

Tax Abatements under GASB Statement 77

Exploring the Effects of the New Disclosure Rules

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IN BRIEF

In recent years, many state and local governmental units have entered into agreements with businesses that offered them tax incentives to establish new facilities (e.g., new branches, stores, headquarters, manufacturing facilities) in their jurisdictions. In exchange, the businesses contributed to economic development and job creation. In an effort to make information about such tax abatement agreements transparent, GASB released Statement 77, *Tax Abatement Disclosures*, in August 2015. This article discusses the definition of tax abatements, the disclosure requirements and scope of GASB Statement 77, and its consequences for state and local governmental units.

Many state and local governmental units have entered into agreements with business entities that offer tax incentives and tax breaks encouraging the companies to establish operations in their jurisdictions. In return, businesses make investments that can increase hiring, economic activity, and real estate value. Often, the expectation is that the tax expenditures for the tax incen-

tives may partially offset increased tax revenues from the aforementioned new employment and business activities (A. Matthew Boxer, "A Programmatic Examination of Municipal Tax Abatements," State of New Jersey Office of the State Comptroller, Aug. 18, 2010). In an attempt to make the economic benefits provided to businesses transparent, GASB issued Statement 77, *Tax Abatement*

Disclosures, in August 2015. The standard addresses financial reporting disclosure rules for tax abatements that affect governmental tax revenues.

This standard applies to "financial reports of all state and local governmental units; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities" (collectively termed "governmental units"). Under GASB Statement 77, all state and local governmental units, when preparing financial statements in conformity with Generally Accepted Accounting Principles (GAAP) for governments, must disclose information regarding tax abatements affecting their revenue-raising abilities in the notes to their financial statements for reporting periods beginning after December 15, 2015. GASB Statement 77 enables greater scrutiny of tax abatements and requires a substantial amount of work in collaboration with related persons, such as a city or county clerk and an attorney, to



identify which agreements to disclose and how to comply with the disclosure rules.

Defining Tax Abatements

State and local governments prepare financial statements in conformity with GAAP to provide stakeholders (e.g., citizens, policymakers, legislative and oversight bodies, municipal bond analysts) with necessary information from financial statements, intended to assist users of those financial statements in assessing the financial stability and accountability of governmental entities and making important decisions (GASB, “Summary of Statement No. 77: Tax Abatement Disclosures,” 2015, <http://bit.ly/2FTRfBq>). Financial statement users also need information about limitations on revenue-raising capacity resulting from certain government programs, including tax abatements.

Historically, tax abatements have emerged as policy tools for the enhancement of economic development, as the role of states in setting economic development policy has grown (Esteban G. Dalehite,

John L. Mikesell, and C. Kurt Zorn, “Variation in Property Tax Abatement Programs among States,” *Economic Development Quarterly*, vol. 19, no. 2, p. 158). Tax abatement programs were introduced amid the efforts of Southern states to industrialize through the relocation of low-wage businesses from the Northeast and Midwest; the structural changes in the U.S. economy after World War II and the devolution of states’ rights in the 1970s and 1980s accelerated the expansion of tax abatement programs. These events brought states and localities into fierce competition for revenue sources and pushed them to become more proactive in promoting economic development. As a result, the number of states offering tax abatements has increased from 15 in 1964 to 40 in 2014 (David Robinson, *Economic Development from the State and Local Perspective: Case Studies and Public Policy Debates*, Springer, 2014).

Indeed, in 2012, the *New York Times* reported that state and local governments offered \$80.4 million in tax incentives to

businesses (<http://www.nytimes.com/interactive/2012/12/01/us/government-incentives.html>). Among these cases, Nevada promised to provide Tesla Motors \$1.3 billion in tax incentive packages to build the Tesla Gigafactory in that state. According to the agreement, Tesla would be exempt from paying property and business taxes for 10 years and from sales taxes for 20 years (Diane Davis, “Will GASB Statement No. 77 Put State Tax Abatements under Scrutiny?” *Accounting Web*, 2015, <http://bit.ly/2HGWULH>). Some municipal governments, such as Cleveland and St. Louis, offer property tax abatements that eliminate or substantially reduce property tax payments for years in order to attract businesses to locations with lower demand, such as blighted areas (Norman Krumholz, “Equity and Local Economic Development,” *Economic Development Quarterly*, November 1, 1991; vol. 5, no. 4, pp. 291–300).

Although these kinds of programs have historically encouraged economic development, the proliferation of tax abatements

made it difficult for stakeholders to determine their full extent and nature. In the past, stakeholders had to independently contact management to identify forgone revenues resulting from tax abatement agreements because there was no requirement for governments to disclose tax abatements in their financial statements (Tracy Amer and John Hulsey, "GASB 77, Tax Abatement Disclosures Reporting Requirements," October 16, 2015; University of Georgia, <http://bit.ly/2HHdNpr>). To resolve this issue, GASB issued Statement 77, mandating state and local governments to disclose tax abatements that affect their revenue-raising abilities in the notes to their financial statements.

In general, GASB Statement 77 applies to all taxes, including property taxes and tax reductions, such as exemptions, credits, rebates, or traditional abatements. For financial reporting purposes, however, it is some-

its form or title, is a key factor in determining whether the transaction meets the definition of a tax abatement for the purposes of this Statement." Moreover, tax exemptions and deductions are not regarded as tax abatements under GASB Statement 77 because they are broadly available to anyone who meets certain conditions, whereas tax abatements are only allowable to entities that perform a required activity.

Disclosure Requirements

GASB Statement 77 specifies several pieces of information that should be disclosed and includes general principles for disclosing tax abatement information in order to better assist financial statement users' understanding of a governmental unit's overall financial condition. A governmental unit may disclose required information by a separate agreement, in the

reduced as a consequence of tax abatement agreements during the accounting period;

- Brief descriptive information that includes the names of the governments and dollar amount received or receivable from other governments, if a governmental unit has amounts received or receivable from other governmental units in connection with the forgone tax revenue; and

- A brief description of the types of commitments made and the most substantial individual commitments made, if commitments are made other than to reduce taxes as part of a tax abatement agreement.

With respect to tax abatement agreements that are entered into by "other governments" and that reduce the reporting government's tax revenues, GASB Statement 77 requires the information to be categorically organized by a governmental unit and the specific tax abated, not by a program. The particular items that need to be disclosed in the footnotes are as follows:

- A brief description that includes names of the governments agreeing upon tax abatement programs and specific taxes abated;

- The dollar amount of tax revenues being reduced as a consequence of tax abatement agreements during the accounting period;

- Brief descriptive information that includes the names of the governments, authority under which taxes were or will be paid, and dollar amount received or receivable from other governments, if a governmental unit has amounts received or receivable from other governments in connection with the forgone tax revenue; and

- A concise description of the quantitative threshold set by the governments to determine tax abatements disclosed individually, if tax abatement agreements are disclosed individually.

In addition to complying with the specific disclosure requirements for tax abatement agreements, a governmental unit should disclose such information in compliance with the following "general principles" under GASB Statement 77:

- When a governmental unit makes disclosures, it should distinguish between tax

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times difficult to identify which agreements meet the definition of tax abatements under GASB Statement 77:

A reduction in tax revenues that results from an agreement between one or more governments and an individual or entity in which (a) one or more governments promise to forgo tax revenues to which they are otherwise entitled and (b) the individual or entity promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or the citizens of those governments.

In determining whether a transaction meets this definition, GASB Statement 77 provides that a "transaction's substance, not

aggregate, or by using a combination of both individual and aggregate forms. If individual agreements are disclosed, the governmental unit should use a quantitative threshold (e.g., 10% of the total amount of taxes abated) to determine which programs are to be presented individually.

For a governmental unit's "own" tax abatements, GASB Statement 77 requires the information to be categorically organized by program (i.e., a business-development program). The specific items that need to be disclosed in the footnotes areas are as follows:

- A brief description that contains names and purposes of tax abatement programs, specific taxes abated, and others;

- The dollar amount of tax revenues being

abatements deriving from 1) the reporting government's own agreements and 2) those agreements that are entered into by other governments and reduce the reporting government's tax revenues.

■ Disclosure information concerning tax abatements may be outlined individually or may be aggregated.

■ Disclosure information concerning tax abatements deriving from the reporting government's agreements should be categorically organized by a major tax abatement program.

In summary, all state and local governments must comply with the general disclosure principles in addition to specific disclosure requirements when disclosing information about tax abatement agreements in the notes to the financial statements. The following example abstracted from GASB Statement 77 demonstrates an example of the footnote disclosures for tax abatements to the financial statements.

Example. Imagine that ABC City has property tax abatement agreements with three business entities as of June 30, 2017. ABC City permitted 40% property tax abatement (\$20,000) to a grocery store for opening new locations. The city also granted 20% property tax abatement (\$50,250) to a restaurant for opening new branches and increasing employment in the service industry. Finally, the city allowed 30% property tax abatement (\$32,000) to a retail store for building a new building and opening new locations within the city.

These agreements were negotiated under a state law (the Business Development Act) permitting local governmental units to grant property tax abatements if tax abatement is intended to achieve certain economic development goals. Local government units may permit abatements of up to 40% of annual property taxes to a business that is located or agrees to establish its location within their jurisdictions. The state law does not contain recapture provisions, which demand a tax abatement recipient return the benefits received through tax abatement programs in the event that the recipient does not fulfill the commitment made.

ABC City is not subject to any tax abatement agreements entered into by other governmental units, and the city has only committed to reducing taxes. The city uses 10% of the total dollar amount of taxes abated during the fiscal year as a quantitative threshold for financial reporting purposes, and it discloses information regarding tax abatement agreements individually. In this situation, ABC City should make the footnote disclosures regarding tax abatements as follows:

Note X. Tax Abatements. ABC City has property tax abatements with three businesses under the state's Business Development Act as of June 30, 2017. Under the act, local governmental units may permit property tax abatements of up to 40% of businesses' future property taxes for the purpose of economic development and attracting new residents into their jurisdiction. The agreements grant

retail store for moving its location into the jurisdiction, which amounted to \$32,000 for the fiscal year ending June 30, 2017.

As this example illustrates, a governmental unit must disclose information about tax abatement agreements in compliance with specific disclosure rules and general principles in the notes to the financial statements; this is important, because any missing information in the notes may result in an "adverse" audit opinion. If GASB had allowed a governmental unit to place the disclosure in the supplemental information or statistical sections, the governmental unit could receive an "unmodified" (i.e., clean) audit without fully addressing information regarding tax abatements (Norton Francis, "GASB 77: Reporting Rules on Tax Abatements," October 2015, <http://www.taxpolicycenter.org/publications/gasb-77-reporting-rules-tax-abatements>).

A governmental unit must disclose information about tax abatement agreements in the notes to the financial statements; any missing information in the notes may result in an "adverse" audit opinion.

tax abatements to any businesses either already located within or agreeing to establish its location within the city. During the fiscal year ending June 30, 2017, the city granted 40% property tax abatement to a grocery store for opening a new store in its jurisdiction. This abatement agreement amounted to \$20,000 for the fiscal year. The other two outstanding property tax abatement agreements as of the end of the fiscal year are as follows: a 20% property tax abatement to a restaurant for opening a new branch and increasing employment, which amounted to \$50,250 for the fiscal year ending June 30, 2017, and a 30% property tax abatement awarded to a

The Scope of GASB Statement 77

Under GASB Statement 77, tax abatement agreements consummated by state and local governmental units should be disclosed. In other words, all state and local governmental entities, when preparing financial statements in accordance with GAAP, must disclose any related information regarding tax abatement programs for financial reporting purposes. Specifically, GASB Statement 77 requires governmental units to disclose tax abatement information related to 1) tax abatement agreements that are entered into by a reporting government (a government issuing a financial statement) and 2) those that are entered into by other governmental entities (e.g., by a county in

which a reporting city is located) and that reduce the reporting government's tax revenues. In the former case, a government is required to fully disclose its own tax abatement agreements, whereas in the latter case, a governmental unit is allowed to make reduced disclosures. The following scenario illustrates the scope of GASB Statement 77.

Example. Assume that ABC County comprises several cities, including XYZ City. ABC County entered into a tax abatement agreement with a business entity, which reduced XYZ City's tax revenue. In this situation, although the city is not a party to the abatement agreement, it must disclose partial information regarding the agreement entered into by ABC County in the notes to the financial statements under GASB Statement 77; however, if XYZ

closure requirements for information regarding tax abatement agreements entered into by discretely presented units (i.e., those that do not meet the requirements to be blended units) varies, depending on whether such information is essential for the fair presentation of financial statements—meaning that the financial statements are presented faithfully without any bias from the perspective of the users (AU-C Section 200.14). If the information is essential for fair presentation, tax abatement agreements that are entered into by a primary government's discretely presented component units and that reduce the primary governmental unit's tax revenues must be disclosed as the primary governmental unit's own tax abatement disclosures, thereby making full disclosures.

auditors exercising professional judgment determined that the information regarding the tax abatement agreement entered into by the company is essential for fair presentation, based on the company's significance to all discretely presented component units, plus the nature and significance of the company's relationship to the primary government. Under this scenario, GASB Statement 77 requires the state of ABC to make full disclosure regarding the company's tax abatements as if it were entered into by the state, because the limited disclosures may be insufficient for users. Therefore, the state will need to fully disclose the information regarding the discretely presented component unit's tax abatements, achieving fair presentation of the financial statements.

By mandating unified disclosure rules for tax abatements, GASB will be able to achieve consistency in financial reporting.

City had been a party to the agreement, it would have made full disclosures regarding such information.

Note that GASB Statement 14 defines component units as "legally separate organizations for which the elected officials of the primary governmental unit are financially accountable." Such units are reported as being "blended" under GASB Statement 61 if 1) their governing body is substantively the same as the primary government's governing body or 2) they provide services almost exclusively to the primary government. Tax abatement agreements that are entered into by a primary government's "blended" component units and reduce its tax revenues must be disclosed in the notes to the financial statements by the primary governmental unit as if it had granted such agreements. Unlike disclosure rules for the blended component units, dis-

On the other hand, if the information is not essential for the fair presentation of financial statements, the governmental unit may disclose the information regarding the discretely presented component unit's tax abatement agreements as if it had been entered into by another governmental unit. This means that the primary government is allowed to make "reduced disclosures" regarding tax abatement information. The following example illustrates disclosure rules under GASB Statement 77 when a primary government's discretely presented component unit enters into tax abatement agreements.

Example. Imagine that the state of ABC established an economic-development company that is reported as a discretely presented component unit. The company entered into a tax abatement agreement resulting in the state's taxes being reduced. The state

Effects and Results

GASB made significant progress toward enhancing the quality of governmental financial reporting by releasing the first disclosure rules for tax abatements. GASB Statement 77 will help improve transparency in governmental financial reporting. Its additional disclosures gives users the information necessary to evaluate how the tax abatement programs affect the governmental unit's financial position—which will make it easier to evaluate governmental units' financial information. In addition, by mandating state and local governmental units to use unified disclosure rules for tax abatements under GASB Statement 77, GASB will be able to achieve consistency in financial reporting. Policymakers, researchers, and rating agencies will then be able to easily compare the information regarding tax abatements across jurisdictions.

Although the disclosure requirements of GASB Statement 77 will enhance transparency and consistency in financial reporting, the standard may also bring greater scrutiny to tax abatement programs. Using the information about tax abatements available through GASB Statement 77, government stakeholders—including citizens, CPAs, and other interested parties—will be able to review specific information, such as the dollar amount of forgone tax rev-

enues and any commitments made other than reducing taxes. Stakeholders can then question governmental units about whether they achieved their intended purpose (i.e., economic development) by allowing tax abatements to business entities (Davis 2015; Kevin Spiegel and Dean J. Uminski, "The New Tax Abatement Disclosure Requirements," *IPT Insider*, December 2015). As a result, stakeholders may send a strong message to the governmental units to improve their tax abatement programs. GASB Statement 77 could also be used as a guide to questions to ask and debate during decision-making processes, such as city council committee meetings and planning commissions.

For many governmental units, particularly smaller ones, complying with GASB Statement 77 will be a challenge because it will require significant setup costs. Small governmental units may need technical assistance and support from the state or local government in developing reporting and auditing procedures to comply with GASB Statement 77 (Spiegel and Uminski).

CPAs' Role

In response to these tax abatement disclosure standards, CPAs should assist governmental units in developing action plans for compliance with the extensive disclosure rules when preparing financial reports. To avoid any negative consequences of noncompliance, CPAs will first need to help governmental clients identify all tax abatement agreements, including those entered into by other governments (Arner and Hulsey). For example, CPAs may assist clients with obtaining attorney opinion letters, which demonstrate the legal authority under which a client entered into a tax abatement agreement and identify all of the agreements made. CPAs should also encourage clients to work with related departments within their respective governmental unit. Early involvement of the city or county clerk, tax commissioner, the jurisdiction's legal counsel, and other department managers can assist with

maintaining and assembling the requisite information required to adequately comply with GASB Statement 77. When assisting clients with gathering information, CPAs must ensure that the list of the tax abatement agreements is complete. Lastly, due to the potentially substantial outcomes GASB Statement 77 would have for their clients in cases of noncompliance, CPAs should stay cur-

rent on these extensive disclosure rules for tax abatements. □

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