Accounting for indemnification arrangements associated with transferable credits

This article summarizes the accounting for indemnification arrangements, including seller indemnifications and third-party insurance policies, associated with the acquisition of transferable credits in accordance with U.S. generally accepted accounting principles (GAAP).

Background

Due to the influx of new and modified tax credits created by the Inflation Reduction Act, the market for transferable credits has increased significantly. This has resulted in more entities acquiring or planning to acquire transferable credits for the first time. Because the acquirer of U.S. federal transferable credits obtains nonrefundable, nontransferable credits, they are accounted for within the scope of Accounting Standards Codification (ASC) 740 following acquisition. Additionally, the acquirer of a U.S. federal transferable credit becomes the primary obligor for any underpayment due to the taxing authority. As a result, the acquirer accounts for and discloses any potential uncertainties associated with the benefit of the credits in accordance with accounting for uncertainties in income taxes under ASC 740-10.

Given the acquirer becomes the primary obligor for any potential future assessment, buyers may seek indemnification arrangements to help mitigate potential risks. Generally, the indemnification is either in the form of a direct contractual arrangement with the seller of the credits, a third-party insurance policy arranged by the seller with the buyer as the insured, or the direct purchase of an insurance policy by the buyer from a third-party provider. As a result of these types of arrangements, many questions have arisen on how to account for such transactions.

This article is written in the context of the purchase of a tax credit; however, the same principles generally apply in other contexts associated with indemnifications related to income tax matters.

Accounting for the purchase of a tax credit

An entity that purchases a tax credit may do so at a price that is discounted from the credit amount (the discount). When the purchase price, including direct costs to acquire the credit, is less than the measured amount of the credit under ASC 740-10, the difference is recorded as a deferred credit. The deferred credit is recognized in income tax expense (benefit) in proportion to the use of the credit. Accordingly, an entity that uses a tax credit immediately upon purchase will immediately recognize an income tax benefit for the discount. However, to the extent the purchase price of the credit, including direct costs, is greater than the measured amount under ASC 740-10, no deferral arises and the difference is recognized immediately in income tax expense.

Accounting for seller provided contractual indemnification arrangements

Entities acquiring credits may request the seller to indemnify them against uncertainties or contingent events that could affect the sustainability of the acquired credits. This not only mitigates financial risk but also facilitates smoother negotiations and enhances the buyer's confidence in the transaction. Additionally, indemnification arrangements can help allocate specific risks to the party best positioned to manage them, thereby optimizing overall risk management for all parties involved.

When an indemnification arrangement has been entered into with the seller as part of the acquisition of tax credits, the acquiring entity should account for and disclose any uncertainty associated with the benefit of the credit in accordance with accounting for uncertainty in income taxes under ASC 740-10. The acquiring entity separately assess whether to recognize an indemnification asset for any rights to recover from the seller. When determining the amount of any potential indemnification asset to recognize, we believe it is appropriate to use the mirror approach if it is probable that recovery would occur if there is a loss related to the purchased credit. Under this approach the indemnified entity recognizes an indemnification asset concurrent with the recognition of the unrecognized tax benefit associated with the indemnified item and measures the asset on the same basis as the indemnified item, subject to collectibility and contractual limitations.

In situations in which the indemnification is part of the acquisition of the transferable credit, assuming it is deemed fully collectible and is not subject to contractual limitations, the amount of the asset is equal to the unrecognized tax benefit plus liabilities for interest or penalties at each reporting date. This situation results in a *gross up* of the acquirer's balance sheet because the indemnification asset is recognized separately from the unrecognized tax benefit. Additionally, while any subsequent adjustments to the unrecognized tax benefit and related indemnification asset will be equal when there are no modifications for collectability or contractual limitations, separate reporting in the income statement is required. Subsequent adjustments to any unrecognized tax benefits are reflected through income tax expense (benefit) while subsequent adjustments to indemnification assets are reflected within pretax income (loss). Subsequent adjustments for the accrual of interest and penalties would follow the entity's policies for the presentation of interest and penalties related to income taxes, with the related adjustment to the indemnification asset presented in pretax income (loss). Thus, while a dollar-for-dollar change in an unrecognized tax benefit and a related indemnification asset may result in offsetting amounts, both pretax income and an entity's effective tax rate are generally impacted.

Regardless of indemnification agreements, unrecognized tax benefits are reported separately as part of the income taxes disclosures within the notes to the financial statements. Public business entities include the unrecognized tax benefit, gross of any indirect effects or indemnifications, as part of the tabular rollforward of the total amounts of unrecognized tax benefits from the beginning to the end of the period, as well as the total amount of unrecognized tax benefits that would impact the effective tax rate, if recognized, in accordance with ASC 740-10-50-15A. [1] Entities also need to consider additional disclosures, including but not limited to, the terms of any material contractual indemnification arrangements.

Contractual indemnification arrangements example

Company A acquires $10,000,000 of transferable credits from Company B for $9,500,000 on December 31, 20X1 which is expected to be fully utilized against its 20X1 income tax liability. An unrecognized tax benefit amounting to $1,000,000 is reflected upon acquisition as a result of the recognition and measurement analysis of the acquired credits; however, an indemnification from Company B was obtained as part of the acquisition for which there are no contractual limitations or collectibility concerns. It is probable that if the ultimate benefit of the credits obtained from the taxing authority is the $9,000,000 recognized for financial statement purposes, then the $1,000,000 difference from the face value would be recovered through the indemnification.

[1] Prior to the adoption of ASU 2023-09, *Improvements to Income Tax Disclosures,* this requirement applies to public entities.

The journal entry would be as follows:

To record the acquisition of the credit, the current year utilization, the unrecognized tax benefit and the indemnification asset

DR	Income taxes payable - current[2]	$10,000,000	
DR	Indemnification asset	1,000,000	
CR	Cash		$9,500,000
CR	Current tax expense[3]		500,000
CR	Income taxes payable - noncurrent		1,000,000

The gross presentation outlined above ensures that the financial statements accurately reflect the indemnification arrangement and the associated income taxes related liabilities. The indemnification asset should be evaluated periodically for any changes in the expected indemnification amount. The entity measures the indemnification asset on the same basis as the indemnified item, subject to management's assessment of collectibility and contractual limitations. As noted above, subsequent changes to an indemnification asset, including write-off of the asset due to changes in the seller's creditworthiness, would be recognized in earnings in the period when the unrecognized tax benefit is remeasured or all or a part of the asset is deemed uncollectible.

Accounting for buyer purchased insurance policies

In instances when the buyer separately purchases an insurance policy from a third-party insurance provider, the purchase of the insurance is a separate transaction from the acquisition of the credit being insured. In determining the appropriate accounting treatment, it is first necessary to determine if the policy related to the transferable credit meets the requirements to be accounted for as insurance in accordance with ASC 944, *Financial Services – Insurance*, as a derivative in accordance with ASC 815, *Derivatives and Hedging*, or another acceptable model.

Assuming the insurance on the transferable credit meets the requirements under ASC 944 to be accounted for as insurance, the premium for the insurance would not be included as a direct cost of the credit. Instead, the buyer would account for the insurance premium separately from the credit acquisition. To the extent the insurance is for risks that exist as of the date the credit is acquired, the premium would be expensed immediately upon the policy entering into force. To the extent the policy is insuring for future events, such as the property ceasing to be investment credit property, the premium would be expensed over the coverage period. If the policy covers both retrospective and future risks, each component should be accounted for separately.

The accounting for any uncertainty associated with the acquired credit is expected to continue to follow the accounting for uncertainty in income taxes guidance in ASC 740-10. To the extent that an uncertainty arises for which it is probable that recovery would be obtained from the insurance provider, the measurement of the indemnification asset would be determined using the mirror approach, as described above. For insurance policies covering retrospective risk, if the resultant asset exceeds the amounts paid for the insurance policy, the benefit is limited to the related premiums paid and the resultant gain is deferred.[4] If the amount and timing of the recovery of the insurance can be reasonably estimated, the deferred gain is amortized using the interest method over the estimated period over which the entity expects to collect the insurance proceeds. If the amount and timing of the recovery cannot be reasonably estimated, then the proportion of actual recovery to total estimated recovery is used to determine the amount of gain recognized.[5] For policies that cover future risks, the pretax benefit is recognized as the unrecognized tax benefit is established.

---

[2] To the extent that a buyer expects to offset its current year (or prior year) income tax liability, we believe the Company has a policy election to present the purchased credit as an adjustment to income taxes payable or as a deferred tax asset upon acquisition. Refer to section 5.5 of KPMG Handbook, *Tax credits* for additional detail. The above illustration assumes Company A has adopted a policy to present such acquired credits as an adjustment to income taxes payable.
[3] Reduction in income tax expense as a result of the discount on the acquisition of the credit.
[4] See ASC 720-20-25-4.
[5] See ASC 720-20-35-2.

Accounting for seller purchased insurance policies

In practice, it is common for the purchase price of a credit to include a third-party insurance policy arranged by the seller. Under these arrangements, the seller acquires the third-party insurance with the buyer identified as the insured with the policy included with the credit as part of the purchase agreement. We believe the accounting for seller purchased insurance should generally follow the accounting discussed above for buyer purchased insurance. As such, the cost of the insurance would generally be bifurcated from the purchase price and treated as a separate transaction from the acquired credit.

Conclusion

Entities need to be mindful of the accounting complexities associated with any indemnification arrangements entered when acquiring tax credits or other situations.

Related content

For additional guidance on accounting for income taxes under U.S. GAAP, refer to the KPMG Accounting for Income Taxes handbook.

For additional guidance on accounting for various forms of tax credits in accordance with U.S. GAAP, refer to the KPMG Tax Credits handbook.

For more information, contact a tax professional in KPMG Washington National Tax:

Ashby Corum | acorum@kpmg.com

Jenna Summer | jsummer@kpmg.com

Jack Coman | jcoman@kpmg.com

© 2025 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.