October 6, 2022

Ms. Hillary H. Salo
Technical Director, Chair, Emerging Issues Task Force
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

Via email: director@fasb.org

Re: Comments on Proposed Accounting Standards Update - Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (File Reference No. 2022-004)

Dear Ms. Salo:

On behalf of the members of the GAAP Accounting for Tax Credits Working Group ("GAAP Working Group"), we submit the following comments, considerations, and recommendations in connection with the Proposed Accounting Standards Update - Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method (File Reference No. 2022-004). We believe that improving the accounting treatment for investments in tax credits is of vital importance to ensure the relevant and faithfully representative financial reporting for investments such as those made in the Low-Income Housing Tax Credit ("LIHTC"), New Markets Tax Credit ("NMTC"), Historic Rehabilitation Tax Credit ("HTC"), Renewable Energy Tax Credit ("RETC") and others.

The Proposed Accounting Standards Update (the "Update") to remove the LIHTC limitation so that ALL tax credit investments have an opportunity to elect into the proportional amortization method is a positive step forward to simplifying the accounting treatment for various tax credit investments. However, in order for the guidance to be applied broadly, we recommend the FASB Board also consider reviewing and making changes to the current conditions as part of a new project after the current Proposed Update is implemented. Any comments related to issues outside of the scope of the Update are intended to be for future consideration and we would recommend that the FASB not delay issuing finalized guidance (inclusive of recommended changes discussed herein) as a result.

In an effort to organize the GAAP Working Group's comments for the FASB Board's consideration, we have organized our comments by addressing the fourteen questions in the exposure draft.

Question 1: Do you agree that a reporting entity's tax equity investment that meets the conditions in paragraph 323-740-25-1 as amended by this proposed Update should be able to elect to use the proportional amortization method? That is, do you agree that the conditions are appropriate? If not, please explain why.

In general, we do agree that if a reporting entity's tax equity investment meets the conditions in paragraph 323-740-25-1 as amended by this proposed Update, it should be able to elect to use the proportional amortization method. We agree with the stakeholder observation that entities should have the same election to apply the proportional amortization method to economically similar investments that are made primarily for the purpose of receiving tax credits and other tax benefits as they do for LIHTC structures, since the proportional amortization method provides users with a better understanding of the returns from such investments than the equity or cost method. In order to further the objectives of the project and provide better financial reporting to investors, we believe FASB should consider allowing the application of the proportional amortization method to both consolidated tax equity investment structures and to debt instruments.

We request that FASB remove the addition of "income" before tax credits in the amended language throughout the Update. The addition of "income" unnecessarily limits tax credit investments to those tax credits that reduce income tax liabilities. Some tax credits, especially certain state tax credits and potentially future tax credits, allow the reporting entity to offset tax liabilities that aren't related to income taxes, like a premium tax liability. Since the Update's intention is to expand the guidance to all tax credit investments, limiting it to only income tax credits would be counterproductive and may also impact the current application to certain state LIHTCs.

We also recommend that FASB consider a new project to review some of the conditions in paragraph 323-740-25-1 and modify them in order to allow more tax credit investments to meet the conditions. We recommend that the EITF or FASB include the re-examination of these conditions in a follow-up project that performs a deeper dive into reviewing the existing conditions so that proportional amortization may be applied for all investments that are made primarily for the purpose of receiving tax credits and other tax benefits. We further recommend that this future project be added to the FASB's agenda immediately after this Update is finalized.

We believe that when the proportional amortization method is made available to all tax credit investment types with limited changes to the current five conditions, that only a limited additional amount of tax credit investments would qualify, and this would severely limit the number of reporting entities that choose to make the election to use the proportional amortization method. While expansion to all tax credit investments is an improvement and one that is welcomed by those that are able to meet the existing conditions, many investors, especially those that invest in multiple credits, would see it as falling short of what is needed to truly level the playing field for all tax credit investments.

Of the five conditions in paragraph 323-740-25-1 (shown as amended by the Update), we believe that the following three will need to be re-examined to determine ways that they can be changed to allow more tax credit investments to be eligible toapply the proportional amortization method:

aa. The investor does not have the ability to exercise significant influence over the operating and financial policies of the limited liability entity underlying project.

aaa. Substantially all of the projected benefits are from <u>income</u> tax credits and other <u>income</u> tax benefits (for example, tax benefits generated from the operating losses of the investment). <u>Projected benefits include, but are not limited to, income tax credits, other income tax benefits, and other non-income-tax-related benefits, including refundable tax credits (that is, those tax credits not dependent upon an investor's income tax liability). Tax credits that would be accounted for outside of the scope of Topic 740 (for example, refundable tax credits) shall be included in total projected benefits, but not in income tax credits and other income tax benefits when evaluating this condition. This condition shall be determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the tax equity investor for the purpose of making a decision to invest in the project.</u>

b. The investor's projected yield based solely on the cash flows from the <u>income</u> tax credits and other <u>income</u> tax benefits is positive.

Currently, the substantially all threshold isn't expressly defined within the context of the proportional amortization guidance. In current practice, most practitioners have interpreted substantially all to be 90% or more. If there is no guidance provided that indicates the threshold is lower,, many transactions, especially investments in RETCs, will fail to meet this condition and will not be able to use the proportional amortization method. If a lower percentage is included in the guidance, such as 70%-75%, or a different measurement, we believe a majority of existing RETC transactions will be able to meet the substantially all condition.

We also agree with the staff observation that lowering the substantially all threshold by itself may not have a meaningful impact on the types of investment tax credit programs that would be able to apply the proportional amortization method because many of those programs may not meet the positive yield condition in paragraph 323-740-25-1(b). Therefore, we recommend FASB also examine ways to modify the positive yield requirement in conjunction with the substantially all condition.

The positive yield requirement will likely preclude many investment structures currently utilized by the solar industry, specifically those involving investment tax credits, from qualifying for the proportional amortization method. This is a result of credits being recognized upfront in conjunction with tax equity investors contributing more than one dollar per dollar of tax credit received. Conversely, production tax credits, LIHTCs, HTCs and NMTCs are monetized over a period of five years or more and are typically invested on a discounted basis for less than one dollar per dollar of tax credit received. Tax credits invested on a discounted basis naturally have a higher proportion of tax credits/benefits relative to equity contributions that help in satisfying both the positive yield and substantially all conditions. It's worth noting that all of these different types of investments are made primarily for the purpose of receiving tax credits and other tax benefits and should be able to apply a consistent accounting method.

Solar and wind transactions generate cash flows, a portion of which tax equity investors receive for both tax and economic motivations. However, cash distributions associated with these investments are minor and they are still made primarily for the purpose of receiving tax credits and other tax benefits. For both production tax credit and investment tax credit solar and wind transactions, these additional cash flows prove problematic in meeting the positive yield and substantially all requirements as it results in investors contributing additional equity and receiving more cash when compared to other tax credit investments.

LIHTC (and NMTC) transactions often operate on a near-breakeven basis which generally results in less cash distributed to the tax equity investor.

We have previously provided to the FASB staff an analysis of the changes to the substantially all and positive yield conditions that are needed to ensure that the proportional amortization method is available to the most types of tax credit investments.

Please refer to our comments to Question 2 below for our recommended changes to the significant influence condition.

Question 2: Should the condition in paragraph 323-740-25-1(aa) be retained? Should only an investor that does not have the ability to exercise significant influence over the operating and financial policies of the underlying project be able to elect to apply the proportional amortization method to its tax equity investment? Please explain why or why not. What would be the impact of removing that condition?

We recommend removal of the condition in paragraph 323-740-25-1(aa). We agree with the Task Force member regarding the frequency and complexity of evaluating whether an investor has significant influence over the operating financial decision-making models encountered in practice. We further agree with the Task Force member that “questioned whether it would be appropriate to conclude that an investor cannot apply the proportional amortization method because the entity has significant influence over the operating and financial policies of the limited liability entity even though the investor meets all the other economics-focused criteria for applying the proportional amortization method. That Task Force member highlighted that the existence of significant influence may not change the fact that the investor is primarily receiving tax credits and other tax benefits.”

In addition to the Task Force member comments noted above, we agree that “the significant influence criterion appears to be more of a qualitative overlay to the other economics-focused criteria and that removing that criterion would likely not change practice.”

We also agree with the Task Force member that noted “(a) if the intent of the criterion is to safeguard against investments that are not made primarily for the tax credits and other tax benefits, the criterion seems to focus on the nature of the investment rather than the economic return, and (b) significant influence does not equate to control.”

In current practice, it’s not common for a tax credit investor to have significant influence but there may be instances when control is spung upon the investor due to unforeseen circumstances. A change in an investor’s control is typically a protective measure to ensure their investments that were made primarily for the tax credits and other tax benefits are protected. The removal of the condition won’t change the need for the reporting entity to show that their investments meet the other conditions. If those other conditions are met, it would still indicate that the investments were made primarily for the tax credits and other tax benefits.

Question 3: Are the conditions in paragraph 323-740-25-1 as amended by this proposed Update operable and auditable? Please describe the nature and magnitude of costs and any operability or auditing concerns, differentiating between one-time costs and recurring costs.

> We believe that the conditions in paragraph 323-740-25-1 as amended by this proposed Update are generally operable and auditable because of the existence of the conditions and their application to LIHTC investments since ASU 2014-01 became effective. However, the conditions would be more operable and auditable if our recommendations throughout are included.
>
> It is difficult to determine the magnitude of one-time and recurring costs, as the costs would be entity-specific and based upon the volume of investments that may be eligible. It is anticipated that there will be one-time costs associated with determining how to evaluate new tax credit investment types under the five conditions and apply the proportional amortization method for all current investments that are include in tax credit programs for which the entity has made an election. Recurring costs will be related to new investments included in the tax credit programs for which the entity has elected to use the proportional amortization method.

Question 4: Does the proportional amortization method fairly represent the economics and provide financial statement users with an appropriate understanding of the returns from tax equity investments that meet the conditions in paragraph 323-740-25-1 as amended by this proposed Update to apply the proportional amortization method? If not, please explain why.

> Yes, we believe the conditions in paragraph 323-740-25-1 as amended by this proposed Update to apply the proportional amortization method represents the economics more fairly and provide financial statement users with an appropriate understanding of the returns from tax equity investments that meet the conditions.

Question 5: Do you agree that applying the proportional amortization method to investments that meet the conditions in paragraph 323-740-25-1 as amended by this proposed Update should be an accounting policy election, or should those investments be required to be accounted for using the proportional amortization method? Please explain why or why not.

> We agree that applying the proportional amortization method to investments that meet the conditions in paragraph 323-740-25-1 as amended by this proposed Update should be an accounting policy election. Due to the existing conditions in paragraph 323-740-25-1 as amended by this proposed Update and how they are currently understood, it will be difficult for some investments in certain types of tax credits to be eligible for the proportional amortization method. Due to this diversity in types of tax credits as well as the possibility of future, unknown tax credits, we believe it is most practical to allow preparers to make an election rather than be required to account for those investments using the proportional amortization method.

We support the previous staff comments that an election "…allows for an appropriate level of flexibility for entities to manage the costs associated with evaluating whether an investment is eligible to apply the proportional amortization method and the benefits of the resulting financial reporting in the income tax line item depending on the number and size of investments within that tax credit program." It is difficult to expand the existing conditions to all investments and assume that one size fits all. Having an election in place allows investors the flexibility needed to address the diversity of investments in their portfolio and make the accounting policy election that will provide the most relevant information for each portfolio. It would be much more costly if an investor is required to determine eligibility for all of its tax credit investments and may impact its decision to make certain tax credit investments.

Question 6: Do you agree that the accounting policy election should be made on a tax-credit-program-by-tax-credit-program basis? That is, should an entity be able to elect to apply the proportional amortization method to investments in certain tax credit programs and not to apply it to investments in certain other tax credit programs? If not, at which level should the accounting policy election be applied (for example, for all investments in tax credit programs that meet the conditions in paragraph 323-740-25-1 as amended by this proposed Update or at the individual investment level)?

In conjunction with our agreement above in Question 5 that an election to apply the proportional amortization method is preferred over being required, we also agree with and support the ability to make the election on a tax-credit-program-by-tax-credit-program basis. Due to the diversity in types of tax credits as well as the possibility of future, unknown tax credits, we believe it is most practical to allow preparers to apply the election to use the proportional amortization method on a tax-credit-program-by-tax-credit-program basis for tax credit investments that meet the conditions in paragraph 323-740-25-1. We agree with the Task Force members who supported an election on a tax-credit-program-by-tax-credit-program basis "…because it allows companies flexibility to evaluate the cost of applying the proportional amortization method for tax credit programs in which they may not have a high volume of transactions in comparison to the benefits of improved financial reporting."

We further support the previous staff comment that an election on a tax-credit-program-by-tax-credit-program basis "…allows for an appropriate level of flexibility for entities to manage the costs associated with evaluating whether an investment is eligible to apply the proportional amortization method and the benefits of the resulting financial reporting in the income tax line item depending on the number and size of investments within that tax credit program." It is difficult to expand the existing conditions to all investments and assume that one size fits all. Having an election in place on a tax-credit-program-by-tax-credit-program basis allows investors the flexibility needed to address the diversity of investments in their portfolio and make the accounting policy election that will provide the most relevant information for each portfolio. It would be much more costly if an investor is required to determine eligibility for all of its tax credit investments and may impact its decision to make certain tax credit investments.

Question 7: Is a tax-credit-program-by-tax-credit-program accounting policy election understandable, operable, and auditable? Please explain why or why not.

Yes. The proposed tax-credit-program-by-tax-credit-program accounting policy election generally would be understandable, operable and auditable because of the existence of the election for LIHTC investments since ASU 2014-01 became effective.

Question 8: Under existing GAAP, LIHTC investments that do not qualify for the proportional amortization method or equity method are accounted for using the cost method. The proposed amendments would expand the use of the cost method in Subtopic 323-740 to other tax equity investment programs. Should tax equity investments that are not accounted for under the proportional amortization method or the equity method be permitted to apply the cost method, or should they be required to apply Topic 321?

We believe the expansion of the use of the cost method in Subtopic 323-740 to other tax equity investment programs is appropriate because other similar types of tax equity investments should be accounted for similarly rather than required to apply Topic 321 (Investments –Equity Securities).

Question 9: Do you agree that the proposed disclosures would provide decision-useful information for financial statement users? Are there any other disclosures about tax equity investments that should be required?

We agree that the proposed disclosures would provide decision-useful information for financial statement users. We don’t recommend any additional disclosures.

Question 10: Do you agree that the proposed disclosures should apply to tax equity investments that generate credits through a tax credit program for which the entity has elected to apply the proportional amortization method, including investments that do not meet the conditions in paragraph 323-740-25-1 as amended in this proposed Update? If not, please explain why.

We agree that the proposed disclosures should apply to tax equity investments that generate credits through a tax credit program for which the entity has elected to apply the proportional amortization method, including investments that do not meet the conditions in paragraph 323-740-25-1 as amended in this proposed Update.

Question 11: Are the proposed disclosures operable to produce and auditable? Please describe the nature and magnitude of costs and any operability or auditing concerns, differentiating between one-time costs and recurring costs.

We believe the proposed disclosures are generally operable to produce and auditable. It is difficult to ascertain the magnitude of costs to implement the requirements of the amendments in the proposed Update.

Question 12: Do you agree with the proposed transition provisions? Please explain why or why not.

We agree with the proposed transition provisions. In previously submitted comments we recommended that a reporting entity be allowed to choose between the three options (prospective, modified prospective or retrospective methods) the Task Force considered. While the Update doesn't allow for the prospective method, we support the proposed option to choose between the modified prospective and retrospective methods. In practice, preparers have found that implementing ASU 2014-01 on a retrospective basis was costly and complex to implement. In the current Update, the option between two transition methods will give the reporting entity the ability to choose what is most cost effective.

We further believe that a single transition method would not be easily applied as the terms of the credits vary widely from LIHTCs. The composition of tax credit investor portfolios of various credits will vary considerably. Therefore, instead of requiring all entities to conform to a single transition method regardless of the composition of their tax credit portfolios, we believe it would benefit the reporting entities and the financial statement users if the reporting entities are allowed to elect a transition method based upon their own portfolio and what would be the most accurate presentation.

Question 13: What is the earliest period that an entity would be able to adopt the proposed amendments? Should early adoption be permitted? If not, please explain why.

We recommend that language similar to that included in ASU 2014-01 be included in this accounting standards update:

> The amendments in this Update are effective for public business entities for annual periods and interim reporting periods within those annual periods, beginning after December 15, 2023. For all entities other than public business entities, the amendments are effective for annual periods beginning after December 15, 2023, and interim periods within annual reporting periods beginning after December 15, 2024. Early adoption is permitted.

The option to early adopt is critical. When ASU 2014-01 was released and early adoption was permitted, many entities early adopted because of the more accurate accounting treatment for their LIHTC investments. Many entities have indicated that they similarly plan to elect to use the proportional amortization method for their qualifying tax equity investments (such as NMTCs, HTCS, and RETCs) as soon as they're allowed, which we recommend include any interim reporting period between the issuance date of the final standard and the mandatory effective date.

Question 14: Are there any specific private company considerations that should be brought to the Board's attention?

We are not aware of any specific private company considerations that should be brought to the Board's attention.

We believe a principles-based approach is necessary so that the proportional amortization method can be applied to investments in existing tax credits as well as those that will be created in the future. We appreciate the opportunity to submit these comments and recommendations. We believe the time and effort the FASB and EITF have spent on this issue is vitally important to the overall impact that tax credit investments can have on communities across the country, many of which are low-income. Thank you 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,
Novogradac & Company LLP

by

Brad Elphick