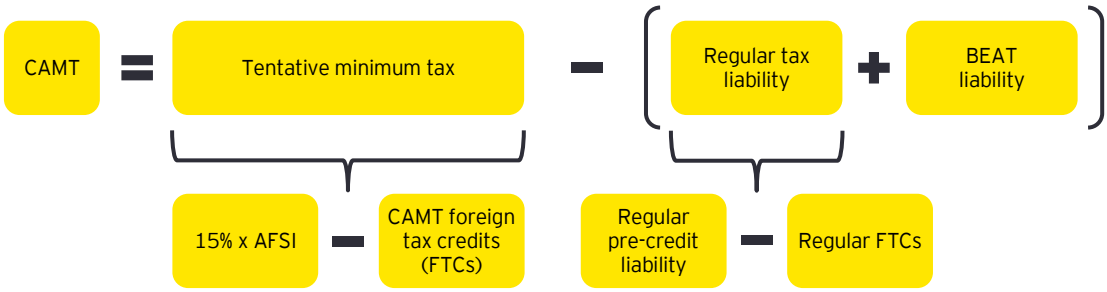
A corporation that is a member of an international financial reporting group with a foreign parent is considered an applicable corporation if its average annual AFSI exceeds the $1 billion threshold and its average annual US-related AFSI (i.e., income of the US corporation(s), income of controlled foreign corporations and effectively connected US income) is $100 million or more.

A taxpayer's AFSI is generally the net income or loss reported on its annual financial statements (e.g., annual financial statements included in Form 10-K filed with the Securities and Exchange Commission (SEC)), with certain adjustments. The calculation of AFSI starts with a company's financial statement net income or loss attributable to members of the taxpayer's US consolidated tax return group. Adjustments are then made to increase or decrease AFSI, including an adjustment to conform income and expense items related to pensions to those for regular federal income tax, accelerated tax basis depreciation for tangible assets and amortization on certain assets (i.e., qualified wireless spectrum) and financial statement net operating losses (NOLs) carryforwards, which are limited to 80% of AFSI. Financial statement NOLs are the amount of net loss reported in the entity's consolidated financial statements for tax years ending after 31 December 2019. Financial statement NOLs can be carried forward indefinitely.

## Calculating the CAMT

The CAMT is calculated by first determining the tentative minimum tax (TMT), which is done by multiplying AFSI by 15% and reducing that amount by CAMT foreign tax credits. The TMT is compared to an applicable corporation's regular tax liability, plus its base erosion and anti-abuse tax (BEAT) liability. The applicable corporation's regular tax liability is the tax liability before consideration of tax credits other than foreign tax credits.

If the CAMT liability is greater than the regular tax liability plus the BEAT liability, the applicable corporation pays the CAMT. After determining the CAMT, a company will then determine the amount of general business credits (GBCs) to be used in a particular tax year, since the IRA amends the limitation on GBCs to include the amount of CAMT paid.




A CAMT credit will be earned for taxes paid on the CAMT basis and carried forward indefinitely. It will be used to reduce the regular tax liability in future years if the regular tax liability exceeds the CAMT liability.

The IRA directs the Treasury Department to issue regulations[1] or other guidance relating to the CAMT, including clarifying the definition of an applicable corporation, and providing guidance on the starting point for, and adjustments to, AFSI. Regulations and additional guidance may also address additional AFSI adjustments to prevent duplication or omission of items, treatment of financial statement NOLs and determination of the CAMT foreign tax credit.

## Accounting considerations related to the CAMT

To determine its US federal income tax liability, a company will need to compute taxes under both systems — the regular tax system and the CAMT system. The company then will pay the larger amount as its tax liability in any given year.

Accounting Standards Codification (ASC) 740-10-25-42 through 44 and ASC 740-10-30-10 through 12 provide guidance on the income tax accounting treatment for alternative minimum taxes (AMTs). This guidance requires a company to measure its deferred taxes using the regular tax rate, not the AMT rate, even if the company anticipates being subject to an AMT system in the foreseeable future. The amount of the AMT is recognized as a current period tax expense in the period incurred, and a company should recognize a deferred tax asset for any AMT credit carryforwards allowed. As with other deferred tax assets, a valuation allowance is recognized against recorded tax benefits of AMT credit carryforwards, if necessary, to reduce the net deferred tax asset to the amount that is more likely than not to be realized.

We believe this guidance should be applied when accounting for the CAMT. Because this guidance results in a company measuring deferred taxes using the regular tax rate (e.g., 21%), the effects of CAMT should not be considered in measuring deferred taxes in the period of enactment.

*Valuation allowance considerations in the period of enactment*

ASC 740 requires the regular tax rate to be used to measure deferred tax liabilities and assets even when a company expects to be a CAMT taxpayer in the future. However, when a company expects to be a CAMT taxpayer indefinitely, this may affect its ability to realize the entire amount of tax benefits for deductible temporary differences and carryforwards and other tax credits under the regular tax system. Thus, the effect of the CAMT system and the ability to realize future CAMT credits may need to be considered in evaluating the need for and the amount of a valuation allowance on the enactment date.

In addition, under the CAMT, a company can reduce its CAMT tax liability by certain general business tax credit carryforwards (e.g., research and development, energy-related credits, work opportunity credits). If a company had recorded a valuation allowance because it previously concluded that it would not be able to use these credits, it may need to reassess its valuation allowance conclusion in the period of enactment. This is because when a company is subject to the CAMT, it will generally be able to use more credits, or use them sooner, than it was able to use to offset its regular tax liability alone. Thus, companies with general business tax credit carryforwards should consider the effect of the CAMT system when evaluating the need for, and the amount of, a valuation allowance on the enactment date.

If the CAMT changes an entity's conclusions regarding an existing valuation allowance, the related tax consequences should be accounted for in the period of enactment.

*Valuation allowance considerations after the effective date of CAMT*

Companies that are subject to CAMT will need to assess the realizability of CAMT credit carryforwards that arise after the effective date. In assessing the need for a valuation allowance for CAMT credit carryforwards, ASC 740-10-55-33 states a valuation allowance is not necessary if the deferred tax asset can be realized in one of the following ways: (1) by reducing a deferred tax liability from the amount of regular tax on regular tax temporary differences to not less than the amount of TMT on AMT temporary differences; (2) by reducing taxes on future income from the amount of regular tax on regular taxable income to not less than the amount of TMT on AMT income; (3) by employing a tax-planning strategy, such as changing from tax-exempt to taxable interest income; or (4) by loss carryback.

Companies that generate CAMT credit carryforwards need to carefully analyze the realizability of those carryforwards to determine whether a valuation allowance should be recorded.

*Timing of accounting for enacted tax law changes*

ASC 740 requires companies to recognize the effect of changes in tax laws on deferred tax balances in the period in which the legislation is enacted. For changes in US federal income tax law, the enactment date is the date the bill becomes law, which generally is upon presidential signature.

Except for changes to existing valuation allowances as discussed above, the IRA will not affect the recognition or measurement of deferred tax assets. As a result, the financial statement consequences related to the CAMT will generally not be recognized earlier than the effective dates of the provisions.

Companies that change an existing valuation allowance as a result of the enactment of the IRA will need to recognize the related tax consequence discretely as a component of income tax expense from continuing operations in the interim period that includes the enactment date.

*Accounting for CAMT in interim period at its effective date*

For interim reporting purposes, a company will need to determine whether it expects to meet the average annual AFSI test for 2023 during the first interim period after the CAMT is effective (i.e., for 31 December 2022 taxpayers, the first quarter of 2023). If a company determines it is subject to the CAMT in 2023, it will need to consider the effects of the CAMT in its estimated

annual effective tax rate (EAETR). A company is required at the end of each interim reporting period to make its best estimate of the annual effective tax rate for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis.

Companies that determine they do not meet or expect to meet the average annual AFSI thresholds at the effective date should establish processes and controls to monitor when future changes in the business could result in it being subject to CAMT. This is particularly important for those entities that approached the AFSI thresholds but did not meet them initially.

In addition, if being subject to the CAMT results in a significant variation in the customary relationship between income tax expense and pretax income in the interim period financial statements, a company should disclose the reasons in its interim financial statements if they are not otherwise apparent from the financial statements or from the nature of the company's business.

### How we see it

The CAMT will be accounted for as a period cost when the related tax consequences arise, rather than through adjustments to deferred taxes. Therefore, for many taxpayers subject to the CAMT, the tax accounting consequences of the CAMT will be not recognized in their financial statements until the first period after the effective date (i.e., tax years beginning as early as 1 January 2023). However, if the CAMT changes a company's conclusion regarding an existing valuation allowance because it changes expectations of future taxable income, the related tax consequences should be accounted for in the period of enactment.

### Disclosure considerations related to the CAMT

Companies need to carefully consider how aspects of the IRA may affect each of the income tax disclosures required under ASC 740. In the period that includes the enactment date, this may include disclosure about the effects on income tax expense (benefit) related to the reassessment of a valuation allowance. In the periods after the effective date, companies that are subject to the CAMT may need to make additional disclosures.

#### *Additional SEC disclosure considerations*

If the effects of the tax law changes are, or will be, material to a registrant, the registrant should consider the disclosure implications in preparing its management's discussion and analysis (MD&A) under Item 303 of Regulation S-K, including its discussion of results of operations and liquidity and capital resources. For example, the reassessment of the realizability of deferred tax assets may have a material effect on a registrant's income tax provision.

In addition, if the effect of the tax law changes on a company's effective tax rate is reasonably likely to be material, the company may need to start providing disclosures about that effect when the IRA provisions become effective.

## Overview of new excise tax on stock repurchases

The IRA creates a new excise tax on stock repurchases of more than $1 million by publicly traded US corporations. The excise tax equals 1% of the fair market value of the stock repurchased during the year. That amount is reduced by the fair market value of stock issued during the tax year, including stock issued to employees of the corporation or its subsidiaries. The excise tax also applies to repurchases of stock of a publicly traded foreign corporation by the foreign corporation's domestic affiliate.

The excise tax applies to repurchases of stock made after 31 December 2022.

### Accounting considerations related to the excise tax on stock repurchases

The new excise tax is a cost associated with the repurchase of a reporting entity's stock. However, there is no authoritative guidance on the accounting for such costs. Given that this excise tax is not based on income, it is outside of the scope of the income tax accounting guidance in ASC 740. A company will need to determine the appropriate accounting for the excise tax based on the facts and circumstances of its particular stock repurchase transactions.

## Government assistance

The IRA and the CHIPS Act contain funding designed to provide assistance to taxpayers to support the objectives of the laws discussed earlier. To receive assistance under these laws, companies may be required to agree to certain conditions.

Each government program established under these laws has its own specific requirements that need to be carefully assessed to determine both the eligibility and the proper accounting treatment of any government assistance a company receives. The accounting and disclosure implications (e.g., timing of recognition, financial statement presentation) vary significantly, for example, depending on whether the assistance is considered a loan, a grant, a payment for goods or services, a contribution or an income tax credit.

Refundable tax credits may not be subject to the provisions of ASC 740 since receipt of such credits is not dependent on having taxable income.

### How we see it

A company's accounting for and disclosures about government assistance depend on the type of government assistance it receives. Legislation providing assistance may use terms such as "grant" or "credit" to describe the form of the assistance, but companies will need to carefully evaluate the substance of the legislation to determine the appropriate accounting.

### Determining whether government assistance relates to income taxes

We generally believe that a company that receives government assistance in the form of an income tax credit should account for it in accordance with ASC 740.

ASC 740 applies to all federal, foreign, state and local (including franchise) taxes based on income. That is, any tax levied on (or credited to) a company based on the company's income (or income tax liability) is generally subject to the provisions of ASC 740. Companies need to evaluate the provisions of assistance provided under the IRA and the CHIPS Act to determine whether the assistance is provided based solely on the company's income (or income tax liability).

For example, refundable tax credits may not be subject to the provisions of ASC 740, since receipt of such credits is not dependent on having taxable income. In contrast, government assistance subject to the provisions of ASC 740 that is determined to be an investment tax credit would be accounted for using either the deferral or the flow-through method, depending on the company's accounting policy election.

Refer to section 4.2.8, *Government assistance received (investment tax credits and government grants)*, of our FRD, ***Income taxes***, for additional information on the accounting for government assistance that is within the scope of ASC 740.

A credit from a government entity that isn't based on taxable income would generally be considered a government grant and would, therefore, be outside of the scope of ASC 740. A company receiving assistance from a government entity that isn't based on taxable income must consider whether the payment represents revenue in accordance with ASC 606,[2] a loan in accordance with ASC 470,[3] a contingency in accordance with ASC 450,[4] or a government grant in accordance with other GAAP by analogy (e.g., IAS 20,[5] ASC 958-605[6]). A company

receiving assistance will need to carefully evaluate the scope of the assistance received before concluding that the assistance is a government grant that should be accounted for by analogy to other GAAP.

ASC 832[7] requires business entities that account for transactions with a government by analogizing to a grant or contribution accounting model (e.g., IAS 20, ASC 958-605) to make certain annual disclosures. That is, the disclosure requirements don't apply to transactions with a government that are accounted for in accordance with existing US GAAP (e.g., ASC 450 on contingencies, ASC 740 on income taxes, ASC 606 on revenue from contracts with customers, ASC 470 on debt).

## How we see it

A company receiving assistance in the form of one of the credits under either the IRA or the CHIPS Act will need to consider the facts and circumstances of the assistance when determining how to account for any payment received in its financial statements.

**Endnotes:**

1 Additional US federal regulations are expected that may change the CAMT. Companies should continue to monitor developments.

2 ASC 606, *Revenue from Contracts with Customers*.

3 ASC 470, *Debt*.

4 ASC 450, *Contingencies*.

5 International Accounting Standards 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

6 ASC 958-605, *Not-for-Profit Entities — Revenue Recognition* (before the adoption of ASC 606), or ASC 958-605, *Not-for-Profit Entities — Revenue Recognition — Contributions* (after the adoption of ASC 606).

7 ASC 832, *Government Assistance*.

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