Tax Abatements: Evaluation and Reporting

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Critics argue that tax abatements have little significance as it is difficult to assess success or failure as no required information is available in the comprehensive annual financial report (CAFR). Using a case study approach, abatement and financial information provided by a modest sized, anonymous city are used to display the impact of the abatements, an analysis of the current year's outstanding abatements, and their economic impact. Although the abatement awards are an insignificant percent of the property tax levy, their impact has an overwhelming financial contribution to the region that supports disclosing the information in the CAFR.

INTRODUCTION

In times of need, state and local governments have been known to offer economic incentives for new businesses through the tax structure in an effort to spur economic development. These incentives can be conceived in different formats, but the overall goal is to grow the local economy through job creation and eventually higher tax revenues. Abatements can be short-term or long-term, usually with a limit of 10 or 12 years, and can also be for a total or a percentage of the tax. Abatements are primarily given to promote economic development within a community or county, but can also be used to help companies having financial problems, or nonprofit groups such as churches and youth organizations.

These incentives take many forms such as property tax abatements, abatements for increases in property value, and even tax penalty abatements, though they are typically applied to ad valorem taxes such as a property tax. With these tax giveaways, corporations are given the potential to bring consumers savings and smooth their entry into new geographical markets which could potentially create jobs and increase the economic welfare of that community.

Planning for economic development assumes a systematic process where the variables are weighed and balanced, and technical studies are compiled. In this process, public planners and local officials often become instruments used to promote the agenda of the private sector and the private development process. Tax subsidies are used and new projects are developed, but poverty and unemployment still increase (Krumholz, 1991).

Tax abatements and economic incentives have become a fairly standard instrument employed by state and local governments to attract businesses to the area. However, when tax giveaways are offered, it puts increasing pressure on neighboring local governments to do the same or risk financial discourse as valued business and needed jobs move to where they can reap the greatest benefits. Therefore, it has become the status quo for businesses and corporations to locate where they can receive the most tax incentives rather than where they would best operate according to their business function (Maurer, 2005; Middleton, 2001).

Critics of these incentives argue that at the national level, the incentives are a zero-sum game and that in many cases the results are not significant. In either case, it is difficult to assess the validity of either claim due to the fact this information is not readily available in state and local government financial statements. Under current Government Accounting Standards Board (GASB) guidance, there is no requirement for disclosure of tax abatement or incentive benefits. This study explores the different incentives governments offer businesses, proposes the need for additional disclosures, and concludes with sample financial statement disclosures.

TAX EXPENDITURES

While this research explores tax abatements, it is imperative to understand the nature of tax abatements as a subset of tax expenditures. The Congressional Budget Act of 1974 defines tax expenditures as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deductions from gross income or which provide a special credit, a preferential rate of tax or a deferral of tax liability" (Toder, Rosenberg, & Eng, 2013, p. 808). Tax expenditures are not only limited to the federal government, however; the concept is very much a part of state and local government tax structures. In any scenario where a state or local government removes a group or a particular taxpayer from the tax rolls, tax expenditure has occurred by definition. These types of expenditures are not, in essence, any different from a direct expenditure save the fact that instead of being administered through the appropriations process, they are administered through the tax code. Because they are *omitted revenue* rather than a *recorded expense*, these items are difficult to measure and assess. Tax expenditures are not typically reported in a government's budget either as expenditures or a deduction from revenues (Gamkhar & Granof, 2008, p.32).

To illustrate the difficulty in measuring these types of expenditure, assume a state has decided to address the regressive structure of their sales tax and omits certain items such as clothing and food, as in the State of New Jersey (New Jersey Division of Taxation, 2010). Then assume that in order to help a certain segment of the population, say college students, the state excludes college students from sales tax on textbooks. The argument addresses the difficulty of differentiating between items that are meant to be excluded from the tax roles as a matter of original policy (food and clothing exemption) and items that are simply meant as a tax expenditure (textbooks). To further complicate matters, assume these items are identified, the difficulty in measuring their cost is yet another challenge. Businesses are expected to measure taxable items and keep records to determine their tax liability, but it is impractical to expect these entities to also maintain records for those items sold that *are not taxable*. For this reason, the opportunities for measurement are quite limited, perhaps only to industry associations and consumer surveys (Gamkhar & Granof, 2008, p.33).

Nevertheless, these matters of tax policy do affect their respective economies and the taxpayers. As such, there should be a layer of transparency for taxpayers to be aware of such policies and for analysis of the efficacy of such programs to be possible. Assessing the effectiveness of a policy is exponentially difficult if data is not available. One solution to this information asymmetry problem is the use of a tax expenditure budget or report. Tax expenditure budgets can close the information gap by measuring revenue losses from preferential provisions in the tax structure. California was the first state to pass legislation requiring the tax expenditure budget in 1971 with the first revenue loss figures in 1976. By 1984, this practice had expanded to fifteen states and in 2001, thirty-three states had tax expenditure budgets, all of which are public, and available online. By 2009, forty-one states and the District of Columbia published tax expenditure budgets. Since then, Indiana and New Jersey have developed tax expenditure budgets and tax expenditure reporting has recently been authorized in Georgia (Connolly & Bell, 2011, p.7). While this movement is in the direction of more transparency, the application of these budgets is hardly universal and there are no standards on the display of information. Some states based their display on several federal models, such as those prepared by the Joint Committee on Taxation and the Office of Management and Budget, but there is no explicit example as there is no federal sales tax (Mikesell, 2002, p.37).

Mikesell (2002, p.35) argues the process is a classification exercise that divides the provisions of the tax system into a benchmark or norm and a series of deviations from that norm. This supports the concept of a tax expenditure being an omitted item and any deviation from the *true* revenue should be reported. In order for reporting to be accurate, there must be a clear distinction between the normal or baseline tax structure (in the illustration, the exemption for clothing and food) and the deviations from the norm (textbooks). It is imperative this baseline be established as accurately as possible: if the baseline is too *low*, then exemptions originally determined as a matter of overarching policy become a hit list of items the government can tax in a quest for additional revenues; if the baseline is set too *high*, then the purpose of the reporting becomes defeated. Either case is undesirable and does not achieve the objectives of transparency and greater information for decision making and accountability. Maryland makes a distinction between *structural* tax expenditures which are a part of the tax structure, and *categorical* tax expenditures which are more narrowly defined provisions that have an easily defined set of beneficiaries (Gamkhar & Granof, 2008, p.33).

To shift the focus to property taxes, a review of tax expenditure reports by Connolly and Bell (2011) reveals that in the fourteen states that included property tax expenditures set the baseline as all real property except property exempt in the State Constitution and/or by the federal government. This makes the baseline for property tax expenditure significantly less complex to establish. In Wisconsin, the state establishes what real and personal property is subject to the local property tax, which is determined by the uniformity clause of the State Constitution that prohibits different treatment of most property including partial exemptions. Kentucky contends that not all deductions or exemptions are classified as tax expenditures. Tax expenditures, according to Kentucky, are deviations from the normal tax structure. Montana indicates they use a baseline, but anything that deviates from this is included in property tax expenditures, including all provisions in law. Basically anything that deviates from the general structure of the tax and any provisions that affect taxpayer behavior are included as tax expenditures (Connolly & Bell, 2011, pp.6-7).

Tax expenditures in many cases pose logistical challenges in measurement, especially when this method of *spending* focuses on *omission* of revenues rather than *direct* expenses. Even with the challenges of information collection, some states have still recorded these expenses in tax expenditure budgets for state taxes and others have further expanded into including property taxes. Therefore, because many state governments budget tax expenditures that are by nature cumbersome and difficult to measure, there should be a movement for local governments to take a similar approach in recording tax abatements.

ECONOMIC DEVELOPMENT

There are several types of tax expenditures that local governments use as part of economic incentive programs. These include tax increment financing, enterprise zones, freeport exemptions, and tax abatements.

Tax incremental financing is used by local governments to publicly finance structural improvements and boost infrastructure within a particular area. These enhancements are typically undertaken to promote the viability of an existing business or to attract new businesses to the area. The costs of the improvements are eventually repaid by the future tax revenues associated with economic development within the improved area. Each taxing unit (e.g. county, city, school) can choose to allocate all, a portion, or none of the tax revenue that is associated with the increase in property values within the reinvestment zone. Each unit decides what percentage of this tax increment, if any, will be committed to the repayment of the cost of financing the public improvements (Office of the Attorney General of Texas, 2008, p.117). In a typical model, public-sector bonds are used to raise the funds needed to finance the improvements desired at the beginning of the project. The tax revenue generated by the tax incremental financing district is then used to repay the bonds. When the bonds are paid in full, the tax base is displayed at its gross value.

An enterprise zone is a tool for economic development for local communities to promote job creation and capital investments. These zones are focused in communities that have higher poverty rates and are seeking incentives. In Texas, an enterprise zone is more specifically a census tract block group that characteristically has a poverty rate of twenty percent or greater as compared to the census federal poverty level information. Other ways an area can become an enterprise zone is to be a distressed county, a federally designated zone or a renewal community. Enterprise zones are automatically also considered a reinvestment zone for tax abatement and tax increment financing if the community also agrees to designate it as that particular type of zone. Designated projects are eligible for sales and use tax refunds on qualified expenses. In Texas, these are directly related to the capital investment and jobs created. Depending on the level of capital investment and the number of jobs created, total refunds can be as large as $3,750,000 total and as much as $7,500 per job created (Office of the Attorney General of Texas, 2008, pp.286-287).

Freeport exemptions give local governments the option of taxing certain goods that are defined as *in-transit* by state law. In Texas all taxing entities may grant the freeport exemption. This is particularly helpful to manufacturers and distributors which ship products outside the state. Some taxing entities even allow exemptions for goods shipped within the state. These exemptions apply to certain types of tangible personal property from property taxes if certain requirements are met.

These tax expenditures provide for economic development by granting tax breaks to entities by exempting their inventory from the property tax rolls. It could be argued that these types of exemptions are more similar to abatements than other tax expenditures as they take certain items *permanently* off tax rolls.

TAX ABATEMENTS

Local governments are known to use tax abatements to make their municipality or area more attractive to new industrial and commercial investments and also to encourage the development and retention of existing businesses. There is a widespread use of these economic incentives as over 700 tax abatement agreements valued at more than $487.4 million have been extended by governments in Texas with the stipulation that the companies hire in cities and rural areas at wages above the area’s average (Office of the Attorney General of Texas, 2008, p.107; The Economist, 2013, p.28).

Property tax abatements can be structured different ways. Companies may receive an abatement for a certain percentage for a specified number of years, such as a fifty-percent abatement for twenty years where they would only be responsible for paying half of the property taxes they would have normally incurred. Another option is phasing the property tax over a period of time. For instance, this could be structured as a graduated reduction of the abatement. In this example, the firm would pay twenty percent of the tax liability the first year, forty percent the second year, and so forth until the firm would reach the full rate on the fifth year. Some abatements may also be structured to freeze the property taxes at a given level when the deal is executed to protect the firm from higher tax liabilities after the new improvements on the property (Dalehite, Mikesell & Zorn, 2008).

The most common situation is a manufacturer convincing the local government to issue an abatement in exchange for building a plant in the area which promises to provide jobs for the local area and permanently increase economic development by supporting industries. In 2012, Georgia granted over $14 million in credits and cost exemptions to Voestalpine, a medal forming company, to construct a $62 million facility northwest of Atlanta and hire 220 workers (The Economist, 2013, p. 27). Much of the investment to be made by Voestalpine will find its way back into the community as employees buy houses, food, and cars. As the future employees spend they will pay sales and property taxes that increase the government’s revenue. If Voestalpine fails to meet 80% or more of the promised investment, Georgia can claw back whatever amount of the State credits that have not been expended.

An alternate idea may also be a retailer making similar promises; however, tax abatements also happen in other industries (Wall, 2011, p.10; Lawrence, Briskin & Qu, 2013). Berman (2013) cites an example in the film industry. During the filming of the movie “42” which covered the life of legendary baseball player Jackie Robinson, the filmmakers received millions in subsidies from the states of Alabama, Tennessee, and Georgia. Then, once filming concluded, the filmmakers outsourced the soundtrack to London. These film companies take the abatements and go to other states in the country to get credits during shooting, but once this is concluded, they outsource post-production overseas due to salary and benefit concerns. The State of California has offered $100 million in annual tax credits and abatements since 2009, paying up to 25% of California costs for smaller-scale feature films, television movies and series, but no post-production. Industry producers, however, do not have to prove that they would film outside the state without such tax incentives. Also, California is not alone in offering such programs. A study of Louisiana's incentives found that in 2010, the state *spent* $7.29 in tax credits and abatements for every dollar of revenue collected (Berman, 2013) which begs the question of whether abatements and incentives are worthwhile!

EVALUATION

Evaluations of these economic development programs have brought some degree of doubt as to the logic behind the design of these abatement programs and the rationality of decision choices. A Pew Center on the States (2012) study finds 13 states lead the way in evaluating state tax incentives for jobs and growth. Another 12 states have mixed results while 26 states perform no evaluation at all. Analysts have identified that, hypothetically, it is possible for these abatement programs to be effective given that certain conditions are met. They undoubtedly affect the firm's decision to locate where these tax breaks are awarded, and with these awards create a different set of organizational and political problems (Wolkoff, 1985).

When implementing tax abatements there are two general methods that can be used. The first is to offer them indiscriminately to every firm requesting them in a manner that could be considered an across-the-board policy. The second is to offer them selectively to firms that show characteristics that have been identified to be the most desirable to the taxing board providing the incentives.

In general, literature suggests that there is little to no potential for long-term benefit from offering tax abatements in an indiscriminant manner, but this approach is the most commonly used. Wolkoff, (1985) claims abatements are virtually awarded whenever requested and implies this negatively impacts the programs efficiency. When these economic development subsidies are awarded, they influence the likelihood that other firms will demand subsidies and local officials on the taxing board failed to differentiate between applicants despite good reason to do so. Wolkoff calls this a policy failure on two fronts. The first being that offering excessive amounts of subsidies harms municipalities because these subsidized dollars undoubtedly are extended to undeserving recipients. The second failure is characterized in the policy itself, as indiscriminate tax abatements indicate a poor program design and raise questions as to what the policy is trying to accomplish in the first place (Wolkoff, 1992).

Politicians and economic development practitioners have analyzed this issue from both sides, focusing on the resulting outcomes that show the fundamental principle of tax abatement programs work to increase development of a given economy. Conversely the widespread use of tax abatement programs makes their use a requirement of communities, as programs that are not generous enough cause firms to relocate to other areas. This leaves a conundrum that policymakers must contend with in order to find a middle ground as programs that are too generous or not generous enough will inevitably hurt the community as a whole. As with any economic development tool, it is a game of trade-offs, and finding the right mix of these societal and economic interests can very well lead to growth and prosperity in the area, as well as maintain a reputation in good standing with the community (Cassel & Turner, 2010; Middleton, 2001).

Support Position

Tax abatements are appealing to state and local governments because they can be issued where new corporate investment is needed, but may not otherwise be considered without some incentive. This helps develop the areas that need it most while attracting new jobs and wealth to a once suffering area. Though tax abatement is just one tool that can be used to promote economic incentives, it has a tremendous impact on an economy.

As one of its most successful economic devices, Sample City, a Texas municipality with a population of 200,000 that wishes to remain anonymous, has successfully used tax abatements to encourage new investment in the area, and has the results and economic data to back it up. There are drawbacks to any type of tax abatements and in either method of distribution elected. There are those who believe that the use of tax abatement in any amount will hurt the tax base and therefore ultimately hurt the municipality. Hypothetically, incentive competition can harm the tax base of local governments. But when limited to development of new investment the initial tax base is unaffected. Sample City abates properties that apply only to new capital investment in real and personal property and can never be applied toward the purchase of land with an existing plant or equipment.

Sample city has a list of guidelines that corporations must follow in order to receive benefits from the tax abatement program. The first step in Sample City's abatement program is the review and consideration for the eligibility of each applicant. By setting qualification guidelines, Sample City ensures that it meets its goals of generating economic opportunities for small and medium-sized businesses and creates jobs. For eligibility into the program, the minimum requirements of the project are a capital investment cost of at least $1 million excluding land, new annual payroll of $400,000, and a minimum of 25 new full-time jobs. Provided requirements are met, an application can be submitted for review.

The second step in Sample City's process involves a series of interviews and meetings to determine the eligibility, validity, and survivability of the applicant firm. First, the application is reviewed by economic development staff and then submitted to a review committee. After some consideration, if the review committee approves, it provides a recommendation to the appropriate taxing entities and allows contracts to be negotiated. The abatement at this point has succeeded in creating jobs and potential future taxes on property valued at least $1 million. Plus, the region receives new payroll tax revenues on at least $400,000, presuming the applicant firm is relocating from out-of-state.

The third step is an annual review. After the abatement project is approved, the new investment is subject to annual review. Any company that fails to meet their abatement contract terms regarding job creation may be subject to termination or term reduction. The example that Sample City uses is, 'If the company only created 80% of the total jobs they were expected to create, they may only receive 80% of the abatement and would have to pay taxes on the remaining 20%.' Sample City has designed the system to punish those who would seek to take advantage, and disregard the guidelines set by their contract, while simultaneously encouraging private investment in capital improvements around the city. All this new investment becomes taxed at the current assessed rate. The average tax abatement period for Sample City is five years, but can last as long as ten.

Sample City demonstrates the direct benefits of the proper use of tax abatements and steadily creates new jobs and wealth. These new jobs make way for higher wages, allowing them to improve their standard of living and encouraging people to make large life decisions such as buying a house. This new activity generates more prosperity and brings in more tax revenue for the city.

Contradiction Position

Abatements can effectively and actively attract business activity and new investment, but there are also potential side effects they may have on a particular community. An economist would call these externalities, and they may be either positive or negative. In any tax abatement policy there will be winners and losers due to the fact that the only way to determine whether the given course of action was optimal is by retroactive means. One unexpected consequence of tax abatements would be a rise in property taxes on non-abated properties. Krumholz (1991), a city planning director for the cities of Pittsburgh and Cleveland, indicated tax abatement trades-off growth for greater inequality in the tax system. Property taxes are generally considered to be regressive; tax abatement makes it more so by shifting the tax burden from capital to consumers, from large corporations to small businesses and homeowners (pp.293-294). This means when the burden of tax shifts, it is usually picked up by those who can least afford it. This causes homeowners and small businesses to feel marginalized and excluded as they pay for more than their fair share of the tax, while the beneficiaries of these tax discounts become more profitable (Krumholz, 1991).

Tax abatement recipients are not subject to the same market-driven cost-cutting techniques as non-recipients. But, city planning practitioners insist that these subsidies are necessary to bring in new investment, often feeling desperate to bring in new business to the point where these policies seem to work against themselves. Krumholz (1991) reports a Cleveland situation where although tax abatement was to be limited to the most blighted and poorest areas of the city, developers' guppy enthusiastic support persuaded Cleveland officials to designate the most valuable real estate in the city to be 'blighted' (p.294). It was clearly evident that Cleveland officials were offering these abatements for reasons other than pure economic development. But still, few questions were asked even though the principal purpose of the abatement was forgone. The irony in the Cleveland case is apparent in that city officials made ostentatious claims that the economic benefits of the tax concessions could make a great economic impact and bring wealth to Cleveland, but, in actuality, they made citizens and small businesses worse off. Whether or not a given municipality issues tax abatements without begetting an increase in taxes on non-abated property lies in the particular circumstances of that city, and the amount of money abated in comparison to the total assessed property value of the area (Krumholz, 1991).

NEED FOR DISCLOSURE

The literature argues the effects of tax abatements on the local government revenues are too small to affect decisions. Dalehite et al. (2008, p.202) suggest a reward to an individual taxpayer that is derived from taking action to eliminate the benefits to business is too small to justify the costs of pursing this course of action. The idea behind this statement is that the additional tax burden created by giving a particular entity a tax break is spread over so many taxpayers that the marginal cost to each individual taxpayer is minimal. Dalehite et al. (2008) report abatements resulted in modest increases between the hypothetical rate -where all properties would be taxed at the same rate- and the current structure where some properties enjoyed abatements. This difference, according to Dalehite et al. amounts to between 2 and 7 cents per $100 of net appraised value or, stated another way, between 0.6 and 3.3 percent. They further conclude that it is these reasons why there has been a proliferation of tax abatements over the past thirty years. Politicians simply see this as a symbolic tool which is relatively harmless to appease certain businesses and citizens (Dalehite et al., 2008, pp.202-203).

Delehite et al.'s (2008) study is limited to the property tax abatement program in Monroe County, Indiana, which would be difficult to argue is a microcosm for all local governments in the nation. In addition, it would also be difficult to argue that the property tax abatement ratio to total property values in one particular county is representative of every county. Their study, while no doubt significant in its particular jurisdiction, does not make an argument for the effects of a large abatement on the tax revenue of a small or rural county. Since the abatements/incentives are awarded on a case-by-case basis and not to a particular class of business or property type as a matter of policy, it is a hard argument that in general these types of awards do not affect the burden on additional taxpayers. It could also be argued that taxpayers may very well be sensitive to changes in the tax rate and may not allow enough rate increase caused by tax abatements, therefore leaving the county at a shortfall rather than the taxpayers absorbing the increase.

Lack of Transparency

Unfortunately, many state and local governments do not provide much information about their property tax incentive programs for business. To clarify, it is indeed, typically *not* difficult to find information about whether a state has an enterprise zone or a property tax abatement program and the qualifications for said program. What *is* difficult, is finding any information about *firm-specific* tax incentives, which, of course, makes evaluation regarding the effectiveness of those programs quite difficult. To evaluate the effectiveness of the programs, one must have basic information such as the firm receiving the incentive, the amount of the incentive, and the response to the incentive, such as increases in employment levels. Currently 44 states produce tax expenditure reports, but only eight states include figures for local property taxes (Kenyon, Langley, & Paquin, 2012, p.1016).

Disclosure in Other States

Some states have decided to be more transparent in their disclosure of tax incentives for economic development through their own legislatures. Illinois for example, approved a new disclosure requirement in 2012 for their Economic Development for a Growing Economy (EDGE) tax credit program (Staats & Williams, 2012, p.17). This program grants tax credits to qualifying companies, equivalent to the amount of state income taxes withheld from the salaries of employees in the newly created jobs (Illinois Department of Commerce & Economic Opportunity, 2014). Under the new legislation the Illinois Department of Economic Opportunity will post the terms of each new EDGE agreement executed on its website. The agreement will show the value of the tax incentives given the participant, the amount of credit allowed for each year, and the duration of the credit. In addition to these details, there will also be a thorough description of the project, the amount of the investment, and the number of jobs either created or retained. In addition, the state website will include the amount of the investment the business will make as capital improvements, the date such property will be placed in service, and the designated location site in Illinois of the project (Staats & Williams, 2012, p.17).

The State of Oregon has also followed this path by enacting a transparency initiative in 2011. This included most enterprises zones, so the state now provides information online that includes the name of the business, its address, the total amount of credits received, and the program outcomes among other information (Kenyon et al., 2012, p.1016). These types of actions by state governments seeking transparency with tax incentive programs further show the necessity for these programs to be extended to property tax rolls. If the states are willing to record and publish these records at the request of their taxpayers, then local municipalities and counties should also follow suit with the movement of transparency.

Disclosure Feedback

Surveys from the taxpayers, among other groups, show that they do care about tax abatements awarded by their local governments. Harris, McKenzie and Rentfro (2012, p.40) find several results reflecting the desire of taxpayers to see various items reported. The desired items include: outstanding agreements, performance expectations, and tax recovery.

These findings are significant because they confirm financial statement users' desire for particular information to be presented in the financials of local governments. Another point to be noted is that, to some degree, desires of citizens, county board members, and municipal bond analysts are aligned. Citizens had the most desires, followed by county board members and finally by analysts, but the desires of the latter two were within the expectations of the citizens.

PROPOSED DISCLOSURE

Given Gamkhar and Granof's (2008, p.34) suggestions, a financial statement disclosure proposal is created to display the gross property tax revenues (i.e. what would have been collected had an abatement not been granted), and then report abatements as a tax expenditure. The Harris et al. (2012) study took this concept further and reports that citizens and board members preferred a display where abatements would be shown as a reduction to revenues. Analysts also preferred this method, but it is secondary to a financial disclosure (p.42). In keeping with the concept of the treatment of receivables and the necessity for creating an allowance for uncollectible accounts, abatements should be shown as a contra item to property tax revenue.

EXHIBIT 1

Sample City
Partial Statement of Activities
For the Year Ended December 31, 2013

		Governmental Activities
General Revenue		
Taxes		
Property tax levied for general purposes	$	43,582,539
Tax abatements (See Exhibit 2)	(144,469)	
Net property tax	$	43,438,070
Sales tax	$	15,650,035
Total General Revenue	**$**	**59,088,105**

Exhibit 1 illustrates Sample City's Statement of Activity revenue based upon a full disclosure of the tax levy and outstanding abatements/incentives awarded. The illustration displays the gross levied tax for general purposes adjusted by the tax abatements for the current year which results in the net levied tax for general purposes. Details of the tax abatement agreements are presented in Exhibit 2 can be included as a financial statement disclosure tying to the amount reported in the Partial Statement of Activities. These exhibits respond to information requested in prior research (Harris et al., 2012, Gamkhar & Granof, 2008). Although the total agreement amounts displayed in Exhibits 1 and 2 appear to be insignificant when the economic input/output impact is considered, the consequence is extensive.

EXHIBIT 2

Sample City
Current Year Tax Abatement Analysis

				Jobs		Investment (000's)				
Company	**Agreement Date**	**Term**	**City Obligation**	**Required**	**Actual**	**Approved**	**Actual**	**Allowed**	**Tax Rate**	**Tax Abatement**
ABC Corporation	May 2012	5 years	none	100	124	$15,000	$16,436	$15,000	0.323564	$48,535
BCD Corporation	June 2013	3 years	none	10	21	$12,000	$4,108	$4,108	0.323564	$13,292
CDE Corporation	April 2011	5 years	water service est $10K	50	70	$6,000	$11,948	$6,000	0.323564	$19,414
DEF Corporation	August 2012	3 years	none	25	16	$9,000	$11,505	$9,000	0.323564	$29,121
EFG Corporation	April 2013	6 years	drainage est $25K	56	56	$32,000	$8,941	$8,941	0.323564	$28,930
FGH Corporation *	June 2013	5 years	none	7	7	$3,600	$2,838	$1,600	0.323564	$5,177
Combined total										$144,469
*First year allowance limited to $1,600,000										

An input/output analysis looks at the economic relationships to ascertain how the operation of a firm affects and is affected by other companies. For example, when an existing firm expands, the analysis determines how other firms will be affected and what will be the total economic impact on regional production, income, and employment. When a new firm is attracted to an area, the analysis helps determine the impact the new firm's payroll has on incomes, production and regional employment.

Using Miller and Blair's (2009) methodology, the impact of each of the abatements listed in Exhibit 2 is calculated. Three types of multipliers are computed: an output, an employment and an earnings multiplier. Of the illustrated abatement agreements, the three current year agreements are with firms currently in a start-up phase as their operations will not commence until the new fiscal year. The three prior year agreements are with firms in an operating mode.

Exhibit 3 displays the analysis produced using the Miller and Blair (2009) multipliers applied to the projected annual production based on the information provided in Exhibit 2. The output projections derive an estimate of the firms' operation impact on regional production. It is estimated that the six firms receiving tax abatements will trigger a $38.4 million increase in regional outputs. The total impact of the six firms' operations on regional incomes equals over $3.2 million. Multiplying each industry's employment multiplier by 10 reveals that total employment in the region would increase by 438. The economic impact multipliers are an aggregation of different firm types which in turn result in a matrix of computations to arrive at the overall estimate. Although Exhibit 3 is a complex computation, the information would be appropriate for inclusion in the City's Management Discussion and Analysis section of the Comprehensive Annual Financial Report (CAFR).

EXHIBIT 3
Sample City
Potential Abatement Impact

Annual output[1]	$26,232,000
Tax abated [2]	$144,469
Economic Impact[3]	
Based on total output	$38,439,740
Based on total income	$3,237,800
Total employment	438

[1] Assumed

[2] Statement of Activity (Exhibit 1)

[3] Computed using Miller & Blair (2009) multipliers

While the amount abated was not found to be a significant item in Exhibit 1, there seems to be stakeholder agreement on knowing about the impact of outstanding abatements and tax incentives. In order to accurately reconcile these abatements down to the materiality level, it is a practical consideration to include all outstanding agreements in the Exhibit 2 analysis. These disclosures would tie into the amount on the statement of activities contra figure to gross property tax revenues.

CONCLUSION

This study explores different tax incentives used for economic development and champions the need for additional disclosures. First, the concept of tax expenditures is reviewed in the literature and how they are used in the state and local government arena. Because they are typically a tax omission rather than direct tax expense, tax expenditures are difficult to measure and assess, and in most cases, governments do not report this information through a tax expenditure budget or through oversight by a higher level entity. This lack of transparency makes it difficult for financial statement users to assess the effectiveness of programs that use tax revenue reduction tools as opposed to direct expenditures by the government. While a majority of states do have tax expenditure budgets, only a handful actually have tax expenditure budgets that drill down to the property tax level. These budgets involve setting a *baseline* for tax collections, which in the case of property tax revenue tends to be the value of all real estate. Any deviation from this should be reported in the tax expenditure budget.

Different types of tax expenditures that local governments use are tax incremental financing, enterprise zones, free exemptions and tax abatements. Tax incremental financing is used by local governments to publicly finance structural improvements and boost infrastructure within a particular area. Enterprise zones are a tool for economic development for local communities to promote job creation and capital investments. These zones are focused in communities that have higher poverty rates and are seeking incentives. Freeport exemptions give local governments the options of taxing certain goods that are defined in-transit by state law. Property tax abatements can be structured in different ways. The typical structure is a firm receiving an abatement for a certain percentage for a specified number of years, such as a fifty-percent abatement for twenty years.

Some have argued that the effects of tax abatements on the local government revenues are too small to affect decisions. Unfortunately, many state and local governments do not provide much information about their property tax incentive programs for business. The requirements to participate in the program are readily available but firm-specific information is quite difficult to find. This has begun to change with some states becoming more transparent in their disclosure of tax incentives through their legislatures. Illinois and Oregon have both started sharing firm-specific information and some performance metrics through government websites.

Through surveys of citizen and taxpayer groups, county board members, and municipal bond analysts reported in the literature, this study presents illustrations of the information different stakeholders desire to be reported in financial reports regarding property tax abatements. The sample disclosures included the items explicitly shown to be desired by the different user groups along with the actual abatement amounts, as a reconcilement of the tax abatement figure on the face of the financial statements.

This analysis contributes to the literature by taking the next step beyond user surveys along with some real-life data to present a more transparent set of financial data for the CAFR presentation. These disclosures provide greater transparency for local governments and the communities that are affected by these economic incentives.

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