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Financial Accounting Standards Board
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# Proposed Accounting Standards Update: Investments-Equity Method and Joint Ventures (Topic 323) Accounting for Investments in Qualified Affordable Housing Projects

We appreciate the opportunity to comment on the above proposed Accounting Standards Update. BB&T Corporation and its subsidiaries ("BB&T") offer full-service commercial and retail banking and additional financial services such as insurance, investments, retail brokerage, corporate finance, treasury services, international banking, leasing and trust.

We support the Financial Accounting Standards Board ("FASB" or "the Board") in its efforts to provide guidance related to the accounting for investments in affordable housing projects that qualify for the low income housing tax credit. BB&T currently holds investments in over 100 qualified affordable housing projects with an aggregate carrying value that totals approximately $1.2 billion.

As more fully described in this letter, we support the Board's decision to re-evaluate the conditions required to apply the effective yield method of accounting. Based on our experience with applying the equity method of accounting to investments in qualified affordable housing projects, such an approach fails to appropriately match the recognition of tax benefits with reductions to the carrying value of the investment. This inappropriate matching generally results in (1) the recognition of tax credits on an accelerated basis, and (2) the recognition of an impairment charge later in the life of the investment. We do not believe that such an approach provides financial statement users with decision-useful information.

We also believe that the Board should give additional consideration to the method used to calculate the effective yield of qualified investments in affordable housing projects. Based on an analysis of the Board's proposed approach, we believe that the use of a pre-tax effective yield as illustrated in the proposed ASU would result in inappropriate matching, similar to that described above related to the application of the equity method. As an alternative, we believe the Board

should consider requiring that the effective yield be calculated based on (1) calculation of the pre-tax effective yield based on tax credits only, or (2) calculation of the effective yield on an after-tax basis. We believe that either of these approaches would result in a better representation of the economics of these types of investments (i.e., better matching of tax credits recognized with the write-off of the underlying investment).

While the remainder of this letter provides additional insight into our analysis of the Board's proposed approach, we believe that many of the concepts outlined in our letter could be better communicated during a field visit with the FASB staff. We believe this would provide the staff with an in-depth understanding of the nuances and complexities associated with these types of investments. Please do not hesitate to contact us if the Board believes that such field visit would be beneficial.

We have provided additional insight into our analysis of the Board's proposal as follows:

Scope

In general, we believe the scope of investments that would qualify for the effective yield method of accounting under the Board's proposed approach is appropriate. However, we believe that several clarifications to the conditions should be considered by the Board during the re-deliberation process as more fully described below:

- We do not believe the scope should be limited to investments in affordable housing projects. Rather, the scope should be more principles-based and include other types of investments with similar tax credit and other economic benefits.

- The Board's third condition should be revised to state that "*The investor's total net cash flow from the investment is positive*." We believe that the second condition already embodies the concept that the benefits are substantially the result of tax effects.

- The Board should provide additional interpretative guidance related to its fourth condition, which states:

  > *The investor is a limited liability investor in the affordable housing project for both legal and tax purposes, and the investor's liability is limited to its capital investment.*

  It is not uncommon for a financial institution that holds an investment in an affordable housing project to make a separate loan to the project. We believe that the Board should consider providing interpretative guidance to clarify whether these types of loans would preclude the use of the effective yield method of accounting.

Amortization of Investment

The Board's proposed approach related to calculating the effective yield of an investment in an affordable housing project investment includes "other tax benefits," which typically represent the pass-through of tax depreciation By way of the example provided, the proposed ASU implies that the effective yield would be determined using a "pre-tax" effective yield. Based on our analysis of the Board's proposed approach, the inclusion of other tax benefits and the use of a pre-tax effective yield invariably results in higher net income early in the life of the investment with impairment toward the end of the tax credit period. The end result of such an approach is that the overall benefits are recognized over a shorter period of time than the period over which tax credits are received. We believe it is fundamentally wrong to recognize higher income upfront with the knowledge that there will be impairment later. In our opinion, the following effective yield alternatives, which would eliminate this issue, are significantly better approaches.

*Pre-tax Effective Yield Using Only the Tax Credit Period*

The following table compares the example that is currently in the existing codification that uses only the tax credits to determine the rate of return (323-740-55-10) to the revised example contained in the Proposed ASU that also includes other tax benefits:

| | **Current Example in Codification** | **Proposed ASU** | **Difference** |
|---|---|---|---|
| Yr 1 | $ 12,164 | $ 13,246 | $ (1,082) |
| Yr 2 | 11,795 | 12,852 | (1,057) |
| Yr 3 | 11,391 | 12,401 | (1,010) |
| Yr 4 | 10,948 | 11,886 | (938) |
| Yr 5 | 10,464 | 11,297 | (833) |
| Yr 6 | 9,931 | 10,623 | (692) |
| Yr 7 | 9,349 | 9,853 | (504) |
| Yr 8 | 8,710 | 8,974 | (264) |
| Yr 9 | 8,009 | 7,969 | 40 |
| Yr 10 | 7,239 | 899 | 6,340 |
| Yrs 11 - 15 | — | — | — |
| | $ 100,000 | $ 100,000 | $ - |
| Rate of Return | 9.61% | 14.32% | |

As noted in the above table, the inclusion of "other tax benefits" that extend beyond the tax credit period ultimately results in an acceleration of the recognition of the net benefits, which we believe is neither the intent of the Board nor the appropriate outcome.

*After-tax Effective Yield*

The following illustrates this concept using substantially the same assumptions as the Board's example, except as noted below the table.

**Calculations Using an After-tax Effective Yield**

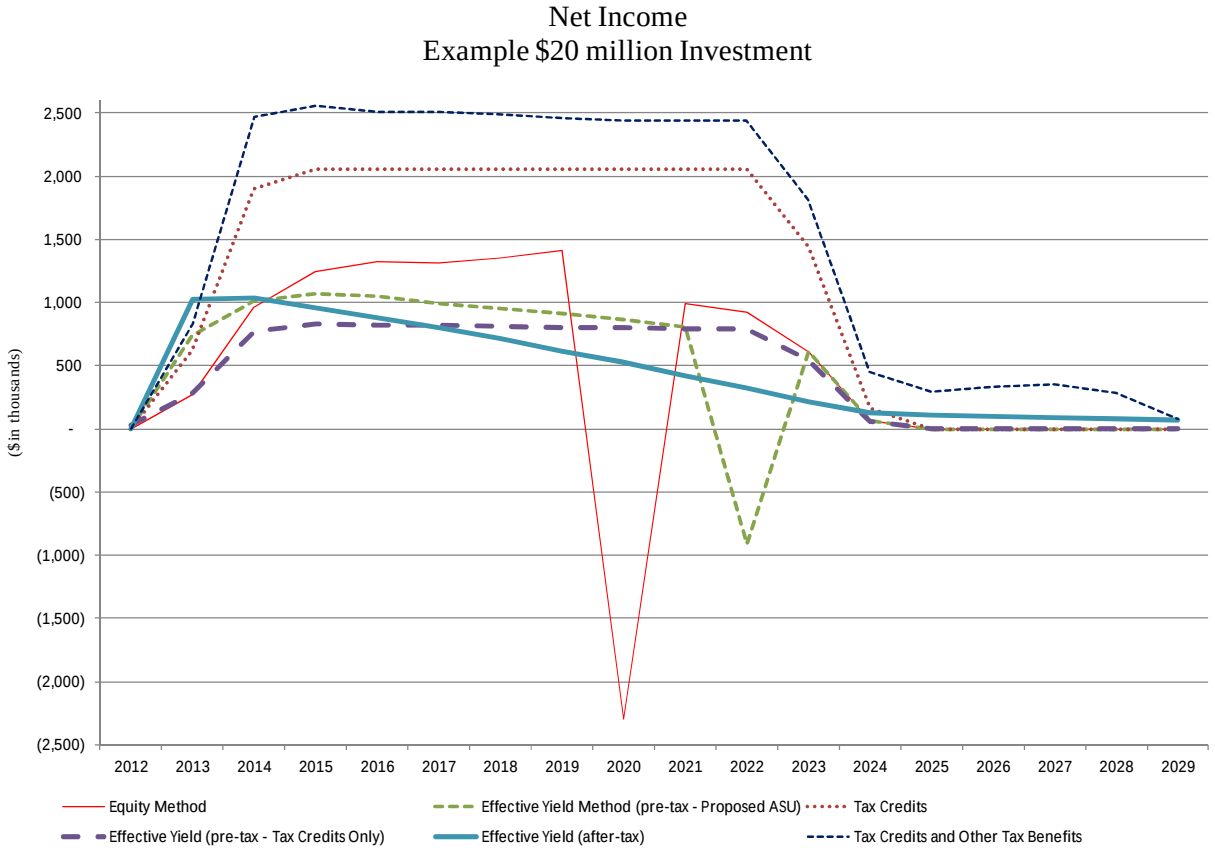
| | Net Investment (1) | Tax Credits (2) | Amortization of Investment (3) | Tax Depn (4) | Current Tax Benefit (5) | Deferred Tax Benefit (Expense) (6) | Deferred Tax Asset (Liability) (7) | **Impact on Net Income (8)** |
|---|---|---|---|---|---|---|---|---|
| Yr 0 | $ 100,000 | | | | | | | |
| Yr 1 | 96,996 | $ 16,000 | $ 3,004 | $ 7,273 | $ 15,905 | $ (1,708) | $ (1,708) | **$ 14,197** |
| Yr 2 | 92,878 | 16,000 | 4,118 | 7,273 | 14,791 | (1,262) | (2,970) | **13,529** |
| Yr 3 | 87,487 | 16,000 | 5,391 | 7,273 | 13,518 | (753) | (3,722) | **12,765** |
| Yr 4 | 80,642 | 16,000 | 6,845 | 7,273 | 12,064 | (171) | (3,893) | **11,893** |
| Yr 5 | 72,136 | 16,000 | 8,506 | 7,273 | 10,404 | 494 | (3,400) | **10,898** |
| Yr 6 | 61,734 | 16,000 | 10,402 | 7,273 | 8,507 | 1,251 | (2,149) | **9,758** |
| Yr 7 | 49,167 | 16,000 | 12,567 | 7,273 | 6,342 | 2,118 | (31) | **8,460** |
| Yr 8 | 34,127 | 16,000 | 15,040 | 7,273 | 3,870 | 3,107 | 3,075 | **6,977** |
| Yr 9 | 16,264 | 16,000 | 17,863 | 7,273 | 1,046 | 4,236 | 7,312 | **5,282** |
| Yr 10 | (4,824) | 16,000 | 21,088 | 7,273 | (2,179) | 5,526 | 12,837 | **3,347** |
| Yr 11 | (2,928) | — | (1,896) | 7,273 | 4,806 | (3,668) | 9,170 | **1,138** |
| Yr 12 | (1,451) | — | (1,477) | 7,273 | 4,386 | (3,500) | 5,670 | **886** |
| Yr 13 | (453) | — | (998) | 7,273 | 3,907 | (3,309) | 2,361 | **598** |
| Yr 14 | — | — | (453) | 5,451 | 2,633 | (2,361) | — | **272** |
| Yr 15 | — | — | — | — | — | — | — | — |
| | | $ 160,000 | $ 100,000 | $ 100,000 | $ 100,000 | $ — | | **$ 100,000** |
| | | | | | | **Rate of return** | | **14.20%** |

(1) End-of-year investment for a 5 percent limited partnership interest in the project net of amortization in Column (3).
(2) 8 percent tax credit on $200,000 tax basis of underlying assets.
(3) Column (2) + (Column (4) x 40% tax rate) - Column (6) - Column (8)
(4) Depreciation (on $200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years. Note that tax depreciation allowed has been limited to the amount of the investment.
(5) Column (2) – Column (3) + (Column (4) x 40% tax rate).
(6) The change in deferred taxes resulting from the difference between the book and tax bases of the investment and tax losses in excess of the at-risk investment. In this Example, that amount can be determined as follows: (Column (3) – Column (4)) x 40% tax rate.
(7) Deferred tax asset (liability) at the end of the period.
(8) Beginning-of-year investment plus beginning of year deferred tax asset (liability) times the rate of return. (Column (1) + Column (7)) x 14.20%

Note for this example, we have limited the tax depreciation to the total amount of the investment as this is consistent with how this is recognized in our tax returns. The calculation would still apply if excess tax losses were claimed; however, there may be a loss in later year(s) that would result in a slight impairment.

*Actual Investment*

We believe it is useful to consider the effect of various accounting consequences using a real example. The following graph illustrates the impact on net income of the effective yield method (pre-tax with and without the other tax benefits and after-tax) as well as the equity method of accounting based upon one of our current investments. Impairment is based upon the net present value of future tax credits.




We believe that either a pre-tax effective yield method using only the tax credits or an after-tax effective yield method is clearly preferable to any calculation that, at the inception of a transaction, would inherently result in a known impairment, which is ultimately the result of either equity method or a pre-tax effective yield method using all tax benefits. Either suggested method will result in a much better matching of the income with the economics of these investments.

In addition, the expected tax benefits are typically revised each year in conjunction with the project sponsor providing the K-1s. Normally, these result in insignificant changes to the timing of benefits expected to be passed along to the investor. However, these relatively minor changes can have material accounting consequences by moving the anticipated recognition of impairment into different years. Both of the alternative effective yield methods presented above would eliminate this arbitrary and egregious result. Importantly, this would place the impairment focus on events that truly warrant consideration such as tax credit recapture or other issues.

Impairment
We believe the Board should specify the impairment methodology to ensure a uniform and consistent application across all investors. Specifically:

- Tax Credit Recapture – any previously recognized tax credits that are recaptured should be recognized as an expense immediately.

- Loss of Some or All Future Tax Credits – we believe that impairment should be based upon the following:

    - If revised projections indicate a negative yield over the remaining term of the investment, the total negative yield should be recognized on an undiscounted basis. This would have the impact of recognizing the cumulative future loss in the year of determination, which would result in no income or expense in future periods.

    - If revised projections indicate a positive yield over the remaining term, amortization should be adjusted to a new effective yield. We believe this is reasonable given the one line presentation in income taxes. We considered recognizing the impairment such that the original effective yield was retained; however, that introduces unnecessary complexity and would result in a net loss in the current period with income in future periods, which is somewhat nonsensical.

- If the Board retains the proposed amortization method, then substantially all investments will ultimately have impairment. We believe the impairment in this instance should be modeled after the first bullet under "Loss of Some or All Future Tax Credits" above, which is essentially what the exposure draft used in its example.

Other Matters
It is of utmost importance that the Board specifically excludes investments that qualify under the Proposed ASU from the scope of the Financial Instrument projects that are currently under consideration by the Board.

We believe that the existing disclosure requirements as it relates to income taxes and commitments and contingencies are sufficient. We agree with allowing early adoption once the final ASU is issued. We do not believe there is significant additional effort required to implement the proposed amendments.

The Proposed ASU, modified as discussed above, represents a significant improvement over the current accounting and will provide for a much better matching of the accounting with the economics of the investment. We encourage the Board to adopt it as soon as possible.

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We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Henry R. Sturkie, III
Assistant Corporate Controller