GAO

Government Accountability Office

New Mexico Office of the State Auditor

Bulletin
GASB 77 is Coming

GASB 77 Requires Disclosure of Tax Abatement Agreements

The tax codes of federal, state and local governments contain many provisions that give taxpayers a “tax break” based on something that the taxpayer does or agrees to do. “Tax expenditures” are revenue losses attributable to those provisions. The Governmental Accounting Standards Board (GASB) has recognized that tax expenditure information “is informative about a government’s economic condition and, therefore, highly relevant to the objectives of financial reporting.” GASB has taken a first step toward requiring the disclosure of tax expenditures through its newest standard, GASB 77. The new accounting standard is a critical piece of the larger project of understanding how redirected revenue affects government finances. This Bulletin discusses the basic principles of GASB 77. The Office of the State Auditor (OSA) will continue to issue guidance on this critical topic as the time for implementation begins.

GASB 77 is effective for financial periods beginning after December 15, 2015. For agencies with a June 30 fiscal year end, this means that Fiscal Year 2017 will be the first year for which GASB 77 is effective. Because Fiscal Year 2017 begins on July 1, 2016, the OSA encourages agencies to learn about GASB 77 as soon as possible, so that they can gather the information that will be necessary for financial reporting.

GASB 77
In a nutshell

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The Governmental Accounting Standards Board (GASB) periodically imposes new requirements for the audited financial statements of governmental entities. The latest GASB standard is GASB 77, which requires governments that enter into tax abatement agreements to present certain information in the notes to their financial statements.

How Will GASB 77 Data be Useful?

Tax expenditures usually come about because lawmakers want to create an incentive for a certain behavior. A “tax break” may reward companies that create jobs, foster a particular industry or encourage certain consumer behavior. However, New Mexico has yet to engage in a comprehensive cost-benefit analysis of tax expenditures. Having a comprehensive inventory of tax expenditures is a first step, and GASB 77 will help to identify some of the local programs not covered in the TRD report. Understanding the amount of money that governments forgo from tax breaks through GASB 77 disclosures is a critical piece of the “cost” side of the cost-benefit equation. The next step after that - understanding whether and to what extent the tax break is working to create its intended effect - is the more complex, “benefit” half of the analysis.

If you are interested in participating in the OSA’s GASB 77 Working Group, please contact Chief Government Accountability Officer Sarita Nair at (505) 476-3800 or Sarita.Nair@osa.state.nm.us.

What are Tax Expenditures?

Tax code provisions can take many forms. A *tax exemption* decreases taxable income by a set amount. For example, many families claim an exemption for a dependent. A *tax deduction* also decreases taxable income, but generally by an amount that the taxpayer has spent during the year. For example, an individual may deduct the amount he or she has donated to charity. A *tax credit* or *tax rebate* is a tax mechanism that allows the taxpayer to subtract the amount of the credit or rebate from the total tax liability owed to the state. For example, in New Mexico, businesses that create high wage jobs may be eligible for a tax credit. Finally, a *rate differential* is a program under which certain taxpayers pay at a different rate than others because of a specific circumstance. For example, in New Mexico, certain local breweries and wineries pay the alcohol tax at a different rate than non-local breweries and wineries.

OSA can help

OSA will continue to provide information and guidance as it becomes available from national sources. If your agency is considering an arrangement that may be covered by GASB 77, please contact us to discuss ways to plan for GASB 77 implementation.

Governments and experts do not agree about whether all of these provisions are "tax expenditures," for technical and theoretical reasons. The New Mexico Taxation and Revenue Department's (TRD) most recent Tax Expenditure Report (2014) identified 125 exemptions, deductions, credits, rebates and tax differentials that met its definition of "tax expenditure"; another 113 exemptions, deductions, credits, rebates and tax differentials that did not meet the definition; and 19 others that were "arguable."

Only a fraction of the 257 tax provisions discussed in the TRD Tax Expenditure Report will be covered by GASB 77. On the other hand, the TRD report did *not* include tax expenditures at the local level that will meet the GASB definition of a "tax abatement agreement."

How does GASB Define the Tax Abatement Agreements that Will be Disclosed?

GASB 77 defines a tax abatement agreement 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.

Learn More

The entire standard for GASB 77 is available on the GASB website. (http://www.gasb.org)

The Journal of Accountancy (http://www.journalofaccountancy.com/news/2015/aug/gasb-tax-incentive-disclosure-standard-201512846.html) and the Governmental Finance Officers Association (http://www.gfoa.org/sites/default/files/GFR101551.pdf) have published initial materials.

The NM Department of Taxation and Revenue's Tax Expenditure Report for 2014 is available at: http://realfile.tax.newmexico.gov/Final%20Report%20-%202015%202%2004_Final.pdf

GASB 77 states, “Tax abatement agreements may be in writing or may be implicitly understood by the government and the individual or entity. The agreement does not need to be written or legally enforceable….” The OSA anticipates that the definition will cover any tax deduction, exemption, credit, rebate or rate differential that (a) involves a written agreement *or* (b) results from an application process that occurs before the taxpayer performs its commitments.

The OSA continues to work with national groups to gain clarity on what GASB 77 will cover. Industrial Revenue Bonds, or IRBs, clearly fall under GASB 77. The OSA also believes that letters or agreements intended to attract companies with the promise of tax incentives would also require disclosure. In addition, building on the disclosure and transparency considerations that inspired GASB 77, the OSA may require similar disclosure on a fixed set of tax expenditures that may ultimately be broader than the requirements of GASB 77.

What Information Will Governments Need to Disclose?

For tax abatement agreements that meet the definition, each government involved will need to disclose:

1. Brief descriptive information, including:
    a. the names of the program(s),
    b. the taxes being abated,
    c. the authority for the agreement,
    d. the eligibility criteria,
    e. the mechanism by which taxes are abated,
    f. any provision for recapturing abated taxes and
    g. the commitments made by recipients of the abatement.
2. The gross dollar amount by which tax revenues were reduced during the reporting period.
3. Information about other governments affected.
4. Other commitments that the government made in connection with the abatement agreement.

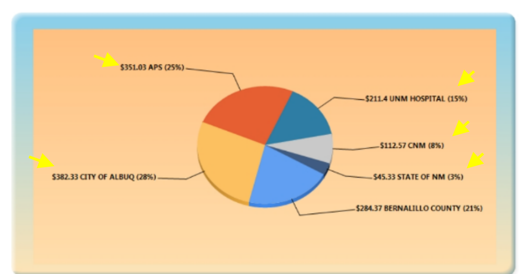
Intergovernmental Disclosures

Another key facet of GASB 77 is the requirement of intergovernmental disclosures. For example, suppose County A enters into an industrial revenue bond with Company X, which results in an abatement of Company X’s property tax liability. This would affect the other governments that receive an increment of County A’s property taxes. This may include school districts, hospitals, the state and other agencies. It may also affect separately audited component units. Under GASB 77, County A has the obligation to report the required information to all governments affected by the tax abatement agreement. Those governments, in turn, have the obligation to include that information in their own financial statements.

This requirement may be particularly onerous for the New Mexico Taxation and Revenue Department. The OSA will consider whether the Department may be able to develop blanket disclosures that it could provide to all recipients of gross receipts tax revenue, which is the major revenue stream the OSA anticipates may be affected by GASB 77.

Bernalillo County offers a “[Tax Dollars at Work]” Tool that illustrates the issue of intergovernmental disclosures.

ESTIMATED PROPERTY TAX DISTRIBUTION SCENARIO - $1,387.03 tax bill



TAXING AUTHORITY	RESIDENTIAL MILL RATE	PERCENT OF TOTAL BUDGET	TAXPAYER PORTION
BERNALILLO COUNTY (21%)	8.531	21%	$284.37
CITY OF ALBUQ (28%)	11.470	28 %	$382.33
APS (25%)	10.531	25 %	$351.03
UNM HOSPITAL (15%)	6.342	15%	$211.40
CNM (8%)	3.377	8 %	$112.57
STATE OF NM (3%)	1.36	3 %	$45.33
	41.611	100%	$1,387.03

The chart and graph above indicate the distribution of tax revenue on a hypothetical parcel with a value of $100,000. If property tax on this parcel were abated by 100 percent, Bernalillo County would need to report to the agencies shown the items marked with arrows and highlighted.