

# Statutory Issue Paper No. 145

## Accounting for Transferable and Non-Transferable State Tax Credits

### STATUS

Finalized December 7, 2011

**Original SSAP and Current Authoritative Guidance: SSAP No. 94R**

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. Current statutory guidance allows for transferable state tax credits to be admitted assets as long as they comply with the requirements of *SSAP No. 94—Accounting for Transferable State Tax Credits*. It has been identified that some states have requested to allow non-transferable tax credits to be admitted based on specific criteria.
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 Accounting Standards Codification Topic 740, Income Taxes* which incorporated *FASB Statement No. 109, Accounting for Income Taxes* (FAS 109). *SSAP No. 101—Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10* (SSAP No. 101) 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. The Office of the Comptroller of the Currency in Interpretive Letter #948 dated December 2002 concluded that “purchasing, holding and subsequently reselling **transferable** state tax credits are permissible activities for national banks” (bolding added for emphasis).
3. The purpose of this issue paper is to amend SSAP No. 94 to expand the admittance criteria to include non-transferable state tax credits that meet specific criteria.

### SUMMARY CONCLUSION

4. This issue paper amends guidance included in SSAP No. 94 by 1) substantively revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8; 3) adding a disclosure; and 4) updating terminology throughout the document as appropriate.
5. The primary proposed revisions to the guidance allowing admission for non-transferable state tax credits are tracked below. Illustration of the substantively revised SSAP No. 94 (reflected as SSAP No. 94R) is reflected in Illustration A.

4. The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e. credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).

### **Transferable State Tax Credits**

45. 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 transferable 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 a 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.

56. For purposes of this statement, such programs will be referred to as “transferable state tax credits.” The criteria in subparagraphs 45.b., 45.c. and 45.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. 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).

### **Non-transferable State Tax Credits**

7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:

- a. The tax credit is nonrefundable;
- b. The successive holder of a state tax credit must redeem the credit, by April 15 of the subsequent year to the entity’s acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit.
- c. The non-transferable state tax credit will expire if not used by the predetermined date; and
- d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.

8. The criteria in subparagraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement.

689. Transferable and non-transferable state tax credits as defined within this SSAP 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 this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.

## **DISCUSSION**

6. This issue paper amends SSAP No. 94 to expand the admittance criteria to include non-transferable state tax credits that meet specific provisions. Although the transferability of state tax credits was previously identified as a characteristic needed for admittance within statutory accounting, it has been identified that specific state laws regarding the use of state tax credits by April 15<sup>th</sup> of the subsequent year provide conservative treatment that also warrants admittance within statutory financial statements. The original request included the phrase “required by the applicable states’ laws.” It was felt that this did not achieve the statutory accounting goals of consistency and comparability. It was replaced with the phrase “specific criteria.” This issue paper also expands the disclosures required by identifying transferable and non-transferable state tax credits, and the admitted and nonadmitted portions of each classification.

## History of SSAP No. 94 Guidance

7. As detailed in *Issue Paper No. 126—Accounting for Transferable State Tax Credits*, SSAP No. 94 was established as a result of consideration from an interested parties' request in 2003. Interested parties proposed that state tax credits (1) should qualify as an admitted asset to the extent it is probable they will be realized, consistent with the treatment in SSAP No. 35 of credits granted directly to the reporting entity; (2) should not be netted against the tax liability consistent with the treatment in SSAP No. 35 of credits granted directly to the reporting entity; and (3) any gain that accrues to the reporting entity through the use of these tax credits should be reported as miscellaneous income at the time the credits are used. To accomplish this, interested parties' proposed nonsubstantive changes to SSAP No. 35.

8. In considering the interested parties' 2002 proposal, the Statutory Accounting Principles Working Group considered the December 2002, Office of the Comptroller of the Currency (the regulatory body for national banks) Interpretive Letter #948, which indicated that "purchasing, holding, and subsequently reselling transferable state tax credits is a permissible activity for national banks". In its ruling, the OCC stated that "transferable state tax credits ... offset a tax liability, dollar-for-dollar, and are therefore the functional equivalent of money." The Working Group noted that this interpretive letter focused attention on Missouri's transferable state tax credit programs, but that the characterizations that "the purchase and transfer of ... state tax credits is a noncomplex and fairly rapid process" and that "demand for these tax credits typically exceeds supply during tax season" are likely to apply more generally to other states' programs.

9. Although the interested parties had recommended a nonsubstantive change to *SSAP No. 35—Guaranty Fund and Other Assessments*, the Working Group concluded that this placement was not consistent with the scope paragraphs in SSAP No. 35, as that SSAP includes assessments or mechanisms to fund insolvent reporting entities. Since transferable state tax credits are not assessments or mechanisms to fund insolvent reporting entities, the Working Group concluded that transferable state tax credits do not seem to have been contemplated when SSAP No. 35 was developed and that interested parties' proposed revisions did not meet the criteria for a nonsubstantive change. The Working Group moved this item to the substantive active list with an issue paper to be developed, with guidance from the Working Group, particularly as to the admissibility and possible limitations on the admissibility of the transferable state tax credits. In considering this issue, the following was included in the agenda item:

If statutory accounting guidance is developed, it may be appropriate to address transferable state tax credits as an admitted asset. They seem to be marketable and can generate economic benefits to the reporting entity, even if they are not immediately available to pay policyholder obligations. **However, the transferable state tax credits represent a prepayment of premium taxes, statutory accounting usually nonadmits prepaid expenses, as they are not readily available to pay policyholder obligations. The difference between these transferable state tax credits and other prepaid expenses is the ability to sell the state tax credits. This ability to sell the transferable state tax credits is what helps it to meet the other SSAP No. 4—Assets and Nonadmitted Assets criteria of an asset.**

10. Paragraph 19 of Issue Paper No. 126 identifies the transferability of a state tax credit as a major factor in allowing admittance:

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 credits are a major factor in developing statutory accounting guidance, which would admit investments in transferable state tax credits that comply with the guidance.**

### Consideration of Non-Transferable State Tax Credits:

11. As identified in Issue Paper No. 126, even though transferable state tax credits represent a prepayment of premium taxes which would be nonadmitted, they were deemed to be admitted based on the fact that they can be sold. The proposed revision would be a distinct change in the admissibility guidance currently reflected within SSAP No. 94 as non-transferable state tax credits would be allowed to be admitted.

12. One of the reasons that transferability was a key issue in developing SSAP No. 94 was due to variations among states regarding the terms and limitations on the use of state tax credits. By requiring transferability, these various terms and limitations (e.g., limitations in the amount of tax credits that could be used in a tax year) were concluded not to be as relevant since the tax credits could be subsequently sold.

13. The following reasons were noted for the working group's support of the admittance of non-transferable state tax credits if the specific criteria illustrated in paragraph 6 of Issue Paper No. 126 is met:

- a. This proposal is presented as a good public policy issue and economic development, allowing companies domiciled within states with laws that require usage of tax credits within a designated timeframe and that limit transferability to also be allowed to reflect state tax credits as admitted assets.
- b. The short-term usage requirement identified within the proposal is a conservative requirement. It was noted that there is no confirmation on a market for state tax credits, so just because they are transferable, does not mean that they could actually be subsequently sold. By requiring usage within a specific time frame, these assets will be reflected within a reporting entity's financials for a short period of time. It was noted that "transferable" state tax credits could be reflected for an extensive period of time until the tax credit expires or an impairment has been identified.

### RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

#### Statutory Accounting

14. As noted above, existing guidance for transferable state tax credits is in SSAP No. 94. Tracked changes to SSAP No. 94 are shown in Illustration A.

#### RELEVANT LITERATURE:

#### Statutory Accounting

- *Issue Paper No. 126—Accounting for Transferable State Tax Credits*

#### Generally Accepted Accounting Principles

- *FASB Statement No. 109, Accounting for Income Taxes* was adopted with modification in *SSAP No. 101—Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10* (SSAP No. 101).

#### State Regulations:

State laws may prescribe specific criteria regarding the use of state tax credits. The revisions proposed in this issue paper are intended to allow admittance for state laws that require use of a state tax credit before April 15 of the year subsequent in which the purchase or assignment of a state tax credit is made, and that prohibit subsequent transfer of the state tax credit.

**ILLUSTRATION A****Statements of Statutory Accounting Principles No. 94 - Revised****Accounting for Transferable and Non-Transferable State Tax Credits****STATUS**

Type of Issue:	Common Area
Issued:	June 12, 2006; <u>Substantively revised December 7, 2011</u>
Effective Date:	December 31, 2006; <u>Substantive revisions detailed in Issue Paper No. 145 are effective December 31, 2011</u>
Affects:	No other pronouncements
Affected by:	No other pronouncements
Interpreted by:	No other pronouncements

**SCOPE OF STATEMENT**

1. This statement establishes statutory accounting principles for transferable and non-transferable state tax credits that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).
2. 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 statement.
3. Investments in a CAPCO (Certified Capital Company), organized as a partnership or an LLC, which is a company, authorized by state statute that borrows from investors (insurance companies), in order to make venture capital investments in “qualified” businesses, are not within the scope of this statement. Although associated with tax credits, the insurance company is paid principal and interest on its investment with the CAPCO. Depending upon the terms of the CAPCO offering, principal and interest payments to the insurance company will come from the CAPCO and/or the state. The CAPCO will make cash payments directly to the insurance company while the state will make payments in the form of premium or income tax credits.

**SUMMARY CONCLUSION**

4. The criteria in paragraphs 5 and 6 are for transferable state tax credits (i.e., credits which may be sold or assigned). The criteria in paragraphs 7 and 8 are for non-transferable state tax credits (i.e., those which cannot be sold or assigned to other parties).
45. 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 transferable 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.

~~56.~~ For purposes of this statement, such programs will be referred to as “transferable state tax credits.” The criteria in subparagraphs 45.b., 45.c. and 45.d. must be present in order for the transferable state tax credit to receive the accounting treatment described in this statement. 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).

### **Non-Transferable State Tax Credits**

7. If the original or subsequent holder of the transferable tax credit is not able to transfer the tax credit, then the admissibility criteria in paragraph 8 for non-transferable tax credits apply. These non-transferable state tax credits share the following characteristics:

- a. The tax credit is nonrefundable;
- b. The successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity’s acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
- c. The non-transferable state tax credit will expire if not used by the predetermined date; and
- d. The non-transferable state tax credit can be applied against either state income tax or state premium tax.

8. The criteria in subparagraphs 7.b., 7.c. and 7.d. must be present in order for the non-transferable state tax credit to receive the accounting treatment described in this statement.

~~69.~~ Transferable and non-transferable state tax credits as defined within this SSAP held by reporting entities ~~will~~ meet the definition of assets as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and ~~will be~~ are admissible assets to the extent that they comply with the requirements of this statement. If the criteria in paragraphs 6 or 8 are not met, the tax credits are nonadmitted.

### **Acquisition**

~~710.~~ Transferable and non-transferable state tax credits are recorded at cost at the date of acquisition.

### **Balance Sheet Treatment**

~~811.~~ Transferable and non-transferable state tax credits expected to be realized are initially recorded at cost.

~~912.~~ Transferable and non-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~~13. As transferable and non-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~~14. Gains on transferable and non-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~~15. Losses on transferable and non-transferable state tax credits are recognized when known.

~~13~~16. Gains and losses on transferable and non-transferable state tax credits are reflected in other income.

### Impairment

~~14~~17. 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 or non-transferable state tax credits. ~~Transferable s~~State tax credits should be evaluated for impairment at each reporting date.

~~15~~18. When there is a decline in the realizability of a transferable or non-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~~19. The new cost basis shall not be changed for subsequent recoveries in realizability.

### Disclosures

~~17~~20. The following disclosures shall be made in the financial statements. For purposes of this disclosure, total unused transferable and non-transferable state tax credits represent the entire transferable and non-transferable state tax credits available:

- a. Carrying value of transferable and non-transferable state tax credits gross of any related state tax liabilities by state and in total,
- b. Total unused transferable and non-transferable state tax credits by state;
- c. Method of estimating utilization of remaining transferable and non-transferable state tax credits or other projected recovery of the current carrying value.
- d. Impairment amount recognized in the reporting period, if any.
- e. Identify state tax credits by transferable and non-transferable classifications, and identify the admitted and nonadmitted portions of each classification.

### Effective Date and Transition

~~18~~21. This statement is effective for reporting periods ending on or after December 31, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. Substantive revisions to 1) revising the title; 2) incorporating the criteria for non-transferable state tax credits as described in paragraphs 7 and 8;

3) adding a disclosure; and 4) updating terminology throughout the document as appropriate, are effective for reporting periods ending on or after December 31, 2011.

## **AUTHORITATIVE LITERATURE**

### **Generally Accepted Accounting Principles**

- *FASB Statement No. 109, Accounting for Income Taxes was adopted with modification in SSAP No. 101—Income Taxes, A Replacement of SSAP No. 10R and SSAP No. 10 (SSAP No. 101)~~SSAP No. 10R—Income Taxes—A Temporary Replacement of SSAP No. 10.~~*

## **RELEVANT ISSUE PAPERS**

- *Issue Paper No. 126—Accounting for Transferable State Tax Credits*
- *Issue Paper No. 145—Accounting for Transferable and Non-Transferable State Tax Credits*

**Appendix A – Accounting for Transferable State Tax Credits**

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>		

**Appendix B – Accounting for Non-Transferable State Tax Credits**

On 7/1/X1 LJW Insurance Company purchased non-transferable state tax credits for a cost of \$100,000. The state tax credits are redeemable for \$110,000, are not transferable and expire on, April 15, 20x2. LJW expects to utilize the tax credits before expiration in their state of domicile in the amount of \$110,000.

<u>7/1/x1</u>	<u>State tax credits</u>	<u>100,000</u>	
	<u>    Cash</u>		<u>100,000</u>
	<u>To record the purchase of the tax credits</u>		
<u>9/30/x1</u>	<u>Premium tax expense</u>	<u>200,000</u>	
	<u>    Premium taxes payable to domiciliary state</u>		<u>200,000</u>
	<u>To record premium tax expense and accrue the liability.</u>		
<u>3/15/x2</u>	<u>Premium tax payable</u>	<u>110,000</u>	
	<u>    Other Income</u>		<u>10,000</u>
	<u>    State tax credits</u>		<u>100,000</u>
	<u>To record the use of premium tax credits in excess of cost and recognize a gain on premium tax credits in other income. (The additional \$90,000 of premium taxes payable would still be due.)</u>		