NOVOGRADAC
& COMPANY LLP
CERTIFIED PUBLIC ACCOUNTANTS

June 14, 2013

Susan M. Cosper, Chairman
Emerging Issues Task Force
File Reference No. EITF-13B
FASB
401 Merrit 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. EITF-13B

Dear Ms. Cosper:

Novogradac & Company LLP is a national certified public accounting and consulting firm that works extensively in the affordable housing, community development and renewable energy fields, providing tax, accounting, audit, transaction consulting and valuation services. We specialize in various federal and state tax credit programs, including low-income housing tax credits, historic tax credits, new markets tax credits and renewable energy tax credits. We are a leading provider of accounting and consulting services to syndicators, developers, lenders, property managers and investors in these tax credit industries.

We are pleased to provide our responses below to the questions for respondents in regards to the Proposed Accounting Standards Update, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects*.

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.

Yes, in general, we believe the criteria for investments in affordable housing are appropriate and provide a principles-based approach toward accounting for tax credit investments; however, we recommend that certain changes be made to clarify their application. For example, we propose the following underlined changes to 323-740-25-1:

> An entity that invests directly or indirectly in a qualified affordable housing project through a limited liability entity may elect to account for the investment using a proportional amortization method or the effective yield method (described in paragraphs 323-740-35-2 and 323-740-45-2) provided all of the following conditions are met:
>
> a. It is probable that the tax credits allocable to the investor will be available.
> aa. The investor retains substantially no operational influence over the 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).
> b. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.
> c. 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.

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First, we recommend that the guidance be clarified so that an investor may invest directly in a qualified affordable housing project and indirectly in a fund or through other entities that invest directly in a qualified affordable housing project. This will help minimize misinterpretation of criteria c. above. While investments in affordable housing projects through a fund marketed by a tax credit syndicator have long been treated as in-substance real estate, the proposed change will minimize the likelihood that this guidance would be misapplied and limited to only a direct investor in an affordable housing project.

Second, we recommend that the Task Force consider the implementation of a proportional amortization method in accounting for tax credit investments, or at the very least permit this method as an alternative to the effective yield method. Similar to the effective yield method, amortization of the investment would be recorded net of the tax benefits in the tax provision; however, a proportional amount of the investment would be amortized based on the amount of tax credits received in the year as compared to the total tax credits allocable to the investor. The proportional amortization method eliminates the complexity inherent in the effective yield method. Companies that use the effective yield method may be required to provide multiple iterations or constantly update their calculations based on changes to tax depreciation and operating results. It would also eliminate concerns or questions regarding how investors should account for their investments when they may receive bonus depreciation deductions and other tax benefits through special elections. One benefit the proportional amortization method provides is significant cost savings in management personnel calculating and updating the effective yield method amortization schedules. In addition, the proportional amortization method significantly reduces the opportunity for errors inherent in the effective yield method calculation.

Third, we propose that the word “substantially” be added to precede “no operational influence….” Currently, as the proposed guidance reads, there is potential for misapplication. Under Internal Revenue Code Section 42, an investor must participate as an equity partner in the affordable housing project in order to be allocated low-income housing tax credits. Within the partnership or operating agreements that govern the activities of affordable housing projects, the limited liability investor may have approval rights on certain elections for tax purposes, disbursements from operating reserves to cover operating deficits or loans from other partners to the affordable housing projects. Because protective rights are currently defined as “rights that are only protective in nature [and] do not allow the limited partners to participate in financial and operating decisions of the limited partnership that are made in the ordinary course of business[1],” the change would eliminate the potential misinterpretation of certain protective rights that may be construed as participating in financial or operating decisions. These rights are minor in nature and help ensure that the limited liability investor’s expected rate of return will be achieved and funding is available or will be provided so that the tax credits will continue to be generated and available. We do not believe these decisions are other than protective rights to the limited liability investor (used to support the investor’s projected rate of return or mitigate risks of noncompliance or foreclosure) but the criteria as it currently is written could pose differences in interpretation by investors or their auditors.

Fourth, as more fully discussed later in this letter, we believe this method of accounting should not be limited to low-income housing tax credit investments.

[1] *FASB Codification*, Master Glossary, Protective Rights.

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.

We agree the effective yield method is an acceptable method; however, it is cumbersome and subject to manipulation, misapplication and misinterpretation. We believe the proportional amortization method would provide a more stable and less complex method for determining the annual amortization expense. Calculation of the effective yield method requires multiple computations and assumptions in order to determine the annual amortization expense of the investment. We believe the current effective yield method example in the Exposure Draft is overly simplistic. For example, initial investments in affordable housing projects may occur up to two years before tax credits begin to be received and additional contributions may continue for up to two or more years after the start of the initial tax credit period. We have received numerous inquiries from investors with regard to applying the effective yield method. They are asking, when should the amortization period begin? Should amortization be recorded before tax credits are received? These questions and others which represent real concerns to tax credit investors are not clearly addressed through the example in the Exposure Draft.

We believe that the proportional amortization method also provides a cost beneficial alternative to the effective yield method and provides better matching of the costs of these investments with their benefits and greater consistency and transparency in financial reporting.

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?

We accept that the elimination of the guarantee changes the nature of the investment. With the guarantee, the investment more closely resembled a debt instrument. Without the guarantee, the principal motivation for the investment is the tax benefits. We also contend that because the investment is linked to the delivery of tax credits (that is, the investor's capital contributions and overall investment are adjusted based on the delivery of tax credits), the use of a proportional amortization model, resulting from the delivery of tax credits, provides a better and more consistent approach in matching the costs and tax benefits.

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.

In order to incentivize investment, stimulate economic growth, and influence behavior, the U.S. and numerous state governments have implemented tax incentive programs that promote public policy.

On occasion, other tax credits are combined in a transaction with affordable housing tax credits, allowing project sponsors to generate more equity to close project financing gaps. We recommend that the proposed conditions for affordable housing projects be extended to analogous situations and permit the combining of multiple tax credits into a single transaction. Also, if particular tax credits separately meet the conditions, they should be provided the same accounting treatment. Different accounting principles should not exist for tax credit investments with similar attributes.

As we noted in a paper previously submitted, "[New markets tax credit], [historic rehabilitation tax credit] and renewable energy tax credit investments all share certain investment structure attributes with affordable housing tax credit investments … Generally, they are structured as equity investments in entities that are formed specifically to qualify for tax credits under the respective Federal and state tax credit programs. The entities vary as to the types of business operations they conduct. However, the common feature is that the tax credit investment is structured in a manner where the controlling financial interest as well as the risks and rewards of those businesses are retained by the other owners and not by the tax credit investor. Where operational risks exist, the other owners typically provide guarantees to protect the tax credit investor from absorbing those losses. Likewise, the investments are structured where the tax credit investor does not have any significant rights to receive benefits resulting from operations or from residual values. Such benefits are also retained by the other owners."[2]

Below, we highlight three tax credit programs, new markets tax credits (NMTC), renewable energy tax credits (RETC) and historic rehabilitation tax credits (HTC), that federal and state governments use to achieve their public policy goals. We are not suggesting that these or other tax credit programs will always qualify, but we believe some structures or transactions will qualify and investors in such structures or transactions should receive similar accounting treatment.

Within the NMTC program, a tax credit equity investor using the leveraged structure would often meet the proposed conditions. In such a structure, an investor contributes equity to a partnership or limited liability company, which is combined with a loan from a third party lender to make a qualified equity investment in a certified development entity (CDE). The CDE uses the proceeds to make loans and/or an equity investment in a qualified active low-income community business (QALICB). By making the equity investment in the CDE, the investor receives tax credits over seven years equal to 39 percent of the total proceeds invested in the CDE. The loans and/or equity investments made by the CDE to the QALICB are generally below market. The tax credit equity investor makes an investment for which its return is substantially derived from the NMTC and related tax benefits.

Similarly, North Carolina offers a state RETC that is received ratably over a five-year period. Under this program, North Carolina offers a tax credit equal to 35 percent of the cost of eligible renewable energy property constructed, purchased or leased by a taxpayer and placed into service in North Carolina during the taxable year. The credit is subject to various limits depending on the sector and the type of renewable-energy system and the investor's current state tax liability. For most taxpayers, the credit is taken in five equal installments beginning with the year in which the property is placed in service. The credit can be claimed against franchise tax, corporate tax, income tax, or in the case of insurance companies, against the gross premiums tax. The investor makes an investment for which its return is substantially derived from the RETC and related tax benefits.

Also, in certain scenarios, an HTC investment through a master lease structure may qualify. The lessor (landlord) will incur qualified rehabilitation expenditures in a residential or commercial property (Historic Building) for federal and/or state HTCs. The investor will make an equity investment in the lessee or master tenant entity for a limited liability interest. The lessor makes an election to treat the master tenant as having incurred the qualification rehabilitation expenditures on its federal tax return. When the Historic Building is placed in service, it will generally receive all of the federal and/or state historic tax credits. The investor must hold its investment for 5 years, after which time, the investor may dispose of its investment. In addition, the partnership and operating agreements generally provide that the investor

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[2] Michael Beck and Bentley Stanton, *Significant Changes Needed in Accounting for Affordable Housing and Other Tax Credit Investments*, June 22, 2012, p. 15.

is entitled to receive cash distributions based on its ownership interest in the Historic Building to the extent cash flow is available. The investor makes an investment for which its return is substantially derived from the HTC and related tax benefits.

These and other examples are representative of structures and transactions frequently identified in other tax credit programs that would satisfy the conditions in the proposed Update.

Alternatively, investors may invest in tax credits through investment in a fund. Tax credit syndicators combine various tax credit transactions or even tax credits from different programs within an investment fund. A fund provides further insulation to a tax credit investor from exerting any operational influence at the tax credit project level. The tax credit syndicator performs asset management services for the investor, providing management and oversight of these investments and ensuring delivery of the tax credits. Many of these transaction structures will meet the proposed conditions.

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.

Yes, we believe that other types of tax credit investments that meet the proposed criteria should be permitted to follow the same accounting provided to investors in affordable housing projects. However, we believe a proportional amortization method that matches the cost of the investments directly with the tax benefits is more appropriate.

As previously discussed, different accounting principles should not exist for tax credit investments with similar attributes.

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?

Yes, for consistency in reporting purposes the proposed Update should prescribe certain recurring disclosures for the reporting entity. However, we believe that certain proposed disclosures may be voluminous or cumbersome, if disclosed, without providing a significant benefit to the users of the financial statements. For example, the proposed guidance recommends disclosure of the yield used to calculate the effective yield method. Assuming investors would disclose a blended yield of all of their affordable housing investments rather than each individual project used to calculate the amortization cost of the effective yield method, this disclosure provides no comparison to the yields of other transactions or investors, as such amounts will vary by numerous factors, including but not limited to, the size of investments, type of tax credit investment (new constructions vs. qualified rehabilitation), timing of tax credit investments, location of properties, industry experience of tax credit developer and syndicator, and other incentives.

In addition, the disclosure regarding whether the qualified affordable housing project is currently subject to any regulatory reviews and the status of such reviews would certainly be voluminous. State housing finance agencies, which allocate tax credits to the affordable housing projects, collect fees for the purpose

of monitoring compliance with the federal and state requirements of the tax credit program. Also, depending on other financing sources received by the affordable housing projects, they may be subject to other reviews. Inspections of the property and tenant files are performed periodically, together with other reporting requirements imposed by these agencies. Additionally, the affordable housing projects may be subject to "surprise audits" from time to time by the Internal Revenue Service. These regulatory reviews are routine at affordable housing projects and represent measures taken to ensure compliance with tax credit program requirements. The results of the regulatory reviews often result in immaterial findings that are required to be addressed by the affordable housing projects. In the event that affordable housing projects are noncompliant with the tax credit program requirements, there is typically a "cure" period to correct the noncompliance before the tax credits are disallowed or recaptured. We believe the proposed disclosures of regulatory reviews and their status may lead to too much information that is unnecessary, confusing and distracting to the users of the financial statements, as the information is no indication that tax credits have been disallowed or recaptured or at such possible or likely risk.

We believe the other disclosures are appropriate under the proposed Update, including disclosure of the investment write-down when loss or recapture of tax credits is probable.

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

Yes, we agree that the amendments in the proposed update should be applied using a retrospective approach.

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

Yes, early adoption of the proposed amendments is preferable and should be permitted to allow investors to timely reflect the nature of their investments in qualified affordable housing projects, as well as other tax credit investments.

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.

No, the proposed amendments should apply to the tax credit investments of both public and nonpublic entities.

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

Implementation of the proposed amendments would vary based on the roles of the different participants in the affordable housing industry. A general partner would continue to consolidate, or in the case of multiple general partners, may account for its investment using the equity method due to their significant involvement in the operational and financial activities of the affordable housing projects.

Syndicators would continue to report the results of tax credit investments through a fund using the equity method. Because the funds are organized through pass-through entities, which have no tax liability, the proposed changes are not expected to have any impact.

Investors should be able to restate their financial statements without significant difficulty. Preparing the effective yield method calculations requires multiple computations; however, the calculations and implementation effort could be minimized through the adoption of a proportional amortization method. In addition, the elimination of certain disclosures regarding regulatory reviews will simplify the implementation of the proposed amendments.

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We appreciate the opportunity to comment on this matter and the consideration taken in making your decision. We commend the Task Force in their efforts and conclusions with regard to this very important issue to the affordable housing and other tax credit industries. We would be glad to discuss our comments and address any questions or comments you may have.

Very truly yours,
NOVOGRADAC & COMPANY LLP

by:
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