FASB Emerging Issues Task Force

Issue No. 13-B

Title: Accounting for Investments in Qualified Affordable Housing Projects

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Background

1. At the March 14, 2013 EITF meeting, the Task Force reached a consensus-for-exposure that an entity may elect to account for its Low Income Housing Tax Credit (LIHTC) investment using the effective yield method if all of the following conditions are met:

a. It is probable that the tax credits allocable to the investor will be available.

b. The investor retains no operational influence over the LIHTC investment other than protective rights, and substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment).

c. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

d. 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.

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

2. The Task Force agreed that for those LIHTC investments that do not qualify for the effective yield method, the LIHTC investment would continue to be accounted for as an equity or cost method investment in accordance with Subtopic 970-323.

3. The Task Force also reached a consensus-for-exposure that the amendments in the proposed Update should include required disclosure objectives. In reaching its consensus-for-exposure, the Task Force noted that disclosures should help users of the financial statements understand the nature of the LIHTC investments and the effect of those LIHTC investments on the reporting entity's financial statements. The proposed Update includes disclosure objectives for reporting entities.

4. Additionally, as stated in Issue 94-1, the Task Force observed that the decision to apply the effective yield method would continue to be an accounting policy election rather than a decision to be applied to individual LIHTC investments that qualify for the use of the effective yield method. In other words, an entity could continue to apply other U.S. GAAP, for example the equity method of accounting or the fair value option, for all LIHTC investments without considering the applicability of the effective yield method.

5. The Task Force reached a consensus-for-exposure that an entity should apply the proposed amendments on a retrospective basis by applying the requirements for accounting changes in paragraphs 250-10-45-5 through 45-10. Early adoption would be permitted. The Task Force reached a consensus-for-exposure to apply the disclosure requirements in Section 250-10-50 for an accounting change required by this Issue. No additional transition disclosures other than the requirements in paragraphs 250-10-50-1 through 50-3 are required.

6. At its March 28, 2013 meeting, the Board ratified the consensus-for exposure reached by the Task Force in this Issue and approved the issuance of a proposed Update for a 60-day public comment period. The proposed Update was posted to the FASB website on April 17, 2013, with a comment period that ended on June 17, 2013. Seventy-three comment letters were received on the proposed Update and have been distributed to Task Force members.

7. At the September 13, 2013 EITF meeting, the Task Force will have the opportunity to consider the comment letters received as it redeliberates the consensus-for-exposure. The Task Force will then be asked whether it would like to affirm its consensus-for-exposure on this Issue as a final consensus.

Summary of Comment Letters Received and FASB Staff Analysis and Recommendation

8. All 73 comment letters received on the proposed Update generally agreed with the proposed amendments. Comment letter respondents included:

Constituency Group	**Number of Comment Letters**
Industry trade associations	15
Syndicators	18
Developers	10
Preparers	18
Accounting firms	6
Other professional associations	4
Users	2
Total	**73**

9. The "industry trade associations" category consists of organizations that represent the views of a unified member group with membership consisting primarily of home builders, developers, owners, property managers, investors, and syndicators. Syndicators connect investors with developers or owners seeking cash for a project that qualifies for tax credits. Syndicators can pool several projects into one equity fund and market the tax credits to investors. The "developers" category consists of entities that develop, own, and operate properties that qualify for LIHTCs. Finally, 2 of the 18 preparers are also guarantors of tax credit investments.

10. Constituents were asked to comment on the following questions in the proposed Update:

> **Question 1:** Do you agree that an entity should meet the conditions in this proposed Update in order to elect to account for the investment in a qualified affordable housing project using the effective yield method? If not, please explain why.

Question 2: Do you agree that the effective yield method is an appropriate method to account for investments in qualified affordable housing projects? If not, what method of accounting should be used? Please explain.

Question 3: Do you believe that removal of the requirement for guaranteed tax credits should change the method used to account for such investments from an effective yield method to an approach where the cost of investment is amortized in proportion to tax credits and other tax benefits received and recognized as a component of income taxes attributable to continuing operations?

Question 4: Do other types of investments made primarily for the purpose of receiving tax credits meet the conditions in this proposed Update for an entity to elect to account for the investments using the effective yield method? If so, please describe them.

Question 5: Should the guidance in this proposed Update extend the effective yield method of accounting to other types of investments for which the economic benefits are realized primarily as a result of tax credits and other tax benefits? Please explain.

Question 6: Do you agree that the amendments in this proposed Update should prescribe recurring disclosure objectives that would enable users of financial statements to understand the nature of investments in qualified affordable housing projects and the effect of the measurement of that investment and the related tax credits on the financial position and results of operations of the reporting entity? Alternatively, should the proposed amendments include minimum required disclosures?

Question 7: Do you agree that the amendments in this proposed Update should be applied using a retrospective approach? If not, please explain why.

Question 8: Do you agree that early adoption of the proposed amendments should be permitted? If not, please explain why.

Question 9: The amendments in this proposed Update would apply to public and nonpublic entities. Should the proposed amendments be different for nonpublic entities? If so, please describe how and why you think they should be different.

Question 10: For preparers, how much effort would be needed to implement the proposed amendments?

11. The FASB staff has analyzed the comment letters received and included the significant comments, as well as the FASB staff's recommendation on how the Task Force should proceed, in the following sections:

- Scope (Question 1)
- Measurement (Questions 2 and 3)
- Disclosure (Question 6)
- Transition and Early Adoption (Questions 7 and 8)
- Effective Date (Questions 9 and 10)
- Other Tax Credit Investments (Questions 4 and 5).

Scope

12. In Question 1, respondents were asked whether they agreed that an entity should meet the conditions in the proposed Update in order to elect to account for the investment in a qualified affordable housing project using the effective yield method. Respondents who answered Question 1 generally agreed. However, 11 respondents expressed concern about the requirement that the investor retains no operational influence over the LIHTC investment other than protective rights. Those respondents stated that the proposed condition of "no operational influence" may be overly restrictive, would be inconsistent with the fundamentals of equity investments, and would potentially make it difficult for many investments in LIHTC to qualify for use of the effective yield method. Therefore, those respondents generally believe that the condition should be either removed or made less restrictive by requiring "substantially no operational influence" or "no significant operational influence" over the LIHTC investment other than protective rights.

13. In support of the view that the proposed condition is too restrictive, one respondent (CL#26) noted that an investor in LIHTC may have certain rights, such as super majority voting rights over hiring employees (the so-called "block votes"), that may not be viewed by some as merely protective rights in nature and may meet the accounting definition of *participating rights* (defined in the Mater Glossary as "participating rights allow the limited partners to participate in certain financial and operating decisions of the limited partnership that are made in the ordinary

course of business"), even though the investor cannot unilaterally make those decisions. Another respondent (CL#39) noted that the limited liability investor may have approval rights of certain elections for tax purposes, disbursements from operating reserves to cover operating deficits, or loans from other partners to the affordable housing projects. According to that respondent, such rights are integral to the LIHTC investments because they are designed to help ensure that the investor's expected rate of return will be achieved and that funding will be available so that the tax credits will continue to be generated and available.

14. In developing the proposed condition, the FASB staff understands that the Task Force's intent was to prevent investors from applying this guidance if they have substantive rights to participate in certain financial and operating decisions of the LIHTC investment that are in the ordinary course of business; that is, an investor should not apply the effective yield method if it had substantive participating rights in the LIHTC investment. Based on the comments received, the FASB staff believes that the condition in paragraph 323-740-15-3(aa) of the proposed Update should be clarified and recommends revising that condition as follows (additions are underscored and deletions are ~~struck through~~):

> The investor retains no ~~operational influence over~~ substantive participating rights in the LIHTC investment ~~other than protective rights~~, and substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment).

15. The FASB staff continues to believe that an investor should not have any ongoing operational or financial decision-making rights other than protective rights in the LIHTC investment; therefore, the word "substantive" is not intended to mean "significant" or "substantial." Rather, the FASB staff believes that this concept would be more operable than the "no operational influence" concept because "substantive participating rights" already exists within the consolidation guidance in U.S. GAAP (Section 810-20-25) and is referred to in practice when evaluating the presumption of control by a general partner (by way of assessing the rights of limited partners). In contrast, the notion of "operational influence" is not as well understood in practice. The FASB staff recommends deleting the phrase "other than protective rights" because participating rights exclude protective rights by definition.

16. In developing the proposed language, the FASB staff has considered the Board's ongoing project and its proposal on consolidations specific to the determination of principal versus agent. That proposal eliminated the current definition of participating rights in Section 810-20-25 and amended the related guidance. The proposal introduced a new definition of participating rights applicable to both partnerships and other types of entities, as follows: *"The ability to block or participate in the actions through which a reporting entity decision maker exercises its power to direct the activities that most significantly impact an entity's economic performance."* The staff does not believe that the proposed definition however would be appropriate for purposes of investors qualifying for the effective yield method because it would be so high that effectively all investors that do not control an investment would qualify for the effective yield method. The staff understands that the Task Force still prefers to keep the threshold low and narrow enough so that the effective yield method is available only to those investors with little to no influence in activities other than protective rights to support the exception provided on the basis that these investments are investments in tax credit (and not operating investments). Therefore, the staff recommends retaining the existing definition of participating rights in the partnership-specific guidance in Section 810-20-25 for that purpose.

17. Five respondents (CL#50, CL#53, CL#56, CL#65, and CL#68) indicated that the requirement that substantially all of the projected benefits be from tax credits and other tax benefits should be clarified or revised to address other arrangements between the investor and the limited liability entity. For example, those respondents noted that it is not uncommon for investors to provide loans to the limited liability entities that manage the qualified affordable housing projects and then receive interest income on those loans. Further, for variable-rate debt, investors that are financial institutions may enter into agreements with the limited liability entity to swap the variable rate for a fixed rate.

18. The FASB staff believes that certain transactions between the investor and the limited liability entity, other than the investment in the limited liability entity, should not preclude a reporting entity from applying the guidance in the proposed Update as long as the primary purpose of investing in the limited liability entity is to receive the tax credits and other tax

benefits and not to provide other services, such as loans to the affordable housing project, and as long as the investor does not acquire substantive participating rights as a result of the transaction. For example, banks often provide loans to the LIHTC investment entity in which they are also a limited partner. However, as long as the purpose of the LIHTC investment is to receive the tax credits and as long as the loan does not provide the investor with controlling financial interest, or substantive participating rights as defined above, the FASB staff believes that the use of the effective yield method by the investor should not be prohibited. Therefore, the FASB staff recommends that the proposed Update include the following:

> **323-740-25-1A** Other transactions (for example, bank loans) between the investor and the limited liability entity shall not be considered when determining whether the conditions for the effective yield method are met, provided that all three of the following are true:
>
> - The reporting entity is in the business of entering into such other transactions (for example, a financial institution that regularly extends loans to other housing projects).
> - The transactions are entered into at market rates commensurate to rates offered to other counterparties with similar credit quality
> - The reporting entity does not acquire substantive participating rights as a result of these transactions.

19. Before applying that guidance, a reporting entity would continue to be required to first evaluate whether the LIHTC investment entity is a variable interest entity that should be consolidated in accordance with Topic 810 on consolidation, and all transactions with the limited liability entity (including other transactions that would be considered variable interests) would continue to be considered in that evaluation.

20. Two respondents (CL#53 and CL#59) believe that a reporting entity should only evaluate whether the conditions have been met to elect to apply the effective yield method to LIHTC investments (a) at the time of initial investment or (b) upon occurrence of an event that changes the nature and design of the entity. While the proposed Update does not specify when the

conditions to elect the effective yield method should be evaluated, the FASB staff believes that this was the intent of the guidance in the proposed Update. Therefore, the FASB staff recommends adding clarifying language in the proposed Update as illustrated in Attachment 13-BA.

21. The FASB staff also believes that a reporting entity should test the LIHTC investment for impairment if changes in facts and circumstances indicate that it is no longer probable that the tax credits allocable to the investor will be available. As this requirement is currently included in paragraph 325-20-35-6 for a cost method investment in affordable housing projects with allocated tax credits, the FASB staff recommends adding clarifying language in the proposed Update as illustrated in Attachment 13-BA for LIHTC investments accounted for using a proportional amortization method.

Question 1 for the Task Force: Does the Task Force agree with the staff recommendation to revise the condition in paragraph 323-740-15-3(aa) as proposed in paragraph 14 of this Issue Supplement and retain all other conditions as proposed?

Question 2 for the Task Force: Does the Task Force agree with the following staff recommendations?

a. **Certain other arrangements between the investor and the limited liability entity should not be included in the determination of whether the conditions are met in order to elect to use the effective yield method, provided that the primary business purpose of the reporting entity is to enter into these transactions, the transactions are entered into at market rates commensurate to rates offered to other counterparties with similar credit quality, and the reporting entity does not acquire substantive participating rights as a result of these transactions.**

b. **A reporting entity should only evaluate whether the conditions have been met to elect to apply the effective yield method to LIHTC investments at the time of initial**

investment or upon occurrence of an event that changes the nature and design of the entity.

c. **A reporting entity should test a LIHTC investment for impairment if an event occurs or circumstances change that would indicate that it is no longer probable that the original amount of tax credits allocable to the investor will be available.**

Measurement

22. In Question 2 of the proposed Update, respondents were asked whether they agreed that the effective yield method was an appropriate method to account for investments in qualified affordable housing projects. Of the 68 respondents who answered the question, 67 respondents agreed with the proposed Update's main principle that a qualifying LIHTC investment should be accounted for under an alternative method such as the effective yield method. However, because of the potential complexities associated with the effective yield method, 40 respondents also supported a proportional or ratable amortization method as follows:

- Fourteen respondents stated that a proportional or ratable amortization method is also an acceptable method
- Twenty-one respondents stated that a proportional or ratable amortization method is more appropriate than the effective yield method because it is more practical to implement and would better match the recognition of the cost of the investment with the recognition of the related tax benefits.
- Five respondents stated that the amendments in the proposed Update should permit a reporting entity to use either the effective yield method or a proportional or ratable amortization method.

23. In Question 3, respondents were asked whether they believed that the removal of the requirement for guaranteed tax credits should change the method used to account for such investments from an effective yield method to an approach in which the cost of the investment is amortized in proportion to tax credits and other tax benefits received and recognized as a component of income taxes attributable to continuing operations. As previously mentioned, 40

respondents supported an alternative method for amortizing the LIHTC investment. Of the 22 respondents who answered this specific question separately, 8 respondents (CL#18, CL#32, CL#39, CL#41, CL#44, CL#55, CL#56, and CL#60) agreed and 14 respondents disagreed. Of the 14 respondents who disagreed, 2 respondents (CL#14 and CL#22) commented that the removal of the guarantee would not change the underlying substance of the investment.

24. The FASB staff notes that most respondents agreed that the Task Force's proposed presentation of LIHTC investment amortization as a component of income tax expense is a better reflection of the nature of the investment as an investment in tax credits and a better presentation of the investment performance. Two respondents (CL#51 and CL#56), however, believe that LIHTC investment amortization and the tax credits should be presented net, above the tax line, as part of investment income because that presentation would more appropriately reflect the nature of the transaction and it would result in accounting similar to investments in debt instruments.

25. The staff acknowledges that the presentation of investment amortization in the income tax line item is an expansion of an existing exception to the accounting for investments under U.S. GAAP. The Task Force determined at its June 2013 meeting (and consistent with the previous consensus on Issue 94-1) that an investment in limited partnerships for affordable housing tax credits is different from investments in an operating entity that owns real estate. Investors who make limited partnership investments in an operating entity that owns real estate do so primarily to earn income from the real estate owned by the operating entity. That income is provided by the cash flows generated from operations and from appreciation of the real estate held by the operating entity. Although investors in limited partnerships for tax credits are legally required to participate in some of the risks and rewards of ownership in order to receive the tax credits, they generally do not rely on the cash flows of the underlying assets, such as real estate, or their eventual disposition for their investment return, rather, they consider their investment return to be primarily the receipt of tax credits and other tax benefits. The Task Force therefore determined that the operating losses generated by the LIHTC investment should be considered as part of the net investment in tax credits and not as operating losses that should be presented separately in the pretax income of the investor.

26. Based on the preponderance of the feedback received, the FASB staff recommends revising the proposed Update to change the method of amortizing a qualified LIHTC investment from the effective yield method to a proportional amortization method in which the cost of the investment is amortized each reporting period in proportion to the tax credits received. Consistent with the feedback received and proposed Update, the FASB staff believes that the resulting amortization should be recognized as a component of income taxes attributable to continuing operations consistent with the proposed Update. The amortization amount under that method would be calculated as follows:

> Gross investment balance × Percentage of tax credits allocated to the investor in the current period (Actual tax credits allocated to the investor in the current period ÷ by the total estimated tax credits expected to be received during the life of the LIHTC investment*)
>
> *An entity would reassess and adjust the estimated amount of total tax credits expected to be received each reporting period.

27. Respondents have raised questions about the application of the effective yield method such as whether the investment should be amortized over the period in which the tax credits are received or over the entire life of the investment during the time the reporting entity continues to receive other tax benefits from the investment. The proposed revision would specify that all qualifying LIHTC investments are amortized in proportion to the receipt of tax credits, so that the investments would be fully amortized by the date all tax credits are received or by the date the available tax credits expire, whichever is earlier.

28. Concerns were also raised by the respondents about the complexity of applying the proposed effective yield method due to the significant variability that would result from including other tax benefits (generated by operating tax losses of the LIHTC investment). Further, questions have arisen about how differences between assumptions about the other tax benefits used in the initial calculation of the yield and the actual investment performance should be addressed. Some respondents questioned the appropriateness of the impairment recognized in the effective yield

example included in the proposed Update when the investment is performing as intended and no significant adverse event has occurred.

29. The FASB staff acknowledges that a proportional amortization method that is premised solely on tax credits is not entirely consistent with the qualification criteria under the proposed Update. The proposed Update requires that both tax credits and other tax benefits are evaluated in determining whether a LIHTC investment qualifies for the alternative method of accounting. However, because of the potential complexities of estimating the pattern of other tax benefits, the staff believes that using tax credits (the primary driver of returns for LIHTC investments), as a proxy for the useful life and the pattern of amortization is a rational and practical method in estimating the economic pattern of benefits received from LIHTC investments by a reporting entity. The staff believes that incorporating other tax benefits in the amortization calculation (as in the case of the effective yield method) simply to determine a "more precise" economic pattern of benefits is not warranted because doing so would introduce greater subjectivity and therefore uncertainty in the initial determination and subsequent reassessment of useful lives and the amortization patterns without commensurate benefits for users. Further, even under the effective yield method, the staff notes that most of the investment would be amortized by the date all of the tax credits are realized; therefore, the difference between the 2 methods would largely relate to the estimated pattern of amortization during the first 10-15 years of the same initial investment amount. In summary, the staff does not believe that the complexities of the proposed effective yield method are justified and therefore recommends changing the method of amortization to a proportional method based on the realization of tax credits.

Question 3 for the Task Force: Does the Task Force agree with the staff recommendation to change the method of amortizing an LIHTC investment from the effective yield method to a proportional amortization method described above?

Disclosure

30. In Question 6, respondents were asked whether they agreed that the amendments in the proposed Update should prescribe recurring disclosure objectives. Of the 27 respondents who

answered the question, 23 respondents generally agreed and 4 respondents (CL#14, CL#22, CL#50 and CL#51) disagreed. The four respondents who disagreed indicated that the existing disclosures relating to variable interest entities, commitments and contingencies, income taxes and/or debt instruments are adequate. Additionally, 9 of the 22 respondents who generally agreed expressed concerns about the suggested disclosures regarding (a) whether the qualified affordable housing project is currently subject to any regulatory reviews and the status of such reviews, and (b) the yield used to calculate the amounts recognized as a component of income taxes attributable to continuing operations. Those respondents generally noted that significant costs and effort would be required to provide those disclosures.

31. Five respondents (CL#26, CL#48, CL#59, CL#67, and CL#69) who supported recurring disclosure objectives agreed that the proposed Update should not include minimum required disclosures, while three respondents (CL#29, CL#41, CL#56) supported minimum required disclosures if the disclosures provide relevant information that is not already required by other U.S. GAAP.

32. The proposed Update provides example disclosures that a reporting entity may consider to meet the disclosure objectives that would enable users of financial statements to understand the nature of the investments in qualified affordable housing tax projects, the financial statement effect of the measurement of the investments, and the related tax credits. Because those are not required disclosures and only disclosures to be considered, the FASB staff recommends that the Task Force affirm its consensus-for-exposure related to the disclosure objectives and provide example disclosures consistent with the proposed Update with one exception: the FASB staff recommends removing the example disclosure related to regulatory reviews based on comments received from respondents.

Question 4 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that the proposed Update include disclosure objectives while providing a listing of example disclosures to meet those objectives?

Transition and Early Adoption

33. In Question 7, respondents were asked whether they agreed that the amendments in the proposed Update should be applied using a retrospective approach. Of the 29 respondents who answered the question, 24 respondents agreed and 5 respondents (CL#18, CL#26, CL#61, CL#62, and CL#64) disagreed. The five respondents who disagreed supported a modified retrospective approach with a cumulative effect adjustment to opening retained earnings at the beginning of the year of adoption. Six respondents who agreed with the retrospective approach (CL#55, CL#60, CL#67, CL#68, CL#69, and CL#73) also either preferred or supported as an option the use of a modified retrospective approach. Eight respondents (CL#25, CL#26, CL#27, CL#41, CL#53, CL#56, CL#65, and CL#68) who answered Question 7 commented that applying the effective yield method on a retrospective basis would be operationally difficult, would require significant time and resources, and would be more complex than applying a proportional amortization method retrospectively.

34. The FASB staff notes that applying the amendments in the proposed Update retrospectively would improve the consistency between periods and therefore the usefulness of the financial statements, in particular, due to the income statement presentation changes that would affect the comparability of the operating metrics. However, if the Task Force decides to maintain the effective yield method of amortization, the staff believes that a retrospective transition may be overly costly and complex for some reporting entities because that method would require significant judgments about the pattern of other tax benefits to be made in the hindsight. Accordingly, if the Task Force decides to maintain the effective yield method of amortization, the FASB staff believes that the use of a modified retrospective approach (in addition to the retrospective approach) should be permitted. If the Task Force decides to change the method of amortizing the investment to a proportional amortization method, while complexities could still arise, the FASB staff recommends that the Task Force affirm its consensus-for-exposure that an entity should apply the proposed amendments retrospectively.

35. In Question 8, respondents were asked if they agreed that early adoption of the proposed amendments should be permitted. All 29 respondents who answered the question agreed.

Question 5 for the Task Force: Does the Task Force wish to affirm its consensus-for-exposure that an entity should apply the proposed amendments retrospectively, with early adoption permitted as of the beginning of the fiscal year of adoption for financial statements not yet issued?

Effective Date

36. In Question 10, respondents were asked about the effort that would be necessary to implement the amendments in the proposed Update. Of the 19 respondents who answered the question, 7 respondents (CL#5, CL#14, CL#22, CL#30, CL#32, CL#50, and CL#57) noted that significant effort would not be needed. Three respondents (CL #41, CL #56, and CL #62) added that the costs and the level of effort needed to apply the guidance in the proposed Update would be substantial, particularly for reporting entities with a large number of investments that qualify for the effective yield method. One of those respondents (CL#41) noted that projected tax losses can fluctuate significantly from the time an initial investment is made, and significant effort would be needed to recalculate the internal rate of return at the investment level each time the cash flow projections were updated. Additionally, two respondents (CL#48 and CL#65) expressed concern about the time and resources required to implement the proposed Update and indicated that the effective date should be at least one year from issuance to allow reporting entities sufficient time to apply this guidance.

37. In Question 9, respondents were asked whether the amendments in the proposed Update should be different for nonpublic entities. All 19 respondents who answered the question indicated that nonpublic entities should not have different accounting than public entities. One respondent (CL #18) noted that many of these investments are partnerships between public and private companies, including not-for-profits, so the private companies should be subject to the same guidance.

38. The FASB staff has considered the feedback provided and notes that the effective yield method would require more time to implement than a proportional amortization approach, however, reporting entities with a significant number of investments in affordable housing projects may require significant time to implement either approach because they would have to

evaluate under the new criteria a large number of investments and potentially on a retrospective basis. The FASB staff recommends that the amendments in the proposed Update be effective for fiscal years beginning after December 15, 2014, and interim periods within those years. In addition, the FASB staff believes that given the timing of the issuance of the final Update, and the opportunity for early adoption, the effective date need not be further delayed for nonpublic entities.

Question 6 for the Task Force: Does the Task Force agree with the FASB staff recommendation that the amendments in the proposed Update should be effective for fiscal years (and interim reporting periods within those years) beginning after December 15, 2014?

Other Tax Credit Investments

39. In Question 4, respondents were asked whether other types of investments made primarily for the purpose of receiving tax credits would meet the conditions in the proposed Update. Of the 25 respondents who answered the question, 23 noted that other tax credit investments would meet the conditions in the proposed Update, and 2 (CL#5 and CL#32) noted that they would not. The respondents who agreed noted that other examples of tax credit investments that may meet the conditions in the proposed Update include investments in New Market Tax Credits (NMTC), Historic Tax Credits (HTC), and Renewable Energy Tax Credits (RETC). Those respondents noted that those types of tax credits have structures and characteristics similar to the LIHTC. One respondent (CL#5) who disagreed indicated that they were not aware of other types of investments that would meet the conditions in the proposed Update, while the other respondent (CL#32) who disagreed noted that LIHTCs are unique because the tax credits are the primary source of the investment returns in lieu of cash from operations. In all other tax credit investments, the tax credits are issued as a subsidy to supplement annual cash flow or as a "one-time payment" used to reduce project costs. Appendix 13-BA provides a comparison of some of the characteristics of the LIHTC, NMTC, HTC, and RETC.

40. One respondent (CL#55) who agreed with Question 4 noted that other tax credit programs and the related equity investments share many common attributes with LIHTC investments.

What separates these investments are differences in the underlying assets, the period of time over which the tax credits are received, and certain tax-related requirements that are focused on whether or not the investment is required to have a profit motive. The paper, *Significant Changes Needed in Accounting for Affordable Housing and Other Tax Credit Investments,* [1] explains a profit motive as follows:

> 58. To encourage investments in affordable housing tax credit property entities, the U.S. Treasury waived its usual requirement that such investments have a profit motive under Section 183. This is significant since equity investments are generally required to have a profit motive for tax purposes. By waiving the profit motive, the U.S. Treasury effectively condoned investments in affordable housing tax credit property entities being made for the purpose of obtaining tax benefits.
>
> 59. Waiver of the profit motive means that even though tax credit investors are required to acquire an ownership interest in the entity that owns the affordable housing property entity, the investment can be structured in a manner whereby the significant economic benefits the tax credit investor receives from the investment can be limited primarily to the tax benefits. In other words, the tax credit investor is not required to demonstrate at inception of its investment a reasonable expectation of recouping its investment and earning a profit based solely on cash flows from the investment. No return of capital and no substantial participation in property income or appreciation are required to be provided to the tax credit investor.

41. Three respondents (CL#55, CL#56 and C#62) indicated that many investors in other types of tax credit investments receive cash distributions and therefore would not meet the condition in the proposed Update requiring that substantially all of the projected benefits are from tax credits and other tax benefits. Those respondents believe that this condition would have to be modified to allow for some amount of projected cash flow benefits so that other types of tax credit investments could qualify for the effective yield method.

42. In Question 5, respondents were asked whether the guidance in the proposed Update should extend the effective yield method of accounting to other types of investments for which the economic benefits are realized primarily as a result of tax credits and other tax benefits. Twenty-

[1] Beck, Michael and Stanton, Bentley: *Significant Changes Needed in Accounting for Affordable Housing and Other Tax Credit Investments*, June 22, 2012.

nine respondents generally agreed and 3 respondents (CL#5, CL#32, and CL#67) disagreed. The FASB staff notes that seven respondents (CL#14, CL#26, CL#51, CL#64, CL#67, CL#68 and CL#69) expressed concerns about the time and additional research that would be required to evaluate whether the guidance in the proposed Update should be extended to other types of tax credit investments. Those respondents indicated that additional analysis and deliberations that may be necessary should not postpone or delay issuance of the amendments in the proposed Update. One respondent (CL#69) also noted that the expansion of scope could be more efficiently and effectively addressed as part of the Board's overall research project on the accounting for government assistance.

43. The FASB staff notes that other tax credit programs have similar characteristics to the LIHTC program; however, not all of the currently proposed criteria may be appropriate for all tax credit investments. There are additional facts and circumstances that should be considered before the scope of this guidance is expanded. Those specific facts and circumstances include the significance of other projected benefits, such as priority returns or an investor's share of the net income of the limited liability entity, the significance of any put option that would enable an investor to sell its share of the investment to the general partner, and the impact, if any, of the U.S. Treasury requirement for a "profit motive" on the conditions and resulting accounting. The FASB staff also notes that expanding the scope of the proposed Update to include other tax credit investments may potentially result in re-exposure of the proposed Update. Additionally, the FASB staff notes that the FAF's is conducting a Post-Implementation Review (PIR) of Income Taxes currently which could help the staff obtain additional feedback before proceeding with an expanded scope.

Question 7 for the Task Force: Does the Task Force wish to preclude reporting entities from analogizing to the guidance in the proposed Update for tax credit investments other than LIHTC investments, and recommend that the Board add a separate project about whether the proposed guidance should be extended to other types of tax credit investments?

Appendix 13-BA

Comparison of Tax Credit Characteristics (Source: Comment Letter #58)

Program	Affordable Housing Tax Credit (LIHTC)	New Markets Tax Credit (NMTC)	Renewable Energy Tax Credit (RETC)	Historic Tax Credit (HTC)
Credit	Tax credit is equivalent to 4% or 9% of qualified basis. Qualified basis = Eligible basis (depreciable costs) * % of low-income tenancy	Tax credit is equal to 39% of the qualified investment into a Community Development Entity (CDE) which has been provided an allocation of tax credits. The CDE makes an investment into a Qualified Active Low Income Community Business (QALICB).	Tax credit is equal to 30% of the project expenditures.	10% or 20% of qualified project expenditures.
Public Policy	Legislated tax credit program designed for constructing and renovating affordable rental housing for people facing financial challenges in urban and rural areas.	Legislated tax credit program designed for growing businesses, creating jobs and spurring economic development in designated underserved communities.	Legislated tax credit program for designing, financing, installing and monitoring renewable energy technologies that generate electricity.	Legislated tax credit program designed to rehabilitate certified historic buildings into income-generating properties that create jobs and revitalize communities.
Community Reinvestment Act (CRA) Qualifying	Yes	Yes	Yes, depending on facts.	Yes
Credit Period	10 years, beginning in the year the property has been leased to a certain occupancy.	7 years, beginning when the investment is made to the CDE.	1 year, in the year the property is placed in commercial operation.	1 year, in the year the property is placed into service.
Recapture Period	Tax credits are earned over 10 years but recapture period is 15 years. (In years one through 10, one-third of the total credit amount claimed has the potential for recapture. In Years 11 through 15, the potential for recapture (1/3 of the credits) decreases by one-fifth so by the end of Year 15, the potential for recapture is zero.	Tax credits are earned equally over 7 years but fully recapturable the entire 7-year period.	Tax credits are earned over 5 years; recapture risk burns off by 20% each year	Tax credits are earned over 5 years; recapture risk burns off by 20% each year
Inception/Status	• 1986 • Permanent	• 2000 • Currently extended through 2013 • Permanent status being considered	• 30% ITC credit started in 2005 • 30% Currently extended through 2016, reduces to 10% thereafter.	• 1976 • Permanent

Program	Affordable Housing Tax Credit (LIHTC)	New Markets Tax Credit (NMTC)	Renewable Energy Tax Credit (RETC)	Historic Tax Credit (HTC)
Tax credits and tax benefits associated	• Tax credits • Deductions - Equity investor's share of operating income/losses (i.e. depreciation and rental expenses).	• Tax credits • Deductions - Equity investor's share of operating income/losses (primarily fees and net interest income).	• Tax credits • Deductions - Equity investor's share of operating income/loss (primarily depreciation). Note - may include non-tax benefits such as cash returns (priority returns structured in the transaction.)	• Tax credits • Deductions - Equity investor's share of operating income/loss (primarily depreciation). Note - may include non-tax benefits such as cash returns (priority returns structured in the transaction.)
Cash flow variability	•The investor return is based solely on the cash flows from tax credits and other tax benefits. Cash flows rarely vary from projected amounts.	•The investor return is based solely on the cash flows from tax credits and other tax benefits. Cash flows rarely vary from projected amounts.	Same as LIHTC, plus the following: • Priority Return - represent the cash returns noted above. Certain transactions may include returns from cash which are above and beyond the tax benefits from operating losses/income and tax credits. These returns may be variable and if significant, the investment structure should not qualify for this treatment. • Put - Nominal stated value to be paid to the investor at exit/maturity (that is, end of compliance period). The put is the investor controlled withdrawal option and provides for the structure to be "put" to the developer/sponsor for this nominal value.	Same as LIHTC, plus the following: • Priority Return - represent the cash returns noted above. Certain transactions may include returns from cash which are above and beyond the tax benefits from operating losses/income and tax credits. These returns may be variable and if significant, the investment structure should not qualify for this treatment. • Put - Nominal stated value to be paid to the investor at exit/maturity (that is, end of compliance period). The put is the investor controlled withdrawal option and provides for the structure to be "put" to the developer/sponsor for this nominal value.

Program	Affordable Housing Tax Credit (LIHTC)	New Markets Tax Credit (NMTC)	Renewable Energy Tax Credit (RETC)	Historic Tax Credit (HTC)
Tax credit variability:				
Operating - Note, if these events cause variability, it typically impacts the timing and potential amount of the tax credit - not the ultimate receipt of it.	• Basis from certain developmental costs • Percentage of the project set-aside for low-income housing • Applicable tax credit percentage. • To mitigate this variability, structures typically include a guarantee and its purpose is to restore the investor's return in the event that the expected amount of tax credits is not realized.	• The amount of the tax credit is driven by the Qualified Equity Investment into the CDE, not the operations of the underlying project/business. Therefore, operating risk with NMTC is very low.	• Expenditures which determine tax credit amount • Placed in service date • Project must produce energy but the amount of energy produced, and cash flows from operations does not impact the amount of the tax credit.	• Expenditures which determine tax credit amount • Placed in service date
Compliance	Amount of tax credits projected at close typically do not vary. If tax credits are not received, a recapture event has occurred. Recapture is caused by the following pre-defined criteria: • Non-compliance with Section 42 of the Code • 10% carryover • Placement-in-service • Qualified lease-up/Minimum set-aside • 50% bond test • Recording LURA • Foreclosure	Amount of tax credits projected at close typically do not vary. If tax credits are not received, a recapture event has occurred. Recapture is caused by the following pre-defined criteria: • Substantially all (Sub-all) compliance criteria: • Substantially all, defined as 85 percent, of the qualified investment proceeds must be deployed by the CDE to a project during the compliance period • The QALICB must maintain QALICB status during the compliance period • The CDE must maintain certified status	Amount of tax credits projected at close typically do not vary. If tax credits are not received, a recapture event has occurred. Recapture is caused by the following pre-defined criteria: • Change in ownership of the Project • Failure of the project to constitute "investment property" within the meaning of Section 50(a) of the Internal Revenue Code • Failure to be in continuous operation (caused by vandalism, maintenance issue or equipment malfunction). If repair is required, a cure period is allowed.	Amount of tax credits projected at close typically do not vary. If tax credits are not received, a recapture event has occurred. Recapture is caused by the following pre-defined criteria: • Disposition of the property/Change in ownership • Disposition of at least 1/3 partnership interest • National Park Service Certification Revoked • Conversion to Tax Exempt Use Property