Quarterly tax developments

Things to know about this quarter's tax developments and related US GAAP accounting implications

Updated through 31 December 2022

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Building a better working world

Welcome to our December 2022 Quarterly tax developments publication. This edition is updated for certain developments identified from 16 December through 31 December 2022, except as noted. New developments are designated by a square (■) after the state or country name.

Here we describe certain tax developments previously summarized in Tax Alerts or other EY publications or identified by EY tax professionals or EY foreign member firms. These developments may affect your tax provision or estimated annual effective tax rate.

We compile this information because we recognize that, for many companies, the most challenging aspect of accounting for income taxes is identifying changes in tax law and other events when they occur so the accounting can be reflected in the appropriate period. However, this publication is not a comprehensive list of all changes in tax law and other events that may affect income tax accounting.

*We list EY publications that you can access through our **Tax News Update website**, if you are registered. Anyone interested in registering should contact Joan Osborne at **joan.osborne@ey.com**.*

*See our **previous editions** for additional tax developments.*

Tax developments

Legislation enacted in the fourth quarter

Companies are required to account for the effects of tax law changes on their deferred tax assets and liabilities in the period the legislation is enacted. Similarly, companies must reflect the effects of an enacted change in tax laws or rates in their annual effective tax rate computation in the period the changes are enacted.[1] If an interim change is significant, temporary differences may need to be estimated as of the enactment.

Federal, state and territories

Colorado — On 8 November 2022, voters approved a ballot measure reducing Colorado's corporate income tax rate to 4.4% from 4.55% for tax years 2022 and onward. See the **State and Local Tax Weekly for 11 November 2022**.

International

Canada — On 15 December 2022, Canada enacted legislation increasing its general corporate income tax rate to 16.5% from 15% for banks, life insurers and any financial institution related to a bank or a life insurer. A related group, however, is exempt from the 1.5% tax on the first $100 million of taxable income. The change is effective for tax years ending after 7 April 2022.

The legislation also applies a one-time tax of 15% (i.e., a Canada Recovery Dividend) on the average 2020 and 2021 taxable income of banks and life insurers, if that taxable income exceeds $1 billion. The $1 billion exemption must be shared among members of a related bank or life insurer group. This tax is to be imposed in the 2022 tax year and payable equally over five years.

Other changes include:

- Limiting or denying deductions for the "contractual service margin," which stems from the adoption of IFRS 17 for insurance contracts and represents deferred insurance profits that are gradually included in income for accounting purposes, effective for tax years beginning after 2022
- Tightening the withholding tax rules so that withholding tax (generally 25%, unless reduced by a tax treaty) applies to interest paid by a Canadian-resident borrower to a party not subject to withholding tax (e.g., a US or Canadian resident), or subject to a lower rate of withholding tax than that of the related foreign lender under an interest-coupon-stripping arrangement (i.e., an arrangement in which the lender sells its right to future interest payments but retains the right to repayment of principal), effective as of 7 April 2022
- Amending the definition of "tax benefit" under the general anti-avoidance rules (GAAR) so that Canadian tax authorities can use GAAR to adjust tax attributes before they are used to reduce, avoid or defer tax, generally effective for transactions that occur, or occurred, after 6 April 2022
- Broadening the types of clean-energy equipment that are eligible for accelerated depreciation for unused property acquired and available for use after 6 April 2022
- Eliminating Canada's flow-through share regime for oil, gas and coal exploration, which allows investors to deduct the company's exploration expenses for those resources in exchange for purchasing shares at prices above fair market value, for flow-through share agreements entered into after March 2023
- Introducing a temporary 30% tax credit that investors in a flow-through share regime for critical minerals (e.g., copper, nickel, lithium, cobalt, graphite) may claim for eligible exploration expenditures, effective for flow-through share agreements entered into after 7 April 2022 and before April 2027

See **Tax Alert 2022-1895**, dated 16 December 2022.

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[1] Nonpublic business entities that have not adopted Accounting Standards Update (ASU) 2019-12, *Income Taxes (Topic 740): Simplifying the Accounting for Income Taxes,* should reflect the effects of enacted changes in tax law or rates in estimates of their annual effective tax rate in the first interim period in which the change is effective. For more information on ASU 2019-12, see our **Financial reporting developments publication on income taxes**.

Colombia[2]■ – On 13 December 2022, Colombia enacted a tax reform law. Changes in the new law include:

- Applying a 5% surtax (total corporate income tax rate of 40%) to the income of some financial institutions, insurance companies and stockbrokers, among others, until 2027
- Applying a permanent surtax, which will range from 0% to 15% for oil companies (total corporate income tax rate from 35% to 50%) and from 0% to 10% for coal mining companies (total corporate income tax rate to 45% from 35%)
- Applying a 3% surtax (total corporate income tax rate of 38%) to the income of certain hydropower generators
- Applying a 15% corporate income tax rate for 10 years to the income of hotels and theme parks that are developed in some municipalities and approved by the Ministry of Commerce
- Extending through 2024 the 20% corporate income tax rate for eligible industries operating in a free-trade zone (FTZ)
- Allowing companies operating in an FTZ to continue applying a 20% corporate income tax rate to income derived from export activities, beginning in 2024, if the company signs an agreement with the Ministry of Commerce, establishing an internationalization and sales plan (a 35% rate applies to income from local sales)
- Requiring certain companies to have a 15% minimum tax rate (as determined under local rules, which do not necessarily align with the global minimum tax rules under Pillar Two of the Base Erosion and Profit Shifting (BEPS) project of the Organisation of Economic Co-operation and Development (OECD)) and to adjust that rate if it falls below the minimum 15%
- Applying a 20% withholding tax to certain dividends paid to nonresident companies
- Increasing the 10% capital gains tax rate to 15%, rather than the previously proposed 30%, for capital gains of resident and nonresident companies
- Disallowing deductions on royalties paid for the exploitation of nonrenewable resources
- Repealing the five years accelerated amortization for investments in exploratory activities carried out between 2017 through 2027 and the incentive credit for oil, gas and mining investments
- Limiting certain nontaxable income, special deductions, exempt income and tax credits to 3% of net taxable income, calculated without including the special deductions subject to the limit
- Imposing a 10% withholding tax on the Colombian-sourced income of nonresident companies with a "significant economic presence" in Colombia and generally basing that economic presence on the number of Colombian customers and gross income from transactions with Colombian customers
- Eliminating a prior proposal to tax profit on the sale of listed shares on the Colombian Exchange Market but narrowing the circumstances under which the profit will be considered nontaxable income

The changes are effective for tax years beginning on or after 1 January 2023.

Germany[3]■ – On 20 December 2022, Germany enacted legislation eliminating retroactively the taxation of certain royalty income and capital gains that an unrelated party pays to nonresident licensors of intellectual property registered in Germany. For intercompany transactions, the payments remain subject to tax unless an applicable income tax treaty bars German taxation. Companies must apply German anti-treaty shopping rules in determining whether an income tax treaty bars German taxation.

Other changes include introducing a nondeductible 33% "solidarity contribution" (effectively, a windfall tax) for tax years 2022 and 2023, which applies to "surplus profits" of certain companies in the oil, gas, coal and refinery sectors (i.e., the taxable profits exceeding a 20% increase in a company's average taxable profits over the four tax years beginning on or after 1 January 2018). The changes are generally effective 1 January 2023.

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[2] A Tax Alert has not been published on the legislation's enactment. For discussion of congressional approval of the bill, see **Tax Alert 2022-1757**, dated 22 November 2022.

[3] A Tax Alert has not been published on the legislation's enactment. For discussion of the legislation's approval by one chamber of the German Parliament, see **Tax Alert 2022-1800**, dated 2 December 2022.

Hong Kong■ — On 23 December 2022, Hong Kong enacted legislation that, among other things, narrows the scope of the income tax exemption for certain foreign-sourced passive income. The legislation deems a multinational company's specified foreign-source income (e.g., interest, dividends, income from the use of intellectual property (IP) and disposal gain on equity interest) as taxable in Hong Kong if the company received the income in Hong Kong while operating a trade, profession or business there. Exceptions to this deemed sourcing apply to companies meeting requirements for economic substance or nexus, among others.

The legislation also creates a new unilateral tax credit to offset foreign taxes paid to non-treaty jurisdictions on specified foreign-source income that is no longer exempt in Hong Kong as a result of the changes. For dividends received from treaty or non-treaty jurisdictions, companies may claim the credit for foreign taxes paid on the dividend and the underlying profits from which the dividend was paid.

The changes apply to income accrued and received in Hong Kong on or after 1 January 2023. See **Tax Alert 2022-1898**, dated 16 December 2022.

Italy■ — On 29 December 2022, Italy enacted its Budget Law for 2023. Tax changes include:

- Generally limiting deductions for expenses from transactions with entities in a jurisdiction that is noncooperative for tax purposes to the "normal value" of the relevant goods and services
- Allowing Italian companies to elect to pay a 9% transition tax (6% in specified cases) on qualified undistributed earnings of subsidiaries in low-tax jurisdictions
- Imposing, under certain circumstances, capital gains tax on nonresidents (with an exception for qualifying investment funds) upon indirect sales of Italian real estate, such as the sale of a foreign company that owns, directly or indirectly, stock in an Italian company that holds Italian real estate
- Allowing foreign entities to elect to pay a 16% substitute tax to step up the shares in Italian companies (as well as qualifying Italian land or Italian shares traded on regulated markets or multilateral trading systems)
- Modifying Italy's permanent establishment (PE) definition to exclude under certain circumstances nonresident investment vehicles whose asset managers operate in Italy
- Requiring for tax year 2023 certain energy companies to pay a 50% "solidarity surcharge" (effectively, a windfall tax) on the portion of their 2022 corporate income that exceeds, by at least 10%, their average income for the four years preceding tax year 2022, but limiting the surcharge to 25% of the value of the shareholders' equity on 31 December 2021 (for calendar-year entities)
- A package of tax amnesty measures

The changes are effective 1 January 2023. See **Tax Alert 2023-1842**, dated 8 December 2022.

Rwanda — On 28 October 2022, Rwanda enacted legislation imposing corporate tax on the worldwide income of domestic companies. The legislation exempts dividends paid between resident companies from corporate tax and withholding tax, and unrealized foreign exchange gains on outstanding loans are exempt from corporate tax. The legislation also expands application of the corporate income tax to digital services, gaming activities and certain conversions of profits into shares. Taxpayers may deduct, for corporate income tax purposes, the 13% tax on gross gaming revenue.

Other changes include:

- Broadening Rwanda's PE definition to include Agency PEs, which will exist when a person plays a principal role in concluding contracts in Rwanda on behalf of a nonresident company
- Denying deductions for realized foreign exchange loss from certain related party loans and unrealized foreign exchange losses
- Lifting, under certain circumstances, restrictions on carrying forward tax losses for shareholders in companies whose shares are not traded on a recognized stock exchange and whose share capital ownership or voting rights changed by more than 25% by value or number
- Clarifying that capital gains tax applies to the direct and indirect sale or transfer of shares in Rwanda and abroad

- Clarifying that the exemption from capital gains tax applies only to the sale or transfer of listed shares and other securities on Rwandan securities exchanges
- Broadening applicability of the corporate income tax to include the income of nonresidents with a Rwandan PE, among others
- Exempting income of special purpose vehicles from corporate tax, unless their revenue exceeds their related expenses
- Expanding the types of payments subject to withholding tax
- Introducing anti-abuse rules on avoidance arrangements that lack commercial purpose or where a principal purpose is to obtain a tax benefit

The changes are effective upon enactment. See **Tax Alert 2022-1782**, dated 1 December 2022.

South Korea■ – On 31 December 2022, South Korea enacted tax reform legislation decreasing its corporate income tax rates to:

- 24% from 25% for taxable income exceeding KRW300 billion
- 21% from 22% for taxable income ranging from KRW20 billion to KRW300 billion
- 19% from 20% for taxable income ranging from KRW200 million to KRW20 billion
- 9% from 10% for taxable income up to KRW200 million

South Korea also enacted new global minimum tax rules, which align with the minimum tax rule under Pillar Two of the OECD's BEPS 2.0 project. The new rules include an income inclusion rule (IIR) and supplementary rules for income inclusion (known as the undertaxed payments rule (UTPR)).

Other reforms include:

- Increasing the annual deductibility limit for net operating losses to 80% of taxable income (currently 60%) for domestic corporations
- Extending the expiration date of the accumulated earnings tax regime to 31 December 2025 from 31 December 2022
- Deferring, until 1 January 2025, the imposition of withholding taxes on gains from the disposal of virtual assets by nonresidents (withholding tax currently applies beginning 1 January 2023)
- Exempting withholding taxes on interest and capital gains derived from government bonds and certain monetary stabilization bonds by nonresidents or foreign corporation

The changes are generally effective 1 January 2023, unless otherwise specified. See Tax Alerts **2023-0068**, dated 11 January 2023, and **2023-0069**, dated 11 January 2023.

Spain[4] – On 3 November 2022, Spain enacted the rules under the EU's Anti-Tax Avoidance Directive (ATAD 2) on reverse hybrid mismatches (e.g., Spain treats a domestic entity as a pass-through for income tax purposes, but the resident jurisdictions of the entity's members or investors treat the entity as a corporation). As a result, Spanish corporate income tax applies to a pass-through entity that is incorporated or located in Spain and meets the reverse hybrid mismatch conditions. The change is retroactively effective from 1 January 2022.

On 28 December 2022, Spain[5]■ enacted legislation limiting a consolidated group's use of tax losses to 50% of taxable income for tax year 2023. Beginning 1 January 2024, consolidated groups may claim the unused losses over 10 years, even if the group member that incurred the loss is subsequently excluded from the group. If the consolidated group disbands, the unused losses must be claimed in the group's last tax year. The changes are effective 1 January 2023.

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[4] A Tax Alert has not been published on the legislation's enactment. For discussion of approval of the Royal-Decree Law by the Spanish Council of Ministers, see **Tax Alert 2022-1654**, dated 3 November 2022.

[5] A Tax Alert has not been published on this development.

Turkey — On 9 November 2022, Turkey enacted legislation clarifying the order and tax treatment of a reduction of share capital that includes elements other than cash and in-kind capital. The new law also extended the expiration date of the corporate income tax exemption for interest and other earnings that are derived from foreign exchange-protected accounts and converted from foreign currencies into Turkish lira (TRY). The exemption now applies through 31 December 2023 rather than 31 December 2022. The changes are effective upon enactment. See **Tax Alert 2022-1689**, dated 10 November 2022. For information on a related development, see the Other considerations section of this publication.

United Arab Emirates (UAE)■ — On 10 October 2022, the United Arab Emirates enacted a 9% corporate income tax, which is expected to apply to taxable income above AED375,000. The tax affects UAE businesses (with some exceptions) and nonresidents with a PE in the UAE, UAE-sourced income or nexus in the UAE. Nonresidents will be considered to have a PE in the UAE if they have a fixed place of business or a dependent agent in the country.

Other features of the new income tax regime include:

- Taxation of worldwide income, with exemptions for dividends, capital gains and foreign branch profits, provided certain conditions are satisfied
- Foreign tax credits for taxes paid overseas on income that is not exempt from UAE corporate income tax
- A 0% corporate income tax rate for income of a "qualifying free zone person"
- Use of book income, with certain adjustments, as the tax basis
- Restrictions on the deductibility of interest on related party debt, and the ability to carry disallowed interest deductions forward for up to 10 years
- A 0% withholding tax on certain payments made by UAE businesses to nonresidents
- Transfer pricing rules requiring related parties to comply with the arm's-length principle
- GAAR designed to disregard transactions or arrangements undertaken with the main purpose of obtaining a corporate income tax advantage (effective 9 December 2022)
- Allowing a parent corporation to form a consolidated group with its subsidiaries, provided certain conditions are met
- Limiting tax losses to 75% of taxable income in future periods, but allowing businesses to carry losses forward indefinitely under certain conditions
- Disallowance of losses incurred before 1 June 2023

The changes are generally effective 25 October 2022. See **Tax Alert 2022-1861**, dated 13 December 2022.

Uruguay — On 3 November 2022, Uruguay enacted legislation exempting interest income from nonresident income tax if:

- The interest income comes from a corporation's debt securities and financial trusts.
- More than 90% of the corporation's assets generate non-taxable income.

The changes, among others, are effective 1 January 2023. See **Tax Alert 2022-1664**, dated 4 November 2022.

On 7 December 2022, Uruguay enacted legislation changing the criteria for sourcing passive income to Uruguay to comply with EU requirements. In addition to taxing certain passive income of multinational companies, the legislation:

- Applies the new sourcing rules to capital gains from assets that could potentially generate passive income abroad
- Eliminates the corporate income tax exemption for dividends that are now taxed under the new sourcing rules
- Introduces a tax credit for passive income that is taxed abroad

The changes are effective 1 January 2023. See **Tax Alert 2022-1879**, dated 15 December 2022.

Other considerations

Court decisions, regulations issued by tax authorities and other events may constitute new information that could trigger a change in judgment in recognition, derecognition or measurement of a tax position. These events also may affect your current or deferred tax accounting.

Federal, state and territories

Federal■ — In interim guidance, the Internal Revenue Service (IRS) described rules that it intends to include in proposed regulations on the corporate alternative minimum tax (CAMT). The regulations are expected to include guidance on troubled corporations; mergers and acquisitions; groups of corporations that file consolidated returns; depreciation of Internal Revenue Code (IRC) Section 168 property; and the treatment of certain federal income tax credits under the CAMT, among other things. Taxpayers may rely on the interim guidance pending the release of proposed regulations. A Tax Alert is forthcoming. For a high-level overview of the interim guidance, see **Breaking Tax News 2022-9011**, dated 29 December 2022.

In proposed regulations on foreign tax credits, the U.S. Treasury Department addressed the definition of a foreign income tax and the allocation and apportionment of foreign taxes on certain payments. The proposed regulations would offer certain relief from the cost recovery requirement and the source-based attribution requirement on royalty income for purposes of determining the creditability of foreign taxes under IRC Sections 901 and 903. The proposed regulations would also modify the disregarded payment rules for purposes of allocating and apportioning foreign taxes under IRC Section 861. See **Tax Alert 2022-1764**, dated 25 November 2022.

In final regulations, the Treasury Department and IRS modified the average income test, which landlords may use to determine whether a residential building qualifies as a low-income housing project for purposes of the low-income housing credit. Landlords may now consider residential units collectively instead of individually when calculating tenants' average income. See **Tax Alert 2022-1546**, dated 12 October 2022.

In a notice, the IRS explains how taxpayers (e.g., builders, developers and owners of clean energy facilities) may receive the increased tax credits or deductions added by the Inflation Reduction Act (IRA) by satisfying certain wage and apprenticeship requirements. It also describes how to determine the prevailing wage and apprenticeship requirements and the beginning of construction and installation dates. The new requirements apply to projects beginning construction on or after 29 January 2023. Taxpayers can still receive the increased credits for projects begun before this date but do not have to comply with the new requirements. See **Tax Alert 2022-1832**, dated 7 December 2022.

In a revenue procedure, the IRS allowed taxpayers to automatically change their accounting method to comply with amendments that were made to IRC Section 174 by the Tax Cuts and Jobs Act (TCJA) in 2017 and became effective in tax year 2022. The revenue procedure is effective for research and experimental expenditures paid or incurred in tax years beginning after 31 December 2021, the effective date of the TCJA amendment to IRC Section 174. See **Tax Alert 2022-1910**, dated 19 December 2022.

Arkansas — In a notice, the Department of Finance and Administration announced that state income tax does not apply to loans forgiven under the Paycheck Protection Program (PPP) or to federal employee retention credits (ERCs). Businesses may also deduct, for state tax purposes, expenses paid with PPP loans or ERCs. Economic Injury Disaster Loan grants, Restaurant Revitalization grants, Shuttered Venue Operator grants, Aviation Manufacturing Job Protection grants, and U.S. Department of Agriculture grants and forgiven loans are subject to Arkansas income tax. Businesses may deduct expenses paid with these grants. See the **State and Local Tax Weekly for 21 October 2022**.

Louisiana — In a revenue ruling, the Department of Revenue specified which COVID-19 relief benefits are exempt from Louisiana income tax. The department noted that companies may not deduct for Louisiana income tax purposes expenses paid with tax-exempt benefits. See the **State and Local Tax Weekly for 28 October 2022 and 4 November 2022**.

New Jersey — The Division of Taxation announced on its COVID-19 Loan and Grant Information webpage that state income tax does not apply to PPP loans and COVID-19-related grants. Businesses may deduct, for state tax purposes, expenses paid with PPP loans. See the **State and Local Tax Weekly for 21 October 2022**.

Puerto Rico — In an informative bulletin, the Treasury Department clarified that the US enactment of a 15% CAMT under IRA has not caused Puerto Rico's tax on industrial development income to increase to 15% from 10%. The department reasoned that CAMT does not automatically apply in a tax year, depending instead on a corporation's adjusted financial statement income. See **Tax Alert 2022-1688**, dated 10 November 2022.

Texas — The Texas Court of Appeals, on remand from the Texas Supreme Court, held that an out-of-state corporation could apportion its revenue from satellite radio subscriptions to Texas using cost-of-performance data to determine the "fair value" of services performed in the state. See **Tax Alert 2022-1755**, dated 21 November 2022.

Tax amnesties

This table shows tax amnesties that were announced or went into effect in the fourth quarter of 2022.

Jurisdiction	Amnesty period	Taxes covered	Reference
Ghana	Through 31 December 2022	Unpaid corporate income taxes and other taxes through 31 December 2020	**Tax Alert 2022-1610**, dated 24 October 2022

International

Curaçao — In a decree, the Ministry of Finance implemented a system of exemptions and credits to prevent double taxation of various types of income. The system exempts the passive foreign real estate income of Curacao tax residents from Curaçao profit tax, provided that income is taxed in the source country. It also permits unused exemptions and losses to be carried forward for 10 years. See **Tax Alert 2022-1590**, dated 20 October 2022.

Ecuador — In an Administrative Resolution, the Internal Revenue Service, among other things, removed the following regimes or jurisdictions from its tax havens list:

- Channel Islands
- Grand Duchy of Luxembourg
- Gibraltar
- Ireland (regarding its 12.5% corporate income tax rate)
- Isle Of Man — Mann
- Ostrava
- Principality Of Liechtenstein
- Republic Of Albania
- Republic Of Cyprus
- Republic Of Malta
- Republic Of San Marino
- Svalbard — Spitsbergen

See **Tax Alert 2022-1515**, dated 7 October 2022.

In regulations, the Government outlined how to apply the 22% tax rate on income from new investment projects and the 20% tax rate that applies for companies that enter into an investment agreement with the Ecuadorian Government. It also removed limits on deducting related party payments of royalties, technical service fees, administrative service fees and/or advisory fees if:

- Both parties are Ecuadorian residents whenever the payer's corporate income tax rate is equal to, or lower than, the payee's

  or

- The reported payments between the related parties do not exceed US$226,200 for the tax year

Companies may request a higher limit of deductibility based on an advanced pricing agreement with the Government.

See **Tax Alert 2022-1762**, dated 23 November 2022.

European Union — The Finance Ministers revised the EU's list of noncooperative jurisdictions for tax purposes (the EU list) by adding Anguilla, the Bahamas, and Turks and Caicos Islands to Annex I (the so-called "black" list). They also added Armenia and Eswatini to Annex II (the so-called "gray" list) and removed Bermuda and Tunisia. See **Tax Alert 2022-1500**, dated 4 October 2022.

In a regulation, the EU Member States adopted a temporary "solidarity contribution" (effectively, a windfall tax) of at least 33%, which applies across the EU to "surplus profits" of companies in the oil, gas, coal and refinery sectors (i.e., the taxable profits exceeding a 20% increase in a company's average taxable profits over the four tax years beginning on or after 1 January over 2018). Member States may apply the contribution to tax years 2022, 2023 or both as they adopt it into their local legislation. See **Tax Alert 2022-1535**, dated 11 October 2022.

India — The Mumbai Bench of the Income Tax Appellate Tribunal held that an Irish reinsurer's provision of reinsurance services to Indian businesses did not establish a PE in India. The Tribunal reasoned that the Irish reinsurer's core activity was assuming risk, which occurred outside of India. The tribunal also noted that the tax officer did not specifically find that the Irish reinsurer had a fixed place of business at its disposal, so it did not have a Fixed Place PE in India. See **Tax Alert 2022-1685**, dated 10 November 2022.

Israel — Tel Aviv's District Court held that a software company owed additional taxes on its 2010 sale of IP to a related party. The court upheld the tax authorities' claim that the company undervalued the IP, because the company failed to shift the burden of proof to the tax authorities due to insufficient documentation supporting the IP's fair market value from the time of the sale. See **Tax Alert 2022-1721**, dated 16 November 2022.

Netherlands — In an updated decree, the State Secretary of Finance announced that the Dutch anti-hybrid rules allowed a US company's Dutch subsidiary to deduct operational expenses that the US parent could also deduct because the subsidiary was disregarded for US tax purposes. The State Secretary explained that the operational income on the US parent's income tax return qualified as dual inclusion income to the extent it was used to pay the Dutch subsidiary's operational expenses on a cost-plus basis. The Dutch deduction would be limited, however, to the extent the US parent included in its US tax return the operational income connected with the cost-plus remuneration paid to the Dutch subsidiary.

The decree applies retroactively for tax years starting on or after 1 January 2020 (i.e., the effective date of the Dutch anti-hybrid rules).

The State Secretary also confirmed that prior guidance from October 2021 remains valid, including:

- Application of the anti-hybrid rules and the dual income inclusion exception in a specific scenario involving a US real estate investment trust (REIT) that is part of the same consolidated group as a Dutch company that is a "qualifying REIT subsidiary" for US federal income tax purposes
- Confirmation that a Dutch taxpayer that is remunerated on a cost-plus basis for its operational expenses does not have to apply the anti-hybrid rules if it is treated as a partnership (i.e., flow-through) for US federal income tax purposes and the cost-plus income is also fully taxable in the US because the US parent company recognized the income

See **Tax Alert 2022-1659**, dated 4 November 2022.

Organisation of Economic Co-operation and Development — The following country deposited its instrument of ratification for the multilateral convention to implement tax treaty related measures to prevent BEPS this quarter:

- South Africa (enters into force 1 January 2023)

See **Tax Alert 2022-1575**, dated 18 October 2022.

Turkey — In a presidential decree, the Government extended the date of the balance sheets to be used for the purposes of the corporate income tax exemption for gains from converting foreign currencies into TRY and depositing the funds into TRY time deposit accounts. The exemption now applies to foreign currency deposits that are available in Turkish companies' balance sheets dated 30 September 2022 (rather than 30 June 2022), converted into TRY, and deposited in the appropriate account. See **Tax Alert 2022-1641**, dated 1 November 2022.

Uruguay — In a resolution, the Executive Branch outlined the conditions under which employees may telework outside an FTZ if their employer operates inside the FTZ. Satisfying the requirements allows the employer to continue qualifying for FTZ income tax benefits and other incentives. See **Tax Alert 2022-1799**, dated 30 November 2022.

Things we have our eyes on

National, state and local governments continue to seek to increase their revenues. Companies should continue to monitor developments in this area. Some of these potential tax law changes are summarized here.

International

Australia — In the second 2022-23 Federal Budget, the Federal Treasurer proposed amending the three alternative tests in Australia's debt limitation rules to align them more closely with the OECD's BEPS project. The proposed amendments would, among other things, replace the existing safe harbor debt test (which generally disallows debt deductions to the extent that debt exceeds 60% of an entity's Australian assets less non-debt liabilities) with a rule limiting a multinational company's interest expense deductions to 30% of earnings before interest, taxes, depreciation and amortization (EBITDA). Debt deductions above the 30% threshold could be carried forward and claimed in a subsequent tax year (up to 15 years).

Finally, a separate proposal would deny companies with global revenue of at least A$1 billion a tax deduction in Australia for cross-border payments for the use of intangibles if those payments were made to entities in low- or no-tax jurisdictions. See **Tax Alert 2022-1624**, dated 27 October 2022.

Canada — In the Federal Fall Economic Statement, the Finance Minister proposed introducing two new tax credits for investment in clean technologies and clean hydrogen production. Other proposals include imposing a 2% corporate tax on the net value of share buybacks by Canadian public corporations, similar to the stock buyback measure recently enacted in the US. See **Tax Alert 2022-1662**, dated 4 November 2022.

The federal Government also revised prior legislative proposals that, among other things, would change the effective date of a prior proposal to limit deductions for net interest expense to 40% of tax EBITDA. The proposal would apply to tax years beginning on or after 1 October 2023 instead of tax years beginning on or after 1 January 2023. The proposal to limit deductions for net interest expense to 30% of tax EBITDA would still apply for tax year 2024 and onward. See **Tax Alert 2022-1699**, dated 11 November 2022.

Chile — The Executive Power proposed the following changes, among others, to its July 2022 tax reform bill:

- Allowing companies to deduct paid corporate income taxes from their annual taxable income basis to prevent double taxation of certain dividends caused by reversals of temporary differences
- Clarifying that the 2% development surtax would not be creditable against dividend withholding taxes since it does not qualify as a corporate income tax
- Maintaining the current foreign tax credit mechanisms available in Chile that the July 2022 bill proposed to eliminate or limit
- Increasing the proposed tax on the retained earnings of certain companies to 2.5% from 1.8% and decreasing the base to which it would apply to 22% from 100%
- Postponing proposed limits on the use of tax losses one year, to 1 January 2025, and gradually applying them over three years through calendar year 2027
- Repealing a recently enacted tax modification, which confirmed that leases should be treated similarly for book and tax purposes from 1 January 2023 onward, and restoring the prior law, which deemed the lessor to own and depreciate the asset for tax purposes
- Codifying the concept of "valid business purpose"
- Allowing companies to immediately depreciate 50% of the value of certain fixed assets acquired or imported during tax year 2023 and accelerate depreciation for the remaining 50%

See **Tax Alert 2022-1612**, dated 24 October 2022.

European Union — At an 8 November 2022 meeting of the Economic and Financial Affairs Council, the Finance Ministers agreed to previously proposed changes to the EU's Code of Conduct for Business Taxation (Code), which is designed to curb harmful tax competition among EU members. The changes expand the Code's scope beyond preferential tax measures (e.g., exemptions from the general tax

system for certain businesses) and allow the EU to assess whether the general features of a jurisdiction's tax laws are harmful (e.g., create opportunities for double non-taxation or multiple tax benefits for the same income). The changes apply to harmful tax features that are introduced or amended on or after 1 January 2023. See **Tax Alert 2022-1687**, dated 10 November 2022.

The EU Member States unanimously adopted a directive implementing the global minimum tax rules in Pillar Two of the OECD's BEPS 2.0 project. Member States must enact the directive into their national laws by the end of 2023. Pillar Two's IIR will apply for tax years beginning on or after 31 December 2023, while the undertaxed profit rule will apply for tax years beginning on or after 31 December 2024. See **Tax Alert 2022-1892**, dated 16 December 2022.

Italy — The Italian Council of Ministers approved a draft of the Budget Law for 2023, which is expected to be enacted for US GAAP purposes by the end of December 2022. Tax proposals include:

- Generally limiting deductions for expenses from transactions with entities in a jurisdiction that is non-cooperative for tax purposes to the "normal value" of the relevant goods and services
- Allowing Italian companies to elect to pay a 9% transition tax (6% in specified cases) on qualified undistributed earnings of subsidiaries in low-tax jurisdictions
- Imposing capital gains taxes on indirect sales of Italian real estate, such as the sale of a foreign company that owns, directly or indirectly, stock in an Italian company that holds Italian real estate
- Allowing foreign entities to elect to pay a 14% substitute tax to step up the shares in Italian companies (as well as qualifying Italian land or Italian shares traded on regulated markets or multilateral trading systems)
- Modifying Italy's PE definition to exclude under certain circumstances nonresident investment vehicles whose asset managers operate in Italy
- Requiring for tax year 2023 certain energy companies to pay a 50% "solidarity surcharge" (effectively, a windfall tax) on the portion of their 2022 corporate income that exceeds, by at least 10%, their average income for the four years preceding tax year 2022, but limiting the surcharge to 25% of the value of the shareholders' equity on 31 December 2021 (for calendar-year entities)

See **Tax Alert 2022-1842**, dated 8 December 2022.

Luxembourg — In the draft 2023 budget bill, the Minister of Finance proposed clarifying the Reverse Hybrid Entity Rule, which treats, under certain conditions, Luxembourg transparent entities or arrangements as corporations and taxes their otherwise untaxed income. Under the proposal, the rule would only apply if the Luxembourg entity's income was not taxed due to jurisdictional differences in the entity's classification. See **Tax Alert 2022-1569**, dated 17 October 2022.

OECD — In a report for the G20 countries, the OECD concluded that global anti-base erosion (GloBE) rules are more likely to affect the operation of tax incentives that result in low-taxed profit than incentives that attract tangible investment and jobs. To determine the extent to which incentives might be affected, the OECD advised jurisdictions to consider:

- Elements in their domestic tax systems that cause multinational companies to be subject to low tax rates
- The nature of the entities operating in the jurisdiction
- The activities undertaken by entities operating in the jurisdiction
- The tax incentives offered to these taxpayers and their design

To minimize the effects of the GloBE rules on tax incentives, the OECD advises jurisdictions to eliminate incentives that would result in top-up taxes and to introduce qualified domestic minimum taxes (QDMTs). See **Tax Alert 2022-1543**, dated 13 October 2022.

At a plenary meeting of the Inclusive Framework, OECD Secretary-General Mathias Cormann stressed the need to make Pillar One and Pillar Two of the OECD's BEPS 2.0 project a reality. Failure to do so, he warned, could prompt a resurgence of uncoordinated tax measures that could lead to controversy at a difficult time in the global economy. He also noted the need to do more to make sure that developing countries can reap the full benefits of the two pillars. See **Tax Alert 2022-1618**, dated 25 October 2022.

G20 — At a meeting on 12 and 13 October 2022 in Washington, DC, the G20 Finance Ministers and Central Bank Governors welcomed the progress made on the BEPS 2.0 project and reaffirmed their commitment to swift implementation of the new rules. See **Tax Alert 2022-1603**, dated 21 October 2022.

Peru — The Tax Authority updated its list of tax-planning ideas that could be challenged under the Peruvian GAAR. The updated list includes 13 ideas. See **Tax Alert 2022-1579**, dated 19 October 2022.

United Kingdom — UK Chancellor Jeremy Hunt withdrew a September 2022 proposal to repeal the previously enacted increase in the corporate income tax rate to 25%. Accordingly, the rate will increase to 25% from 19%, effective 1 April 2023. See **Tax Alert 2022-1574**, dated 18 October 2022.

Subsequently, in his Autumn Statement, the Chancellor announced a new Electricity Generator Levy and changes to the operation of the Energy Profits Levy. He also confirmed that the UK will implement the proposed Pillar Two global minimum tax rules for tax years beginning on or after 31 December 2023. See Tax Alerts 2022-1727, dated 17 November 2022, and 2022-1734, dated 18 November 2022.

Appendix

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

This publication, which appeared in the Q3 2022 Quarterly tax developments publication, was updated 17 November 2022 to reflect the FASB staff's view that the most appropriate way to account for nonrefundable tax credits with transferability features is to apply ASC 740. If the entity that generates the credit transfers it to another party, it would recognize the gain or loss on the transfer in income tax expense (benefit). However, the FASB staff said other views to account for credits with transferability features are acceptable because ASC 740 does not specifically address the issue.

Overview

President Biden signed into law the Inflation Reduction Act of 2022 (IRA or Act) on 16 August 2022. The Act includes climate and energy provisions, extends the enhanced Affordable Care Act (ACA) subsidies, increases IRS enforcement funding and allows Medicare to negotiate prescription drug prices. The IRA introduces a 15% CAMT for corporations whose average annual adjusted financial statement income (AFSI) for any consecutive three-tax-year period ending after 31 December 2021 and 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 ending after 31 December 2021 and 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 ending after 31 December 2021 and 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.

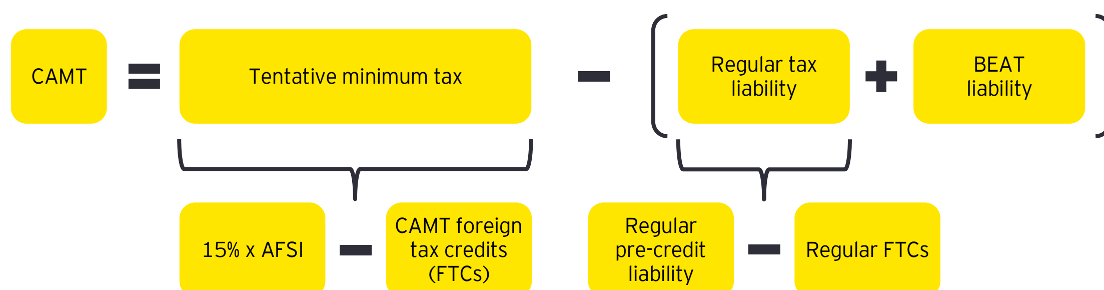
A corporation that is a member of an international financial reporting group with a foreign parent is considered an applicable corporation if its average annual AFSI exceeds the $1 billion threshold and its average annual US-related AFSI (i.e., income of the US corporation(s), income of controlled foreign 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[6] 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.

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

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 (Updated 29 September 2022)

Questions have arisen about whether a company should consider the effects of being subject to the new CAMT in the future when they assess the realizability of tax benefits from deductible temporary differences and carryforwards, as well as tax credits.

In response to a technical inquiry, the Financial Accounting Standards Board (FASB) staff said because ASC 740 does not specifically address this issue, a company could make an accounting policy election to either consider the effect of the CAMT system when evaluating the need for, and the amount of, a valuation allowance or account for the effects on deferred tax assets and carryforwards and tax credits in the period they arise. The policy elected should be consistently applied. The FASB staff said the application of this view is limited to the accounting for the new US CAMT, and a company should have transparent disclosures about its policy election.

Companies that elect to account for the future effects the CAMT may have on the realizability of deferred tax assets, carryforwards, and other tax credits under the regular tax system will need to determine whether changes to their valuation allowances are necessary in the period of enactment.

> In the period of enactment, companies that expect to be subject to the CAMT in future periods will need to elect a policy to account for the potential effects the CAMT might have on the realizability of deferred tax assets.

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 elects an accounting policy to consider the effects of the CAMT when assessing the need for a valuation allowance and had recorded a valuation allowance previously for these business tax credits, it may need to reassess its valuation allowance conclusion in the period of enactment. This is because when a company expects to be subject to the CAMT in the future, it will generally be able to use more credits, or use them sooner, than it was able to use them to offset its regular tax liability alone.

Valuation allowance considerations after the effective date of the CAMT

Companies that are subject to the 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, depending on a company's accounting policy election, 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 (Updated 29 September 2022)

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. Companies subject to the CAMT should also disclose the accounting policy they elected for considering the future effects of being subject to the CAMT when assessing the need for 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 (Updated 31 August 2022)

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 tax year, 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. Since the excise tax is not based on income, it is outside of the scope of the income tax accounting guidance in ASC 740.

Therefore, an entity could generally record the excise tax as a cost in treasury stock if it determines that the tax is a direct cost associated with repurchasing its common stock. That accounting would align with the American Institute of Certified Public Accountants' Technical Questions and Answers — Costs Incurred to Acquire Treasury Stock (TQA 4110.09), which states that costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock in a manner similar to stock issuance costs. Additional considerations may be necessary for the accounting of excise tax incurred to redeem preferred stock or for stock classified outside of permanent equity. Refer to section 3.5.1.1, *Treasury shares*, of our FRD, ***Issuer's accounting for debt and equity financings***, for further detail.

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.

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 (updated 17 November 2022)

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.

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.

Accounting for nonrefundable tax credits with transferability features

The IRA created a number of tax credits that are transferable, meaning an eligible taxpayer can apply the credit against its own tax liability or transfer (e.g., sell) the credit, or a portion thereof, to an unrelated taxpayer. The only way a nonrefundable transferable credit can be used is to include it in an income tax return to offset an income tax liability of either the entity that generated the credit or, of the transferee. A transferee that cannot transfer the credits to another party (i.e., the transferee can only use the credits against its own tax liability) would account for the tax credits under ASC 740.

US GAAP does not address how an entity that generates a nonrefundable transferable credit should consider its ability to transfer the credit when determining which accounting guidance to apply. However, there are several views in practice, including:

- **View A**: The entity applies ASC 740 to account for the credit. When the entity transfers the credit, the gain or loss on transfer is recognized in income tax expense (benefit) in the income statement.
- **View B**: The entity applies ASC 740 to account for the credit. When the entity transfers the credit, the gain or loss on transfer is recognized in pretax income.
- **View C**: The entity applies guidance other than ASC 740 to account for the credit. The ability to transfer or sell the credit allows the entity to realize the economic benefit of the credit without regard to incurring an income tax liability, similar to a refundable tax credit.

In response to a technical inquiry, the FASB staff responded that because ASC 740 does not specifically address this issue, any one of these views is acceptable. However, the staff said that view A is most appropriate. An entity should apply the view it elects consistently to all tax credits that can be monetized either as a reduction of its income tax liability or in a transfer to a third party.

Entities that generate tax credits and account for them under ASC 740 will need to determine whether the deferred tax assets for these credits are realizable or require a valuation allowance. Future realization of tax benefits of the generated credits ultimately depends on the existence of sufficient taxable income of appropriate character considering the four sources of taxable income noted in ASC 740. However, the FASB staff said that under views A and B, an entity could also consider its ability to transfer the credits in determining whether a valuation allowance is necessary.

In addition to the views discussed above, we understand that there is an alternative view that the accounting treatment of a transferrable credit (i.e., whether to apply ASC 740) should be based on how the entity intends to realize the credit. Under this view, an entity that intends to use a tax credit on its own tax return would apply ASC 740, while an entity that intends to sell a tax credit would account for it under guidance other than ASC 740. A public company considering applying this view for a material transaction should seek preclearance from the SEC staff.

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,[7] a loan in accordance with ASC 470,[8] a contingency in accordance with ASC 450,[9] or a government grant in accordance with other GAAP by analogy (e.g., IAS 20,[10] ASC 958-605[11]). 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.

Disclosure

ASC 832[12] 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.

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[7] ASC 606, *Revenue from Contracts with Customers*.

[8] ASC 470, *Debt*.

[9] ASC 450, *Contingencies*.

[10] International Accounting Standards 20, *Accounting for Government Grants and Disclosure of Government Assistance*.

[11] 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).

[12] ASC 832, *Government Assistance*.

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