Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: New Market Tax Credits**

**Check (applicable entity):**

P/C Life Health

Modification of Existing SSAP

New Issue or SSAP

Interpretation

Description of Issue: The New Market Tax Credits (NMTC) Program was established by Congress in December 2000 and permits individual and corporate taxpayers to receive a non-refundable tax credit against federal income taxes for making equity investments in financial intermediaries known as Community Development Entities (CDEs). CDEs that receive the tax credit allocation authority under the program are domestic corporations or partnerships that provide loans, investments, or financial counseling in low-income urban and rural communities. The tax credit provided to the investors total 39% of the total cost of the investment and is claimed over a seven-year period. The CDEs in turn use the capital raised to make investments in low-income communities. CDEs must apply annually to the CDFI Fund to compete for NMTC allocation authority. The NMTC program is currently subject to expiration but has been extended to Dec. 31, 2025. The NMTC Extension Act of 2021 (introduced February 2021) would make the NMTC program permanent, modify the credit to provide for an inflation adjustment to the limitation amount for the credit after 2021, and allow an offset against the alternative minimum tax for the credit.

The success of the federal NMTC program has led to states adopting their own NMTC legislation. Per one noted article, majority of state NMTC programs follow the federal rules with some modifications that vary from state to state. State modifications have been noted to specifically target smaller business, simplifying the application process, prohibiting the use of real estate business, and capping the amount of tax credits that can be allocated to one project. The economic impact of the state NMTC programs is typically less than the impact of federal NMTC programs because the economic return to investors for state tax credits is generally lower than what they receive for federal credits. Some states require that state tax credits can only be used in conjunction with federal credits. Pairing federal and state programs is beneficial to the qualifying business as they keep more of the investment without an obligation to return as the investors gets more tax credits.

Overview of Federal Program:

* Federal government authorizes an annual credit authority for NMTCs (amount of tax credits available).
* The Community Development Fund Institutions (CDFI fund) is a division of the U.S. Treasury responsible for implementing the NMTC program. Since there are limited tax credits each year, the CDFI fund has a competitive application process for the right to grant tax credits to investors and to make qualified NMTC investments.
* The right to grant tax credits is referred to as “NMTC Allocation” and is awarded to Community Development Entities (CDEs) that invest in low-income communities. The CDEs offer the tax credits to cash investors, and then use the cash to make investments (typically loans to a qualifying project – a “Qualifying Active Low-Income Community Business” - QALICB) that further the mission and objectives of the NMTC program.
* The program specifies that the investor must provide cash as an equity investment (qualified equity investment – QEI) and it must stay invested in the CDE and the resulting NMTC qualifying project (QALICB) for a period of seven years.
  + The restrictions are specific that the investment is an equity investment as stock (other than nonqualified preferred) in an entity that is a corporation for federal tax purposes or any capital interest in an entity that is a partnership for federal tax purposes. (The investor is generally a 99.99% or 100% equity owner.)

* NMTC investments must remain in a qualified business for a seven-year period. Any principal amount repaid during that period must be reinvested by the CDE until the seven-year period expires. Most CDEs and investors avoid the reinvestment requirement and structure interest-only loans that prohibit principal repayment within the seven-year timeframe.
  + The 39% tax credit is provided as 5% of the investment in the first 3 years and then 6% of the investment for the next 4 years.
  + For tax purposes, the basis adjustment in the qualified equity investment is reduced by the amount of any new market tax credits on each credit allowance date.
  + Programs that cease to qualify are subject to tax credit recapture.
* Investors enter these transactions recognizing that the original investment amount will not be fully returned. Rather, a portion (or perhaps all) of the equity investment will be unpaid without an obligation to return from the borrowing business. NMTC investments with these terms have specific maturing terms / actions. One approach could be that an option (put/call) is held by the investor that gives them the right to sell its equity investment to the borrower for a nominal price.
* The designs are often complex and introduce leverage lenders to maximize tax credits to the equity investor:
  + Equity investor provides $3M to acquire 100% equity interest in an investment fund.
  + Investment fund borrows $7M from a leverage lender.
  + This results with a $10M qualifying NMTC transaction, resulting with the equity investor receiving $3.9M in tax credits over 7 years from an initial $3M investment.
  + The investment fund provides two loans to the qualified low-income business (QALICB). The first loan is for the $7M leverage loan, the second is for the $3M equity investment.
  + Both loans only pay interest for the seven-year period to meet the NMTC terms.
  + At the conclusion of the 7 years, the project sponsor purchases the second loan via a ‘put/call’ agreement, converting the $3M into a permanent subsidiary for the project.
  + The borrower / project sponsor refinances the $7M loan to repay the leverage lender.
  + The ultimate result is that the equity investor received $3.9M over 7 years in tax credits for $3M.
* Example without leverage lender:
  + Investor provides a $10M NMTC Investment
  + Investor receives $3.9M in tax credits over seven years.
  + Investors receives $7.4M of original investment at the end of the seven years.
  + Borrower keeps $2.6M of the original investment to further their low-income qualifying activities.
  + Investor receives a net return of $1.3M. ($10M less $3.9M tax credits less return of 7.4M principal.)

FASB Discussion

The FASB has a current Emerging Issues Task Force project to assess whether the proportional amortization method of accounting, which is used for Low-Income Housing Tax Credits (LIHTC), should be expanded to investments in tax credit structures beyond LIHTC. The proportional amortization method results in the tax credit investment being amortized in proportion to the allocation of tax credits in each period and allows the investment amortization and tax credits to be presented on a net basis within the income tax line item. Currently, investments in other tax credit structures are typically accounted for using the equity method or the cost method. Under the equity and cost methods, investment gains/losses and tax credits are presented on a gross basis on an entity’s income statement. The FASB has received two requests asking that the proportional amortization method be made applicable to New Market Tax Credit Structures as well as other investment structures that are made primarily for the purpose of receiving tax credits and other tax benefits. The FASB added a project to the Emerging Issues Task Force agenda on Sept. 22, 2021. The FASB Task Force reached a consensus-for-exposure on June 16, 2022, that the proportional amortization method can be elected on a tax credit program by tax credit program basis. This proposed ASU was exposed in August 2022, with comments due Oct. 6, 2022. A final ASU is expected later in 2022 or early in 2023.

IRS Provisions – The NMTC is captured as a nonrefundable ‘general business credit’ and is limited to tax liability. If tax liability is not sufficient to take the credit, then the tax credit is subject to carryforward / carryback provisions. Per instructions from the *2021 Instructions for Form 3800 – General Business Credit*, general business credits that cannot be used because of a tax liability limit are first carried-back 1 year through an amended return. If there are unused credits after carrying back 1 year, the tax credit can be carried forward to each of the 20 tax years after the year of the credit.

Inflation Reduction Act Provisions – The Inflation Reduction Act was signed by President Biden on Aug. 16, 2022. Although there are several elements within the Act, it includes a 15% corporate minimum tax rate for corporations with at least $1 billion in income and includes numerous investments in climate protection, clean energy production and tax credits aimed at reducing carbon emissions. Although the Act has been signed, several elements are pending further application guidance. From preliminary information, the act allows for general business credits, such as the low-income housing tax credit (LIHTC), new markets tax credit (NMTC), historic tax credit (HTC) and renewable energy tax credits (RETCs) to be taken against the minimum tax. However, further monitoring of application / interpretation guidance that is still forthcoming is required to assess the actual application and impact of tax credits on companies subject to the minimum tax.

Statutory Accounting Considerations:

* Although the design is an equity investment of stock or interest in a corporation or partnership, which would normally be subject to *SSAP No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, the intent of NMTC investments is for tax credits and not equity returns. As such, this structure is closer to the existing low-income housing tax credits guidance in SSAP No. 93 than the partnership / LLC guidance in SSAP No. 48.
* Although *SSAP No. 93—Low Income Housing Tax Credit Property Investments* provides guidance for an equity investment, that provides tax credits with a limited (or zero) residual investment value, the guidance in SSAP No. 93 is specific to LIHTC programs.
* It has been identified that there are structures that have been designed to resemble fixed-income notes that do not pay regular cash interest, but rather provide NMTC tax credits as interest returns. These structures are in substance that same as other investments in NMTC, with an underlying equity interest in the CDE that generates tax credits. However, they have been structured with a guarantee for compensatory interest in the form of cash for the amount of the tax credit expected to have been received that year. These structures are also being considered within scope of this agenda item. Such structures have to meet specific criteria to qualify for tax credits under the IRS rules.

Existing Authoritative Literature:

*SSAP Authoritative Guidance:*

* SSAP No. 93—Low Income Housing Tax Credit Property Investments

This statement establishes accounting principles for investments in federal certain state sponsored Low Income Housing Tax Credit (LIHTC) properties owned through limited liability entities that are flow-through entities for tax purposes. The guidance requires LIHTC investments to be initially recorded at cost and carried at proportional amortized cost unless the investment is identified as impaired. Under the proportional amortization method, amortization of the LLC investment is recognized in the income statement as a component of net investment income/expense and the current tax credit is accounted for as a component of income tax expense:

* + Federal tax credits are recognized in the income statement as an offset to federal 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.
  + Tax benefits received, other than tax credits, shall be accounted for pursuant to SSAP No. 101.

SSAP No. 93 indicates that immediate recognition of the entire benefit of the tax credit to be received during the term of the investment in a low-income housing project is not appropriate. It also indicates that low-income housing tax credits shall not be recognized in the financial statements before their inclusion in the investor’s tax return.

* SSAP No. 94R—Transferable and Non-Transferable State Tax Credits

This statement establishes accounting principles for investments transferable and non-transferable state tax credits, with an explicit exclusion for LIHTCs (or similar tax credits) captured in scope of SSAP No. 93.

Guidance for admittance of state tax credits under this statement varies based on whether it is transferable or non-transferable:

Transferable – Per the SSAP, all the following criteria must be met for admittance:

1. The holder of the transferable state tax credit may sell or otherwise transfer the transferable state tax credit to another entity, which can likewise sell or transfer the credit;
2. The transferable state tax credit will expire is not used by a predetermined date; and
3. The transferable state tax credit can be applied against either state income tax or state premium tax.

Non-Transferable – Per the SSAP, all the following criteria must be met for admittance:

1. Successive holder of a state tax credit must redeem the credit by April 15 of the subsequent year to the entity’s acquisition of the state tax credit and is not permitted to carry-over, carry-back, obtain a refund, sell or assign the credit;
2. The non-transferable state tax credit will expire if not used by the predetermined date; and
3. The non-transferable state tax credits can be applied against either state income tax or state premium tax.

Review of Existing Statutory Accounting Guidance for NMTC and Overall Application:

* Existing statutory accounting guidance does not encompass federal NMTC (or other federal tax credits), as SSAP No. 93 is limited to LIHTC and SSAP No. 94 is specific to state tax credits.
* Provisions in SSAP No. 93 do not fully address earned (received) tax credits that carryforward for future use.
* The admittance criteria in SSAP No. 94 are applied to characteristics that perhaps may not be factors that would impact admittance:
  + A tax credit that does not expire would be precluded as an admitted asset under the guidance.
  + A non-transferable tax credit that can be carried-forward, carried-back, able to be refunded or that can be sold or assigned is precluded as an admitted asset under the guidance.

*Statutory Accounting Reporting Guidance:*

Guaranteed and non-guaranteed federal low-income housing tax credits have separate reporting lines on Schedule BA along with an “all other” low-income housing tax credit line. The guidance is specific that these lines are only for low-income tax credits (or tax credits for affordable housing) that are in the form of a partnership or limited liability company. Non-qualifying LIHTC are to be reported in the “All Other” category. With this current guidance, there is no explicit reporting provision for tax credits that are not captured in LIHTC.

Reporting Lines and Instructions:

Guaranteed Federal Low Income Housing Tax Credit

Unaffiliated 3599999

Affiliated 3699999

Non-Guaranteed Federal Low Income Housing Tax Credit

Unaffiliated 3799999

Affiliated 3899999

Guaranteed State Low Income Housing Tax Credit

Unaffiliated 3999999

Affiliated 4099999

Non-Guaranteed State Low Income Housing Tax Credit

Unaffiliated 4199999

Affiliated 4299999

All Other Low Income Housing Tax Credit

Unaffiliated 4399999

Affiliated 4499999

Low Income Housing Tax Credit

Include: All Low Income Housing Tax Credit Investments (LIHTC or affordable housing) that are in the form of a Limited Partnership or a Limited Liability Company including those investments that have the following risk mitigation factors:

A. Guaranteed Low Income Housing Tax Credit Investments. There must be an all‑inclusive guarantee from a CRP-rated entity that guarantees the yield on the investment.

B. Non-guaranteed Low Income Housing Tax Credit Investments.

I. A level of leverage below 50%. For a LIHTC Fund, the level of leverage is measured at the fund level.

II. There is a Tax Credit Guarantee Agreement from General Partner or managing member. This agreement requires the General Partner or managing member to reimburse investors for any shortfalls in tax credits due to errors of compliance, for the life of the partnership. For a LIHTC Fund, a Tax Credit Guarantee is required from the developers of the lower tier LIHTC properties to the upper tier partnership and all other LIHTC investments.

III. There are sufficient operating reserves, capital replacement reserves and/or operating deficit guarantees present to mitigate foreseeable foreclosure risk at the time of the investment.

Non-qualifying LIHTCs should be reported in the “All Other” category

*Statutory Accounting RBC Impact:*

Life: The RBC factor for LIHTC are captured as part of the real estate on LR007:

|  |  |  |  |
| --- | --- | --- | --- |
| (17) | Federal Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 75 | 0.0014 |
| (18) | Federal Non-Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 76 | 0.0260 |
| (19) | State Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 77 | 0.0014 |
| (20) | State Non-Guaranteed Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 78 | 0.0260 |
| (21) | All Other Low Income Housing Tax Credits | AVR Equity Component Column 1 Line 79 | 0.1500 |
| (22) | Total Schedule BA Real Estate | Lines (16) + (17) + (18) + (19) + (20) + (21) |  |

P/C and Health: The RBC factors for LIHTC are captured as components of other long-term assets. The reporting lines and factors are the same as they are for life (as shown above).

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS):** NA

Recommendation:

NAIC staff recommends that the Working Group direct NAIC staff to draft statutory accounting guidance in the form of a new or revised SSAP that expands the current LIHTC guidance for equity investments that general federal business tax credit and state premium tax credits. Although this agenda item is focusing on NMTC, it is recommended that consideration be given to guidance that does not name specific designs, such as NMTC or other specific tax credits, so that it can be applicable for all qualifying tax equity investments. This guidance will consider the proposed FASB guidance as well as admittance and impairment provisions, recognizing that tax credits cannot be used to provide direct payment to policyholders, but rather are utilized to impact a reporting entity’s tax liability. This agenda item also recommends a review of *SSAP No. 94—Transferable and Non-Transferable State Tax Credits* to ensure the guidance properly reflects items that should be captured in scope and appropriate admittance provisions.

With the proposal of a new or revised SSAP, this agenda item is proposed to be captured as a ‘New SAP Concept’ with a corresponding issue paper. Along with statutory accounting revisions, a resulting blanks proposal and a potential RBC referral are anticipated to update blanks reporting and RBC references accordingly. As detailed within, all Schedule BA reporting lines and RBC instructions (for both federal and state) only reference Low-Income Housing Tax Credits. The BA instructions also need to be updated as the concept for ‘guaranteed’ provisions from a CRP-rated entity seems to only be applicable to limited NMTC designs, as a guarantee may disqualify an entity from being able to use tax credits under IRS provisions.

Staff Review Completed by: Julie Gann - NAIC Staff, September 2022

Status:

On December 13, 2022, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as a new SAP concept, and exposed a discussion document to expand current statutory accounting guidance for low-income housing tax credits to capture all tax equity investments that provide general federal business tax credit and state premium tax credits if they meet specified criteria.

https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/National Meetings/A. National Meeting Materials/2023/3-22-23 - Spring/Hearing/16 - 22-14 - NMTC.docx