Case 26-2c

Solar Energy Corp.

Solar Energy Corp. (“SE” or the “Company”) is a solar manufacturing company.

The Inflation Reduction Act of 2022 (or “IRA”), which was signed into law in August 2022, introduced a number of tax-related provisions, including a plethora of clean energy tax incentives in the form of tax credits, some of which include a direct-pay option, transferability provisions, or both. Qualifying assets in place as of January 1, 2023, are eligible for IRC Section 48C credits (“48C credits”), which provide an income tax credit for investment in advanced energy projects that produce energy from alternative sources.

These 48C credits include a transferability provision whereby an “eligible taxpayer” can elect to transfer (i.e., sell) the credit, or some portion thereof, to an unrelated taxpayer. That is, an entity that generates 48C credits can either use the credits to reduce its own federal income tax liability or sell the credits to an unrelated third party (often at a discount). To transfer (sell) the credits, entities need to execute a transfer election form with the IRS that identifies the registered project and includes specific information about the credits being sold. The transfer election form allows the buyer of the 48C credits to claim the credits to reduce its own federal income tax liability.

SE anticipates its construction of solar farms to qualify for the 48C credits. Although the 48C credit is generated, as noted above, SE can (1) use it to reduce an income tax liability or (2) transfer the credit to a third party in exchange for cash. Although SE has generated and used these credits in the past, the IRA made these credits transferrable for the first time. Accordingly, SE is evaluating the relevant accounting standards and guidance applicable to these credits now that they can be transferred.

On January 1, 2023, SE began the construction of a new facility, which is a qualified asset for the investment tax credit (ITC) described above (the 48C credits). The construction of the new facility costs $100 million and is eligible for $6 million (6 percent of qualifying asset cost) of 48C ITCs. The construction began on January 1, 2023, and was completed on December 30, 2023. The facility was then placed in service on December 31, 2023.

The facility will be depreciated beginning January 1, 2024, on a straight-line basis over a 25-year useful life for both financial statement and income tax purposes. The current income tax rate is 21 percent.

Required:

How should SE account for the ITC as of December 31, 2023; December 31, 2024; and December 31, 2025, under ASC 740 (the deferral method) and IAS 20 (assuming SE has a policy to record nonmonetary grants at fair value and the fair value of the credit is $5.5 million)?

Scenarios:

1.) The entity uses the credits to offset its income tax liability that would otherwise be due. The income tax liability as of December 31, 2023; December 31, 2024; and December 31, 2025, is $2 million for all periods.
2.) The Company elects the transferability option and transfers the ITCs to an unrelated third party. In this scenario, SE expects to receive $5.5 million in exchange for the ITC. The Company's policy is to include the expected proceeds from the sale of the credits when evaluating whether it is more likely than not that tax credits will be realized. On December 31, 2024, SE sells the ITCs for $5.5 million. Upon sale of the credit, there is a reversal of the valuation allowance (under ASC 740).