February 2, 2021

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Simplification of Income Statement Presentation for New Market Tax Credit Investments

Dear Technical Director:

The PNC Financial Services Group, Inc. ("PNC" or "we") would like to request that the Financial Accounting Standards Board ("FASB" or the "Board") add a new project to its technical agenda to simplify the accounting for new market tax credit ("NMTC") investments by expanding the scope of the FASB's existing accounting guidance for qualified affordable housing project investments (or low-income housing tax credits "LIHTC") found in ASC 323-740 Investments—equity method and joint ventures ("ASC 323-740") to include NMTC investments.

Since there is no guidance specific to NMTC investments today, reporting entities must present the depletion of these tax credit investments as an expense in their pre-tax income line while recognizing the economic benefit of the investment *below* the pre-tax income line as a reduction to income tax expense. The timing of the recognition of this expense and the associated tax credit benefit are often misaligned as well.

Such income statement presentation and recognition of NMTC investments complicates stakeholders' understanding of the tax-related benefit derived from these investments and, as a result, further effort must be made by tax credit investors to explain these accounting complexities to their stakeholders.

Moreover, our request to simplify NMTC investment accounting aligns with the Board's Simplification Initiative which was launched in 2014 "to simplify and improve accounting standards through a series of short-term, narrow-scope projects"[1].

Much of the same accounting complexity exists for other types of tax credit investments[2] apart from LIHTC investments[3]. If the FASB so chooses, we would also be in favor of adding a new project to simplify the accounting for *all tax credit investments*.

[1] www.fasb.org – Simplifying Accounting Standards - https://www.fasb.org/cs/Satellite?c=Page&cid=1176164432530&d=Touch&pagename=FASB%2FPage%2FSectionPage
[2] Most notably, historic tax credits investments, and solar and wind tax credit investments which also yield tax credits to investors under the Internal Revenue Code.
[3] As mentioned previously, the income statement presentation for LIHTC investments was addressed by the Emerging Issues Task Force ("EITF" or "Task Force") under ASU 2014-01 in January 2014.

ALLOWING PROPORTIONAL AMORTIZATION FOR NMTCs

ASC 323-740 allows reporting entities that invest in low income qualified affordable housing ("LIHTC") projects to elect the proportional amortization method if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit).

When issuing this guidance, the Task Force stated that, in reaching its consensus, the intent of the guidance was to identify those investments that are made for the primary purpose of receiving tax credits and other tax benefits[4]. However, in order to "more quickly address the concerns in practice" regarding LIHTC investments, the Task Force chose to limit the scope of the amendments in ASC 323-740 *to only LIHTC investments*[5].

Similar to LIHTC investments, NMTC investments are made by tax credit investors *for the primary purpose of receiving tax credits and other tax benefits*. Hence, we believe that the application of the proportional amortization method for NTMC investments is equally appropriate under US GAAP *provided* the same conditions are satisfied under ASC 323-740.

ASC 323-740-25-1 allows a reporting entity that invests in LIHTC projects to elect to apply the proportional amortization method provided the following conditions are met:

a. It is probable that the tax credits allocable to the investor will be available.
b. The investor does not have the ability to exercise significant influence over the operating and financial policies of the limited liability entity.
c. 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).
d. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.
e. The investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the investor's liability is limited to its capital investment.

The following supports our rationale that reporting entities which invest in NMTC investments satisfy the same criteria. However, in order to better understand our rationale, we first must present a brief description of a NMTC structure.

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[4] ASU No. 2014-01 *Investments – Equity Method and Joint Ventures (Topic 323*) - *Accounting for Investments in Qualified Affordable Housing Projects* – see Basis of Conclusions, paragraph BC12 which states that the intent of the ASU is "to identify those investments that are made for the primary purpose of receiving tax credits and other tax benefits."

[5] ASU No. 2014-01 *Investments – Equity Method and Joint Ventures (Topic 323*) - *Accounting for Investments in Qualified Affordable Housing Projects* – see Basis of Conclusions, paragraph BC10 which states "Some Task Force members stated that the proportional amortization method should be applied to all tax credit investments that meet the conditions in this Update because that method would be suitable for all tax credit investments that are made for the primary purpose of receiving tax credits and other tax benefits regardless of the type of investment. Other Task Force members expressed concern that there may be unintended consequences if the guidance in the Update was applied to other types of tax credit investments. The Task Force reached a consensus to limit the scope of the amendments in this Update to only investments in qualified affordable housing projects because it will more quickly address the concerns in practice about the income statement presentation of those investments."

THE NMTC STRUCTURE

(Note: Please see the Appendix for a view of a typical NMTC structure diagram as you read this section.)

PNC invests in NMTC structures in order to obtain federal tax credits that can be used to offset federal income taxes and provide funds for community development in low and moderate-income areas. NMTC investments are typically made through a “leveraged model” that consists of an upper tier NMTC fund and a subsidiary community development entity (“sub-CDE”) that is considered the lower tier.

The NMTC fund uses proceeds from the NMTC equity investment and a leveraged loan to make a qualified equity investment (“QEI”) into the sub-CDE that in turn provides Qualified Low-Income Community Investment (“QLICI”) loans to a Qualified Active Low Income Community Business (“QALICB”). The QLICI loans are typically in the form of an A loan and a subordinated B loan. The tax credits allocated by the IRS are equal to 39% of the QEI and are received over a period of 7 years (5% annually for years 1-3, 6% annually for years 4-7).

The upper tier NMTC fund is formed as a limited liability company (“LLC”). There is generally one investment member (“NMTC fund equity investor”) and one manager who is either a member or non-member manager. If the manager is a member, the party is typically the same as the NMTC fund equity investor. This is the case for nearly all of PNC’s NMTC investments. However, if there is a non-member manager, the entity is typically a third party.

It is the NMTC fund equity investor who receives the tax credits through its investment in the NMTC fund. The NMTC fund equity investor will enter into a put and call agreement at the time of the transaction closing. The put option allows the NMTC fund equity investor to put its investment to an affiliate of the transaction’s QALICB after the 7-year tax credit period for a fraction of its original equity investment, while the call option enables the affiliate of the QALICB to purchase the fund equity investment at fair value.

The investments are modeled assuming no residual gain given the community development nature of the transactions. Thus, the NMTC fund equity investment realizes all of its value through the tax credits. The put option allows for PNC to unwind its investment in the fund after the realization of the tax credits and allows for the QALICB related party to further its involvement with the QALICB.

The fund also obtains a leveraged loan as part of the transaction which subsidizes the investment in the qualified project or business. The leverage lender, typically, is an affiliate of the lower tier project sponsor/QALICB which aggregates non-tax equity sources to provide additional financing that ultimately benefits the QALICB.

The NMTC fund uses the proceeds from both the equity investment and the leveraged loan to invest in a subsidiary-CDE (“sub-CDE”), which is the lower tier of the structure. Typically, the fund makes a 99.99% equity investment in the sub-CDE (“QEI”) while a managing member contributes .01%.

The tax credits which are passed through to the NMTC fund equity investor, are based on the total QEI. The managing member, the CDE and also the NMTC allocatee, provides an allocation of tax credits in an amount equal to 39% of the QEI. Technically, the allocation of tax credits to the tax investor begins when the initial QEI is made to the sub-CDE. However, if those funds are not used to finance a QALICB, the tax credits will be recaptured[6].

The managing member is typically a third party to the NMTC fund equity investor. Once the sub-CDE receives the equity investment from the NMTC fund, the proceeds are used first to pay the managing member fees and transaction costs, with the remainder used to provide financing to a QALICB. Typically, the financing to the QALICB consists of a senior ("A") loan and a subordinated ("B") loan with the A loan mirroring the terms of the leveraged loan made to the NMTC fund and the B loan mirroring the NMTC fund equity investment less CDE manager fees.

Consolidation of the Fund and the Sub-CDE Entity under the NMTC structure

In most cases, PNC consolidates ***both*** the Fund and the sub-CDE pursuant to ASC 810 – *Consolidation* ("ASC 810").

ACCOUNTING ANALYSIS UNDER ASC 323-740

With this basic understanding of a NMTC structure, the following analysis walks through each of the five criteria (or conditions) for proportional amortization pursuant to ASC 323-740-25-1 and explains how a NMTC investor satisfies all five conditions separately.

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

An NMTC investment in a sub-CDE (i.e., the QEI) is governed by an Operating or Partnership Agreement ("OPA"). Within the OPA, (i) the Managing Member, the NMTC Allocatee, sub-allocates NMTC Allocation from its NMTC Allocation Authority to the sub-CDE in an amount equal to the QEI; and (ii) the investor, in exchange for its QEI, is allocated 100% of the NMTCs.

As mentioned above, technically, NMTCs are earned by the investor at the time the QEI is executed. Once the QEI investment is made, the primary economic objective of the sub-CDE is to ensure ongoing compliance with the NMTC program to prevent recapture of the tax credits. The three events that could cause recapture are as follows:

1) Redemption of the QEI
2) Loss of CDE status, or
3) Failure of the 'Substantially All' requirement[7]

Historically, PNC has never had a recapture event.

Although the investor realizes the NMTCs over the 7-year compliance period, 100% of the credits are directly awarded to the allocatee by the Community Development Financial Institution Fund. As a result, there is no risk of losing these credits during the compliance period unless a recapture event occurs.

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[6] IRC section 45D(b)(1) states that a QEI is any equity investment in a CDE if "substantially all of such cash is used by the CDE to make QLICIs".
[7] Per NMTC tax code requirements, the CDE must have at least 85% of its QEI proceeds deployed in financing to the QALICB.

Condition #2 - The investor does NOT have the ability to exercise significant influence over the operating and financial policies of the limited liability entity.

First, a review of how this condition applies to a LIHTC investor is advisable in determining the Task Force's original intent in requiring this condition in its guidance. We will then apply the same analysis to a NMTC investor.

(Note: Please see the Appendix for a view of a typical LIHTC structure diagram as you read this section.)

As it pertains to LIHTC structures, the operating and financial policies of the limited liability entity can be divided into two principal segments of decision-making:

- Operating and financial policies that pertain *solely* to the operation of the low-income housing project held within the limited liability entity AND
- Operating and financial policies that pertain *solely* to the potential risk of noncompliance with the tax code requirements of the limited liability entity.

Based on our review of ASC 323-740 (initially issued as ASU 2014-01), we believe that the Task Force's intent was to evaluate the tax credit investor's influence over *the operating and financial policies of the underlying project that benefits from the investment* based on the following.

As a limited partner/member in a LIHTC entity, a tax credit investor typically only holds veto rights with respect to decisions that potentially risk noncompliance with the tax code for LIHTC investments. The tax credit investor has no other rights over the decisions of the limited liability entity *including* decision-making rights over the operating and financial policies of the underlying housing project.

If the intent of the Task Force was to evaluate only these veto rights in determining significant influence over the limited liability entity, such an evaluation would satisfy this condition and only *further support* the fact that the primary purpose of the tax credit investor's investment is to receive tax credits and other tax benefits, which is the intent of the ASU.[8] This fact would support a decision in favor of proportional amortization.

Furthermore, if one considers the language used by the FASB in their summary of the ASU, the intent becomes clearer. The FASB states that the Revenue Reconciliaton Act of 1993 "retroactively extended the low-income housing tax credit…" allowing "[i]nvestors in *entities operating qualified affordable housing projects* [*emphasis added*] [to] receive tax benefits in the form of tax credits and tax deductions from operating losses."[9]

We believe that the italicized phrase in the summary implies that the Task Force's intent of the criteria is to evaluate significant influence over the entity's operating and financial policies of *the housing project itself*—i.e., the day-to-day decision-making related to the low income housing property including, maintenance and improvements to real estate property, adherence to zoning and commercial real estate laws, administration and execution of lease contracts with lessees, and so forth. Such decisions are held exclusively by the general partner or managing member of the limited liability entity, not the tax credit investor.

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[8] See footnote 3.
[9] ASU No. 2014-01 *Investments – Equity Method and Joint Ventures (Topic 323)* – Summary, par. 2, pg. 1

If such influence over the housing project were held by the tax credit investor, it would suggest that the investor is exposed to more risk than just the risk of losing tax credit benefits in the investment and, therefore, disqualify the investor from the proportional amortization method.

Application to the NMTC Structure

It follows then that when evaluating the NMTC structure, the appropriate application of the 'significant influence' criteria *based on the original intent of the Task Force* would be to determine whether the tax credit investor (i.e., the Fund) has significant influence over the day-to-day operations and financial policies of the QALICB. Similar to the underlying LIHTC housing project, the QALICB is the *qualified business* which both (a) benefits from the investment made by the tax credit investor and (b) ultimately yields the tax credit benefit to the investor.

An evaluation of all other rights of the tax credit investor in a typical NMTC structure would show that they exist only to protect the investor from the risk of a tax credit recapture event[10].

Instead, the more appropriate evaluation is an evaluation of the tax credit investor's influence over the day-to-day decisions of the QALICB. Since a NMTC investor has no decision-making rights with respect to the day-to-day financial and operating policies of the underlying QALICB, we believe the investor satisfies this condition.

Condition #3 - 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).

As mentioned in 'THE NMTC STRUCTURE' section of this memo, over the course of 7 years, the Fund, as the tax credit investor in the sub-CDE, expects to capture 39 percent of its QEI in tax credits. These tax credits cannot be credited against the investor's taxes due entirely in one year, but are useable over the course of the 7 years. However, the underlying economic presumption is that the investment will yield *all* available tax credits to the investor over 7 years.

As these credits are used to reduce income taxes due over time, the carrying value of the Fund's investment in the sub-CDE is amortized as an expense of the Fund pursuant to the annual tax benefits received. Today, PNC does this by using a discounted cash flow model which incorporates cash flow projections including the tax credit benefit, passive losses, a nominal amount from exercising the put option after the compliance period and capital gains taxes paid. A below market rate of interest is earned from the B-loan portion of the investment in the sub-CDE which offsets a small portion of amortization expense.

[10] If the evaluation of 'significant influence' were to be applied at the sub-CDE entity level only rather than at the QALICB level, it would be determined that the tax credit investor's influence over the sub-CDE entity pertains only to those rights which protect it from non-compliance with the tax code requirements for NMTCs. The sub-CDE's primary role is that of a lender to the QALICB and ensuring compliance with the tax code over the 7-year period. Therefore, an evaluation of significant influence at the sub-CDE level would be akin to evaluating *only* those decisions that impact the potential risk of noncompliance with the tax code requirements in a LIHTC structure. Similar to the LIHTC structure, this evaluation would only further support the fact that the primary purpose of the NMTC tax credit investor's investment in the sub-CDE is to receive tax credits and other tax benefits, which is precisely what the ASU is attempting to identify through its guidance. Hence, we believe the intent of the Task Force was to evaluate significant influence over the operating policies of the QALICB.

Interest income from the A-loan is passed through the Fund to the leverage lender dollar-for-dollar in the form of interest expense. The Fund gains no economic benefit from interest income on the A-loan.

Under these expectations, if the economic benefit of tax credits were removed from projected benefits in the investment, the investment would yield a negative return in every case. With the tax credit benefit, on average, the Fund earns an after-tax yield of 7 percent. As such, we believe a NMTC investor satisfies this condition.

Condition #4 - The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

As was mentioned in the section above, with the tax credit benefit included in the projected yield calculation, on average, the Fund earns an after-tax rate of 7 percent on its investment in the sub-CDE and this positive return is entirely dependent upon after-tax benefits yielded from the tax credits. As such, we believe a NMTC investor satisfies this condition.

Condition #5 - The investor is a limited liability investor in the limited liability entity for both legal and tax purposes and investor's liability is limited to its capital investment.

We believe that the appropriate level to evaluate this condition is at the sub-CDE level since the tax credits themselves are allocated to the Fund (as investor member in the sub-CDE) via this limited liability entity. The Fund is the investor member in the sub-CDE for both legal and tax purposes and its investment is limited to its QEI. Accordingly, we believe a NMTC investor satisfies this condition.

CONCLUSION

We believe there is a simpler and more understandable income statement presentation for NMTC investments which the FASB has already adopted for LIHTC investments under the proportional amortization method. Pursuant to the underlying intent of ASC 323-740, we believe that NMTC investments, *which satisfy this intent and the prescribed conditions*, should be afforded the same accounting treatment.

We further believe that the effort to expand the scope of ASC 323-740 to include NMTC investments should not require an extensive "re-write" of the current guidance. We also believe this request aligns well with the Board's Simplification Initiative.

We appreciate the opportunity to share our views with the Board. We welcome any questions or comments you may have on this letter. Please contact me (412-762-6543) with any questions.

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Sincerely,

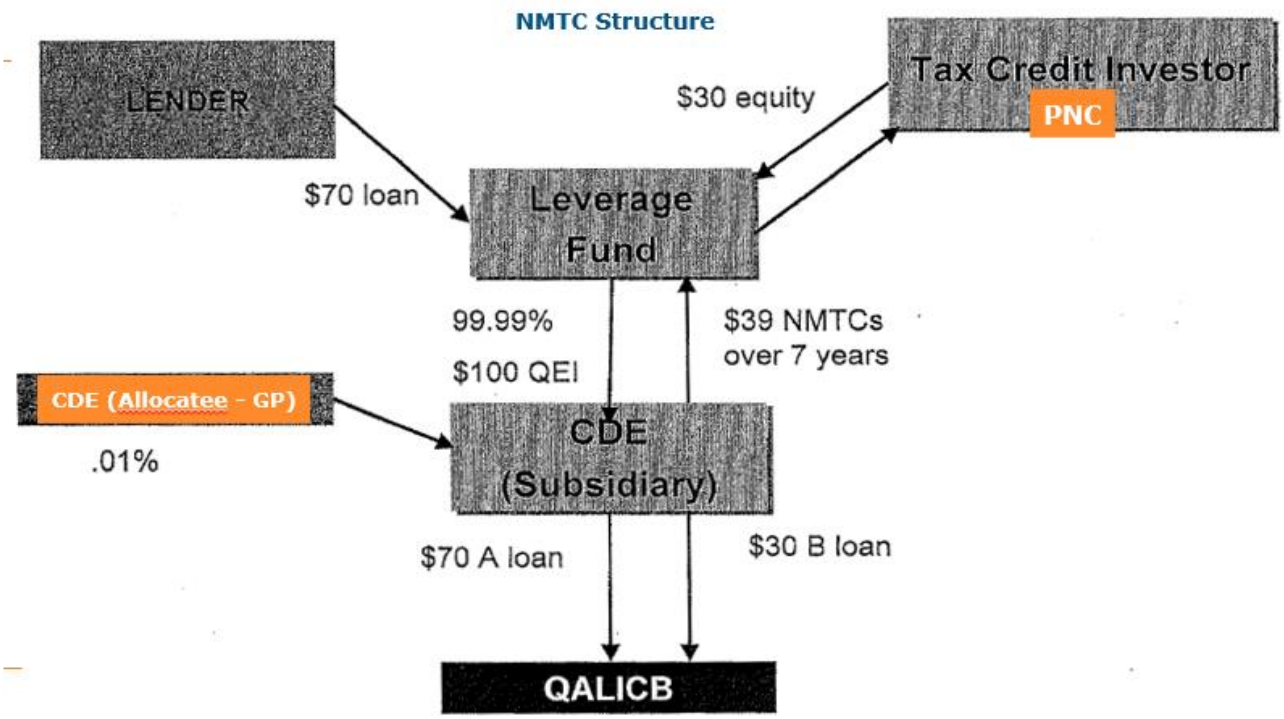
Michael Yenchek

Mr. Michael Yenchek
Director of Accounting Policy
The PNC Financial Services Group, Inc.

cc: Mr. John (JJ) Matthews
Director of Finance Governance & Corporate Accounting
The PNC Financial Services Group, Inc.

Mr. Gregory H. Kozich
Senior Vice President and Corporate Controller
The PNC Financial Services Group, Inc.

Appendix – NMTC and LIHTC Structures



Direct LIHTC Holdings