

# NEW MARKETS TAX CREDIT COALITION

June 17, 2013

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

Dear Ms. Cospers,

I am writing on behalf of the New Markets Tax Credit Coalition (The Coalition), a national membership organization representing community development organizations, investors, public officials and experts in community development and community development finance, in response to questions raised in the Proposed Accounting Standards Update, *Investments – Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Qualified Affordable Housing Projects* (the Update). The Coalition's comments apply specifically to questions 4 and 5 as they relate to NMTC investors. We believe the conditions in the proposed Update are applicable and the effective yield method of accounting, or a similar approach, should be extended to NMTC investments.

The NMTC was first authorized in the Community Renewal Tax Relief Act of 2000 (PL 106-554) in an effort to stimulate private investment and economic growth in low income urban neighborhoods and rural communities that lack access to the patient capital needed to support and grow businesses, create jobs, and sustain healthy local economies. The NMTC program attracts capital to low income communities by providing private investors with a federal tax credit for investments made in businesses or economic development projects located in some of the most distressed communities in the nation – census tracts where the individual poverty rate is at least 20 percent or where median family income does not exceed 80 percent of the area median. A NMTC investor receives a tax credit equal to 39 percent of the total Qualified Equity Investment (QEI) made in a Community Development Entity (CDE) and the Credit is realized over a seven-year period, 5 percent annually for the first three years and 6 percent in years four through seven. The Community Development Financial Institutions (CDFI) Fund within the Treasury Department administers the NMTC program, certifying CDEs and awarding NMTC allocations on a competitive basis to qualified CDEs and Internal Revenue Service (IRS) oversees NMTC taxpayer compliance. We provide the example below to illustrate a NMTC investment.

**Example of a NMTC Investment:** The CDFI Fund awards \$100 million in NMTC authority to a CDE thus granting the CDE the right to secure \$100 million in qualified equity investments (QEIs) from investors in exchange for the NMTC. The CDE raises a portion of this amount, \$50 million, in cash equity from investors to be used for qualified investments in low income community businesses. The investor receives a total of \$19.5 million in tax credits for the \$50 million QEI: \$2.5 million in tax credits for each of the first three years after the QEI is made 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, an investor can only claim NMTCs on the actual equity invested in the CDE. All NMTCs claimed by a taxpayer/investor are subject to recapture if certain conditions are not satisfied continually over the 7-year credit period. While we are not aware of a recorded NMTC recapture event to date, if a recapture event were to occur the Treasury Department would require the investor to pay back the amount of tax credits taken to date with interest.

**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.**

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 low income community businesses 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. The NMTCs are earned over a period of 7 years (the "Compliance Period").

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. The investor may combine its investment for the NMTC with non-recourse debt to increase the total amount of capital required to make the QEI that will define the amount of available NMTC. This is known as the leveraged structure as approved by the Internal Revenue Service in Revenue Ruling 2003-20.

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, or alternative, 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 and earned by the investor over the seven year compliance period. The availability of the tax credits allocable to the investor is strictly dependent on program compliance requirements rather than the success or failure of the business receiving NMTC financing. NMTC investor compliance criteria include: 1) the CDE receiving the QEI must maintain qualified CDE status ; 2) the QEI proceeds must satisfy the substantially all requirement (85% deployed); and 3) the QEI cannot be redeemed or cashed out by a CDE during the 7-year compliance period. NMTC investors perform transaction due diligence and asset management procedures that ensure compliance requirements are achieved throughout the seven year compliance period. This compliance and monitoring has proven to be successful as, 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.)***

In the typical leveraged investment structure, a tax credit investor does not have any operational influence over the investment other than protective rights, and substantially all of the projected benefits are from the NMTC and other tax benefits. 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 expects a discreet return on its investment from the receipt of the tax credits alone.

***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, the investor's projected yield, based solely on the cash flows from NMTCs and other tax benefits, is positive. The leveraged structure allows tax credit equity investors to achieve their required return primarily from tax credits.

**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 leveraged 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 project, nor does it derive its tax credits based on the success or failure of the project'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, the effective yield method of accounting, or a proportionate cost method that amortizes the investment cost against the related tax credits as a component of income tax provision, should be extended to NMTC investments as it should for other similarly structured tax credit investments that meet the proposed conditions. The NMTC Coalition investor 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 as well as does not provide decision-useful reporting information to the financial statement users. We believe that allowing NMTC to apply the effective yield, or alternative method, would allow for similar assets to reflect consistent accounting, more accurately measure and report the performance of the investments, and align with how an investor measures performance.

We appreciate the opportunity to submit our suggestions on the questions raised in the Update. We believe that extending the effective yield, or alternative, method currently contemplated for LIHTC investments, would be appropriate for NMTC investments and is essential to improve the financial reporting of NMTC investors. Additionally, we strongly encourage this guidance as we believe, it will make the NMTC an even more effective tool in restoring economic growth throughout the country. Thank you for your consideration. Please do not hesitate to contact us if you have any questions regarding our comments or if we can be of further assistance.

Sincerely,



Robert A. Rapoza