FORVIS

Proportional Amortization Option for More Tax Credit Programs & LIHTC Accounting Changes

In 2014, FASB created an accounting election for entities to apply the proportional amortization method to low-income housing tax credit (LIHTC) structures. On March 29, 2023, FASB issued Accounting Standards Update (ASU) 2023-02, which expands this accounting election—under certain conditions—to other existing programs, such as the new markets tax credit (NMTC), historic rehabilitation tax credit (HTC), and renewable energy tax credit (RETC), as well as any new federal and state programs. Certain existing specialized guidance for LIHTC investments has been removed to provide more comparable accounting for all tax programs. Additional disclosures are required. Early adoption is permitted in any interim period.

Effective Dates
ASU 2023-02

Public Business Entities
Annual & interim periods beginning after December 15, 2023

All Others
Fiscal year beginning after December 15, 2024

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Background

The LIHTC program was developed to encourage private capital investment in the construction and rehabilitation of low-income housing projects. Unlike traditional equity investors, LIHTC investors receive expected returns from tax credits and other tax benefits instead of the investee's underlying operating cash flows and appreciation. ASU 2014-01 created an accounting policy election that was more reflective of the underlying economics. Under the proportional amortization method, LIHTC investment amortization and tax credits are presented on a net basis within income taxes on the income statement. Investment amortization is taken in proportion to the tax credit benefit. Non-LIHTC structures must use the equity (Accounting Standards Codification (ASC) 323-30) or cost accounting method (ASC 323-740) whereby the equity method losses or the cost method impairment is presented above the line in pretax income, and tax credits are presented within income taxes on the income statement. Because the tax credits are not reported as a component of the investment's performance, a pretax loss is often reported, despite the investment performing as intended and yielding an after-tax net benefit to the investor.

Immediately after the issuance of ASU 2014-01, stakeholders lobbied FASB for the same accounting election for other economically similar investment programs, including the NMTC, HTC, and RETC. See Appendix for program summaries.

Election Level

Under ASU 2023-02, an entity would make an accounting policy election for each tax credit program, rather than at a reporting entity level or an individual investment level. The election should be applied consistently to all investments within an elected tax credit program.

A reporting entity that applies the proportional amortization method to qualifying tax equity investments must account for the receipt of the investment tax credits using the flow-through method under ASC 740, Income Taxes, even if the entity applies the deferral method for other investment tax credits received.

Conditions

FASB leveraged and expanded ASU 2014-01's criteria. To qualify for the proportional amortization method, the following conditions must be met:

- It is **probable** that the income tax credits allocable to the investor will be available.
- The investor does not have the ability to exercise **significant influence** over the operating and financial policies of the underlying project. In evaluating the significant influence criteria, the investor shall consider the operations, financial decisions, and related objectives of the project as a whole.
- **Substantially all** of the projected benefits are from income tax credits and other income tax benefits. Projected benefits include—but are not limited to—income tax credits, other income tax benefits, and other nontax-related benefits (including refundable tax credits). Refundable tax credits should be included in the denominator but not in the numerator when performing the substantially all test. The projected benefits should be determined on a discounted basis, using a discount rate that is consistent with the cash flow assumptions used by the tax equity investor in making its decision to invest in the project. Substantially all should be determined using discounted amounts, and the discount rate to be used should be consistent with the cash flow assumptions used by the investor in making the investment decision.
- The investor's projected yield based solely on the cash flows from the income tax credits and other income tax benefits is positive.
- 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.

Proportional Amortization Method

Under this method, an entity amortizes an investment's initial cost over the period in which it receives income tax credits and other tax benefits. Amortization is calculated as the initial investment balance less any expected residual, multiplied by the percentage of actual income tax credits and other income tax benefits allocated to the investor in the current year divided by the total estimated income tax credits and other income tax benefits expected to be received over the investment's life. Under a practical expedient, the initial investment cost could be amortized in proportion only to the income tax credits, if doing so would produce a measurement substantially similar to the measurement using the calculation above.

The investor should exclude any expected residual value of the investment from the proportional amortization calculation. Non-income-tax-related benefits received from operations should be included in pretax earnings only when realized or realizable. Gains or losses from the sale of the investment, if any, should be included in pretax earnings at the time of the sale.

Changes to LIHTC Accounting

Cost Method

ASU 2023-02 removes the cost method guidance in ASC 323-740 for LIHTC investments. LIHTC investments that are not accounted for using the proportional amortization method or the equity method now must use ASC 321 guidance, consistent with non-LIHTC equity investments. Special transition guidance is noted below.

ASC 323-740, before the issuance of ASU 2023-02, had guidance for LIHTC investment accounted for using the proportional amortization method, as well as specific guidance for using the equity method or the cost method. Under this guidance, LIHTC investments not accounted for using the proportional amortization or equity method could use the cost method. However, other non-LIHTC equity investments, not accounted for using the equity method, had to apply fair value or the measurement alternative guidance in ASC 321.

Delayed Equity Contributions

ASU 2023-02 will require all tax equity investments (LIHTC and non-LIHTC) using proportional amortization to treat delayed equity contributions consistently; a liability would be recognized for delayed equity contributions that are unconditional and legally binding or for equity contributions that are contingent upon a future event when that contingent event becomes probable. To provide consistency for financial statement users, ASU 2023-02 removes the delayed equity contribution guidance for LIHTC investments that are not accounted for using the proportional amortization. Special transition guidance is noted below.

Under GAAP, before the issuance of ASU 2023-02, entities generally did not recognize delayed equity contributions on a gross basis for non-LIHTC investments.

Comment letter feedback noted that including delayed equity contributions in the initial amortization schedule for tax equity investments that are accounted for using the proportional amortization method is consistent with how tax law characterizes these investments and allows entities to create a single amortization schedule (rather than multiple schedules for each investment made, which are more costly to prepare and audit).

Equity Method Impairment Example

Previous LIHTC-specific guidance included an example of impairment for a LIHTC investment using the equity method. Under ASU 2023-02, LIHTC investment accounted for using the equity method must now apply the impairment guidance in ASC 323-10. Special transition guidance is noted below.

ASC 323-740 is now applicable only to tax equity investments accounted for using the proportional amortization method.

Disclosures

Entities are required to disclose information about their investments that generate income tax credits and other income tax benefits from a tax credit program for which the entity has elected to apply the proportional amortization method (including investments within that elected program that do not meet the conditions to apply the proportional amortization method). An entity would be required to disclose the following for interim and annual financial statements:

- The nature of its investments
- The effect of the recognition and measurement of its investments and the related income tax credits and other income tax benefits on its financial position and results of operations

Mandatory details would include:

- The amount of income tax credits and other income tax benefits recognized during the period, including the line item in the statement of operations and statement of cash flows in which they have been recognized
- The amount of the investments and the line item in which the investments are recognized in the statement of financial position
- For investments accounted for using the proportional amortization method, the amount of investment amortization recognized as a component of income tax expense (benefit)
- For investments accounted for using the proportional amortization method, the amount of non-income-tax-related activity and other returns received that are recognized outside of income tax expense (benefit) and the line item in the statement of operations and statement of cash flows in which they have been recognized
- For investments accounted for using the proportional amortization method, 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

The first three disclosures were previously used in ASU 2014-01 as examples. Under ASU 2023-02, they would be required.

An entity may—but is not required to—consider disclosing the following items:

- For investments accounted for using the equity method, the amount of investment income or loss included in pretax income
- Any commitments or contingent commitments (for example, guarantees or commitments to provide additional capital contributions), including the amount of delayed equity contributions and the year or years in which contingent commitments are expected to be paid
- The amount and nature of impairment losses during the year resulting from the forfeiture or ineligibility of income tax credits or other circumstances. For example, in a qualified affordable housing project investment, those impairment losses may be based on actual property level foreclosures, loss of qualification due to occupancy levels, compliance issues with tax code provisions, or other issues

Transition

ASU 2023-02 would be applied on either a modified prospective or retrospective basis. FASB provided both approaches to provide flexibility.

Modified retrospective transition. An entity would evaluate all investments that are still expected to generate either income tax credits or other income tax benefits from a tax credit program as of the *adoption date*. To make that determination, the entity would use actual income tax credits and other income tax benefits received and remaining benefits expected as of the adoption date. A cumulative-effect adjustment would be recognized to the opening balance of retained earnings at the beginning of the fiscal year of adoption for the difference between the previous accounting and the new method of accounting since the investment was entered into.

The assessment of whether the investment would qualify for the proportional amortization method would be performed as of the date the investment was entered into. A cumulative-effect adjustment reflecting the difference between the previous method used to account for the tax equity investment and the application of the proportional amortization method since the investment was entered into would be recognized in the opening balance of retained earnings as of the beginning of the period of adoption.

Retrospective transition. An entity would evaluate all investments that are still expected to generate either income tax credits or other income tax benefits from a tax credit program as of the beginning of the *earliest period presented*. To make that determination, the entity would use actual income tax credits and other income tax benefits received and remaining benefits expected as of the beginning of the earliest period presented. A cumulative-effect adjustment would be recognized to the opening balance of retained earnings at the beginning of the earliest period presented for the difference between the previous accounting and the new method of accounting since the investment was entered into.

Special LIHTC transition guidance

FASB has provided special transition guidance for LIHTC investments that can no longer use the cost method guidance, the equity method example, or the delayed contribution guidance. These entities can use either of the retrospective approaches noted above or a prospective transition method that would change the accounting for all affected LIHTC investments on the books on the adoption date. Under this method, an adjustment is recognized in current-period earnings, the balance sheet, or both on the adoption date. An entity may separately select a transition method for each of the three transition adjustment types (cost method, example, or delayed contribution) but must apply a consistent transition method for each transition adjustment type.

Transition Disclosures

Only the following transition disclosures from ASC 250, Accounting Changes and Error Corrections, are required:

- The nature of and reason for the change in accounting principle
- The transition method and a description of prior-period information that has been retrospectively adjusted, if any
- The effect of the change on income from continuing operations, net income, and any affected per-share amounts for the prior periods retrospectively adjusted
- The cumulative effect of the change on retained earnings
- A qualitative description of the financial statement line items affected by the change

If interim financial statements are prepared, the above transition disclosure should be included in the financial statement in the interim period of the change and the fiscal year of the change.

An entity is not required to why the change in accounting principle is preferable.

Effective Date

ASU 2023-02 is effective for public business entities for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. For all other entities, this ASU is effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years.

For all entities, early adoption, including adoption in an interim period, is permitted. If an entity adopts in an interim period, it shall adopt as of the beginning of the fiscal year that includes that interim period.

Early Adoption Considerations

Early adoption could make sense for some entities. For entities that prepare quarterly financial statements, adoption in the first quarter avoids potential reassessment and restatement versus early adoption in the second or third quarter. FASB acknowledges that certain common tax structures, most notably the NMTC, may not be eligible for the proportional amortization election as the ASU is currently written. Careful review of each tax credit structure will be required to determine eligibility. If you are considering early adoption, please reach out to a professional at **FORVIS** as soon as possible.

Conclusion

The assurance team at **FORVIS** delivers extensive experience and skilled professionals to assist with your objectives. Our proactive approach includes candid and open communication to help address your financial reporting needs. At the end of the day, we know how important it is for you to be able to trust the numbers; our commitment to independence and objectivity helps provide the security and confidence you desire. Whether you are publicly traded or privately held, FORVIS can help provide an independent and objective view into your financial reporting. We leverage the latest technologies and process automation tools to provide companies assurance on their financial statements to help meet stakeholders' needs.

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Appendix

Program	Low Income Housing Tax Credit (LIHTC)	New Markets Tax Credit (NMTC)	Renewable Energy Tax Credit (RETC)	Historic Tax Credit (HTC)
Credit	Tax credit is equivalent to 4% or 9% of qualified basis. Qualified basis = Eligible basis (depreciable costs) * % of low-income tenancy.	Tax credit is equal to 39% of the qualified investment into a community development entity (CDE) that has been provided an allocation of tax credits. The CDE makes an investment into a qualified active low-income community business (QALICB).	For most projects eligible for the investment tax credit (ITC), the base rate is 6% and the full rate is 30% of the cost of the qualifying energy property. Eligible projects may qualify for additional adders in accordance with the *Inflation Reduction Act*. In general, production tax credit (PTC) is 2.6 cents per kilowatt hour of energy generated if wage and apprenticeship requirements are met subject to additional clarifications from Congress or the Treasury.	20% of qualified project expenditures.
Public Policy	Legislated tax credit program designed for constructing and renovating affordable rental housing for people facing financial challenges in urban and rural areas.	Legislated tax credit program designed for growing businesses, creating jobs, and spurring economic development in designated underserved communities.	Legislated tax credit program for designing, financing, installing, and monitoring renewable energy technologies that generate electricity.	Legislated tax credit program designed to rehabilitate certified historic buildings into income-generating properties that create jobs and revitalize communities.
Credit Period	10 years, beginning in the year the property has been leased to certain occupancy.	7 years, beginning when the investment is made to the CDE.	The ITC is a one-time credit in the year that the project is placed into service.	5 years, beginning in the year the property is placed into service.

			PTCs are paid over a 10-year period beginning on the date the project is placed into service.	
Recapture Period	Tax credits are earned over 10 years. Recapture period is 15 years.	Tax credits are earned equally over seven years but fully recapturable the entire seven-year period.	Tax credits are earned over five years; recapture risk burns off by 20% each year.	Tax credits are earned over five years; recapture risk burns off by 20% each year.
Inception/ Status	1986/Permanent	2000/Recently extended through 2025, in process of becoming permanent	ITC – permanent PTC construction begun pre-December 31, 2021	1976/Permanent
Tax Credits & Tax Benefits Associated	• Tax credits • Deductions – Equity investor's share of operating income/losses, *e.g.*, depreciation and rental expenses.	• Tax credits • Deductions – Equity investor's share of operating income/losses (primarily fees and net interest income).	• Tax credits • Deductions – Equity investor's share of operating income/loss (primarily depreciation).	• Tax credits • Deductions – Equity investor's share of operating income/loss (primarily depreciation).
Cash Flow Variability	The investor return is based solely on the cash flows from tax credits and other tax benefits. Cash flows rarely vary from projected amounts.	The investor return is based solely on the cash flows from tax credits and other tax benefits. Cash flows rarely vary from projected amounts.	Same as LIHTC, plus the following: • Priority Return – Represent the cash returns. • Put – Nominal stated value to be paid to the investor at exit/maturity.	Same as RETC