January 20, 2017

Mr. David R. Bean
Director of Research and Technical Activities
Project No. 24-16ED
Governmental Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Mr. Bean:

Baker Tilly Virchow Krause, LLP (“Baker Tilly”) appreciates the opportunity to respond to the GASB Exposure Draft (“ED”), Implementation Guide No. 201X-Y, Implementation Guidance Update—201X.

Baker Tilly is a large accounting firm with approximately 300 partners and 2,700 team members, and is ranked in the top 15 of American CPA firms. Baker Tilly performs approximately 1,000 audits of governmental entities annually. We have drawn on this experience in preparing our response for your consideration.

We have significant concerns with proposed Question 4.42 on Statement No. 77, Tax Abatement Disclosures, which reads as follows:

Q—A local government enters into an agreement with a real estate developer for the purpose of stimulating economic growth. Under the terms of the agreement, the developer will construct a building. The government will rebate to the developer incremental property tax revenues generated above a baseline established prior to the agreement, based on certain costs incurred by the developer related to the new building. The rebate to the developer is limited to no more than the amount of the incremental property tax revenues. Does this agreement meet the definition of a tax abatement in Statement 77?

A—Yes. Unlike the transaction described in Question 4.77 in Implementation Guide 2016-1, this agreement meets the definition of a tax abatement in Statement 77, although both may be labeled as a tax increment financing. The developer is promising to take the specific action of constructing a building for purposes of economic development, and the government is forgoing tax revenues to which it is otherwise entitled by returning some or all of the incremental property tax revenues to the developer. Although many tax abatements directly reduce the amount of taxes paid and do not involve the actual collection and return of taxes, the mechanism used to transact the abatement is not relevant to determining whether a transaction meets the definition of an abatement. Therefore, the fact that the government receives property taxes and subsequently rebates those tax receipts to the developer means that the government did, in substance, forgo tax revenues.
Through this question, GASB has scoped in Tax Incremental Financing (TIF) district development incentive transactions that exist in many governments. A common example of this type of incentive payment is as follows:

A local government, through its TIF District, enters into an agreement with a developer whereby the developer agrees to undertake a project within the District and pay for the related expenditures as allowed in the TIF District project plan. The government agrees that after meeting various criteria outlined in the development agreement, only one of which is the generation of specified levels of tax incremental property tax revenues on the property, the developer will be paid an incentive that is calculated either in dollars or a percentage of the incremental revenue generated from the property.

In our experience, all of the transactions similar to the example described above are reported in the Tax Incremental Financing District at gross (tax incremental property tax revenue and a development incentive expenditure). The transactions may occur in separate fiscal years, depending on when the criteria are met in the development agreement to recognize an expenditure. In addition, the government discloses the existence of these contractual obligations in the notes to the financial statements.

Through this implementation guide question and answer, transactions for agreements as described above in our example are now being considered tax abatements. We do not believe they are a tax abatement as defined in GASB Statement 77:

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.

First, there is no reduction in tax revenue occurring with these agreements. The guidance for recognizing tax revenues in paragraph 18 of GASB Statement No. 33, Accounting and Financial Reporting for Nonexchange Transactions, states that “governments should recognize revenues from property taxes, net of estimated refunds and estimated uncollectible amounts, in the period for which the taxes are levied, even if the enforceable legal claim arises or the due date for payment occurs in a different period.” TIF developer incentive payments are not refunds or uncollectible amounts. Rather these are separate expenditure transactions that are reported when the various criteria in the development agreement are met. Therefore, we believe the tax incremental property tax revenue is appropriately reported at gross.

Also, the summary included in GASB Statement 77 describes a reason for the standard as “Financial statement users need information about certain limitations on a government’s ability to raise resources. This includes limitations on revenue-raising capacity resulting from government programs that use tax abatements….” We understand that the purpose of the tax abatement disclosure requirements is to provide information that is not available on the face of the financial statements. That concept is supported by paragraph B6 of Statement 77 which states that “[t]he standards focus on the amount of tax revenue not collected as a result of tax abatement agreements, which is informative about a government’s economic condition and, therefore, highly relevant to the objectives of financial reporting.” This appears contradictory to the language in the proposed question which states that, “the mechanism used to transact the abatement is not relevant to determining whether a transaction meets the definition of an abatement.” We believe the mechanism is important to determining if a tax abatement disclosure is essential to the financial statements because when it is reported at gross revenue and expenditure, the information is available on the face of the financial statements. As described in the common TIF District incentive program example above, there is no limitation on the government’s ability to raise resources. There is also no deficiency in the reporting or disclosure of the agreements.
By considering the TIF incentive agreements described above as tax abatements, it appears one would also have to assume that the revenue should be reported net of the incentive expenditure, and that the existing commitment disclosures would be omitted and replaced by a tax abatement disclosure. We strongly believe reporting these transactions at net would significantly reduce the usefulness of the information currently provide to the financial statement user.

Therefore, we request the Board remove this question from the final Implementation Guide.

We appreciate the opportunity to provide comments on this exposure draft. Should you wish to discuss any of these comments, please contact Heather Acker at heather.acker@bakertilly.com or 608 240 2374.

Sincerely,

BAKER TILLY VIRCHOW KRAUSE, LLP