**Equity Investments for Tax Credits**

**Discussion Document / Questions for Exposure**

**2022 Fall National Meeting**

**Purpose:** This document has been drafted to provide general concepts to consider in developing a revised or new SSAP to address equity investments that provide general business federal tax credits and state tax credits. It is anticipated that the proposed guidance will supersede *SSAP No. 93—Low Income Housing Tax Credits Property Investments*. Subsequent consideration will also occur to review and revise *SSAP No. 94—Transferable and Non-Transferable State Tax Credits*.

This document is in the form of potential guidance, with NAIC staff questions. Responses to the questions as well as other information that would be beneficial for such structures would be beneficial during the exposure period. As the guidance would reflect new SAP Concepts, an issue paper will also be developed. As an additional note, concepts from the U.S. GAAP exposure for expanding use for the Proportional Amortization Method have been considered. Final guidance is expected in the fourth quarter 2022 and will be assessed prior to finalizing the statutory accounting guidance.

**Proposed Statutory Accounting Guidance and NAIC staff Accounting Questions:**

1. This statement establishes statutory accounting principles for qualifying tax equity investments in programs made primarily for the purpose of receiving allowable general business federal tax credits and state tax credits, including state premium tax credit programs.
2. The programs in scope of this statement are not limited to named programs as new tax credit programs may be introduced. Examples[[1]](#footnote-1) of programs for general business federal tax credits include:
3. Investment tax credits (ITCs)
4. Historical rehabilitation tax credit (HTC)
5. Low-income housing tax credit (LIHTC)
6. New market tax credits (NMTC)
7. Programs that generate general business federal tax credits, corresponding state tax credits or state premium tax credits that meet the following conditions at the time of initial investment are required to be captured in scope of this statement:
8. Reporting entity is an equity investor in a project that generates tax credits and other tax benefits through limited liability entities that are flow-through entities for tax purposes.
9. It is probable that the tax credits allocable to the investor will be available.
10. Reporting entity investor does not have the ability to exercise significant influence over the operating and financial policies of the underlying project.
11. Substantially all of the projected benefits are from tax credits and other tax benefits, determined on a discounted basis using a discount rate that is consistent with the cash flow assumptions utilized by the reporting entity for the purpose of making a decision to invest in the project.
12. The reporting entity’s projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.
13. The reporting entity 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.
14. Equity investments that do not meet the conditions in paragraph 3 shall be captured within the statutory accounting statement that addresses the underlying investment structure. This would generally be *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies.*

*Staff Question / Items for Discussion:*

1. Paragraph 1 – The scope intends to include programs that provide general business federal tax credits, which are income tax credits, and programs that meet the criteria that provide for state premium tax credits. This would be an extension from the FASB exposure that only permits income tax credits but is in line with comments received by the FASB that insurers receive credits for state premium tax. Comments are requested on the proposed inclusion for programs that meet the criteria in paragraph 3 that generate state premium tax credits.
2. Paragraph 3 – The criteria mirror the concepts included in the proposed FASB guidance. Under U.S. GAAP, the use of the portfolio allocation method is an election, but under SAP, the guidance would be required if the criteria are met. (This would be consistent with the existing guidance in SSAP No. 93 for LIHTC.) Based on the FASB comment letters reviewed, the criteria are expected to be met for most state premium-based tax equity investments. Should other criteria be considered or are there concerns with requiring application if the criteria are met?

## SUMMARY CONCLUSION

1. The general structure of investments to qualify for federal tax credits is consistent regardless of the type of tax credit. The reporting entity is required to hold an equity investment, in which they represent a true partner at risk for which equity returns or losses can be generated other than through the tax credits. With the requirement for a ‘true partner’ design, a guarantee of return disqualifies the investor as obtaining a tax credit for federal income tax purposes. A limited exception to this structure can exist for NMTC using a financial institution syndicating a NMTC in which the financial institution guarantees the credits or returns. Although the syndication structure may result with a security structure that resembles a debt instrument, such structures are in substance tax credit investments and shall be captured in scope of this statement regardless of this legal investment structure. Note – Include exclusion in SSAP No. 26R.)
2. The structure for state premium tax credits is similar to federal tax credit programs in which the reporting entity invests in a limited partnership or limited liability company and receives allocated premium tax credits and other tax related benefits. Premium tax credits are non-refundable and may only be utilized up to the amount of premium tax liability each year for the particular state from which the credit was issued.
3. The overall intent with investments in scope of this statement is to obtain a positive rate of return, through tax credits and other tax benefits, prior to disposing the reporting entity’s interest in the project. The liquidation of the investment commonly occurs at the end of the tax credit timeframe through a put agreement, often reflecting a nominal amount, that was established at the time of acquisition. Investors in these tax credit programs recognize that the original investment amount will not be returned.
4. Investments in programs for the primary purpose to generate tax credits benefit reporting entities through a reduction in tax liability. Restrictions in federal tax credit programs may prohibit principal repayment to the reporting entity prior to the conclusion of the stipulated timeframe for the tax credit investment. Further, tax credits are most often not transferable. If the tax credits cannot be used to reduce tax liability, then the investments generally do not provide financial benefits to the reporting entity and likely do not reflect investments that can be liquidated to directly pay policyholder claims.
5. Equity investments in tax credit programs that qualify in scope of this statement meet the definition of an asset as specified in *SSAP No. 4—Assets and Nonadmitted Assets* and are admissible assets to the extent that they comply with the requirements of this statement.

*Staff Question / Items for Discussion:*

1. Paragraphs 5-8 – The information details IRS provisions to qualify for the tax credit and overall information on the use of tax credits investments. Under the IRS rules, the federal business tax credits are not transferable, as only the entity that has a true equity interest can take the tax credit. Furthermore, the designs are most often established to have provisions to liquidate the equity investment (through a put/call) at the end of the timeframe. Comments are requested on whether other designs are prevalent as well as inclusion of this guidance in the SSAP and/or the Issue Paper.

### Accounting

1. At initial recognition, investments in scope of this statement shall be recorded at cost. A liability shall also be recognized for delayed equity contributions that are unconditional and legally binding. (ASU 323-740-25-3)
2. Reporting entities shall recognize income tax credits in the period they are allocated to the investor for tax purposes. Unless all tax credits are allocated to the reporting entity at the date of initial investment, immediate recognition of the entire benefit of the tax credits to be received during the term of the investment project that generates tax credits and other tax benefits is not permitted. Tax credits shall not be recognized in the financial statements before the year in which the credit arises. (ASU 323-740-25-5)
3. Subsequent to initial recognition, the investment shall be carried at proportional amortized cost. Under the proportional amortization method, the reporting entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits allocated to the investor. The amortization amount shall be calculated as follows:
   1. The initial investment balance less any expected residual value of the investment, multiplied by,
   2. The percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the life of the investment.

Exhibit A illustrates the application of accounting guidance in two examples that generate tax credit and tax benefits using the proportional amortization method. The first example illustrates the application of a standard project. The second example illustrates the application of the accounting guidance in a project that generates non-tax related benefits in addition to tax credits and other tax benefits using the proportional amortization method. (ASU 323-740-35-2 & 3)

1. The expected residual value of the investment shall be excluded from the proportional amortization calculation. Non-income-tax related benefits received from operations of the limited liability entity shall be included in earnings when realized or realizable. Gains or losses on the sale of the investment, if any, shall be included as a capital gain or loss at the time of the sale. ASU 3623-740-35-5) Determination of gain or loss will depend on the current reported value (e.g., residual value at the end of the amortization timeframe) to the amount received in exchange for the equity interest.
2. At the end of the amortization timeframe (life of the investment), if the reporting entity retains the equity interest, the investment shall be subsequently captured in scope of *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*.

### Application of Proportional Amortization Method

1. Under the proportional amortized cost method, the amortization of the investment is recognized in the income statement as an expense component of the net investment income calculation. Tax credits or other tax benefits from the investment shall not be reported as a component of net investment income.
2. Tax credits and other tax benefits shall be reflected as follows:
   1. Federal tax credits shall be recognized in the period that they are allocated to the reporting entity for tax purposes. Federal tax credits that can be utilized in the year allocated shall be reported in the income statement as an offset to federal taxes in accordance with *SSAP No. 101—Income Taxes*. Federal tax credits that cannot be utilized in the year allocated and are carried forward to a future tax year shall be recognized as a deferred tax asset (DTA), subject to applicable admittance provisions, in accordance with SSAP No. 101. Use of the tax credit in a future period shall be reflected as an offset to federal tax in the tax reporting year in which the tax credit is utilized.
   2. State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax-reporting year in which the credit is utilized.
   3. Federal or state tax benefits other than tax credits (e.g., tax benefits from investment depreciation) shall be recognized in the year earned as a component of income tax expense pursuant to SSAP No. 101.

*Staff Question / Items for Discussion:*

1. Paragraphs 10-14 – This information mirrors guidance from the proposed ASU with SAP clarifications. Comments are requested on whether SAP modifications should be considered.
2. Paragraphs 15-16 - This guidance details the application of the proportional amortization method for statutory accounting. It is more detailed, but generally consistent with SSAP No. 93. The existing SAP guidance was driven from EITF 94-1 and refers to recognition at the time a tax credit can be included in a tax return. However, that guidance is contradictory with the recognition of tax credit carryforwards under both current SAP and U.S. GAAP. The proposed guidance in paragraph 11 reflects the new GAAP guidance for recognition in the year in which the credit arises, and the guidance in paragraph 16 identifies how carryforwards would be considered a DTA.

### Admittance Requirements

1. Investments in tax credit programs provide benefit to reporting entities through a reduction in tax liability. Investors in these tax credit program recognize that the original investment amount will not likely be returned, but they will obtain a positive rate of return through tax credits and other tax benefits.
2. Although investments in tax credit programs do not represent investments that can be directly liquidated for policyholder claims, the reduction of tax liability represents a benefit that supports admittance of these investments, but only if the tax credit will be received and can be utilized by the reporting entity. Investments in tax credit programs that will not result with tax credits or that will result with tax credits that cannot be utilized by the reporting entity shall be nonadmitted.
3. To support admittance, a reporting entity shall monitor the tax credit eligibility of a program and obtain a tax opinion on the validity of the credits and the structure of the program. Investments in tax credit programs that are not supported by a tax opinion shall be nonadmitted. If the program is a permitted syndicated program with a guarantee[[2]](#footnote-2), the opinion must verify that the investment and guarantee has been properly structured under IRS rules and the guarantee does not disqualify the reporting entity from obtaining federal general business tax credits.
4. Once supported by a tax opinion, a reporting entity is required to assess the realization of tax credits against tax liability for both the tax year in which the credit can be initially utilized as well as in accordance with carry-forward periods to determine the extent the investments can be admitted:
   1. If a reporting entity does not expect tax liability in the upcoming tax year, investments in tax credit programs intended to reduce the tax liability shall be nonadmitted. In subsequent years, and only after verification of tax liability for which tax credits can be applied, a reporting entity can assess utilization of tax credits to determine admittance under paragraph 20.b.
   2. A reporting entity that expects tax liability in the upcoming tax year is permitted to admit investments in tax credit programs to the extent that a reporting entity expects to ultimately utilize the tax credits under permitted IRS or state tax provisions. If projections identify that the tax credits from investments in tax credit programs will exceed what can be utilized under IRS tax provisions (current and other applicable tax periods), the reporting entity shall nonadmit investments as necessary so that investments in scope of this statement (in aggregate) are only admitted to the extent tax credits are expected to be utilized. In making this assessment, the reporting entity is not permitted to assume increased operations (e.g., expanded product sales) beyond actual experience to conclude that additional federal or state tax liability will exist that would allow additional utilization of tax credits.

*Staff Question / Items for Discussion:*

1. Paragraphs 17-20 – These paragraphs provide explicit SAP provisions for admittance. If the program does not generate tax credits or if the reporting entity cannot use the tax credits, the guidance requires nonadmittance. Consideration was given as to whether admittance should be permitted based on the ability to liquidate the investment, but that is not proposed. As detailed in the scope criteria, substantially all of the projected benefits from the investment should be from tax credits or other tax benefits. From information gathered for the federal tax credit programs, liquidation may be restricted for set periods of time or be contingent on finding a buyer for the equity interest. Although a put/call provision may be in place to revert the equity interest at the end of the life for the investment, such amounts are nominal to the original investment amount. With the guidance, if the tax credits will not be received or cannot be utilized, then the investment shall be nonadmitted. If an entity cannot obtain or utilize tax credits from the investment, and can liquidate the investment, then a reporting entity should consider liquidating the investment to have cash for reinvestment / admittance purposes. Until then, the investment is proposed to be nonadmitted.

### Future Contributions and Additional Tax Credits

1. Many tax credit investments require future equity contributions by the investor, that may be contingent on a variety of conditions, such as receiving representations, contract performance, meeting occupancy requirements, etc. A liability shall be recognized for delayed equity contributions that are unconditional and legally binding and a liability shall also be recognized for equity contributions that are contingent upon a future event when that contingent event becomes probable pursuant to the loss contingency guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets*. (ASU 323-740-25-3)
2. If the commitment to provide equity contributions does not meet the definition of a loss contingency, the contingent commitment shall be disclosed in the notes to the financial statements with other contingent commitments.
3. Additional contributions made that do not result in additional tax credits for the reporting entity investor shall be immediately expensed as a component of net investment income.
4. In the event a reporting entity obtains additional tax credits after making an additional contribution, the following shall be applied:
   1. If additional tax credits are allocated without the reporting entity making additional contributions, the additional tax credits shall not be afforded any value in the financial statements. (The reported value of the investment generating tax credits and amortization does not change.) Rather, the tax credit shall be recognized in the period allocated pursuant to paragraph 14.
   2. If additional funding is directly related to acquisition of additional tax credits, the provisions of this statement shall be followed as if the additional funding were a new tax credit investment.

*Staff Question / Items for Discussion:*

1. Paragraphs 21-24 – This guidance is generally consistent with SSAP No. 93, except the recognition of a liability for a future contribution follows the loss contingency guidance in SSAP No. 5R. This is consistent with the ‘probable’ threshold reflected under U.S. GAAP.

### Impairment

1. Reporting entities with investments in tax credit programs shall complete and document an impairment analysis at each reporting period. For this analysis, the reporting entity shall compare the current book value to the fair value of the investment. (In lieu of fair value, an entity can compare book value to the present value of future tax credits and other tax benefits discounted at a risk-free rate of return.) The investment shall be written-down as an other-than-temporary impairment(INT 06-07) if the book value is higher. This will result in a new cost basis and the amount of the write-down shall be accounted for as a realized loss. The new cost basis shall not be changed for subsequent recoveries in the discounted value.
2. An other-than-temporary impairment shall also be considered to have occurred if a previously received tax credit has been recaptured or if it is probable that future tax credits will not be received as expected. This could occur due to changes in ownership of a project or if the project ceases to operate. If a project no longer qualifies for tax credits, the entire investment, less any residual established at initial recognition, shall be written off as other-than-temporarily impaired. If the reporting entity has a tax credit recapture, the reporting entity shall assess whether future tax credits will qualify for use by the reporting entity. If future credits will not be generated or will be subject to future recapture, then the reporting entity shall write-off the investment as other-than-temporarily impaired so that the resulting investment value only reflects expected qualifying tax credits and other benefits expected to be received.

*Staff Question / Items for Discussion:*

1. Paragraphs 25- Paragraph 25 is consistent with SSAP No. 93, except it incorporates fair value as the compared value. Current SSAP No. 93 uses the present value calculation, so it is retained as a proxy of fair value. U.S. GAAP uses fair value, and the existing disclosure in SSAP No. 93 also references fair value.
2. Paragraph 26 - This guidance incorporates concepts on whether the structure will continue to produce qualifying tax credits. The guidance specific to LIHTC from SSAP No. 93 is not retained. The guidance has divided the guidance for nonadmittance to reflect situations that impact a reporting entity’s use of tax credits and OTTI to reflect issues with the actual investment in generating qualified tax credits. Comments are requested on this approach and the principle concepts for OTTI.

### Disclosures

1. A reporting entity shall disclose information that enables users of its financial statements to understand the following information about its tax equity investments in projects that generate tax credits and other tax benefits from tax programs captured in scope of this statement: (ASU 323-740-50-1)
   1. The nature of its investments in projects that generate tax credits and other tax benefits.
   2. The effect of the measurement and recognition of its investments in projects that generate tax credits and other tax benefits and the related tax credits on its financial position and results of operations.
2. A reporting entity shall disclose the following information about its tax equity investments in projects that generate tax credits and other tax benefits from a tax credit program in scope of this statement:
   1. The amount of tax credits and other tax benefits recognized during the period.
   2. Disclose the balance of the investments recognized in the statement of financial position for the reporting period(s) presented.
   3. Significant modifications or events that resulted in a change in the nature of the investment or a change in the relationship with the underlying project for investments in scope. (ASU 323-740-50-1A)
   4. An aggregate schedule of tax credits expected to be generated each year for the subsequent 15 years.
   5. Disclose if the underlying property is currently subject to any regulatory reviews and the status of such review. (Example investigations by the housing authority.)
3. Any commitment or contingent commitment (e.g., guarantees or commitments to provide additional capital contributions) including the amount of equity contributions that are contingent commitments related to tax credit investments and the year(s) that contingent commitments are expected to be paid shall be disclosed.
4. The significance of an investment to the reporting entity's financial position and results of operations shall be considered in evaluating the extent of disclosures of the financial position and results of operations of tax credit investments. If in the aggregate tax credit investments exceed 10% of the total admitted assets of the reporting entity the following disclosures shall be made:
5. (i) The name of each partnership or limited liability entity and percentage of ownership, (ii) the accounting policies of the reporting entity with respect to investments in partnerships and limited liability entities (iii) the difference, if any, between the amount at which the investment is carried and the amount of underlying equity in net assets (i.e., nonadmitted goodwill or other nonadmitted assets) and (iv) the accounting treatment of the difference;
6. For partnerships, and limited liability entities for which a quoted fair value is available, the aggregate value of each partnership, or limited liability entity investment based on the quoted fair value; and
7. Summarized information as to assets, liabilities and results of operations for partnerships, and limited liability entities, either individually or in groups.
8. A reporting entity that recognizes an impairment loss shall disclose the following in the financial statements that include the period of the impairment write-down:
9. A description of the impaired assets and the facts and circumstances leading to the impairment; and
10. The amount of the impairment and how fair value was determined.
11. Disclose the amount and nature of the write-downs or reclassifications made during the year resulting from the forfeiture or ineligibility of tax credits, etc.
12. Refer to the Preamble for further discussion regarding disclosure requirements.

*Staff Question / Items for Discussion:*

1. Paragraph 27 – Disclosures in 27a-b are from U.S. GAAP.
2. Paragraph 28 - Disclosures in paragraph 28 a-c come from U.S. GAAP. The disclosures in paragraphs 28d-e are based on concepts previously included SSAP No. 93. Comments are requested on whether those disclosures (or other disclosures from SSAP No. 93) should be included. (For 28d, the prior SSAP No. 93 disclosure was for a number of remaining years of unexpired tax credits and the required holding period, but since that is an individual investment disclosure, it has been modified to reflect an aggregate investment disclosure.)
3. Paragraph 30 – This disclosure is in SSAP No. 93 and comments are requested on whether it should be retained.

### Relevant Literature

1. This statement adopts with modification \_\_\_\_\_\_\_\_. The ASU is modified for the following statutory concepts:
2. This statement is applicable to all federal and state tax credit programs that meet the requirements in paragraph \_\_\_. Under the ASU, use of the proportional amortization method is an election and only pertains to income tax. With this statement, the election is rejected and the guidance is expanded for state premium tax credits.
3. Investments that meet the criteria of this statement are required to use a proportional amortization method as prescribed in this statement. This method requires the tax credits and benefits to be recognized in proportion to the percentage of actual tax credits and other tax benefits allocated to the reporting entity in the current period divided by the total estimated tax credits and other tax benefits expected to be received by the reporting entity over the life of the investment. This statement requires a gross presentation on the financial statements, with amortization in investment income.
4. Federal tax credits shall be recognized in the income statement as an offset to federal income taxes in the tax reporting year in which the tax credit is utilized in accordance with *SSAP No. 101—Income Taxes*.State tax credits shall be recognized in the income statement as an offset to state premium tax or state income tax, whichever is applicable, in the tax reporting year in which the credit is utilized.
5. Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101. Amortization shall be reported as a component of net investment income.
6. Reporting entities shall follow the guidance in paragraphs 11 and 12 regarding the recognition of contingent commitments from *SSAP No. 5R—Liabilities* *Contingencies and Impairments of Assets* to equity contributions.
7. *SSAP No. 97—Investments in Subsidiary, Controlled and Affiliated Entities* shall be utilized to account for investments that qualify as subsidiary, controlled or affiliated entities.
8. This statement has specific impairment and nonadmittance requirements.
9. For statutory accounting purposes, deferred taxes are not reported as a component of income from continuing operations in the income statement; rather deferred taxes are recognized as a separate component of gains and losses in unassigned funds (surplus).
10. Disclosures should be followed as indicated in the disclosures section in this statement.

### Effective Date and Transition

1. This statement is effective for reporting periods beginning on or after January 1, 2006. Early adoption is permitted. A change resulting from the adoption of this statement shall be accounted for as a change in accounting principle in accordance with SSAP No. 3. The guidance previously in paragraph 3 of this statement superseded paragraph 1 of SSAP No. 48. In 2011, this guidance was moved to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies* and deleted from this statement*.* The original guidance included in this standard is retained for historical purposes in Issue Paper No. 125. The guidance from ASU 2014-01 is effective for reporting periods beginning on or after January 1, 2015, with early adoption permitted.

*Staff Question / Items for Discussion:*

1. Paragraphs 34 & 35 – The relevant literature section and effective date section will be updated once the final ASU has been released to reflect GAAP adoptions / modifications and a revised SSAP is being considered.

## REFERENCES

### Relevant Issue Papers

1. Issue Paper No. 125—Accounting for Low-Income Housing Tax Credit Property Investments

## EXHIBIT A – Application of Proportional Amortization method

***Example 1:*** ***Application of Proportional Amortization Method for Qualifying Investment***

This example is based on paragraph 323-740-55-5 of the Accounting Standards Codification. The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.

Terms:

Date of Investment: January 1, 20X1

Purchase Price of Investment: $100,000

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.
2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).
3. The investor made a $100,000 investment for a 5 percent limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.
4. The partnership finances the project cost of $4,000,000 with 50 percent equity and 50 percent debt.
5. The annual tax credit allocation (equal to 4 percent of the project's original cost) will be received for a period of 10 years.
6. The investor's tax rate is 40 percent.
7. For simplicity, the project will operate with break-even pretax cash flows including debt service during the first 15 years of operations.
8. The project's taxable loss will be equal to depreciation expense. The cumulative book loss (and thus the cumulative depreciation expense) recognized by the investor is limited to the $100,000 investment.
9. It is assumed that all requirements are met to retain allocable tax credits so there will be no recapture of tax credits.
10. The investor expects that the estimated residual value of the investment will be zero.

Proportional Amortization Method with Statutory Modifications

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | Net Investment | Amortization of Investment | Tax Credits | Net Losses/Tax Depreciation | Other Tax Benefits from Tax Depreciation | Tax Credits and Other Tax Benefits |
| Year | (1) | (2) | (3) | (4) | (5) | (6) |
|  | 100,000 |  |  |  |  |  |
| 1 | 90,909 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 2 | 81,818 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 3 | 72,727 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 4 | 63,636 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 5 | 54,545 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 6 | 45,454 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 7 | 36,363 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 8 | 27,272 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 9 | 18,181 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 10 | 9,090 | 9,091 | 8,000 | 7,273 | 2,909 | 10,909 |
| 11 | 6,666 | 2,424 |  | 7,273 | 2,909 | 2,909 |
| 12 | 4,242 | 2,424 |  | 7,273 | 2,909 | 2,909 |
| 13 | 1,818 | 2,424 |  | 7,273 | 2,909 | 2,909 |
| 14 | 0 | 1,818 |  | 5,451 | 2,183 | 2,183 |
| 15 | 0 |  |  |  |  | 0 |
| Total |  | 100,000 | 80,000 | 100,000 | 40,000 | 120,000 |

(1) End-of-year investment for a 5 percent limited liability interest in the project net of amortization in Column (2).

(2) Initial investment of $100,000 x (total tax benefits received during the year in Column (6)/total anticipated tax benefits over the life of the investment of $120,000).

(3) Four percent tax credit on $200,000 tax basis of the underlying assets.

(4) Depreciation (on $200,000 tax basis of the underlying assets) using the straight-line method over 27.5 years up to the amount of the initial investment of $100,000.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

***Example 2:*** ***Tax Equity Investments with Non-Income Tax Related Benefits***

This example is based on paragraphs 323-740-55-11 through 323-740-55-14 of the Accounting Standards Codification and illustrates a tax equity investment that generates non-income-tax-related benefits in addition to tax credits and other income tax benefits.

The amount and timing of amortization in the proportional amortization method is consistent with the statutory modifications; therefore, the table incorporated in this exhibit is based on the proportional amortization table. The statutory income statement requires a gross presentation on the income statement, with proportional amortization of the initial cost of the investment in investment income and the tax credits and benefits included in income tax expense.

Terms:

Date of Investment: January 1, 20X1

Purchase Price of Investment: $100,000

Assumptions:

1. All cash flows (except initial investment) occur at the end of each year.
2. Depreciation expense is computed, for book and tax purposes, using the straight-line method with a 27.5 year life (the same method is used for simplicity).
3. The investor made a $100,000 investment for a 5 percent limited partnership interest in the project at the beginning of the first year of eligibility for the tax credit.
4. The partnership will receive production tax credits based on the energy the project produces. The credits will be received over a four-year period.
5. The tax equity investor will receive cash proceeds based on 2 percent of the project’s cash generated during the life of the project.
6. The investor's tax rate is 40 percent.
7. All requirements are met to retain allocable income tax credits such that there will be no recapture of income tax credits.
8. The investor expects that the estimated residual value of the investment will be zero.
9. All of the condition are met to require use of the proportional amortization method.
10. After 10 years, the tax equity investor has a right to require that the project sponsor purchase the tax equity investor’s equity interest for a nominal amount. It is assumed that the option will be exercised.

Proportional Amortization Method with Statutory Modifications

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | Net Investment | Amortization of Investment | Tax Credits | Net Losses/Tax Depreciation | Other Tax Benefits from Tax Depreciation | Tax Credits and Other Tax Benefits | Non-Tax Related Cash Returns |
| Year | (1) | (2) | (3) | (4) | (5) | (6) |  |
|  | 100,000 |  |  |  |  |  |  |
| 1 | 79,399 | 20,601 | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 2 | 58,799 | 20,601 | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 3 | 38,198 | 20,601 | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 4 | 17,597 | 20,601 | 20,000 | 8,300 | 3,320 | 23,320 | 58 |
| 5 | 14,664 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| 6 | 11,731 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| 7 | 8,799 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| 8 | 5,866 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| 9 | 2,933 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| 10 | 0 | 2,933 |  | 8,300 | 3,320 | 3,320 | 58 |
| Total |  | 100,000 | 80,000 | 83,000 | 33,200 | 113,200 | 580 |

(1) End-of-year investment for a 5 percent limited liability interest in the project net of amortization in Column (2).

(2) Initial investment of $100,000 x (total tax benefits received during the year in Column (6)/total anticipated tax benefits over the life of the investment of $113,200).

(3) These tax credits have been generated through the production of electricity, which generates production tax credits. The tax equity investor is not receiving renewable energy credits or carbon offsets.

(4) Depreciation /other tax losses passed on to the investor.

(5) Column (4) x 40% tax rate.

(6) Column (3) + Column (5).

(7) Non-income-tax-related benefits recognized in current-period pre-tax earnings when received. This represents the cash proceeds received by the tax equity investor based on the cash generated from the project.

1. Permitted tax credit structures are subject to changes under federal and state tax law. [↑](#footnote-ref-1)
2. In 2022, only NMTC programs could be structured as syndicated programs with guarantees. [↑](#footnote-ref-2)