

**Statement of
Financial Accounting Standards
No. 12**

Revised on 8 November 2001

Translated by

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Statements of Financial Accounting Standards No.12

Accounting For Income Tax Credits

I Introduction

- (1) This Statement establishes the accounting standards for income tax credits.
- (2) An income tax credit, as referred to in this Statement, is the credit that is made available to an enterprise by applicable tax laws and regulations, and is used to reduce the amount of income tax payable; the tax credit may arise from the enterprise's acquisitions of equipment or technology, research and development expenditures, human resource development expenditures, investments in equity stock, or other qualified expenditures.

II Explanation

- (3) There are typically two methods of accounting for income tax credits: the deferral method and flow-through method.
- (4) The deferral method is the accounting method that defers and amortizes the entire income tax credit over the useful life of the underlying equipment or technology. Advocates of the deferral method argue that earnings arise from the use or sale of the equipment or technology, not from their acquisitions. Therefore, it is appropriate to allocate the cost savings due to income tax credits over the expected useful life of the assets. Based on accounting theory, adoption of the deferral method of accounting for income tax credit arising from purchase of equipment or technology is preferred.

- (5) The flow-through method is the accounting method that recognizes the entire income tax credit in the year incurred (not in the year the credit is actually realized). Advocates of the flow-through method argue that an enterprise's income tax credit arising from the purchase of equipment or technology results from its investment in, and not from the use of the assets. Therefore, it is appropriate to record the income tax credits as reduction of income tax expense in the year in which the credits arise (not in the year in which the credits are actually realized). In addition, since the future economic benefits of research and development expenditures and human resource development expenditures are uncertain, these expenditures are recognized as expenses in the year in which they are incurred; thus, it is appropriate to recognize the income tax credits resulting from such expenditures in the year they incur, rather than to defer their recognition. Since it is difficult to ascertain the holding period of investments in equity stock and the amortization period cannot be determined, therefore, adoption of the flow-through method is preferred.

III Accounting standards

- (6) An enterprise can adopt either the deferral method or the flow-through method for income tax credits resulting from the purchase of equipment or technology, but the accounting method adopted should be disclosed in the footnotes to the financial statements and be consistently applied over consecutive years.
- (7) An enterprise should adopt flow-through method for income tax credits resulting from research and development expenditures, human resource development expenditures, and investments in equity stock.
- (8) Under the deferral method, the enterprise should record the actual reduction in income tax for the year as a credit to *Deferred income tax credit* account, in the year the equipment or technology is acquired. The unused portion of income tax credits should be accounted for under the provisions set forth in the Statements of Financial

Accounting Standards No. 22 *Income Taxes* in the year in which the credits arise (not in the year in which the credits are actually realized), by debiting *Deferred tax asset* account and crediting *Deferred income tax credit* account. If the available evidence indicates the probability that a portion or all of the deferred tax assets will not be realized is greater than 50%, then an appropriate amount of valuation allowance should be provided, and offset against *Deferred income tax credit*. *Deferred income tax credit* should be classified as a deferred credit account or as a contra account to the related assets.

Deferred income tax credit should be amortized over the useful life of the equipment or technology, and recognized as a deduction of income tax expense or depreciation (amortization) expense.

- (9) Under the flow through method, the enterprise should recognize the actual reduction in income tax for the year as a deduction of *Income tax expense*. The unused portion of income tax credits should be accounted for under the provisions set forth in the Statements of Financial Accounting Standards No. 22 *Income Taxes* in the year in which the credits arise (not in the year in which the credits are actually realized), by debiting *Deferred tax asset* account and crediting *Income tax expense* account. If the available evidence indicates the probability that a portion or all of the deferred tax assets will not be realized is greater than 50%, then an appropriate amount of valuation allowance should be provided.
- (10) If the amount of the income tax credit recognized by an enterprise is different from the amount assessed by the tax authority, the enterprise should account for the difference under the provisions set forth in the Statements of Financial Accounting Standards No. 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- (11) The amount of current year income tax credit (using the flow-through method) or amortization (using the deferral method) should either be presented separately in the income statement, or be disclosed in the footnotes to the financial statements. In addition, the footnotes to the financial statements should disclose income tax credit related information, such as relevant tax laws and regulations,

income tax credit items, total amount of income tax credits, unused income tax credits, and year of expiration.

IV Notes

- (12) This Statement was issued on December 28, 1987, and was revised on November 8, 2001. The revised Statement shall be effective for financial statements with fiscal years ending on or after December 31, 2002 and thereafter, but early adoption is encouraged.

Upon adoption of the revised provisions of this Statement, the financial statements previously prepared under the original provisions of this Statement need not be restated.

The provisions of this Statement need not be applied to immaterial items.