



Government and Economic Incentives ADVISORY ■

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GASB Issues Final Rule on Financial Reporting of Tax Abatements

On August 15, 2015, the Government Accounting Standards Board (GASB) issued *Statement No. 77*¹ (the “Tax Abatement Standard”) concerning financial reporting of tax abatements and other economic development incentives that reduce tax revenues. The new Tax Abatement Standard applies to financial reports of all state and local governmental entities. The requirements are effective for financial statements for reporting periods beginning after December 15, 2015,² though the GASB encourages earlier compliance.

Purpose

Noting that state and local governments employ a variety of programs and policies that reduce taxes with the intent of encouraging economic development, job creation or other governmental goals, the GASB adopted its Tax Abatement Standard for the general purpose of providing citizens, taxpayers, legislative and oversight bodies, municipal bond analysts and others with information regarding tax abatement agreements in order to permit them to better evaluate the financial health of governments, make decisions and assess accountability.

Who Does It Affect?

State and local governmental entities

The Tax Abatement Standard applies to the “financial reports of all state and local governmental entities, including general purpose governments; public benefit corporations and authorities; public employee retirement systems; and public utilities, hospitals and other healthcare providers, and colleges and universities” (collectively, “governments”).

Nonparty affected governments

Even if a government is not a party to the abatement agreement, it can be subject to the reporting requirements of the Tax Abatement Standard if the tax abatement agreement is entered into by one of such government’s component units (e.g., a wholly owned and funded nonprofit), in which case it is treated as if it entered into the agreement. A government must disclose if an abatement agreement results in reduced tax revenue even if it did not enter into such

¹ A link to the new rule can be found here: http://www.gasb.org/jsp/GASB/Document_C/GASBDocumentPage?cid=1176166283745&acceptedDisclaimer=true.

² Government officials should discuss the impact of the new standards with their external auditors and accountants.

agreement (a “nonparty government”). For instance, a tax abatement agreement entered into by a county that affects the tax revenue of the independent county school system and a municipality within the county must be disclosed by the school system and municipality. However, the information required to be reported by the nonparty government is more limited than the information required to be reported by the government that is a party to the agreement. (See *Disclosures Concerning Other Government Tax Abatement Agreements* below.)

Government “components”

Tax abatement agreements entered into by component units of a government may need to be disclosed by the government as if it had entered into such agreements. The GASB generally defines “component unit” as “A legally separate organization for which the elected officials of the primary government are financially accountable.”^{3,4} The example provided in the Tax Abatement Standard is “a separate legal entity established by a primary government for the purpose of deploying economic development strategies, including tax abatements, for the benefit of the government’s jurisdiction or larger region in which the government operates.” The standard goes on to state that the more limited disclosures required by nonparty affected governments may fall short of the disclosures required to be made, particularly when the actions of such governmental component could be considered to be virtually the actions of the primary government. However, the Tax Abatement Standard did not go so far as to define what entities would constitute a governmental component and instead left it to the professional judgment of the primary government to determine whether the tax abatement information related to tax abatement agreements entered into by other related governmental or quasi-governmental entities is essential for the fair presentation of their financial statements.

What Tax Abatements Are Required to Be Reported?

Definition

For financial reporting purposes, a tax abatement is defined as:

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.

The Tax Abatement Standard applies to all taxes, not just property taxes, and to tax reductions regardless of whether they take the form of an exemption, credit, rebate or traditional abatement. It is also not relevant whether the tax abatement agreement is in writing or whether it is legally enforceable. The Tax Abatement Standard specifically provides that “[a] transaction’s substance, not 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.”

³ See GASB Statements 14, 39 and 61 for additional discussion regarding “component units.” Also see: http://www.aicpa.org/InterestAreas/GovernmentalAuditQuality/Resources/AuditPracticeToolsAids/DownloadableDocuments/GASB%2061%20Issues%20Paper_FINAL.pdf and www.bkd.com/docs/pdf/gasb%2061.pdf

⁴ The Georgia Department of Community Affairs Report of Registered Authority Finances Definitions provides that “If your authority’s financial activities are included in the audited financial statements of a local government jurisdiction, the implication is that your authority is a component unit of that government, and that this local government jurisdiction is the primary government. Component unit entities often have separate audits and publish their own audited component unit financial statements; however, component units are still included in the financial statements of a local government jurisdiction.” See <https://www.dca.ga.gov/secured/DCASurveys/RegisteredAuthorities/login.html>.

Performance-based tax reductions excluded

In the Tax Abatement Standard, the GASB attempts to distinguish between tax abatement agreements and (1) governmental tax expenditure programs, such as those providing income exclusions for interest on municipal bonds or property tax deductions for senior citizens or military veterans, and (2) tax deductions, such as income tax deductions for charitable gifts. It does so by denoting that in the case of such tax expenditures and tax deductions, the government does not commit to abate or reduce taxes until after the taxpayer performs the required activity. It states that while such performance-based incentives could be provided through an agreement, such incentives most often involve programs that more closely resemble broad tax exemptions and deductions rather than individual tax abatement agreements. However, in a later section, the GASB states that whether a tax abatement is broadly available or not cannot be used to distinguish tax abatements that are or are not subject to the Tax Abatement Standard. An example given of an excluded tax reduction is a program permitting taxpayers who install energy efficient home features to deduct a portion of the cost from their income taxes.

What Information Must Be Disclosed?

Disclosures concerning a government's tax abatement agreements

For tax abatement agreements entered into by a government, the Tax Abatement Standard requires the government to disclose the following information about those agreements in the notes to their financial statements:

a. Brief descriptive information, including:

1. Names, if applicable, and purposes of the tax abatement programs
2. The specific taxes being abated
3. The authority under which tax abatement agreements are entered into
4. The criteria that make a recipient eligible to receive a tax abatement
5. The mechanism by which the taxes are abated, including:
 - (a) How the tax abatement recipient's taxes are reduced, such as through a reduction of assessed value
 - (b) How the amount of the tax abatement is determined, such as a specific dollar amount or a specific percentage of taxes owed
6. Provisions for recapturing abated taxes, if any, including the conditions under which abated taxes become eligible for recapture
7. The types of commitments made by the recipients of the tax abatements.

b. The gross dollar amount, on an accrual basis, by which the government's tax revenues were reduced during the reporting period as a result of tax abatement agreements.

c. If amounts are received or are receivable from other governments in association with the foregone tax revenue:

1. The names of the governments
2. The authority under which the amounts are or will be paid
3. The dollar amount received or receivable from other governments.

d. If the government made commitments other than to reduce taxes as part of a tax abatement agreement, a description of:

1. The types of commitments made
2. The most significant individual commitments made.

Information about a commitment other than to reduce taxes should be disclosed until the government has fulfilled the commitment.

Disclosures concerning other government tax abatement agreements

The Tax Abatement Standards require governments whose tax revenues are affected by tax abatement agreements entered into by other governments to disclose in the notes to their financial statements the following information separately from the information disclosed for their tax abatement agreements:

- a. **Brief descriptive information, including the names of the governments entering into the tax abatement agreement and the specific taxes being abated**
- b. **The gross dollar amount, on an accrual basis, by which the reporting government's tax revenues were reduced during the reporting period as a result of the tax abatement agreements**
- c. **If amounts are received or are receivable from other governments in association with the foregone tax revenue:**
 1. The names of the governments
 2. The authority under which the amounts are or will be paid
 3. The dollar amount received or receivable from other governments
- d. **If the tax abatement agreements are disclosed individually, a brief description of the quantitative threshold the reporting government used to determine which agreements to disclose individually.**

The Tax Abatement Standard provides that governments should organize those disclosures by major tax abatement program and may disclose information for individual tax abatement agreements within those programs or may aggregate larger numbers of similar agreements. Examples of required disclosures are included in Appendix C of the Tax Abatement Standard.

Exclusions from disclosure

A government may omit specific information required by the Tax Abatement Standards because such information is legally prohibited from being disclosed; however, it must provide a description of the general nature of the tax abatement information omitted and the specific source of the legal prohibition. Other information that is not required to be disclosed includes the names of the recipients of such tax abatement agreements, whether or not those recipients have complied with their commitments under such tax abatement agreements, the amount, if any, of funds recaptured or which are subject to being recaptured from such recipients under related clawback agreements or other similar agreements and the value of any other commitments made by a government in connection with a tax abatement agreement. Furthermore, unlike the required description of the tax abatement agreement itself, the required descriptions of any other commitments made by a government in connection with a tax abatement agreement may cease after the commitments have been met.

Open Issues and Questions

There remain a number of outstanding issues and questions regarding how the Tax Abatement Standard is to be applied.

Government or "component"?

Is a particular entity that enters into a tax abatement agreement a "government" or the "component" of a government? For instance, a development authority created or activated by a government for the general purpose of encouraging economic development might be considered a separate government⁵ or as a component of the government that created or activated it for purposes of the Tax Abatement Standard. If the development authority's financial activities are

⁵ The GASB and FASB agree that "public corporations and bodies corporate and politic are governmental organizations" and some nonprofit 501(c)(3) entities are also considered governments for account purposes. See Miller Governmental GAAP Guide for State and Local Governments (2011).

included in the audited financial statements of the city, county or state, it would seem clear that it should be deemed a component of the city, county or state. However, a disclosure example appearing in Appendix C of the Tax Abatement Standard appears to treat a multicounty economic development corporation as a separate government. If multicounty development authorities and other sufficiently independent authorities are not component units of member counties and cities, could use of such authorities reduce the reporting burdens of member cities and counties?

Government agents

It appears clear that tax abatements provided or authorized by an office or department of a government will be deemed provided by the government. However, would a board of tax assessors appointed by a county be considered the government or an agent of the government? Many traditional tax abatement agreements require the board of tax assessors to be a party to such agreement.

Tax abatement agreement definition

One of the two required components of a tax abatement agreement is the requirement that the government promise to forgo revenues from taxes for which the taxpayer otherwise would have been obligated. If an entity that signs a tax abatement agreement does not have the power to agree to reduce taxes and can do so independently of the government whose tax revenue will be affected, is such a tax abatement an agreement? In Georgia, a development authority may agree to enter into a transaction that has the effect of reducing property taxes without the approval or consent of the city or county that activated the development authority. If the answer to this question is that such transaction would still constitute a tax abatement agreement covered by the Tax Abatement Standard and if the development authority is not deemed a component of the government that activated it, then it would appear that the government would only need to disclose the information regarding the tax abatements required by a nonparty government.

Performance-based tax abatement agreements

The Tax Abatement Standard expressly excludes performance-based tax expenditure and tax deduction programs and agreements when the government does not commit to abate taxes until after the recipient performs the activity for which the government is providing the tax abatement. The example used in the "Basis for Conclusions" in Appendix B of the Tax Abatement Standard was the receipt of an income tax deduction by homeowners for a portion of the cost of installing energy efficient home features. However, a couple of disclosure examples included in Appendix C indicate that the mere requirement that a taxpayer apply under an established program providing tax abatements prior to taking the actions qualifying for the abatements would suffice as a commitment or agreement to provide the abatements. In one example, a county was required to disclose information as a nonparty government regarding a state renewable energy incentive program that offered sales tax rebates and credits against county income taxes on investments in clean energy sources and energy efficient vehicles and facilities made by persons who apply under the program prior to making such investments. In another example, a county was required to disclose the tax abatements provided under a county residential improvement program that permitted homeowners applying in advance of making home improvements to receive a 100 percent abatement of the additional property taxes resulting from the increase in assessed value due to the construction of such improvements. Thus, in order to avoid classification as a "tax abatement agreement" under the Tax Abatement Standard, a government could establish a policy or program that provides certain tax benefits for new or expanded projects that satisfy certain capital investment and/or job creation criteria so long as there is no prior agreement or required application and such tax benefits are not provided until after the project and/or hiring is completed. Would the issuance by the government of a confirmation that the project would comply with such program criteria constitute a prior commitment or agreement? What if the taxpayer were merely required to file a notice prior to construction?

PILOT payments

Does a government need to disclose payments in lieu of taxes (PILOT) payments? What if the tax abatement agreement specifically requires the recipient to make PILOT payments in the amount that such recipient would otherwise have been required to pay for school taxes? Do payments have to be reported? Does the school system have to include the tax abatement agreement in its financial disclosure if its tax revenues are not expected to be affected?

Community benefits

One of the criticisms of the Tax Abatement Standard made by the Government Finance Officers Association, National League of Cities, Georgia Government Finance Officers Association and other similar organizations is that the standard ignored the economic benefits associated with tax abatement agreements and that, by focusing just on tax reductions, disclosures not discussing associated benefits of a tax abatement agreement would be misleading. However, can a government voluntarily note economic benefits in its financial statements by, for instance, including the amount of additional direct or indirect property or other taxes paid as a result of the projects subject to the tax abatement agreement?

TIFS/TADS and other tax diversion agreements

Does the Tax Abatement Standard apply to tax increment financings (TIFs) entered into in connection with tax allocation districts (TADs) or other tax diversion agreements under which a government agrees to use all or a portion of certain property, sales or other taxes to make infrastructure improvements for a private development or to pay debt service on bonds the proceeds of which are used to fund those infrastructure improvements? In these transactions, the government does not suffer a reduction in tax revenues, but rather agrees to use them for specific, project-related purposes. Does the use of such taxes by the government constitute forgone taxes or a tax rebate? Do these types of agreements constitute performance-based agreements that are not subject to the Tax Abatement Standard? What if such improvements are limited to public property that must be made as a condition to a private development? The Tax Abatement Standard makes no specific mention of these widely used development incentives, except to state that the recipient of a tax abatement can be a remitter of taxes, rather than the obligor of the tax, such as a retail business in a sales tax diversion agreement.

Nontax incentives

As the title suggests, the Tax Abatement Standard deals with taxes and specifically makes it clear that agreements to reduce utility rates or charges are not considered tax abatements for reporting purposes even if the utility (electric, water, telecom, water, etc.) is a component unit of the reporting government. Likewise, it would appear that agreements to reduce or eliminate license or permit fees or utility connection charges would not be covered by the Tax Abatement Standard. However, if such agreements are entered into contemporaneously with a tax abatement agreement, those agreements could be deemed an "other commitment" and subject to disclosure. Should governments with related utilities consider using utility incentives in lieu of traditional property tax abatements to incentivize development and thereby reduce reporting requirements?

Disclosure of other commitments

The Tax Abatement Standard requires governments that enter into covered tax abatement agreements to disclose information about other government commitments made as a part of a tax abatement agreement, but such disclosures are not required to be made by affected nonparty governments. Thus, if a government establishes an abatement program that does not qualify as a tax abatement agreement covered by the Tax Abatement Standard, or other nontax government commitments are made in the absence of any tax abatement agreement, then it would appear that such

additional government commitments would not be required to be disclosed. What if a development authority that is not deemed to be a component of its activating city or county enters into an abatement agreement and separately, such city or county agrees to make other nontax commitments for the same project? Does the city or county have to disclose such commitments even though it did not enter into the tax abatement agreement?

For more information, contact [Glenn Thomson](#) at (404) 881-7561 or [Peter Floyd](#) at (404) 881-4510.

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For more information regarding tax abatements or other economic development opportunities, please contact any of the Alston & Bird attorneys listed below.

Mary T. Benton
State & Local Tax
404.881.7255
mary.benton@alston.com

Glenn R. Thomson
Real Estate Finance and Investment
404.881.7561
glenn.thomson@alston.com

Peter K. Floyd
Real Estate Finance and Investment
404.881.4510
peter.floyd@alston.com

Della Wager Wells
Real Estate Finance and Investment
404.881.7891
della.wells@alston.com

Michael M. Giovannini
State & Local Tax
404.881.7957
michael.giovannini@alston.com

Kevin Gooch
Finance
404.881.7852
kevin.gooch@alston.com

Clark R. Calhoun
State & Local Tax
213.576.1137
clark.calhoun@alston.com

Andy Yates
State & Local Tax
404.881.7677
andy.yates@alston.com

ALSTON & BIRD

WWW.ALSTON.COM

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ATLANTA: One Atlantic Center ■ 1201 West Peachtree Street ■ Atlanta, Georgia, USA, 30309-3424 ■ 404.881.7000 ■ Fax: 404.881.7777
BEIJING: Hanwei Plaza ■ West Wing, Suite 21B2 ■ No. 7 Guanghua Road ■ Chaoyang District ■ Beijing, CN, 100004 ■ +86 139-1038-9920
BRUSSELS: Level 20 Bastion Tower ■ Place du Champ de Mars ■ B-1050 Brussels, BE ■ +32 2 550 3700 ■ Fax: +32 2 550 3719
CHARLOTTE: Bank of America Plaza ■ 101 South Tryon Street ■ Suite 4000 ■ Charlotte, North Carolina, USA, 28280-4000 ■ 704.444.1000 ■ Fax: 704.444.1111
DALLAS: 2828 North Harwood Street ■ 18th Floor ■ Dallas, Texas, USA, 75201 ■ 214.922.3400 ■ Fax: 214.922.3899
LOS ANGELES: 333 South Hope Street ■ 16th Floor ■ Los Angeles, California, USA, 90071-3004 ■ 213.576.1000 ■ Fax: 213.576.1100
NEW YORK: 90 Park Avenue ■ 15th Floor ■ New York, New York, USA, 10016-1387 ■ 212.210.9400 ■ Fax: 212.210.9444
RESEARCH TRIANGLE: 4721 Emperor Blvd. ■ Suite 400 ■ Durham, North Carolina, USA, 27703-85802 ■ 919.862.2200 ■ Fax: 919.862.2260
SILICON VALLEY: 1950 University Avenue ■ 5th Floor ■ East Palo Alto, California, USA, 94303-2282 ■ 650.838.2000 ■ Fax: 650.838.2001
WASHINGTON, DC: The Atlantic Building ■ 950 F Street, NW ■ Washington, DC, USA, 20004-1404 ■ 202.239.3300 ■ Fax: 202.239.3333