

June 14, 2013

Technical Director
File Reference No. EITF-13B
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, Connecticut 06856-5116

Dear Technical Director,

On behalf of the members of the New Markets Tax Credit (“NMTC”) Working Group, we submit 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* (the “Update”), specifically questions 4 and 5 as it relates to NMTCs. The members of the NMTC Working Group are participants in the NMTC industry who work together to help resolve technical NMTC Program issues and provide recommendations to make the NMTC Program even more efficient in delivering benefits to qualified businesses located in low-income communities around the country. Our group includes over 50 organizations that are allocatees, nonprofit and for-profit community development entities (“CDEs”), consultants, investors, accountants and lawyers. We believe the conditions in the proposed Update are applicable and the effective yield method of accounting should be extended to NMTC investments.

On Dec. 21, 2000, President Clinton signed into law the Community Renewal Tax Relief Act of 2000, which included the NMTC. The NMTC is regulated by Section 45D of the Internal Revenue Code. The NMTC program is administered by the CDFI Fund, a department of the U.S. Treasury. The main purpose of the NMTC program is to bring capital to communities that have traditionally had inadequate access to capital. The NMTC program was designed to compensate investors for a perceived risk of investing in low-income communities. The NMTC is a 39 percent federal tax credit available to investors over seven periods spanning six years and a day. Federal tax credits equal to 5 percent of the investment amount in the CDE for the qualified equity investment (“QEI”) are recorded on their tax return by the investor in the first three years. Tax credits equal to 6 percent of the QEI are recorded in the remaining four years. NMTCs are used to offset an investor’s federal income tax. The federal tax credits are provided for QEIs that an investor makes in a qualified CDE. The NMTCs are earned over a period of 7 years (the “Compliance Period”).

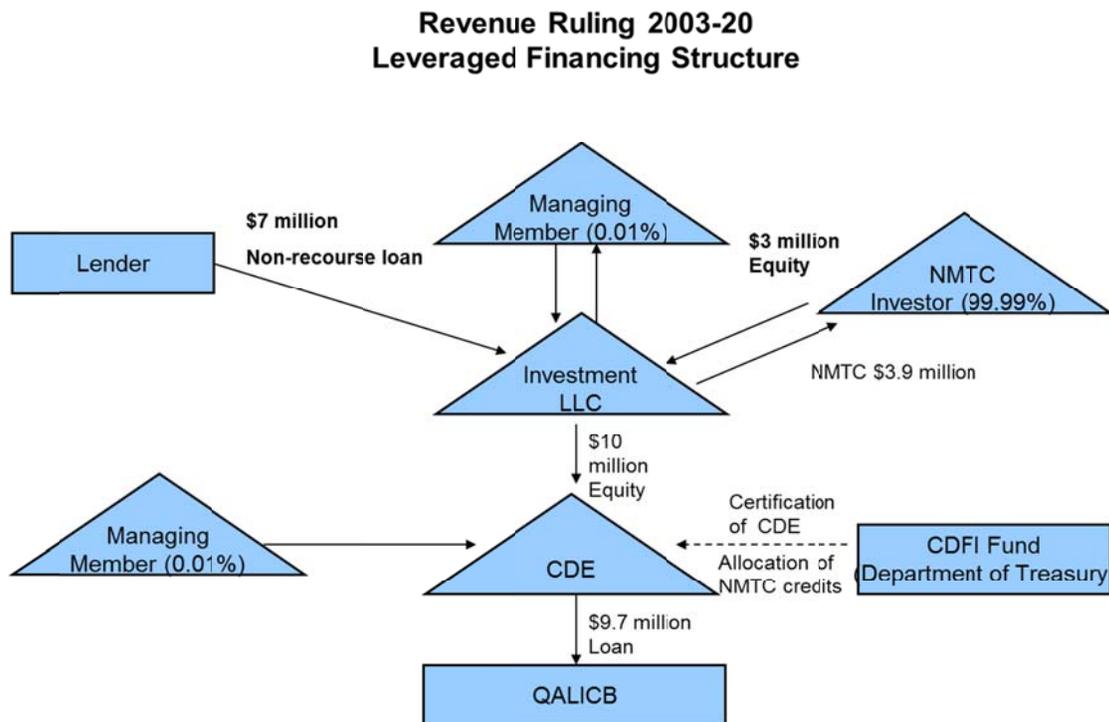
Example: A CDE is allocated by the CDFI Fund the right to issue \$100 million in credit-qualifying equity investment. The CDE raises \$50 million in cash equity to be used for investments in QALICBs. Assuming all other requirements are met, the investors would receive \$2.5 million in tax credits for each of the first three years and \$3 million in tax credits for each of the last four years (\$50 million X 5% and \$50 million X 6%, respectively). While the CDE has the authority to issue as much as \$100 million in QEIs, its investors can only claim NMTCs on the actual cash invested in the CDE.

The value of the NMTC is diminished, however, by the requirement that the taxpayer’s basis in the investment be reduced by the amount of the tax credit. The NMTCs claimed by a taxpayer are also subject to recapture if certain conditions are not satisfied continually over the 7-year credit period.

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.

Yes, the NMTC leveraged structure meets the conditions in the proposed Update. Created, in part, due to the success of the low-income housing credit, the NMTC was designed to attract private capital to be invested indirectly in qualified active low-income community businesses (“QALICBs”) located within low-income communities. Tax credit investors make their investments in CDEs that then use their local expertise to make qualified investments, usually in the form of debt or equity, in businesses located within America’s most distressed communities.

While an investor may make its investment in the CDE directly to qualify for NMTCs, it is more common that it invests its equity in a limited liability entity such as a limited partnership or limited liability company that are flow-through entities for tax purposes. This is known as the leveraged structure as approved by the Internal Revenue Service in Revenue Ruling 2003-20 and illustrated below:



In the leveraged structure, an investor contributes equity to a partnership or limited liability company (the “Investment Fund”), which is combined with loan proceeds so that the Investment Fund may make a QEI in a CDE, primarily for the purpose of receiving tax credits. CDEs use the proceeds from the QEIs to make qualified low-income community investments (“QLICIs”) typically in the form of debt and/or equity to QALICBs.

We believe that the investments made by the tax credit investor under this structure will generally meet the four conditions included in the proposed Update for an entity to elect to account for their investments using the effective yield method as follows:

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

We believe it is probable that the tax credits allocable to the investor will be available. An unrivaled amount of due diligence and asset management, before the investment is made and throughout the 7-year compliance period for NMTC transactions, provides the tax credit equity investors the necessary assurance that they will be able to claim the NMTCs as projected. The tax credits are claimed over seven years and are claimed the date on which the QEI is initially made and each of the six anniversary dates thereafter. Recapture of the credits is triggered if: 1) the CDE ceases to be a qualified CDE, 2) the equity investment proceeds no longer satisfy the substantially all requirement (i.e., less than 85% are used for QLICIs), and/or 3) the equity investment is redeemed or cashed out by a CDE. The availability of the tax credits allocable to the investor is strictly dependent on program compliance rather than the success or failure of the QALICB. Transaction due diligence is performed during structuring and asset management review services are performed by the CDE throughout the 7-year compliance period to ensure compliance requirements are satisfied. This is done at a level that makes it probable that investors receive the intended benefits and to date, we are unaware of any recorded instances of NMTC recapture.

2. The investor retains 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.)

The leverage structure uniquely allows the investor to separate the operational risk associated with investing in a QALICB in a low-income community from the tax credit risk. A typical NMTC investor usually derives nearly all of its return on its investment from the receipt of the tax credits alone. As noted in a paper submitted to the FASB previously, “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.”¹ Tax credit investors that invest using the leveraged structure illustrated above, typically do so without retaining any operational influence over the investment other than protective rights, and substantially all of the projected benefits are from tax credits and other tax benefits.

¹ Michael Beck and Bentley Stanton, *Significant Changes Needed in Accounting for Affordable Housing and Other Tax Credit Investments*, June 22, 2012, p. 15.

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

In NMTC transactions structured with upper tier Investment funds, the investor's projected yield based solely on the cash flows from NMTCs and other tax benefits is generally positive. The leverage structure allows tax credit equity investors to achieve their required return primarily from tax credits. Due to the basis adjustment created by the tax credits, the investor's benefits in the form of tax credits may actually be reduced by the tax burden that an investor generally recognizes when it liquidates its interest due to the gain recognized when it is required to zero out its negative capital account.

Because the NMTCs are claimed over a 7 year period, the basis adjustment described above, recapture risk and other factors, the investor determines the amount of equity (exclusive of any receipt of cash flow) it is willing to invest based upon a discount that allows it to achieve a reasonable, positive rate of return. Currently, investors average between 6 to 10% after-tax internal rates of return based upon their NMTC investments.

4. *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.*

NMTCs share similar attributes to low-income housing tax credit investments. In the leverage structure, the NMTC investor is a member of a limited liability entity. Since the NMTC investor is investing primarily for tax credit benefits, its liability is limited to its capital investment. Similar to how low-income housing tax credit investments are structured, the investor does not typically have any influence over the operations of the QALICB, nor does it derive its tax credits based on the success or failure of the QALICB's operations.

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, at a minimum, the effective yield method of accounting should be extended to NMTC investments. The NMTC Working Group's members generally account for their investments in NMTCs using the equity method, separating the tax benefits of such investments from the cost of those benefits and presenting them in different locations on the income statement. The result is that the NMTC investments are reported in a manner that we believe distorts the financial statements of the investor. This treatment should be available for other tax credit programs with similar attributes meeting the proposed conditions and that are "analogous" to affordable housing tax credit investments.

However, we support a model that requires a proportionate amount of the cost of the investment to be amortized against the related tax credits and reported as a component of the tax credit investor's income tax provision. We believe these changes would more accurately measure and report the performance of the investments than the current equity method.

Conclusion

We appreciate the opportunity to submit our suggestions in response to your invitation to comment on this exposure draft. We believe that extending the effective yield method currently contemplated for LIHTC investments, or a proportional amortization method, which would be more conducive to NMTC investments, is essential to improve the financial reporting of NMTC investors. With further guidance, we believe that the NMTC can also be an even more effective tool in restoring economic growth throughout the country. We commend the FASB for its efforts to update this accounting standard and consider its applicability to NMTC investments. Thank you in advance for your time and consideration. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Yours very truly,
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