APB 2: Accounting for the "Investment Credit"

APB 2 STATUS

Issued: December 1962

Effective Date: December 1962

Affects: No other pronouncements

Affected by: Paragraph 13 amended by APB 4, paragraph 10
Paragraph 16 replaced by FAS 109, paragraph 288(b)
Paragraph 17 deleted by FAS 71, paragraph 26(d)
Footnote 1 effectively deleted by APB 4, paragraph 10
Addendum deleted by FAS 71, paragraph 25

Other Interpretive Pronouncements: FIN 25 (Superseded by FAS 96 and FAS 109)
FIN 32 (Superseded by FAS 96 and FAS 109)
FTB 81-2 (Superseded by FAS 96 and FAS 109)

1. The Revenue Act of 1962 provides for an "investment credit" which, in general, is equal to a specified percentage of the cost of certain depreciable assets acquired and placed in service after 1961. It is subject to certain statutory limitations and the amount available in any one year is used to reduce the amount of income tax payable for that year. The full amount of the investment credit is treated for income tax purposes as a reduction in the basis of the property. An investment credit once allowed is subject to recapture under certain circumstances set forth in the statute.

2. Some decision as to the nature of the investment credit, i.e., as to the *substance* of its essential characteristics, if not indispensable, is of great significance in a determination of its accounting treatment. We believe there can be but one useful conclusion as to the nature of the investment credit and that it must be determined by the weight of the pertinent factors.

3. Three concepts as to the substance of the investment credit have been considered by the Board: (a) subsidy by way of a contribution to capital; (b) reduction in taxes otherwise applicable to the income of the year in which the credit arises; and (c) reduction in a cost otherwise chargeable in a greater amount to future accounting periods.

4. There is no significant disagreement with the view that the investment credit is a factor which influences the determination of net income. The basic accounting issue before us therefore is not whether the investment credit increases net income but, rather, the accounting period(s) during which it should be reflected in the operating statement. Resolution of the accounting issue, in large part, rests upon the accounting principles relative to the realization of income. This is true for both regulated and nonregulated companies. (See paragraph 17 of this Opinion.)

5. **Subsidy by way of a contribution to capital.** This concept, in our opinion, is the least rational because it runs counter to the conclusion that the investment credit increases the net income of some accounting period(s).

6. **Tax reduction.** The argument for this concept essentially is that since the investment credit is made available by the Revenue Act of 1962 it is in substance a selective reduction in taxes related to the taxable income of the year in which the credit arises.

7. A refinement of the tax reduction concept advocates that 48% of the investment credit (the maximum extent to which the credit normally can increase net income, assuming that the income tax rate is

52%) should be recorded as a reduction of tax expense of the year in which the credit arises; the balance of 52% should be deferred to subsequent accounting periods, as provided in Chapter 10B of *Accounting Research Bulletin No. 43,* because of the statutory requirement that the basis of the property be reduced for tax purposes by the amount of the investment credit.

8. The General Rule of section 38 of the Revenue Act of 1962 provides that

> There shall be allowed, as a credit against the tax imposed by this chapter, the amount determined under sub-part B of this part.

The tax code has traditionally distinguished between exclusions from taxable income (which affect the computation of taxes payable on taxable income of the period) and credits to be applied to reduce taxes otherwise applicable to such taxable income (which do not enter into such computation). In our view the relevant materials support the interpretation that the investment credit is an administrative procedure to permit the taxpayer to withhold the cash equivalent of the credit from taxes otherwise payable and that it is not an element entering into the computation of taxes related to income of the period.

9. **Cost reduction.** We believe that the interpretation of the investment credit as a reduction in or offset against a cost otherwise chargeable in a greater amount to future accounting periods is supported by the weight of the pertinent factors and is based upon existing accounting principles.

10. In reaching this conclusion we have evaluated the pertinent portions of the legislative history of the investment credit, which we regard as significant but not decisive. We also evaluated the pertinent provisions of the Revenue Act of 1962 which, as earlier stated, require that the investment credit be treated as a reduction in the basis of the property which gives rise to the credit and which contain recapture and other provisions the effect of which is to make realization of the credit dependent to some degree on future events.

11. The investment credit under certain circumstances is transferable to the lessee of qualified property. We regard it as significant that in such cases the rules and regulations of the Treasury require the lessee to reduce his taxable deduction for rent over a four, six, or eight year period, depending upon the useful life category of the property.

12. In concluding that the cost reduction concept is based upon existing accounting principles we attach substantial weight to two points in particular. First, in our opinion, earnings arise from the use of facilities, not from their acquisition. Second, the ultimate realization of the credit is contingent to some degree on future developments. Where the incidence of realization of income is uncertain, as in the present circumstances, we believe the record does not support the treatment of the investment credit as income at the earliest possible point of time. In our opinion the alternative choice of spreading the income in some rational manner over a series of future accounting periods is more logical and supportable.

CONCLUSIONS

13. [It] shall be considered preferable [for] the allowable investment credit [to] be reflected in net income over the productive life of acquired property [(the deferral method). However,] treating the credit as a reduction of federal income taxes of the year in which the credit arises [(the flow-through method)] is also acceptable.

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[1] [This footnote has been effectively deleted. See Status page.]

14. A number of alternative choices for recording the credit on the balance sheet has been considered. While we believe the reflection of the allowable credit as a reduction in the net amount at which the acquired property is stated (either directly or by inclusion in an offsetting account) may be preferable in many cases, we recognize as equally appropriate the treatment of the credit as deferred income, provided it is amortized over the productive life of the acquired property.

15. We believe it preferable that the statement of income in the year in which the allowable

investment credit arises should be affected only by the results which flow from the accounting for the credit set forth in paragraph 13. Nevertheless, reflection of income tax provisions, in the income statement, in the amount payable (that is, after deduction of the allowable investment credit) is appropriate provided that a corresponding charge is made to an appropriate cost or expense (for example, to the provision for depreciation) and the treatment is adequately disclosed in the financial statements of the first year of its adoption.

16. An investment credit should be reflected in the financial statements to the extent it has been used as an offset against income taxes otherwise currently payable or to the extent its benefit is recognizable under the provisions of FASB Statement No. 109, *Accounting for Income Taxes.* Refer to paragraph 48 of Statement 109 for required disclosures related to (a) tax credit carryforwards for tax purposes and (b) tax credit carryforwards for which a tax benefit has not been recognized for financial reporting.

17. [This paragraph has been deleted. See Status page.]

The Opinion entitled "Accounting for the 'Investment Credit'" was adopted by the assenting votes of fourteen members of the Board, of whom one, Mr. McEachren, assented with qualification. Messrs. Bevis, Black, Cannon, Powell, Tippit, and Walker dissented.

Mr. McEachren agrees with the conclusion that the investment credit should be reflected in net income over the productive life of acquired property but disagrees with the inclusion of paragraphs 9, 10, and 12 to the extent that they argue that the investment credit is a reduction of cost. Whether or not it is a reduction of cost is a question with many ramifications and subject to different interpretations under differing circumstances and in any event is not relevant to the matter here involved. He believes that the fundamental basis for the conclusion in paragraph 13 is that "earnings arise from the use of facilities; not from their acquisition."

Messrs. Bevis, Powell, and Tippit believe that the pertinent factors preponderantly support the views that the investment credit is in substance a reduction in income taxes. They consider that the generally accepted accounting principles applicable (including the pronouncements of the former Committee on Accounting Procedure, especially those relating to the accounting for income taxes and to the reporting of income, which are still in effect) preponderantly support the treatment of the investment credit as a reduction of the provision for current income taxes in the year in which the credit arises. They believe specifically, that the generation of taxable income for the year in and by itself, rather than the future productive use of the related property, effects the realization of the credit. They point out that opinions received by the Board from practitioners and businessmen make it clear that the "48-52" method discussed in paragraph 7 of the Opinion has at least as wide acceptance among these groups as the method sponsored by the majority of the Board. They believe that, in the circumstances, the "48-52" method must also be considered to have substantial authoritative support and, therefore, to be generally acceptable.

Messrs. Black and Cannon dissent from the conclusion that there is only one acceptable accounting treatment of the investment credit. While not objecting to reflecting the investment credit over the productive life of the acquired property, they believe that it would be preferable to defer only that part of the credit (52%) equivalent to the increased taxes in future years arising from the reduction in the tax base of the property acquired.

Mr. Walker concurs with the method set forth in the Opinion as the preferred basis for treatment of the investment credit, but it is his opinion that, with adequate disclosure, it should be considered an acceptable alternative to reduce the taxes of the year in which the credit arises by an appropriate portion of such credit.

APB 2 NOTE

Unless otherwise indicated Opinions present the considered opinion of at least two-thirds of the members of the Accounting Principles Board, reached on a formal vote after examination of the subject matter. Except where formal adoption by the Council or the membership of the Institute has been asked and secured, the authority of the opinions rests upon their general acceptability. While it is recognized that general rules may be subject to exception, the burden of justifying departures from the Board's recommendations must be assumed by those who adopt other practices. Recommendations of the Board are not intended to be retroactive, nor applicable to immaterial items.

ADDENDUM: Accounting Principles for Regulated Industries

[The Addendum has been deleted. See Status page.]

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