

Statutory Issue Paper No. 126

Accounting for Transferable State Tax Credits

STATUS

Finalized December 5, 2005

Original SSAP: SSAP No. 94; Current Authoritative Guidance: SSAP No. 94R

This issue paper may not be directly related to the current authoritative statement.

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. The purpose of this issue paper is to establish statutory accounting principles for transferable state tax credits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).
2. Currently, generally accepted accounting principles do not provide separate guidance for transferable state tax credits; general guidance for income taxes is found in *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109). *SSAP No. 10—Income Taxes* (SSAP No. 10), paragraph 2 notes the adoption of FAS 109 with modifications for state income taxes, the realization criteria for deferred tax assets, and the recording of the impact of changes in its deferred tax balances.
3. Investments in Low Income Housing Tax Credits as discussed in *SSAP No. 93—Accounting for Low Income Housing Tax Credit Property Investments*, which involve an investment by a reporting entity in a limited liability company or similar entity that earns tax credits as a consequence of its operating activities involving low income housing developments and passes those tax credits to its investors, are not within the scope of this issue paper.

SUMMARY CONCLUSION

Definitions

4. Some states have enacted laws that create programs by which transferable state tax credits are granted to entities under certain specified conditions (e.g., an entity makes an investment in a particular industry). The terms of these state tax credits vary from state to state and, within a state, from program to program. However, many of these state tax credit programs share the following four characteristics:
 - a. The tax credit is nonrefundable;
 - b. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise resell or transfer the credit;
 - c. The transferable state tax credit will expire if not used by a predetermined date; and
 - d. The transferable state tax credit can be applied against either state income tax or state premium tax.
5. For purposes of this issue paper, such programs will be referred to as “transferable state tax credits.” The criteria in subparagraphs 4.b., 4.c. and 4.d. must be present in order for the transferable state

tax credit to receive the accounting treatment described in this issue paper. When a reporting entity purchases a transferable state tax credit from another entity, the transaction does not result in a continuing investment in a business entity (i.e. limited partnership).

6. Subject to adoption of a Statement of Statutory Accounting Principles (SSAP) on this topic, transferable state tax credits held by reporting entities will meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and will be admissible assets to the extent that they comply with the requirements of the SSAP.

Acquisition

7. Transferable state tax credits are recorded at cost at the date of acquisition.

Balance Sheet Treatment

8. Transferable state tax credits expected to be realized are initially recorded at cost.

9. Transferable state tax credits shall be established gross of any related state tax liabilities and reported in the category of other-than-invested assets (not reported net).

10. As transferable state tax credits are redeemed, the carrying value of the tax credits is reduced dollar for dollar by the amount of transferable state tax credits applied toward the reporting entity's applicable state tax liability.

Income Statement Treatment

11. Gains on transferable state tax credits are deferred until the value of the transferable state tax credits utilized exceeds the cost of the transferable state tax credits or until the transferable state tax credits are sold to other entities and the payment received is greater than the book value.

12. Losses on transferable state tax credits are recognized when known.

13. Gains and losses on transferable state tax credits are reflected in other income.

Impairment

14. An impairment shall be considered to have occurred if it is probable that the reporting entity will be unable to recover the carrying amount of the transferable state tax credits. Transferable state tax credits should be evaluated for impairment at each reporting date.

15. When there is a decline in the realizability of a transferable state tax credit owned by the reporting entity that is other than temporary, the asset shall be written down to the expected realizable amount and the amount of the write down shall be accounted for as a realized loss. The expected realizable value is the new cost basis.

16. The new cost basis shall not be changed for subsequent recoveries in realizability.

Disclosures

17. The following disclosures shall be made in the financial statements. For purposes of this disclosure, total unused transferable state tax credits represent the entire transferable state tax credits available:

- a. Carrying value of transferable state tax credits gross of any related state tax liabilities by state and in total,

- b. Total unused transferable state tax credits by state;
- c. Method of estimating utilization of remaining transferable state tax credits or other projected recovery of the current carrying value.
- d. Impairment amount recognized in the reporting period, if any.

Effective Date and Transition

18. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principle (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of years ending on or after December 31, 2006.

DISCUSSION

19. This issue paper provides new statutory accounting guidance for a type of investment, which is not currently addressed in the *Accounting Practices and Procedures Manual*. Therefore, in accordance with SSAP No. 4, they default to a nonadmitted asset. In evaluating transferable state tax credits, several points were considered. The transferable characteristics of these state tax credit are a major factor in developing statutory accounting guidance, which would admit investments in transferable state tax credits that comply with the guidance.

20. It is consistent with the Statement of Concepts, conservatism to report the transferable state tax credits at cost.

21. Reporting the transferable state tax credits gross is consistent with other reporting and with the principles in *SSAP No. 64—Offsetting and Netting of Assets and Liabilities*. State premium tax liabilities for multiple states are reported on the same annual statement line on the liabilities page of the annual statement. Therefore, if a reporting entity wrote business in multiple states, it would violate the *SSAP No. 64—Offsetting and Netting of Assets and Liabilities* offsetting criteria to net the premium tax liability from one state against a premium tax credit of another state.

22. The primary reason for purchasing transferable state tax credits is to reduce state premium tax expenses. They are not purchased for investment income, so it seems appropriate to report transferable state tax credits as other-than-invested assets. Losses are realized losses in the other income category.

23. It is consistent with the concept of conservatism to delay any recognition of gain on the utilization or sales of transferable state tax credits until the gain is realized. Realization is determined to have occurred when the state tax credits are utilized and meet or exceed the cost of the credits, or credits are sold and the sales price realized meets or exceeds the cost of state tax credits sold.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

24. *SSAP No. 10—Income Taxes* provides the following references on state income taxes:

2. For purposes of accounting for federal and foreign income taxes, reporting entities shall adopt FASB Statement No. 109, Accounting for Income Taxes (FAS 109) with modifications for state income taxes, the realization criteria for deferred tax assets, and the recording of the impact of changes in its deferred tax balances. As a result, financial statements will recognize current and deferred income tax assets and liabilities in accordance with the provisions of this statement.

4. State taxes (including premium, income and franchise taxes) shall be computed in accordance with SSAP No. 5 and shall be limited to (a) taxes due as a result of the current year's taxable basis calculated in accordance with state laws and regulations and (b) amounts incurred or received during the current year relating to prior periods, to the extent not previously provided as such amounts are deemed to be changes in accounting estimates. Property and casualty insurance companies shall report state taxes as other underwriting expenses under the caption "Taxes, licenses, and fees." Life and accident and health insurance companies shall report such amounts as general expenses under the caption "Insurance taxes, licenses, and fees, excluding federal income taxes." Other health entities shall report such amounts as general administration expenses under the caption "Taxes, licenses, and fees." State tax recoverables that are reasonably expected to be recovered in a subsequent accounting period are admitted assets. State taxes are reasonably expected to be recovered if the refund is attributable to overpayment of estimated tax payments, errors, carrybacks, or items for which the reporting entity has authority to recover under a state regulation or statute.

1.1 A – SSAP No. 10 establishes statutory accounting principles for current and deferred federal and foreign income taxes and current state income taxes. In general, SSAP No. 10 adopts the concepts of FAS 109, with modifications. The primary differences and modifications are summarized below:

1.2 State Income Tax

- FAS 109 – State income taxes should be included as "income taxes incurred." Deferred state income taxes are provided.
- SSAP No. 10 – State income taxes should be included as "Taxes, Licenses, and Fees" by property and casualty insurers and as "Insurance taxes, licenses, and fees, excluding federal income taxes" by life and accident and health insurers. No deferred state income taxes are provided.

25. Statutory accounting guidance does not currently address transferable state tax credits, therefore, in accordance with *SSAP No. 4—Assets and Nonadmitted Assets* (SSAP No. 4), transferable state tax credits default to nonadmitted assets at this time.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 10—Income Taxes*

Generally Accepted Accounting Principles

- *FASB Statement No. 109, Accounting for Income Taxes* was adopted with modification in *SSAP No. 10—Income Taxes*

State Regulations

- No additional guidance obtained from state statutes or regulations

Implementation Guide

On 1/1/X1 SAM Insurance Company purchased transferable state tax credits for a cost of \$100,000. The transferable state tax credits are redeemable for \$160,000 and expire at the end of 12/31/X4. SAM initially expects to utilize the tax credits before expiration. in their state of domicile in the amount of \$40,000 per year. In year X4, SAM sells the remaining \$30,000 in transferable state tax credits for \$20,000

1/1/x1	Transferable state tax credits	100,000	
	Cash		100,000
	<i>To record the purchase of the tax credits</i>		
6/30/x1	Premium tax expense	40,000	
	Premium taxes payable to domiciliary state		40,000
	<i>To record premium tax expense and accrue the liability in Year 1.</i>		
10/1/x1	Premium tax payable	40,000	
	Transferable state tax credits		40,000
	<i>To record the use of tax credits in Year 1. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x2	Premium tax expense	60,000	
	Premium taxes payable to domiciliary state		60,000
	<i>To record premium tax expense and accrue the liability in Year 2.</i>		
9/30/x2	Premium tax payable	60,000	
	Transferable state tax credits		60,000
	<i>To record the use of taxes credits in Year 2. The reporting entity expects to be able to utilize remaining tax credits before expiration.</i>		
6/30/x3	Premium tax expense	30,000	
	Premium taxes payable to domiciliary state		30,000
	<i>To record premium tax expense and accrue the liability in Year 3.</i>		
9/30/x3	Premium tax payable	30,000	
	Other income		30,000
	<i>To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. The Company intends to sell the remaining tax credits in year 4.</i>		
6/30/x4	Cash	20,000	
	Other income		20,000
	<i>To record the sale of the remaining tax credits.</i>		

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