Center on Budget and Policy Priorities

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Comments of the Center on Budget and Policy Priorities Regarding the Proposed Statement of the Governmental Accounting Standards Board on Tax Abatement Disclosures, Project No. 19-20E

January 29, 2015

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Disclosure of government spending through sound financial reporting is essential to a well-functioning democracy. The public needs to know how resources are being spent, what legal obligations the government is incurring and for what purposes, and how today's decisions will constrain future budgets. To the extent possible, such disclosure should apply not only to direct expenditures but also to "tax expenditures" – spending that occurs through tax abatements or other mechanisms that result in lost revenue.

The Governmental Accounting Standards Board has launched a project to develop a standard for the disclosure of tax abatements in the comprehensive annual financial reports (CAFRs) of states and localities. We commend GASB for doing so, and urge GASB to adopt a standard on the proposed timetable set forth in the Exposure Draft document issued on October 20, 2014.

We also commend GASB for putting forward a specific proposed standard for tax abatement disclosure. We generally support the substance of the exposure draft, and in particular we commend GASB for proposing mandatory disclosure *both* of revenue losses resulting from tax abatements granted by other levels of government *and* of the costs of infrastructure upgrades that governments often commit to when they approve an abatement.

We also recommend the following modifications. These modifications will ensure that the final standard better fulfills GASB's own stated objectives:

1. The standard should require the disclosure of the number of years remaining in all outstanding tax abatement agreements. It should also provide data on the size of – although not necessarily the actual revenue forgone from – the abatement in future years.

In its summary of the proposed standard, GASB noted that it is vitally needed because "little information is publicly available regarding . . . the effect [tax abatement] agreements will have on a government's ability to raise resources in the future." We agree. Nonetheless, the current proposal fails to meet this important objective because it does not require the reporting of any type of information that would allow a CAFR user to evaluate the *cumulative future revenue impact* of existing tax abatements. Instead, the proposed standard would require the disclosure of the forgone revenue from existing abatements only in the year to which the CAFR applies.[1]

In the same summary, GASB observed more broadly that one of the fundamental objectives of government financial reporting is to enable users of financial reports to assess "a government's financial position . . . and how [it has] changed over time." Elsewhere, GASB has noted that a government's financial position at a point in time reflects, among other things, its liabilities, defined as "obligations to sacrifice resources that the government has little or no discretion to avoid."[2] Clearly, an agreement on the part of a government to forgo future tax revenue (so long as the private party to the agreement meets its job creation, investment, or similar economic development commitments) constitutes a financial liability for the government under this definition that must be taken into account in assessing its current financial position.

In short, *without a requirement that some measure of cumulative future revenue losses from tax abatements be reported, the standard is inconsistent with GASB's own stated goals with respect to both the standard itself and government financial reporting more broadly.*

The Exposure Draft document indicates that GASB viewed the omission of information about cumulative future revenue losses as a practical necessity. We appreciate the practical challenges posed by these issues. We agree, as GASB notes, that it would be challenging to promulgate methodologies for estimating potential revenue losses from a wide array of tax abatement programs. At the same time, the draft is greatly weakened by its failure to require the reporting of *any* type of information that provides a CAFR user with even the remotest sense of either the duration of tax abatement agreements in effect or the order of magnitude of forgone revenue to which a government has committed itself. Fortunately, there is a middle ground. Meaningful information concerning cumulative future liabilities can be provided without necessarily requiring forecasts of future revenue losses and without forgoing all aggregation of existing abatement agreements. We recommend modification of the standard along the following lines:

a) Where the specific amount of revenue to be forgone in a future year as the result of a tax abatement agreement is known, the actual amounts should be reported for <u>all</u> future years. Only abatements offered under the same program with the identical ending date could be aggregated.

    Example. A city has executed property tax abatement agreements with nine business taxpayers under two different state-authorized programs. The abatements take the form of an actual reduction in property tax dollars owed. The abatements differ in both the amounts abated and the amount of time remaining under the abatement agreement. The following table provides the relevant information about the abatements in effect as of the end of the CAFR year, FY2016:

[1] To its credit, GASB would require such annual reporting for all future years in which a specific abatement is in effect, not just for the initial year.

[2] GASB, "Defining the Fundamental Elements of Financial Reporting," June 2007.

Abatement Program	Taxpayer	Abatement Amount and Term
Property tax abatement for new construction in enterprise zone		
	Taxpayer 1	$100,000/yr in tax through FY2020
	Taxpayer 2	$50,000/yr in tax through FY2020
	Taxpayer 3	$50,000/yr in tax through FY2020; $25,000/yr in tax FY2021 through FY2030
Property tax abatement for construction or expansion of new manufacturing facility		
	Taxpayer 1	$250,000/yr in tax through FY2018
	Taxpayer 2	$100,000/yr in tax through FY2020
	Taxpayer 3	$50,000/yr in tax through FY2020
	Taxpayer 4	$25,000/yr in tax through FY2020
	Taxpayer 5	$50,000/yr in tax through FY2020; $25,000/yr in tax FY2021 through FY2030
	Taxpayer 6	$25,000/yr in tax through FY2020; $12,500/yr in tax FY2021 through FY2030

The following table shows how these agreements would be reported and aggregated under this recommendation in the FY2016 CAFR for this city. Of course, additional information contained in the Exposure Draft (for example, the statutory authorization of each program and the eligibility criteria) would also be disclosed.

Abatement Program	# of agreements in effect	Amount of tax abated and remaining term of abatement
Property tax abatement for new construction in enterprise zone		
	2	$150,000/yr in tax through FY2020
	1	$50,000/yr in tax through FY2020; $25,000/yr in tax FY2021 through FY2030
Property tax abatement for construction or expansion of new manufacturing facility		
	1	$250,000/yr in tax through FY2018
	3	$175,000/yr in tax through FY2020
	2	$75,000/yr in tax through FY2020; $37,500/yr in tax FY2021 through FY2030

b) Where the specific amount of revenue to be forgone in future years as the result of a tax abatement agreement is not known, but where the abatement consists of an exemption from taxation of a known amount of assessed property value, the number of future years of the exemption would be disclosed along with the estimated revenue loss in the CAFR year and the amount of exempt property value. Only abatements offered under the same program with the identical ending date could be aggregated.

Example. A city has executed property tax abatement agreements with nine business taxpayers under two different state-authorized programs. The abatements take the form of an exemption of a fixed amount of assessed value for each taxpayer. The abatements differ in both the amounts of assessed value exempted and the amount of time remaining under the abatement agreement. The following table provides the relevant information about the abatements in effect as of the end of the CAFR year, FY2016:

Abatement Program	Taxpayer	Abatement (exempt assessed value)	Annual property tax savings in CAFR year (current tax rate is 20 mils)
Property tax abatement for new construction in enterprise zone			
	Taxpayer 1	$5,000,000/yr through FY2020	$100,000
	Taxpayer 2	$1,000,000/yr through FY2020	$20,000
	Taxpayer 3	$4,000,000/yr through FY2020; $2,000,000/yr FY2021 through FY2030	$80,000
Property tax abatement for construction or expansion of new manufacturing facility			
	Taxpayer 1	$5,000,000/yr through FY2018	$100,000
	Taxpayer 2	$3,000,000/yr through FY2020	$60,000
	Taxpayer 3	$2,000,000/yr through FY2020	$40,000
	Taxpayer 4	$1,000,000/yr through FY2020	$20,000
	Taxpayer 5	$4,000,000/yr through FY2020; $2,000,000/yr FY2021 through FY2030	$80,000
	Taxpayer 6	$2,000,000/yr through FY2020; $1,000,000/yr FY2021 through FY2030	$40,000

The following table shows how these agreements would be reported and aggregated under this recommendation. Of course, additional information contained in the Exposure Draft (for example, the statutory authorization of each program and the eligibility criteria) would also be disclosed.

Program	# of agreements in effect	Amount of tax abated and remaining term of abatement	Annual revenue loss in current year
Property tax abatement for new construction in enterprise zone			
	2	$6,000,000/yr through FY2020	$120,000
	1	$4,000,000/yr through FY2020; $2,000,000/yr FY2021 through FY2030	$80,000
Property tax abatement for construction or expansion of new manufacturing facility			
	1	$5,000,000/yr through FY2018	$100,000
	3	$6,000,000/yr through FY2020	$120,000
	2	$6,000,000/yr through FY2020; $3,000,000/yr in FY2021 through FY 2030	$120,000

c) Where the specific amount of revenue to be forgone in a future year as the result of a tax abatement agreement cannot be known at the time it is entered into but instead depends on future economic conditions, sales or profits or payroll of the abated taxpayer, tax rates in effect at the time, etc., governments should be required to disclose the remaining years to run of all such abatement agreements in effect as of the end of the CAFR fiscal year, together with the estimated revenue loss in the CAFR year itself. Only abatements offered under the same program with the identical ending date could be aggregated.

Example:

A state law authorizes the state's department of economic development to offer tax credits against the corporate income tax liability of companies that locate a new establishment in the state or expand employment at an existing establishment by at least 500 full-time equivalent employees. The credits may equal up to three percent of the new/expanded payroll for a period of up to 5 years. Excess credits may be sold to other taxpayers. The following table indicates the number of such credits outstanding as of the end of the CAFR year, FY2016:

Agreement	Remaining number of years in agreement	Annual revenue loss in CAFR year
Taxpayer 1	1	$1,000,000
Taxpayer 2	2	$1,500,000
Taxpayer 3	3	$1,000,000
Taxpayer 4	3	$1,250,000
Taxpayer 5	3	$2,000,000
Taxpayer 6	4	$1,000,000
Taxpayer 7	4	$2,000,000
Taxpayer 8	4	$2,500,000

The following table shows how these agreements would be reported and aggregated under this recommendation. Of course, additional information contained in the Exposure Draft (for example, the statutory authorization of each program and the eligibility criteria) would also be disclosed.

Number of Agreements	Remaining number of years in agreement	Annual revenue loss in CAFR year
1	1	$1,000,000
1	2	$1,500,000
3	3	$4,250,000
3	4	$5,500,000

We would be open to other variations of these recommendations that GASB might consider, but the point is that, at a minimum, the standard should in all cases require the reporting of the number of years yet to run on all existing tax abatements together with the most currently-available estimate of the revenue loss from the abatement.[3] Further, no aggregation of this information for abatements that have disparate numbers of additional years to run should be permitted.

[3] We note that GASB staff recommended that the standard mandate disclosure of the remaining term of abatement agreements. See: memorandum to Board Members and David Bean from Dean Mead, Mitchell Harrison, Ken Schermann, and Jay Fountain re: "Tax Abatement Disclosures: Potential Disclosure Requirements, Tentative Board Decisions to Date," May 12, 2014, p. 21.

2. The standard should require the disclosure of the specific recipients of all existing tax abatement agreements.[4]

The Exposure Draft document indicates that GASB considered and ultimately rejected inclusion in the standard of a requirement that the specific recipients of all existing tax abatement agreements be disclosed. The Exposure Draft document acknowledges that CAFR users surveyed during the research phase of the project placed a very high value on the disclosure of this information. In rejecting the proposal, GASB asserted that it "does not believe that disclosure of a tax abatement recipient's name fulfills any of the objectives of financial reporting." We disagree for the following reasons and therefore urge reversal of GASB's decision with respect to this issue:

a) The Exposure Draft document itself states that "The Board believes the commitments a government receives from the recipients are relevant information for assessing the sources <u>and uses</u> of resources," one of the four principle objectives of government financial reporting that GASB says are relevant to tax abatements.[5] The draft goes on to find that "A natural extension of the disclosure of recipient commitments is disclosure of recipient compliance with those commitments." The draft proposal rightly refrains from mandating that the financial notes include an assessment of recipient compliance with the terms of abatement agreements. But if such an assessment will not be in the notes, then the only way that it can occur is for CAFR users to be provided with the names of recipients so they can make an independent assessment of whether compliance in fact occurred.

b) A substantial share of tax abatement agreements are aimed at retaining existing businesses in a jurisdiction rather than attracting new ones to it. In such cases, businesses often need do nothing more than not leave the jurisdiction in order to qualify for the abatement. Without mandatory disclosure of the recipients of tax abatements aimed at business retention, citizens cannot perform an independent assessment of the likelihood that the business in fact would have left the jurisdiction and therefore whether the decision to forgo tax collection with the goal of retention was a wise use of a limited public resource – that is, the jurisdiction's tax base.

c) A number of other commenters have observed that the growing number of extremely large tax abatement deals means that some states and localities are tying their ability to meet their future financial obligations to the economic viability of one or two major ventures whose success is anything but assured (Tesla Motor's recently-announced battery plant, for example). In other cases, abatements may be granted to companies on the verge of failing in a desperate attempt to preserve existing jobs. In smaller jurisdictions, even relatively small tax abatements – say, to attract the regional warehouse of a "big-box" retailer – can comprise a relatively large share of the total property tax base. Finally, successfully attracting

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[4] The discussion of the previous recommendation regarding disclosure of the amount of time remaining on existing abatement agreements contemplates some possible aggregation of information for abatements with identical ending years. We acknowledge that should the Board accept our recommendation here that the specific identities of abatement recipients be subject to disclosure, little if any such aggregated reporting would be feasible. We discuss the merits of both issues separately because we expect the Board to consider them separately.

[5] Financial "information is intended . . . to assist these users of financial statements in assessing . . . (3) where a government's financial resources come from and how it uses them . . ." [Emphasis added.]

a large new employer with a tax abatement can result in costly and unaffordable new obligations to expand schools and other infrastructure if the existing local labor supply is inadequate and large numbers of workers and their families move in to fill newly-created jobs.

In all of these scenarios, the specific identity of the company receiving the tax abatement is highly relevant to an evaluation of whether the granting of the abatement was a wise use of public resources given the risks involved. These situations arguably occur frequently enough to justify disclosure of the identity of tax abatement recipients in *all* cases, but if the Board disagrees it could formulate dollar or share-of-revenue thresholds for the disclosure of recipient identities.

The decision to reject company-specific abatement disclosure seems to have been driven in part by concerns about the amount of detail that would have to be included in notes to the financial statements of jurisdictions with large numbers of abatement agreements in effect; inherent in the notion of providing information about the recipients is that little or no aggregation of individual abatement agreements is possible.[6] We believe that the benefits of company-specific disclosure discussed above substantially outweigh the practical drawbacks of not being able to aggregate abatement information under such an approach. However, if GASB remains concerned about this problem, we believe there is a viable solution: GASB could require the company-specific information to be published only online, with the CAFR merely providing the Internet URL at which that information could be obtained. It is easy to make a searchable database available online, and even a simple table with several hundred lines is not terribly inconvenient to scroll down.[7]

3. The definition of "tax abatement" should be clarified to ensure that it includes agreements in which tax revenue is forgone in exchange for an agreement to *retain* a facility and/or jobs in an existing location.

Several commenters have observed that the specific definition of "tax abatement" in the draft standard may not encompass certain types of common economic development tax incentives that are implemented through agreements with specific recipients, such as tax increment financing mechanisms and those that allow companies to retain employee wage withholdings and sales taxes collected from customers. We share those concerns and recommend that the definition be modified to encompass these types of tax abatements. We will not repeat the analysis underlying this recommendation because it has been offered and supported in sufficient detail by other commenters.

We further note, however, that the proposed definition of "tax abatement" also may fail to encompass tax breaks granted to incentivize the recipient to retain facilities and/or jobs in a particular jurisdiction. One of the criteria for identifying a tax abatement in the proposed

[6] In the Board's words: "[D]isclosure of the name of the recipient would necessitate individual disclosure of all tax abatement agreements, which may not be practical and may adversely affect the usefulness of the disclosure."

[7] See http://fortune.com/fortune500/, where all 500 corporations comprising the Fortune 500 are listed in a single frame with a scroll bar.

definition is that "the taxpayer promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or citizens of these governments." In the case of a retention agreement, the taxpayer is not "taking a specific action . . . that contributes to economic development," but, rather, is *refraining* from taking an action that would harm economic development, that is, not shutting down or relocating an existing facility or reducing the number of persons employed there.

Retention incentives appear to represent a significant share of tax abatements granted by certain governments, particularly as a defensive measure in multi-state metropolitan areas where nearby governments may seek to poach existing businesses with generous tax abatements. All of the considerations that have motivated GASB to consider adopting this standard apply just as much to tax abatement agreements aimed at retention as they do to abatements aimed at stimulating new economic activity and job creation. Accordingly, it is vital that GASB clarify the definition of tax abatement in the standard to ensure that it encompasses retention abatements. One possible modification to achieve this goal would be to re-write the language cited above to read: "the taxpayer promises <u>either</u> to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the governments or citizens of these governments <u>or to retain existing facilities, investments, and/or jobs in the jurisdiction</u>."

4. The definition of "tax abatement" should be modified to drop the requirement that the execution of the agreement precede the taxpayer activity that the abatement is intended to encourage.

We appreciate that GASB does not wish at this time to mandate disclosure of all economic development-oriented tax expenditures but rather limit disclosure to the types of tax expenditures for which publicly-available information is most limited and frequently completely unavailable – those provided to a specific taxpayer through an explicit or implicit agreement with that taxpayer.

Other commenters have pointed out, however, that GASB's decision to include in the definition of "tax abatement" a requirement that "the taxpayer promises to take a specific action *after the agreement has been entered into*" [emphasis added] is likely to exclude from the disclosure requirement a variety of performance-based tax incentives that satisfy all of the other criteria GASB has adopted for classifying a tax expenditure as a "tax abatement." We see no justification for this additional requirement, and, indeed, the Exposure Draft document itself acknowledges that most of the tax expenditures that would satisfy it would not qualify as "tax abatements" in any case because no "agreement" would actually exist.[8] We are also very concerned that this requirement would exclude from disclosure tax abatements that are sometimes approved for specific taxpayers as a reward for investments that have already been initiated, such as the expansion of an existing plant or the construction of a new one.

GASB has drawn a reasonable line between all economic development-oriented tax expenditures and "tax abatements" by defining the latter as encompassing only tax expenditures involving an

[8] "Most often, such programs do not involve an agreement; a taxpayer performs the required activity (such as installing energy-efficient home features), applies for the tax reduction, and is approved by the government." Exposure Draft document, p. 6.

implicit or explicit agreement between a government and a taxpayer. There is no need or justification for adding the additional requirement that the incentivized activity take place after the agreement has been entered into, and there is a very real risk that the inclusion of the requirement will forestall disclosure of many abatements that satisfy all of the other criteria that have led GASB to recommend disclosure in the first place.

Thank you for your consideration of these comments. They are also endorsed by the following organizations:

Arise Citizens' Policy Project (Alabama)
Kimble Forrister, Exec. Dir.

DC Fiscal Policy Institute
Ed Lazere, Exec. Dir.

Georgia Budget and Policy Institute
Alan Essig, Exec. Dir.

Fiscal Policy Center, Voices For Illinois Children
David Lloyd, Director

Maryland Center on Economic Policy
Benjamin Orr, Exec. Dir.

Michigan League for Public Policy
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Montana Budget and Policy Center
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New Hampshire Fiscal Policy Institute
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New Jersey Policy Perspective
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