Good Jobs First Analysis: GASB's Exposure Draft on Government Cost Reporting of Tax Abatements for Economic Development

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Using the umbrella term "tax abatements," the Governmental Accounting Standards Board (GASB) is finally ending its conspicuous silence and proposing standards for how state and local governments should report the costs of tax-based economic development subsidy programs (including those involving property, sales, income and other taxes).

Defining Tax Abatements

For purposes of the new standard, GASB defines a tax abatement (at paragraph B12):

…as resulting from 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 governments or the citizens of those governments. The scope of this Statement is limited to transactions that meet this definition.

Distinguishing Tax Abatements from Tax Expenditures Generally

In defining tax abatements, GASB makes it clear it does not wish to capture all forms of tax expenditures, which include broad carve-outs such as corporate sales tax exemptions on business inputs. (GASB does not have standards for tax expenditure reporting.)

GASB cites (at paragraph B3) three features that distinguish tax abatements from tax expenditures generally:

1) The tax reduction has an economic development or community benefit purpose;

2) The type of revenue reduced (which GASB does not elaborate on); and

3) "the existence of an agreement with a specific taxpayer as the basis for the abatement." GASB describes this (at paragraph B6) as having at least two elements: a government promising to reduce a recipient's taxes and a taxpayer agreeing to "perform a certain beneficial action." It also writes (at paragraph B7) that legal enforceability is not an essential feature of an abatement agreement.

What GASB's Standard Would Require Be Reported, and Where

The GASB Exposure Draft proposes that states and localities report tax abatement spending in the Notes of their Comprehensive Annual Financial Reports (CAFRs).

The reports would capture three kinds of information: direct program costs, costs generated by the actions of other governmental bodies, and costs created by obligations associated with tax abatement economic development projects.

Direct Program Costs

This new content in CAFR notes would include (listed on page 2):

1) A description of the tax abatement program;

2) The tax being abated;

3) The authority under which the program abates taxes;

4) Eligibility criteria that apply to recipients;

5) The abatement mechanism (including how the tax reduction actually occurs and how its value is determined);

6) Any rules that provide for recapture or "clawbacks" (but not dollars actually clawed back, since such monies would already be reflected in general fund revenues or receivables, per paragraph B37);

7) The number of new abatement agreements entered into during the budget period and the total number of agreements in force at the end of the reporting time;

8) Commitments made by recipients, i.e., policy quid pro quos. However, we read this provision (at paragraph B34) to enable a vague descriptor such as "job retention" or "capital investment;" and

9) The current-year cost of the program in foregone tax revenue, but only as one aggregate figure, not specific data by deal or company or project. And by program, GASB means "major program" as distinguished by program purpose or division within government (paragraph B16).

Costs Created by the Actions of Other Governmental Bodies

The new GASB standard (at paragraph B14) will require any government body losing revenue due to the tax abatement actions of another government body to report that revenue loss. If the losses occur as the result of multiple programs, the passive income-losing government body would only be required to report one aggregate revenue-loss number (also paragraph B16). This is unfortunate, because it would, for example, fail to disaggregate the costs of a property tax abatement program from a tax increment financing program.

It is laudable, however, that GASB recognizes that the way some economic development tax subsidies work essentially amounts to what we at Good Jobs First call the "intergovernmental free lunch." The most common example is when city councils or county boards grant property tax exemptions or reductions. Usually the local government body losing the most revenue in such agreements is the local school district, yet few states grant school boards any effective power to shield themselves from such losses. This new GASB standard could create a great deal of new evidence about how the actions of cities and counties affect public education finance in the United States.

Costs Created by Obligations Associated with Economic Development Projects

GASB also correctly recognizes (at page 2, at 6d) that governments often obligate substantial additional monies to tax-abated economic development projects. The most common way this happens is infrastructure commitments (roads, sewer and water lines, utility connections) and/or site preparation expenses (land acquisition and parceling, soil remediation, demolition) associated with large new facilities. And at paragraphs 29 through 31, GASB notes that such obligations are often contractual obligations tied to tax abatement project agreements, "…therefore, this Statement specifically requires disclosure of a government's commitments other than to reduce taxes."

The Exposure Draft would have governments report such obligations, which could span dozens of projects in a big city or county, two ways. Specifically:

A description of (1) the types of commitments other than to reduce taxes, if any, made by the reporting government in the tax abatement agreements and (2) the most significant individual commitments other than to reduce taxes, if any, made by the reporting government in tax abatement agreements. Information about a commitment other than to reduce taxes should be disclosed until the reporting government has fulfilled the commitment.

This latter requirement indicates governments will be expected to disclose at least some major specific infrastructure and/or land assembly expenditures tied to, for example, a large new factory, office park or a stadium project. This is laudable because such projects can cause substantial geographic distortions in the allocation of public resources.

When the New Standard Will Take Effect

The standard applies to budgets that start after December 15, 2015. Effectively, that means budgets starting in calendar 2016 and thereafter will be covered. Governments are encouraged by GASB to comply sooner, but we assume that most of the new data resulting from the standard will start being published in 2017.

Room for Improvement: Good Jobs First's Primary Concerns about Gaps in the Coverage of GASB's Exposure Draft

In addition to matters noted above, we see three broad kinds of possible coverage problems:

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 (at paragraph B24). GASB compromised here, saying governments may voluntarily list deals, described but not with identifying recipient names.

GASB opines that recipient disclosure is not needed for GASB's core mission of sound public budgeting; we disagree. We believe that deal-specific reporting is especially salient when large projects are granted enormous tax abatements, and we have documented that such "megadeals" are increasingly common. For example, when microchip manufacturer Intel was granted a large tax abatement deal in Rio Rancho, New Mexico, the resulting population growth—unaccompanied by sufficient new local tax revenue—severely stressed local school capacity. A very costly tax abatement deal recently granted specifically to Tesla Motors by Nevada and localities near Reno may create the same local dynamic there.

Similarly, when a large past abatement deal fails because a subsidized company shuts down or orders a mass layoff, a community may be left with obligations no longer supported by economic activity intended to generate tax revenue to offset such costs. For example, Ypsilanti Township in Michigan gave General Motors an enormous property tax abatement worth $1.3 billion, yet it lost the plant's 4,500 jobs when GM relocated production to Texas. Similarly, if real estate values are damaged by a recession, the property tax assessments that generate increased tax revenue (the "increment") for tax increment financing (TIF) deals may be revised downward, obliterating the increment. At one time, for example, Kansas City, Mo., was using general funds to cover TIF debt service for numerous "under water" TIF districts. If there is one lesson applicable here from the Collateralized Debt Obligation (CDO) mortgage-debt crisis, it is that investors and others need to see a government's tax abatement "portfolio."

Despite these and many other instances where a small number of specific deals have had a demonstrable impact on the fiscal condition of a body of government, GASB's Exposure Draft says recipient-specific reporting "may not be practical and may adversely affect the usefulness of the disclosure."

Good Jobs First also knows, from our experience with state and local disclosure data, that economic development agencies have spreadsheets of their deals, so we see no burden in having such data also published, preferably in an online and searchable database.

No Future-Year Liability Disclosure: GASB is best known in recent years for its new rules requiring disclosure of other postemployment benefits (OPEB, or GASB Statement 45 covering pensions and retiree health care costs), which is stirring debates in some states and localities over public employee benefits. It is also known for changing the way governments carry the value of physical assets such as infrastructure on their books (GASB Statement 34), depreciating them (spreading their cost) over their useful lives instead of expensing them the year they are built.

In both cases, GASB has codified that some public spending obligations have long-term budget implications. We believe that tax abatement deals, which can last 20 or 30 years or longer, are no different. But in its Exposure Draft on tax abatements, GASB chooses to require only a single-year snapshot of lost revenue, with no future-years' dollar liabilities. GASB says (at paragraph B26) that a future cost-estimating requirement would require a "specific measurement guidance, which is outside the scope of this project."

GASB does reveal (at paragraph B28) that at one stage in its deliberations, it "decided to propose requiring disclosure of the remaining term of tax abatement agreements (in years)." However, once it decided not to include project-specific disclosure, it determined that aggregate data about abatements' duration would not be very useful. We don't agree, but even if it were true, we would only consider it further reason for GASB to call for project-specific disclosure.

We consider lack of future-obligation specific disclosure to be imprudent because some economic development programs have created enormous future-year "budget icebergs" that must be navigated and should be clearly visible. For example, in its second multi-billion tax abatement award to Boeing and other aerospace manufacturers, the State of Washington has agreed to forego about $8.7 billion in revenue starting in the year 2024.

Omitted Costs: Because of the way GASB defines a "tax abatement," several kinds of costly subsidies might not qualify for coverage. Here are brief summaries (which we will amplify in our formal comments) about these possible omissions:

Tax increment financing (TIF): TIF works by diverting tax revenues away from public services, and therefore clearly does reduce government revenues pursuant to a project-specific agreement. But it does not facially involve lowering the taxes paid by a company (it may even require higher property taxes tied to higher property values resulting from re/development), so it might not get captured by GASB's definition. This would be a huge flaw in reporting from many states and localities because TIF proceeds absolutely benefit specific companies pursuant to economic development agreements, and they do at the expense of general funds. In some states they service private activity debt, generate direct payments to developers, and/or cover costs that otherwise would otherwise paid by recipient companies. Forty-six states and the District of Columbia use TIF.

Performance-based incentives: This is a term used in economic development for tax-based subsidies, usually corporate income tax credits, which a company collects after performing an eligible activity (e.g., hiring or investing). But GASB's Exposure Draft proposes, in an oddly worded passage (at paragraph B8), to exclude certain transactions "because the government does not commit to abate taxes until *after* the taxpayer has already performed the activity for which the government is providing the tax agreement." However, this paragraph opens by stating that abatement agreements need to precede the tax reduction promise and the recipient's quid pro quo. We disagree with GASB's concluding sentence that "even when an agreement exists, such programs more closely resemble broad tax exemptions and deductions rather than individual tax abatement agreements."

Such back-loaded structures evolved and became common as governments sought to reduce their risk, because there have been so many failed deals and clawbacks can be politically difficult to enforce.

We fail to see how the *timing* of when a recipient company receives its tax reduction should affect whether the transaction meets GASB's definition of an abatement. At paragraph B10, GASB even acknowledges that income and sales tax-based abatements are necessarily delayed (by the future occurrence of profits and sales).

Tragically, if GASB excludes such programs, the new standards will not only fail to cover many economic development tax expenditures: They will also create a perverse incentive for governments to hide spending by merely tweaking a program's rules.

Personal income tax diversions to employers: As Good Jobs First documented in a 2012 study, "Paying Taxes to the Boss," 16 states have a total of 22 economic development programs in which a company is effectively allowed to receive a share (in some cases a large, long-term share) of some of its employees' state personal income taxes (PIT). The money flows three ways: sometimes the company never remits the PIT to the state treasury; sometimes the company claims the diverted PIT as a credit against its corporate income tax obligation; and sometimes the company receives the diverted PIT as a grant. We estimated total lost state revenues at about $700 million annually, and sharply rising in some states.

However, given the wording of GASB's Exposure Draft, these costly abatements might not qualify for disclosure, because the money originates from employees' taxes, not the abated companies'. For example, in the first and third versions of money-flow, facially the company's CIT is not reduced: it simply gets to keep or receive other taxpayers' remittances that otherwise would have gone to the state treasury.

Sales tax diversions to retailers (non-TIF): Some states (or localities under state-granted authority) allow specific retail companies, pursuant to agreements, to collect but not remit a certain share of sales taxes they collect, usually up to some agreed-upon dollar amount. The purpose of this tax diversion is to subsidize the cost of constructing and equipping the private retail facility. These programs, which otherwise conform to GASB's definition of a tax abatement (government loses revenue, pursuant to an economic development agreement with a specific company), might elude GASB's definition because of a technicality: the retailers are not the actual taxpayers in this case—consumers are—and therefore the retailers are not paying lower taxes.

Payments in Lieu of Taxes or PILOTs: This term most often refers to an economic development property tax abatement agreement in which the recipient does not receive a 100 percent abatement but instead agrees to pay some small share of what it would normally pay in the absence of said agreement. However, in a minority of cases, the term is also applied to non-profit institutions (e.g., hospitals and educational institutions) that have historically been property tax-exempt but which are now agreeing to pay a PILOT to help offset the costs of public services from which they benefit. We would not view this latter kind of PILOT to be an economic development abatement, but the former kind absolutely is, and we hope GASB will ensure that this ambiguity does not exclude PILOTs. In Memphis, property tax abatement-PILOTs cost the city about one-seventh of its property tax revenue.

Conclusion: GASB's Proposal Represents Big Progress, but Loopholes Remain

We applaud GASB for finally taking up this important form of public spending, especially at a time when economic development has become so hyper-politicized in some states due to the long, slow economic recovery.

However, we hope GASB will listen closely to us and others who file public comments to ensure that all economic development tax abatements are included and no perverse incentives are created to hide costly programs.

Done right, the new GASB standards will open a whole new chapter in the United States debate over economic development. They will enable a more honest accounting, and more rational and empirically informed public discourse. That will help everyone who depends on public services have more say: a critical safeguard in public finance.