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Subject: ED & SALT LSs: GASB and state Tax Incentives (Part 2)

New Rule Could Require Governments to Report Tax Incentives as Lost Income

It's the biggest effort yet to make government tax subsidies more transparent.

BY LIZ FARMER | OCTOBER 31, 2014

Corporate tax incentives have become an increasingly popular way for state and local governments to try to attract new businesses. Now those subsidies could begin affecting governments' budgetary bottom lines, under an accounting change being considered that would require reporting those incentives as lost income in annual financial reports.

On Friday, the Governmental Accounting Standards Board (GASB) issued for public comment proposed rules for requiring state and local governments for the first time to disclose information about property and other tax abatement agreements. If approved, the new disclosures could shed light on a previously murky area of government finance and provide hard data on information that has often been assembled piecemeal, if at all. Stakeholders have until Jan. 30, 2015 to comment.

“This is huge," said Greg LeRoy, executive director of Good Jobs First, a policy center that advocates for transparency in economic subsidies. "If you care about school finance or smart growth or regionalism or land use in general, this data will enable you to figure things out that were unthinkable before.”

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Many state and local governments currently have tax abatement programs in place, and the impact of those abatements can be substantial. But there's no way to know the magnitude or the nature of those programs just by looking at government financial statements. Efforts to track such data in the past have been initiated by third-party organizations like Good Jobs First or by media outlets. In 2012, *The New York Times* reported that state, county and city incentives total some $80.4 billion every year. Texas led the nation in incentives, according to the *Times*, offering around $19 billion annually.

“Tax abatements can significantly reduce the amount of revenue a government receives,” said GASB Chair David A. Vaudt in a statement. “But in many cases, little is known publicly about their total size or their terms and conditions. What the Board has proposed would make the financial impact of these transactions much more transparent.”

The proposed tax abatement disclosure requirements would include:

• The tax being abated

• Criteria that must be met for the taxpayer to be eligible for the abatement

• Provisions for recapturing abated taxes

• The types of commitments made by tax abatement recipients

• Number of tax abatement agreements

• Dollar amount of taxes abated

• Other commitments made by a government, such as to build infrastructure assets.

LeRoy said that data could have the biggest implications for school districts, which in most cases are funded by property taxes. Under the proposed disclosure requirements, part of property tax abatements whould show up as lost income for districts. Good Jobs First has released its own analysis of the requirement's implications.

“Schools are obviously the biggest losers when councils grant property tax abatements and tax increment financing agreements,” LeRoy said. “Typically about half of that money would have gone to school districts.”

Also of note is the provision requiring governments to report the criteria that businesses must meet for the abatement and how governments will get that money back if the goals aren't achieved, commonly referred to as clawback provisions. That requirement “puts this on the forefront of disclosures,” said Justin Marlowe, a *Governing* contributor and a public finance professor at the University of Washington’s Evans School. “The fact that they’re going to make entities disclose whether they’ve ever done a clawback is really big and will reveal something about that jurisdiction from a policy standpoint that might not otherwise be clear.”

A change of this magnitude is sure to meet resistance. GASB, established in 1984, has a history of stirring the pot with its proposed accounting standards -- so much so that it was the subject of a 2009 *Journal of Financial Management* article that outlined the board’s increasingly tumultuous role in government accountability in accounting. And in 2007, the Government Finance Officers Association went so far as to try and abolish GASB and transfer the board’s responsibilities to the organization that sets accounting standards for the private sector.

Marlowe predicts strong pushback from those who would argue that reporting tax abatements isn’t an accounting issue – that policymakers think of these decisions as investments, rather than a drain on finances. “But I think what GASB is saying is that state governments and others have had plenty of chances now to put this out there,” Marlowe said. “A lot of what the GASB has done recently is say, ‘Look, no one else is stepping up. If we have to be the ones, than that’s what has to be done.’”

GASB Tax Abatement Disclosure Draft Rule Analysis

By: Ryan Maness, Research Analyst
October 22, 2014

The Governmental Accounting Standards Board (GASB) will hold a comment period from 11/2014 – 6/2015 on a new draft rule that it hopes will bring transparency to the tax abatement programs used in many state and local jurisdictions. GASB intends to issue a final rule in 8/2015, effective for financial statements for fiscal years beginning after 12/15/2015, though earlier adoption would be encouraged.

As described on the Tax Abatement Project's homepage, GASB has been contemplating a regulation on this issue for several years. GASB reports 44 states provide some form of tax abatements, but there is wide variation in disclosure procedures for those abatements. In 2013, GASB surveyed citizen groups, local policymakers and municipal bond analysts to gauge interest in increased tax abatement transparency. The survey found high levels of agreement that governments should generate annual tax abatement and tax recapture reports, and should make these reports available to lawmakers and the general public.

GASB has conducted meetings since 03/2014 to develop the language for its draft rule. In current form, the rule would require governments to disclose:

- General descriptive information about tax abatements, including: the specific tax being abated, relevant statutory authority, eligibility criteria, abatement mechanisms, recapture provisions, and types of commitments made by abatement recipients;
- The number of abatements entered into and in effect during the reporting period;
- The total dollar value of taxes abated during the reporting period; and
- Other inducements, other than to abate taxes, provided as a part of an abatement agreement.

Specifically excluded from the reporting requirements would be disclosure of the names of abatement recipients and whether recipients had acted in compliance with abatement stipulations. The proposed language (p. 13) defines a tax abatement as:

"An agreement between one or more governmental entities and a taxpayer in which (a) one or more governmental entities promise to forgo revenues from taxes for which the taxpayer otherwise would have been obligated and (b) the taxpayer promises to take a specific action after the agreement has been entered into that contributes to economic development or otherwise benefits the government(s) or its citizens."

Thus, abatements covered by the GASB draft could exist not only between a taxpayer and a reporting governmental entity, but also between a taxpayer and other governmental entities so long as the agreement affects the reporting governmental entity's ability to generate revenue.

Due to the substantial volume of tax abatements in some jurisdictions, governments would have the option to disclose its abatements either individually or in aggregate, but the rule stresses "that aggregating all tax abatement agreements would significantly reduce the usefulness of the disclosures." It goes on to specify that aggregating the disclosure of "major programs" would be an acceptable approach. The disclosures would be made publicly available as a part of governments' regular financial statements.

Proposed GASB Standards for Reporting of Tax-Based Economic Development Subsidies

GASB is Proposing New Rules for State and Local Governments to Report on the Costs of Tax-Based Economic Development Subsidies. Public Comments on the Proposed Standards Are Invited Now through January 30, 2015.

For the first time ever, the body that oversees public sector accounting standards is proposing that state and local governments report how much revenue they lose to business tax breaks granted for economic development purposes. Using the umbrella term "tax abatements" to cover property, income and sales tax-break programs, the Governmental Accounting Standards Board (GASB or "GAZ-bee") is finally ending its long, conspicuous silence on the issue.

Good Jobs First's Detailed Summary and Critique of the Proposed GASB Standard on Tax Abatement Disclosures (shorter version is below)

The GASB Subsidy Disclosure Project Overview page

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Why GASB's Proposed New Rules are So Important

Never in its history has GASB issued standards specifically addressing the estimated $70 billion per year states and cities spend each year in the name of jobs. Although much of this spending is recorded (albeit in many different places), tax breaks for economic development are by far the costliest subsidies and also the least well disclosed. So GASB's development of standards to cover reporting of business tax breaks is truly a landmark event.

GASB sets rules that accountants, auditors, and other finance professionals follow when they prepare financial reports. GASB's rules are known as Generally Accepted Accounting Principles (GAAP). Because nearly all state and local governments conform to GAAP, this new standard will have huge ramifications.

Good Jobs First believes that when states and localities start issuing new data under this Standard in 2017, it will enable massive new bodies of analysis and reform policymaking. Organizations and scholars concerned with state and local finances, tax policy, government transparency, economic development, regionalism and sprawl, public education finance, campaign finance, and contracting and privatization will all gain access to significant information heretofore unavailable.

How Much More Will We Learn About Subsidy Spending Under the Proposed GASB Standard?

The short answer is: Far more than we know now, but possibly not nearly as much as we'd like. A lot depends on how much GASB responds to public comments it may receive during the 90-day comment period (ending January 30, 2015). GASB is known to carefully consider feedback from the public during its process of finalizing new standards.

Because GASB has never ventured into tax expenditures for economic development before, what we have now is the Wild West: a great deal of data of very uneven quantity and quality from some state and local governments. Some jurisdictions have good aggregate disclosure (usually through tax expenditure budgets), some have good disclosure of individual awards (including recipient names and other details we capture for our Subsidy Tracker database) and some do well by both measures, while some do poorly on both. Our research indicates that states are more likely to report both company-specific data and aggregate spending than are localities. See our most recent ratings of company-specific state transparency here and of local transparency here.

The proposed GASB standard would ensure that every jurisdiction discloses (in its financial statements) at least the aggregate revenue lost to each of its economic development tax-based subsidy programs. It will also require government bodies that lose revenue due to the action of other public bodies to report such losses (think school boards losing property tax revenue due to property tax abatements or tax increment financing granted by city councils or county boards).

Possible Shortcomings in the Coverage of GASB's Standard

Good Jobs First will soon post our formal public comment on the Exposure Draft. For a fuller discussion of possible shortcomings, go to our detailed analysis and critique here.

We see three broad kinds of possible coverage problems:

Omitted Costs: because of the way GASB defines a "tax abatement," (its umbrella term for economic development tax breaks), several kinds of costly subsidies might not qualify for coverage. These include (at least): tax increment financing (TIF, diverting property, sales and/or other taxes), performance-based incentives, Payments in Lieu of Taxes or PILOTs, personal income taxes that are diverted to employers, and sales tax diversions to retailers (non-TIF).

No Recipient Disclosure: Although GASB considered whether to include the disclosure of deal-specific, company-specific disclosure (which has always been Good Jobs First's litmus test for transparency), it chose not to include such a rule. GASB compromised here, saying governments may voluntarily list deals, described but not with identifying company names. GASB determined that recipient disclosure is not needed for GASB's core mission of sound public budgets; we disagree and will articulate why in our formal comments.

No Long-Term Liability Disclosure: GASB is best known in recent years for its new rules requiring disclosure of Other Post-Employment Benefits (OPEB, or pensions and retiree health care costs) and infrastructure replacement costs. In both cases, these standards require projections about future liabilities (which necessarily require assumptions about variables such as inflation and interest rates). But in its Exposure Draft on tax abatements, GASB chose to only require a single-year snapshot of lost revenue, with no future-years' liabilities. We consider this imprudent because some economic development programs have created enormous future-year "budget icebergs" that must be navigated and should be clearly visible.

These criticisms are rooted in Good Jobs First's deep, intimate knowledge of economic development spending data. While having the aggregate costs of every tax-based job subsidy program published by every unit of government will be true progress, we know the data already exist in far more useful forms as well. We know that economic development agencies have deal-specific records; we know that the projected future costs of programs are routinely legislated or estimated; and we know that subsidies such as TIF really do constitute tax breaks for targeted recipients.

How Your Organization Can Comment on GASB's Proposed Standard

GASB's instructions for commenting are contained within the Draft Exposure itself and reproduced below. Your comments will become part of GASB's public file on the matter.

Comments should be addressed to the Director of Research and Technical Activities, Project No. 19-20E, and emailed to director@gasb.org or mailed to the address below.

Governmental Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

You may also want to revisit this web page, which we will keep updated, and/or contact Good Jobs First. Stay tuned for more information!

The Timeline for the GASB Process

The timeline for public comments and other GASB milestones leading up to the final standard is detailed below. **The most critical window is now through January 30, 2015; that is the 90-day window for comments**. There will be no public hearings.

2008: GASB began to explore the issue of tax abatement disclosure.

2010: GASB commissioned academic research on the subject.

Early 2012: GASB begins to investigate the need for disclosure guidance for governments that have granted tax abatements.

2012 through August 2014: GASB combines staff research with outside commissioned research and debates the issue during numerous meetings, drafting initial recommendations.

October 20, 2014: GASB unanimously votes out an Exposure Draft

November 1, 2014 through January 29, 2015: GASB opens one 90-day comment period to collect, evaluate, and incorporate feedback on its proposed new rules for disclosure of tax abatements. No hearings will occur during or after this comment period.

March through June 2015: GASB will re-deliberate the standard, per the comments it receives.

July 2015: GASB will review its draft of final Statement (new Generally Accepted Accounting Principles)

August 2015: GASB will issue its final Statement.

December 15, 2015: Budgets that occur after this date are covered by the new Standard (i.e., budgets that start in calendar 2016). Governments are free to comply earlier, as soon as the final Standard is issued.

2017: First year in which large numbers of Comprehensive Annual Financial Reports (CAFRs or "CAY-ferz") will be published (for the prior year), triggering massive new opportunities for analysis and reform.

GASB 101

What is GASB?

The Governmental Accounting Standards Board is the professional organization that establishes and improves standards of accounting and financial reporting for U.S. state and local governments. GASB's rules are known as Generally Accepted Accounting Principles, or GAAP, and most units of government choose to conform to GAAP in order to get credit ratings to sell bonds.

GASB's description of itself is linked here.

GASB is not a government entity and its rules are not legislation, but as we detail below, GAAP has the force of law in many states and localities. GASB is technically an “operating component” of the independent, nonprofit Financial Accounting Foundation (FAF). A sister component of FAF, the Financial Accounting Standards Board, or FASB, plays the same role for private-sector accounting, including publicly traded corporations as they report to shareholders.

All of which is to say: GASB and FASB are foundational to the integrity of the U.S. financial system, protecting taxpayers, investors and consumers every day by promoting financial records that are complete, uniform and comparable.

Who Leads GASB and How is GASB Funded?

GASB’s seven-member board is composed of finance and accounting professionals and academics with extensive public sector accounting experience. Founded in 1984, the organization is funded by accounting support fees established under the Dodd-Frank Wall Street Reform and Consumer Protection Act.

Which Government Budgets are Covered by GASB’s Accounting Standards?

The vast majority of states and localities conform their financial reporting and accounting practices to GAAP issued by GASB. Local government bodies include cities, counties, school districts, townships, villages and other local taxing entities. Three-quarters of all states even have laws that mandate the use of GAAP. A research brief published by GASB in 2008 found that even in those states that do not legislatively require it, 87 percent of the major municipalities in those states conform to GAAP. GASB is recognized as the official source of government accounting standards by the accounting industry, capital markets, and governments themselves.

What are the Current Generally Accepted Accounting Principles (GAAP) for Economic Development “Tax Abatements”?

There are none. While the majority of states now publish tax expenditure budgets of varying quality, there are no GAAP specifically covering how government financial reports account for economic development tax abatements. Even though they spend an estimated $70 billion per year on economic development, most of it in foregone tax revenue, state and local governments are not required to disclose any specific kind of information related to tax abatements under current GAAP.

Because there is no standard reporting practice for tax abatements, the quality of financial disclosure of this information varies widely. Many states and localities fail to account for abatements entirely. Much of what passes for abatement disclosure is actually forecasted estimates of foregone revenues for budgeting purposes, not actual accounting. For this reason, policymakers and academics have never been able to state with precision the real cost—or cost trend—of economic development subsidies to state and local governments. We believe the most credible national estimate is $70 billion annually (by Prof. Kenneth Thomas), but that figure was for 2006, and we believe it is conservative.

Why Is GASB Developing GAAP for Tax Abatements?

GASB does not disclose its reasoning for taking up a particular issue. But to commission research and even consider rule-making, the Board must agree that an issue is broadly prevalent and has considerable financial magnitude to governments. We do know that the rising costs of economic development tax expenditures have prompted debates within government finance circles for many years, even as far back as the late 1980s within the Government Finance Officers Association, which convened a task force on the issue.

More recently, as we have documented in studies such as our “Megadeals” report, the number and cost of extremely expensive deals has spiked since 2008. And our Subsidy Tracker database of economic development awards has documented how prevalent and costly such expenditures have become. Policymakers, bond analysts, credit ratings agencies, and taxpayers all have a strong self-interest interest in better disclosure of tax abatements.

Finally, GASB notes in the Exposure Draft that one of its longstanding accounting principles considers whether tax revenues are sufficient to pay for current-year obligations and whether future taxpayers are effectively paying today’s bills. So tax abatements that reduce revenue are relevant to those issues (paragraph B19).

GASB’s Choice of Terminology

At Good Jobs First, we refer to economic development expenditures of any structure as “subsidies.” We call tax-based incentives awarded to businesses as tax subsidies or tax breaks. We have historically used the term “abatement” to refer specifically to property tax exemptions or reductions, but GASB uses this term broadly. GASB defines a tax abatement as “a reduction of or exemption from taxes, offered by a government to a specific taxpayer, typically for the purpose of spurring economic development [or other public benefits].”

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