

January 29, 2015

Via e-mail to director@gasb.org

Director of Research and Technical Activities
Project NO. 19-20E
PO Box 5116
Norwalk, CT 06856-5116

Dear Director:

Thank you for the opportunity to comment on the exposure draft of *Tax Abatement Disclosures*. My comments may seem narrowly focused because my entire experience in government employment has been in the State of Michigan, but it has encompassed both property assessing and financial accounting thereby providing a wide overview of the issues raised by the exposure draft.

As a citizen, I am in general agreement that democracies require a continuous information cycle of expressed community desire; governmental action; evaluation of results; adjustment to the desire or the actions; reevaluation of the results; etc.; as expressed in paragraphs 11 and 12 of GASB Concepts Statement No. 2, *Service Efforts and Accomplishments Reporting*. In particular I am in agreement with the objective outlined in paragraph 2 of the exposure draft. Based on my professional experience however, I think the proposal is far too narrow in its scope, fuzzy in its definitions, and onerous in its requirements to be applied to financial reporting. I question whether in its present form it will provide information "to assist users in (a) assessing accountability and (b) making economic, social, and political decisions" as described in paragraphs 76 through 79 of GASB Concepts Statement No. 1, *Objectives of Financial Reporting*. More colloquially, by focusing on the trees, you have missed seeing the forest.

I do not think the objectives stated in paragraph 2 are met by ignoring broad, pervasive, and material limitations on the ability to raise taxes in the absence of an agreement with a specific taxpayer. The exposure draft creates needless confusion by failing to reconcile the broad disclosure principles outlined in paragraph 5 with the very specific limited disclosures of current year abatements required by paragraph 6. In addition the disclosure of the same tax abatement agreements by multiple levels of government with different fiscal years and levels of materiality is likely to create confusion.

Abatements are usually granted based on planned investments. The abatement disclosure principle described in paragraph 5 (e) does not become quantifiable and subject to the disclosure requirements of paragraph 6 until after the actual investment is made. Not infrequently the initial plan is extensively modified or abandoned before much of the anticipated tax revenue loss occurs. Conflating potential future revenue losses as described in the General Disclosure Principles with the specific disclosures of current year losses required in paragraph 6 disregards the concepts of understandability, reliability, and relevance set forth in GASB Concepts Statement No. 1. The addition of boilerplate language about tax abatements to the notes of thousands of school district, library district, and transportation district financial statements because another local governmental unit entered into an agreement that may in

the future cause an unknown, but possibly material, reduction in collections of a specific tax will serve to confuse rather than inform the public.

I think that the appendices make clear that the intent of the standard is to create a form of service efforts and accomplishments (SEA) reporting. A government offers a tax abatement to accomplish an objective beyond lowering a specific taxpayer's taxes. Focusing the reporting only on the amount of lost revenue seems to be clearly at odds with paragraph 58 of Concepts Statement No. 2 which states that "SEA information should include data that are essential to provide a basis for understanding the accomplishment of goals and objectives of the entity ...". As an example of existing SEA reporting on this topic I invite you to review the reports available under the "What We Do" section of the web page <http://grcity.us/design-and-development-services/Economic-Development/Pages/Default.aspx> . The content of the reports was developed in response to the questions most frequently asked of one local economic development department. What I find striking is how little additional content would need to be added to the two sets of reports to meet the disclosure requirements outlined in both paragraph 5 and paragraph 6. I am persuaded that including a link to this information in the CAFR of the local government administering both the property tax and tax abatement processes is to be desired. I am equally convinced that directing the reader's attention to this one type of revenue loss by emphasizing it with a lengthy presentation in the CAFR notes will divert attention from other more significant losses of tax revenue. Reading the Project Plan Summary on GASB's web-site, I cannot help wondering to what extent the research that indicated that the information is desired and would not take great effort to produce was driven by the researcher's failure to ask follow up questions that would have brought to light that the information was already easily available (if one knew where to look) and could be easily added to the financial statements primarily by a simple process of extracting it from other publicly available sources.

Taxes are so state specific in what is taxed, how the tax is calculated, and what level of government administers the tax that I am having trouble relating the proffered examples to what we are doing in Michigan. The most common tax exemptions and abatements I read about are those mentioned in paragraph B4. Beginning the statement with an example of a community that has determined that a lack of office buildings is so acute that tax abatements are required to cure the problem is a curious choice.

Ignoring the common tax exemptions of the property and income of government, church, and non-profit entities, the following are the principal forms of tax loss urban Michigan governments face:

1. Property transferred from the *ad valorem* tax roll to an IFT, NEZ, or OPRA tax roll with either a change in the tax rate or in the calculation of the taxable value.
2. Low-income housing developments that are subject to a fee of a percent of rent revenue in lieu of property taxes.
3. Income and property taxes related to a specific geographic area where individual taxpayers can apply for, and automatically receive, an exemption from taxes if they are not delinquent to the governmental unit for any fees or non-exempt taxes owed.
4. Constitutional limitations on the annual increase in the taxable value of real property.
5. Tax increment finance authorities that capture all property tax dollars above a base amount.

The fifth category represents a loss of 5 – 10% of the property taxes actually received by our primary government, but because none of the taxpayers pay less in taxes because of the existence of the tax increment authority, the exposure draft language would not disclose any of this revenue loss suffered by the seven overlapping governmental units that would otherwise have received the taxes. Additionally, with the exception of Brownfield remediation plans, the agreement is not with the taxpayer, but rather with other governmental units. Because the revenue losses are considered permanent, no effort has been made to report the amount of these losses in the general purpose financial statements.

The third and fourth categories are similarly outside the scope of the exposure draft, but in the judgment of management, the effect of those provisions had a material impact on property tax revenue trends and needed to be disclosed. The impact on the property tax was initially reported in the 1999 CAFR and was estimated at \$1.3 million. The reported revenue losses increased for several years until in 2008 they exceeded \$8.3 million, or 22% of the property related tax revenue actually collected. Since then, a combination of falling property tax values and sun-setting statutes has reduced the estimated revenue losses from those provisions to \$2.5 million, roughly 7.5% of the taxes collected. Property tax revenues today are in part increasing based on investments made ten years earlier.

The first two categories appear to comprise the type of abatements and exemptions that may be covered by the exposure draft because of the existence of an agreement and a change in the tax calculation. The lack of clarity within the exposure draft's wording is illustrated in the case of the second category. A general *ad valorem* tax exemption is granted under a state statute for property that meets certain definitions under that law and whose owner completes the required administrative steps at the state and local level. The same statute allows a local unit to provide by local ordinance that the exemption will not apply to property within its boundaries. I believe that it is possible to make equally convincing arguments that this type of exemption is, **and is not**, required to be reported by paragraph 4. If it is decided that reporting is required, I think it is possible to make a compelling argument that either the state or the local unit was the party that paragraph 5 b(1) considers to have "entered into" the agreement. I don't see how a reporting "standard" is being created if one cannot clearly determine how it applies to a common set of facts.

I also find troubling the analysis that the proposed reporting applies to the disclosure. Michigan has one method for calculating *ad valorem* taxes. If a method other than that is applied to a specific property the mechanism requires that the property be made entirely exempt from *ad valorem* taxes. Therefore the plain wording of the exposure draft would seem to require that the amount of the abatement to be reported is the entire amount of the exemption, without consideration that another tax or fee is being collected that could not be collected if the property was taxed on the *ad valorem* tax roll. The amount collected in lieu of the *ad valorem* tax can be a substantial dollar amount. The reporting would appear to create a false impression of the size of the tax abatements in effect. A clear principle of netting the abated and the collected taxes should be included in the language of any statement issued, not created by an example in the appendices or in the implementation guide that conflicts with the plain language of the statement.

The exposure draft is largely silent on what constitutes materiality, a weighing of costs versus benefits, the timing of the disclosures, and a clarification of exactly which governmental unit is considered to have granted the exemption versus being a bystander in the process. In Michigan, only the state may grant an exemption. It may be a blanket grant that all property or income that meets a statutory standard is exempt. It may be that the state maintains final administrative review and approval of a process that is initiated at the local level and may or may not require an opportunity for other affected governmental units to concur or object in the process. Clarifying language should be included in the standard so that it will be clear which government has "entered into" the agreement. With the property tax cycle and income tax cycle running on different calendars; state, county, city, township and school systems operating on differing fiscal years, and the final calculation of some specific taxes occurring after the close of the tax year, trying to create consistent and comparable reporting across government units will be a nightmare without additional guidance provided by the GASB. Two small examples are offered to provide context to that comment. In creating the illustration in Appendix C of the Exposure Draft, the integrated multilevel nature of the required disclosures would suggest that for purposes of the illustration Model County should disclose the abatements granted by Sample Village, which in turn might need to report just one of the Counties abatements as reducing the village's tax revenues so that practitioners can visualize how this all fits together. When a tax abatement is material to the finances of a discretely presented component unit, but immaterial to the primary government, what standard is applied to the presentation within the primary government's financial statements?

The resources available for accounting and financial reporting are fairly inelastic. That is true not just in government, but is reflected in the commonly observed experience of the unabated value of property shrinking significantly when the taxpayer's attention becomes focused on that value as an abatement period nears its end. Michigan law already requires that local assessors provide much of the information described in paragraph 6. Including the theoretical amount of abated taxes within the scope of an audit opinion would seem to require significant effort on the part of the government and the auditor which would be diverted from other financial activities that I believe have higher value to the organization and the citizenry.

What disclosure of abatements or exemptions should be made in the General Purpose Financial Statements? I think that paragraphs 12 through 16 of GASB Concepts Statement No. 3 should guide the reporting requirements. I believe that if one can see a facility on Google Earth that is large relative to its surrounding community and it is not generating local tax dollars proportional to its apparent size, but is consuming significant local governmental services, be it a manufacturing plant, a theme park, a federal prison, a state university, a national park, etc., its existence should be prominently mentioned in the CAFR because that is relevant financial information that provides context to the financial statements. The presence or the absence of an agreement between the governmental unit and the property owner should not dictate the presence or absence of disclosure in these cases, but the presence of an agreement may dictate if a dollar amount can be attached to the disclosure.

With regard to the myriad of smaller exemptions and abatements that may or may not be material to the overall financial statements, if a document containing description and analysis is available on the internet, a link to that document should be adequate disclosure within the financial statements of the

unit administering the tax. This manner of presentation would not delay the issuance of the financial statements while the tax abatement disclosures are being prepared and audited and would be consistent with the financial statement user needs identified in your 2011 research brief, The Timeliness of Financial Reporting. If the GASB judges that separate availability is inadequate, then a ten year summary, by categories appropriate to each state, within a section of the CAFR outside the scope of the audit opinion, is the most reasonable and insightful form of disclosure. The required reporting should not conflict with privacy standards commonly applied to income taxes.

The timely availability and auditability of information presented by units of government that do not administer a tax should be of significant concern in the GASB's deliberation of the standard. Any disclosure within a CAFR should relate to actual tax dollars lost during a time period related to the particular tax cycle, rather than require massaging to correspond to the reporting entity's fiscal year. Tying disclosures to the tax cycle, rather than the entity's fiscal year, would facilitate comparability across multiple levels of government without introducing complexity from changing tax rates, variable allocation methodology, etc. Special purpose governments, for example a community college or transportation authority, which includes many separate primary governments within their geographic boundaries and do not administer their own tax system, should be specifically excluded from any reporting requirements created by this standard. Finally, it does not appear that adequate consideration has been given to the difficulty in the application of this standard to types of taxes other than the property tax.

Thank you for your consideration of these views. I apologize for their length, but I am firmly convinced that a broad extension of the reporting on tax abatements and exemptions is unlikely to result in the political process curtailing this popular activity as the authors of many of the comment letters apparently desire and that for the majority of governmental units the proposal will degrade financial reporting usefulness by directing attention away from material forms of tax losses that are occurring by an emphasis on more nuanced forms of tax loss that are more properly the subject of Service Efforts and Accomplishments reporting. If the proposed standard was directed toward establishing SEA reporting standards for tax abatement programs I would be in basic agreement with the entire draft document.

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