EITF Issue 13-B, Examples: Comparison of Effective Yield and Proportional Amortization Methods

The following example illustrates the difference between the effective yield method, the proposed proportional amortization method in which the investment is amortized in proportion to the tax credits received, and a proportional amortization method in which the investment is amortized in proportion to the total tax benefits received. The example

ASSUMPTIONS

a. All cash flows (except initial investment) occur at the end of each year.

b. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).

c. The investor made a $100,000 investment for a 5 percent limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.

d. The partnership finances the project cost of $4,000,000 with 50 percent equity and 50 percent debt.

e. The annual tax credit allocation (equal to 8 percent of the project's original cost) will be received for a period of 10 years.

f. The investor's tax rate is 40 percent.

g. The project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.

h. The project's taxable and book loss will be equal to depreciation expense. The cumulative book loss recognized by the investor under the equity method of accounting is limited to the $100,000 investment.

i. Deferred taxes are provided for the difference between the book and tax bases of the investment.

ii. Under the effective yield method, other tax benefits included in the calculation of the yield include the tax effect of depreciation on the underlying assets.

j. The investor will maintain the investment for 15 years and there will be no recapture of tax credits.

k. The investor expects that the estimated residual value of the investment will be zero.

l. All of the conditions described in paragraph 323-740-25-1 are met to qualify the investment for the use of the effective yield method (or the proportional amortization method).