# APB 4: Accounting for the "Investment Credit"

**APB 4 STATUS**

Issued: March 1964

Effective Date: March 1964

Affects: Amends APB 2, paragraph 13
Effectively deletes APB 2, footnote 1

Affected by: No other pronouncements

Other Interpretive Pronouncements: AIN-APB 4, Interpretations No. 1 through 6
(Interpretations No. 4 and 6 superseded by FAS 96 and FAS 109 and Interpretation No. 5 superseded by FAS 111)
FIN 25 (Superseded by FAS 96 and FAS 109)
FIN 32 (Superseded by FAS 96 and FAS 109)
FTB 81-2 (Superseded by FAS 96 and FAS 109)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. In December 1962 this Board issued Opinion No. 2, "Accounting for the `Investment Credit.'" In this Opinion we said:

> 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. (paragraph 2)

2. The Opinion listed the possible interpretations which the Board had considered:

> 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. (paragraph 3)

3. After noting the arguments in favor of each, the Board said:

> 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. (paragraph 9)

4. The Board concluded (paragraph 13) that the investment credit "should be reflected in net income over the productive life of acquired property and not in the year in which it is placed in service."

5. In January 1963 the Securities and Exchange Commission issued *Accounting Series Release No. 96* in which it reported that in recognition of the substantial diversity of opinion among responsible persons in the matter of accounting for the investment credit the Commission would accept statements in which the credit was accounted for either as this Board concluded in Opinion No. 2 or as a reduction in taxes otherwise applicable to the year in which the credit arises. The Commission has recently reconsidered and reaffirmed that position.

6. The Board's review of experience since the issuance of Opinion No. 2 shows that the investment

credit has been treated by a significant number of companies as an increase in net income of the year in which the credit arose.

7. The Revenue Act of 1964 eliminates the requirement imposed by the Revenue Act of 1962 that the investment credit be treated for income tax purposes as a reduction in the basis of the property to which the credit relates.

## CONCLUSIONS

8. It is the conclusion of this Board that the Revenue Act of 1964 does not change the essential nature of the investment credit and, hence, of itself affords no basis for revising our Opinion as to the method of accounting for the investment credit.

9. However, the authority of Opinions of this Board rests upon their general acceptability. The Board, in the light of events and developments occurring since the issuance of Opinion No. 2, has determined that its conclusions as there expressed have not attained the degree of acceptability which it believes is necessary to make the Opinion effective.

10. In the circumstances the Board believes that, while the method of accounting for the investment credit recommended in paragraph 13 of Opinion No. 2 should be considered to be preferable, the alternative method of treating the credit as a reduction of Federal income taxes of the year in which the credit arises is also acceptable.

11. The Board emphasizes that whichever method of accounting for the investment credit is adopted, it is essential that full disclosure be made of the method followed and amounts involved, when material.

*The Opinion entitled "Accounting for the `Investment Credit'" was adopted by the assenting votes of fifteen members of the Board, of whom eight, Messrs. Bevis, Crichley, Frese, Higgins, Jennings, Queenan, Tippit and Trueblood assented with qualification. Messrs. Armstrong, Blough, Moonitz, Moyer and Spacek dissented.*

Messrs. Crichley and Trueblood believe that, under the Revenue Act of 1964, there is considerable theoretical support for regarding the investment credit as a selective reduction in taxes. Accordingly, they do not necessarily regard amortization of the investment credit over the life of acquired properties as the "preferable method." They believe that the alternative method is preferable, but agree that recognition of both methods is necessary and desirable under existing conditions.

Mr. Frese assents to the conclusions in this Opinion, and to its publication, because he believes developments and circumstances summarized in paragraphs 5, 6, and 9 leave the Board no other practical choice. He desires, however, to express his strong preference for the conclusion of the Board in Opinion No. 2 because he believes it conforms with the basic concept, which has long been generally accepted, that income should be recognized as it is earned through the use of assets and not as an immediate result of their acquisition.

Messrs. Higgins and Jennings assent to Opinion No. 4 and its publication only because they believe the action of the SEC, reported in paragraph 5, and the consequences recited in paragraph 6, leave no other practicable choice. They believe that the Revenue Act of 1964 does not alter the soundness of the conclusion stated in Opinion No. 2 that the investment credit should be reflected in net income over the productive life of acquired property and not in the year in which such property is placed in service. They believe further that the present action recognizing the alternative treatment as acceptable is illogical (for the reasons given in the first sentence of Mr. Moonitz's dissent) and is tantamount to taking no position. They observe that paragraph 17 of Opinion No. 2 is still effective and, accordingly, that the alternative method of treating the credit as a reduction of Federal income tax of the year in which the credit arises is improper and should be unacceptable in those instances where Section 203(e) of the Revenue Act of 1964 effectively requires the credit to be reflected in net income over the productive life of the property.

Mr. Queenan, joined by Messrs. Bevis and Tippit, assents to the Opinion because he continues to believe that the investment credit constitutes a reduction in income tax expense in the year in which the credit arises. In view of the substantial support of the cost-reduction concept, he does not object to inclusion of the credit in net income over the life of the acquired property, but believes that the order of preference expressed in paragraph 10 should be reversed.

Mr. Armstrong dissents from Opinion No. 4. He agrees that the Revenue Act of 1964 does not change the essential nature of the investment credit and agrees with the conclusions expressed in Opinion No. 2. He disagrees with paragraph 10 of Opinion No. 4 wherein an alternative method of treating the credit is recognized as being acceptable, thereby adding one more to the list of principles for which there are a variety of acceptable methods yielding substantially different results in comparable situations.

Mr. Blough dissents from this opinion because he believes the conclusion reached in Opinion No. 2 "that the allowable investment credit should be reflected in net income over the productive life of acquired property and not in the year in which it is placed in service" was and is sound. The fact that there is substantial support for treating the investment credit as an increase in net income of the year in which the credit arose is not a sound reason, in his opinion, for this Board to retreat from a position which it still considers to be "preferable." He does not believe the Board can carry out its major responsibility "to determine appropriate practice and to narrow the areas of difference and inconsistency in practice" if it withdraws its influence from the support of its considered opinion whenever that opinion is not immediately accepted by all influential persons.

Mr. Moonitz dissents to paragraph 10 of Opinion No. 4 because while it is conceivable that the tax reduction method may be right, or that cost reduction may be right, or that both are wrong and some other unspecified possibility right, the investment credit cannot be two different things at one and the same time. As between the two methods set forth in paragraph 10, he believes that accounting principles compel the treatment of the investment credit as a selective reduction in tax available to those who meet the conditions laid down in the statute. The method preferred by the majority of the Board permits identical items bought from the same supplier at identical prices to be recorded at different "costs" depending upon the tax status of the purchaser and not upon the conditions prevailing in the transaction between buyer and seller. Alternatively the method preferred by the majority of the Board permits the balance sheet to include a "deferred credit to income" that cannot be classified as part of the interest of owners, creditors, government, employees, or any other recognizable group. He concludes that the effect of Opinion No. 4 can only be the direct opposite of the Board's ultimate objective of narrowing the areas of difference in practice.

Mr. Moyer believes that Opinion No. 4 should not have been issued, as it carries the strong implication that Opinions of the Board always should follow existing practices. He believes that progress cannot be made under such a policy.

Mr. Spacek dissents from the conclusion in paragraph 10. He believes this Opinion illustrates the accounting profession's complete failure in its responsibility to establish accounting principles that will provide reliable financial statements that are comparable among companies and industries, for use of the public in making personal investment decisions. He states there is no justification for sanctioning two contradictory practices to accommodate SEC and other regulatory bodies and some CPAs who have approved reporting the investment credit as, in effect, profit from acquisition rather than from use of property. This flouts Congress' clear intent in granting the investment credit, "to reduce the net cost of acquiring depreciable property." Alternative procedures under this Opinion can increase by up to 25 per cent the earnings otherwise reported. In this Opinion and in SEC's stated position, Mr. Spacek finds no word of concern for the investor, to whose protection both CPAs and SEC supposedly are dedicated. He believes this Opinion approves accounting of the type that precipitated the 1929 financial crisis, and that history is being repeated by actions of the very authorities created to prevent such catastrophes. He feels this breakdown in safeguards created to protect investors has resulted from fragmentation of responsibility for establishing accounting principles, and the only remedy is to create a Federally established Court of Accounting Principles with a prescribed basis for its decisions; this court would be independent of the profession and regulatory commissions, and its decisions would be binding on all, thus rescuing investors from their present abandonment.

**APB 4 NOTE**

*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.*

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