



## ECONOMIC DEVELOPMENT STRATEGIES, INFORMATION BRIEF 1

# GASB 77: Reporting Rules on Tax Abatements

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**On August 15, 2015, the Governmental Accounting Standards Board (GASB) issued a statement requiring state and local governments to disclose tax abatements affecting their revenue-raising abilities in their annual financial reports. Disclosing tax abatements greatly improves the transparency of state and local government operations and contributes to a more informed dialogue about fiscal policy. Requiring the disclosure as part of the comprehensive annual financial report (CAFR) is an important step toward more consistent and uniform reporting across governments. Complying will compel most state and local governments to develop new reports and procedures, opening a window for a top-to-bottom review of economic development programs in general.**

Currently, there is no requirement for government financial statements to disclose tax abatements, but abatements that limit a government's revenue-raising capacity should be included to provide a complete picture of a government's finances. Taking a step toward greater disclosure of tax expenditures, GASB Statement 77 (GASB 77) will require all government entities to disclose in their CAFR any agreement with a specific taxpayer to abate or reduce tax liability (see box 1 for additional information about CAFRs). GASB 77 will have a major impact on tax policy by shining a light into the dark corners of tax abatements. A potentially helpful economic development tool, tax abatements and incentives have proliferated in recent years. The *New York Times* reported that states offer over \$80 billion in tax incentives to businesses.<sup>1</sup> This proliferation makes it difficult for taxpayers, investors, and other stakeholders to determine the actual size of the tax base and to discern trends over time. Data on how one government's or government entity's economic development agreements affect the revenue-raising ability of other governments or government entities are limited. One of the most significant

outcomes of GASB 77 may be the reporting of abatements affecting fiscally related governments or government entities, such as city or county governments and the school districts within their geopolitical boundaries. For example, a city- or county-based incentive that reduces the assessment of an owner's property value can reduce the tax base of an overlapping jurisdiction like a school district. The new reporting requirement creates a burden for the reporting entity (the one preparing the CAFR) to get the required information from the entity providing the tax abatement, but it should result in a more comprehensive look at how abatements affect overlapping jurisdictions.

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#### BOX 1

##### **What Is a Comprehensive Annual Financial Report, and Why Is It Important?**

The CAFR is a snapshot of a government's fiscal health. It includes financial statements, which unlike budget documents and agency reports, are audited records of actual receipts, expenditures, assets and liabilities. CAFRs are historical documents that discuss the past fiscal year and generally avoid forward-looking statements. Adhering to standards set by GASB following generally accepted accounting principles (GAAP), CAFRs present the same type of information for every government in a mostly consistent format. This consistency is the reason CAFRs are used by ratings agencies and researchers to measure fiscal health. However, as with publicly traded companies' annual reports, the footnotes often contain important information the tables do not reveal. CAFRs also contain supplemental materials that compare the budgeted revenues and expenditures to actual experience and statistical information.

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## What Is Included in the New Rule?

GASB 77 requires disclosure of abatements when there is an agreement between a specific entity and the government (GASB 2015, paragraph B10). Usually, the government asks for a specific investment or increase in jobs in exchange for a reduction in taxes. For example, to better serve a neighborhood without a grocery store, a city may provide incentives to attract a new store. An economic development package offered to a company for relocation would be covered by GASB 77, such as that of Nevada's comprehensive tax package for Tesla Motors. These transactions that benefit specific taxpayers regardless of the public benefit can be opaque and reduce revenue, increasing the burden on other residents either through reduced government services or increased tax rates.

The disclosure does not apply to broadly available tax provisions (legally referred to as "as-of-right," meaning anyone who satisfies certain conditions has a right to the provision; e.g., a credit for the purchase of an efficient appliance is available to anyone in the jurisdiction who purchases the appliance). For example, a preferential manufacturing exemption that all manufacturers receive would not be included under the new standard. Another example is a property tax exemption for nonprofits,

which is almost universal across the country, would be excluded because it does not require an agreement and is generally available.

## What Governments Must Do

In fiscal years that begin after December 15, 2015, CAFRs must include enumerations of tax abatements with the following minimum information:<sup>2</sup>

1. Descriptive information about the abatement program including the relevant tax program, the authority cited, and eligibility criteria;
2. Information about the recipient(s) including the mechanism for abatement and any clawback provisions, including the commitments made to receive the abatement;
3. How much the abatement costs; and
4. Other commitments the government has made (such as infrastructure investment).

The government will also be required to report tax abatements agreed to by other governments that affect the reporting government's revenue.

## How GASB 77 Will Affect Governments?

For many governments, especially smaller ones, complying with GASB 77 will be a challenge, but one that will provide long-term benefit from greater transparency. Of the 50 states and the District of Columbia, 43 have some type of tax expenditure or economic development report at the state level that contains some if not all the information required by GASB 77 (Pew 2015). But local governments have more limited audit resources to deploy. GASB considers the costs to be largely one-time setup costs (GASB 2015, paragraph B54). A significant concern is the ability for one government to get another government's abatement information. This problem is particularly true for governments that do not share the same fiscal year.<sup>3</sup>

GASB 77 represents an opportunity for state governments to develop reporting and auditing procedures for their local governments that comply with GASB 77 and are consistent with state reporting. In several states, local governments may need technical assistance in preparing the information required. This assistance will be particularly important for local governments whose revenue has been reduced by the state or another local government.

The focus on tax abatement disclosure also presents state and local government officials with an opportunity for a thorough review of economic development programs. State leaders can use the process of educating local governments about GASB 77 compliance to get a better picture of how programs are working, learn where there is both programmatic and jurisdictional overlap, and potentially obtain an aggregate value of all state programs. This information could guide revisions and improvements to the statewide economic development strategy and could point to areas of greater intergovernmental collaboration.

## What GASB 77 Will Mean for the Public?

For the public, GASB 77 will mean a lot more information about tax abatements. The amount of foregone revenue will be in black and white and available for anyone to review. Not only will the CAFR document current abatements, but successive CAFRs will create a historic record as each year of abatements is reported. As a top-down requirement from GASB, GASB 77 will enforce a measure of consistency across jurisdictions (see box 2 for additional information on full disclosure). Currently some jurisdictions report information about tax abatements and some do not. Those jurisdictions that do report adhere to a confusing range of reporting standards.

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### BOX 2

#### **Significance of the Location of Tax Abatement Information**

GASB 77 calls for the information about tax abatements to be included in the notes section of the financial statement.<sup>a</sup> This is an important decision because missing or incorrect information here may result in an adverse audit. If GASB had decided to allow the disclosure as part of the supplemental information or statistical sections, a government could still get a clean audit without fully accounting for tax abatements.

<sup>a</sup> See American Institute of CPAs, “AU Section 558A: Required Supplementary Information,” Audits and Attest Standards, April 1988. <https://www.aicpa.org/Research/Standards/AuditAttest/DownloadableDocuments/AU-00558A.pdf>.

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GASB 77 is a significant step forward in government transparency. It will provide a consistent set of information, similar to the financial information reported, that will highlight concerns or risks to both financial markets and to the public. Consistent reporting will enable comparisons across jurisdictions, allowing greater oversight by policymakers, researchers, auditors, and ratings agencies. GASB has taken this step, but it is up to state and local governments to use the new reporting requirements as an opportunity to set up comprehensive reviews of tax expenditures (both those required to be reported by GASB 77 and those not required) and their economic development strategy.

It will be incumbent on the government to make the information prepared for the CAFR accessible to the public. Accounting reports can be impenetrable to nonaccountants. Creating “citizen’s guides,” as the District of Columbia does with its annual financial reports, will allow more people to access and understand the content and implications of the CAFR.<sup>4</sup>

## Other Issues

There were 298 comments on the proposed rule, and GASB was diligent in reflecting on the comments and in several cases revisiting some definitions and concepts.<sup>5</sup> Some concerns were recognized but not incorporated:

- There is no requirement for disclosing future-year liability.<sup>6</sup> GASB responded that their concern is with the current year and the application of sound accounting principles, and they are not in a position to provide guidance on how to construct future cost estimates (GASB 2015, paragraph B35).
- The identification of recipients is not required.<sup>7</sup> GASB responded that identifying the specific taxpayer did not fulfill “any of the objectives of financial reporting” (GASB 2015, paragraph B30).
- The benefits of tax abatements are not recognized.<sup>8</sup> GASB addressed this concern by referencing the other items in the financial statements (e.g., revenues) that would reflect any benefit implicitly (GASB 2015, paragraph B6). In GASB’s opinion, any net positive benefits as a result of the abatement would be reflected in the financial statement.
- The definition of tax abatement does not include tax increment financing.<sup>9</sup> One of the most frequent responses to the proposed rule was that it did not explicitly include tax increment financing programs. These programs establish districts where taxes above a baseline amount (the increment) are used for developing the district. GASB believes the broad language will include these taxes, but because tax increment financing programs do not “reduce tax revenue” as required by GASB 77, GASB leaves them subject to interpretation by both the local governments and the accountants auditing the financial statements (GASB 2015, paragraph B5).

Because of fiscal-year start dates, many local governments will have to begin implementing GASB 77 before their state government does. A government whose fiscal year starts on January 1, 2016, has to report on abatements agreed to by another level of government even if that government’s fiscal year starts on July 1, 2016. For example, Arkansas’ fiscal year begins July 1, but because the cities and counties in Arkansas start their fiscal year on January 1, they will have to prepare their reports earlier than the state government. However, this problem will occur only in the first year of implementation when the governments’ procedures are being developed.

## Notes

1. In 2012, the New York Times assembled a database of 1,874 state business incentives that is available online at <http://www.nytimes.com/interactive/2012/12/01/us/government-incentives.html>.
2. Most state governments have fiscal years that begin on July 1, so the first affected fiscal year would be 2017. Many local governments have a January 1 fiscal year start date, so their first affected fiscal year would be 2016.

3. This concern was raised by many of the public comments to GASB 77. See, "Online Comment Letters," GASB, accessed October 2, 2015, [http://www.gasb.org/jsp/GASB/CommentLetter\\_C/GASBCommentLetterPage&cid=1176157116776&project\\_id=19-20E](http://www.gasb.org/jsp/GASB/CommentLetter_C/GASBCommentLetterPage&cid=1176157116776&project_id=19-20E).
4. See "Annual Financial Reports (PAFR)," DC.gov, accessed October 2, 2015, <http://cfo.dc.gov/node/215162>.
5. See note 3 above.
6. Multiple organizations submitted comments. See note 3 above, comments 120 and 156.
7. Multiple organizations submitted comments. See note 3 above, comments 120, 154, and 155.
8. William Hall and Gary Donaldson, letter to David R. Bean, December 16, 2014, letter of comment no. 173. [http://www.gasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175830156018&blobheader=application/pdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=38593&blobheadervalue1=filename%3D%2FDTAD\\_ED\\_CL173.pdf&blobcol=urldata&blobtable=MungoBlobs](http://www.gasb.org/cs/BlobServer?blobkey=id&blobnocache=true&blobwhere=1175830156018&blobheader=application/pdf&blobheadername2=Content-Length&blobheadername1=Content-Disposition&blobheadervalue2=38593&blobheadervalue1=filename%3D%2FDTAD_ED_CL173.pdf&blobcol=urldata&blobtable=MungoBlobs).
9. Multiple organizations submitted comments. See note 3 above.

## References

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- GASB (Governmental Accounting Standards Board). 2015. "Statement No. 77 of the Governmental Accounting Standards Board: Tax Abatement Disclosures." *Governmental Accounting Standards Series* No. 353.

# About the Economic Development Strategies Project

The Economic Development Strategies project is a three-year project to assemble comprehensive research on state economic development strategies. The scope of the project goes beyond tax incentives and abatements (discussed here) to include workforce development and best practices. This is the first of eight informational briefs that will frame the project.

## About the Author

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