

GASB 77 – TAX ABATEMENT DISCLOSURES

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The Governmental Accounting Standards Board (GASB) issued statement No. 77, *Tax Abatement Disclosures*, in August 2015 for financial statements beginning after Dec. 15, 2015. GASB Statement No. 77 defines tax abatements as an agreement between a government and an entity in which the government forgoes tax revenues in return for a promise from the entity to take specific actions that contribute to the economic development that benefits the taxpayers of that government. Auditors of governmental financial statements need to have an understanding of what is required by GASB 77 to ensure compliance with the standard by the reporting governmental entity.

History of Tax Abatements

Tax abatements became popular in the early 1930s when southern governments used abatements as recruitment tools to attract industries to remote and/or rural areas in an effort to diversify their economies. Present day, tax abatements, most common in the form of tax credits or cash grants, are increasingly used by state and local governments to encourage business investment and job creation.

In the last 30 years, both the amount and variety of tax abatements have increased significantly as evidenced by the over \$6.4 billion in disclosed tax abatements awarded in the United States by state and local governments in 2017 alone. However, with these projects quickly escalating and totaling billions of dollars in tax abatements, the users of the government financial statements – the investors and creditors – desired to know more about the impact of the tax incentives from both the present and future perspectives.

Tax abatements are just one component of economic development incentives used by state and local governments to attract and keep companies. While it is difficult to determine an exact number of incentives provided by state and local governments in the past due to inconsistent disclosures, one estimate in 2012 was that

total economic incentives were around \$80 billion, with Texas accounting for approximately \$19 billion.

Texas Tax Abatements

In Texas, there are a number of different tax-related economic development programs. They include:

- Incentives types, such as property tax incentives (tax increment financing, tax abatements, value limitations and Freeport exemption);
- Local sales and use tax incentives (development corporation act and county assistance districts);
- State sales and use tax incentives (enterprise zones);
- Sales and use tax incentive (chapter 380/381 agreements);
- Sales tax and local fee waivers (neighborhood empowerment zones);
- And others, such as the NAFTA impact zones.

However, only two of the programs are considered tax abatement programs and, therefore, are subject to GASB 77 disclosure requirements. They are Tax Code Chapter 312, which addresses tax abatements for municipal and county governments, and Tax Code Chapter 313, which addresses tax abatements through value limitations for school districts.

Tax Code Chapter 312, also known as the Property Redevelopment and Tax Abatement Act, was passed by the state legislature in 1987. The Texas Comptroller of Public Accounts defines a tax abatement as “a local agreement between a taxpayer and a taxing unit that exempts from taxation all or part of the increase in the value of real property and/or tangible personal property for a period not to exceed 10 years.” Section A of the act covers general provisions, while Section B and C cover municipal and county reinvestment zones. A city or county must first establish guidelines and criteria for the tax abatement agreements. Then the city or county must

Tax Code Chapter 312 and Tax Code Chapter 313 are considered tax abatement programs and are subject to GASB 77 disclosure requirements.

establish a reinvestment zone, because only real property that is in a designated reinvestment zone can be subject to a tax abatement agreement.

Once a reinvestment zone has been established, a city or county can negotiate and approve a tax abatement agreement as long as the required procedures have been completed. The term of the tax abatement agreement can be up to 10 years. The designation of a reinvestment zone can be up to five years, and the established guidelines and criteria automatically expire after two years. Section 312 will expire on Sept. 1, 2019, unless a bill to extend the expiration date is passed by the Texas Legislature and signed by the governor.

Some argue that renewing section 312 is imperative to ensure that Texas is competitive in attracting businesses to the state, while others argue that it is a form of corporate welfare that shrinks the tax base for municipal and county governments.

Tax Code 313, also known as the Texas Economic Development Act (Texas Tax Code 313), was passed by the legislature in 2002. Through this act, school districts are able to provide incentives to businesses through value limitations. The Texas Comptroller of Public Accounts defines a value limitation as "an agreement between a taxpayer and a school district in which the taxpayer proposes to build or install property – and create jobs meeting certain wage and other requirements – in exchange for a 10-year limit on its taxable value for school maintenance and operations tax (M&O) taxes.

For the term of the limitation agreement, school M&O taxes are not levied on the property value in excess of the limitation amount. Section 313 allows school districts to grant property tax breaks to companies and those tax breaks are reimbursed to the school district by the state using general state revenues. Section 313 is considered by some to be Texas' biggest tax incentive. School districts are allowed to provide this incentive if the tax break is a deciding factor in the company's decision to invest in that locality.

The Texas Comptroller's biannual report estimated section 313 incentives to be valued at approximately \$326 million in 2016 and projected it to grow to about \$1.1 billion in 2022. The Comptroller's report also indicated that in 2015, section 313 incentives supported 10,818 jobs in Texas and added approximately \$754 million in wages.

Rationale for GASB 77

The intent of GASB 77 is to ensure that tax abatement information is properly disclosed not only about a reporting government's own tax abatement agreements, but also those tax abatement agreements of other governments that reduce the reporting government's tax revenues. It was the position of GASB that financial statement users should have information disclosed to them regarding agreements that either reduce revenues or limit the revenue raising capacity of a government.

Past disclosure of tax abatements by state and local governments was found to be sporadic and insufficient to meet the needs of the public. Many tax abatements were found to be not recorded at all in the accounting system of the reporting government, because the taxes were either never billed or collected. In addition, it was found that recapture provisions were not enforced when the beneficiary of the tax abatement failed to meet its financial investment or job creating commitment.

GASB 77 requires the disclosure of tax abatement information, because it is considered necessary for understanding the following in the reporting government's financial statements:

- The ability to meet current year's expenditures with current year revenues;
- Compliance with legal and contractual obligations that affect its financial statements;
- The sources and uses of its financial resources; and
- The financial position and economic condition, as well as how those two changed over time.

Legal Prohibition to Disclosing Tax Abatements

Governments legally prohibited from disclosing specific information about tax abatements that are required by GASB 77 may omit the information provided that they disclose the general nature of the tax abatement information omitted and disclose the specific source of the legal prohibition.

Tax Abatements Covered by GASB 77

Tax abatements or reductions can go by a number

of different names, including abatements, reductions, exemptions, deductions, credits, rebates, value reductions and incentives. The focus of GASB 77 is one of substance over form.

The objective of GASB 77 is to require the disclosure of an agreement between a reporting government and individual or entity in which the government reduces the individual's or entity's taxes in return for a commitment by the individual or entity to perform an action or actions that will result in some benefit to the government or its taxpayers.

FASB Position on Government Assistance

In July 2015, the Financial Accounting Standards Board (FASB) proposed Accounting Standards Update Topic 832 that would require disclosures of government assistance that companies receive, as well as disclosures on the effect of that assistance on the company's financial statements. The proposal would require companies to disclose the following:

- The nature of the assistance;
- The items in the balance sheet and income statement affected by the assistance; and
- Terms and conditions of the agreement.

Feedback from companies raised a number of concerns that would result from the implementation of the proposed standards, which included:

- Increase in compliance costs;
- Difficult to quantify;
- Disclosure of information that is considered proprietary; and
- Places businesses in legal jeopardy.

Currently, FASB is continuing to research the topic and get feedback from all constituents.

IASB Standard on Government Assistance

International Financial Reporting Standards IAS 20, which was effective in 1984, addresses companies' disclosure of government assistance that they receive. IAS 20 provides guidance on how to disclose the government assistance and how to account for it in the balance sheet.

Companies can account for the assistance using either the capital approach or the income approach. With the capital approach, the company recognizes the assistance as equity, while the income approach allows the company to recognize the assistance as profit or loss over a span of at least one period. The capital approach is favored by those who view government assistance as a financing device and, therefore, should not be reflected in the profit or loss of a company. The income approach is favored

by those who do not agree with treating the assistance as equity, since the assistance is received from an outside entity that is not a shareholder.

Additionally, since the assistance provided requires the company to incur certain costs, the income approach advocates argue that because the costs are reflected in the profit and loss of the company, the assistance should also be reflected in the profit and loss.

GASB 77 Compliance

Every year, state and local governments must find ways to both increase and maintain business investments and job creation through economic development packages for *Fortune* 500 companies, global brands and local startups. Rural America accounts for over half of the U.S. landmass, and state and local leaders are aware that they must rebrand their municipalities to both stabilize their current population while also attracting new residents to their communities. Often, the price tag of these growth initiatives is large amounts of foregone tax revenues by these government entities.

In 2013, GASB added the project on tax abatement disclosures to the board's technical agenda and noted that it had become apparent that tax abatements have a significant effect on a government's financial health. Per GASB, a government failing to disclose those tax abatements severely limits the financial statement user's ability to understand the impact of those abatements on the reporting government's current financial resources and whether the government entity will be able to meet its future financial obligations, such as bond and pension payments.

After two years of board discussions and comments

FIGURE 1. DISCLOSURE REQUIREMENTS

- Disclose own tax abatement separate from tax abatements of other governments that reduce the taxes of the reporting government
- Own tax abatements are to be disclosed by major program
- Tax abatements of other governments are disclosed by government and specific tax abated

Disclosure begins in the period in which a tax abatement agreement is entered into and continues until the tax abatement agreement expires

FIGURE 2. REPORTING GOVERNMENT'S OWN ABATEMENT DISCLOSURE ITEMS

- Name of program
- Purpose of program
- Type of tax abatement
- Amount of tax being abated
- Criteria for eligibility
- Mechanism for abatement
- Provisions to recapture abatements
- Types of commitments from recipients
- Amounts received or to be received from other governments
- Any other commitments associated with the abatement by the government
- Quantitative threshold for disclosure
- Information omitted due to legal prohibitions

FIGURE 3. REPORTING GOVERNMENT'S DISCLOSURE ITEMS OF OTHER GOVERNMENTS THAT AFFECT ITS OWN TAX REVENUES

- Name of government
- Type of tax abatement
- Amount of tax being abated
- Amounts received or to be received by the reporting government
- Quantitative threshold for disclosure
- Authority by which tax abatements are entered into

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from the profession, GASB issued Pronouncement 77 in an effort to ensure that any agreements that reduce or limit the revenue generating ability of a government are to be properly disclosed. Although GASB 77 requires the disclosure of tax abatements, it is not intended to communicate whether or not it was an effective or efficient use of taxpayer current or future resources for economic development or job creation.

Endnotes

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