Wednesday's
News You Can Use

UNDERSTANDING PROPERTY TAX "ABATEMENT"

HOW IT WORKS IN GEORGIA

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Learning Objectives

At the end of this session, you should be able to:

- Describe how bond issues work and why a bond issue is needed for incentive purposes
- Navigate the process and procedures that are required to reconcile accounting and tax issues (including GASB's new exposure draft for tax abatement disclosures)
- Discuss the use of agreed upon procedures as a best practice for ensuring compliance with Payment in Lieu of Tax (PILOT) agreements

THE GEORGIA WAY

- GEORGIA HAS 159 COUNTIES
- SO, THERE ARE 159 WAYS THAT PROPERTY TAX "ABATEMENT" IS DONE IN GEORGIA
- TAKE-AWAY
  - IT'S NOT REALLY "ABATEMENT"
    - THAT'S A MISNOMER

THE GEORGIA WAY

- IT'S REALLY PROPERTY TAX SAVINGS
- BUT IN THIS PRESENTATION, WE'LL CALL IT "ABATEMENT", TOO
- JUST DON'T GET CONFUSED

THE GEORGIA WAY

ANOTHER TAKE-AWAY

- GEORGIA IS A "TRANSACTION" STATE
  - NO PROPERTY TAX ABATEMENT WITHOUT A TRANSACTION
  - Exception- limited zones under Georgia Constitution, for example: state enterprise zone, urban enterprise zone
  - Another exception- "freeport" inventory exemption

TELL ME WHY

- PROPERTY TAX ABATEMENT IS A LOCAL INCENTIVE
  - A TRANSACTION IS REQUIRED BECAUSE OF THE STATE CONSTITUTION
    - "UNIFORMITY OF TAXATION"
    - NO "GIFTS OR GRATUITIES" FROM PUBLIC SECTOR TO PRIVATE SECTOR
- ALSO WANT TO AVOID TAXPAYER SUITS OVER "SHAMS"

MAKE IT LEGAL

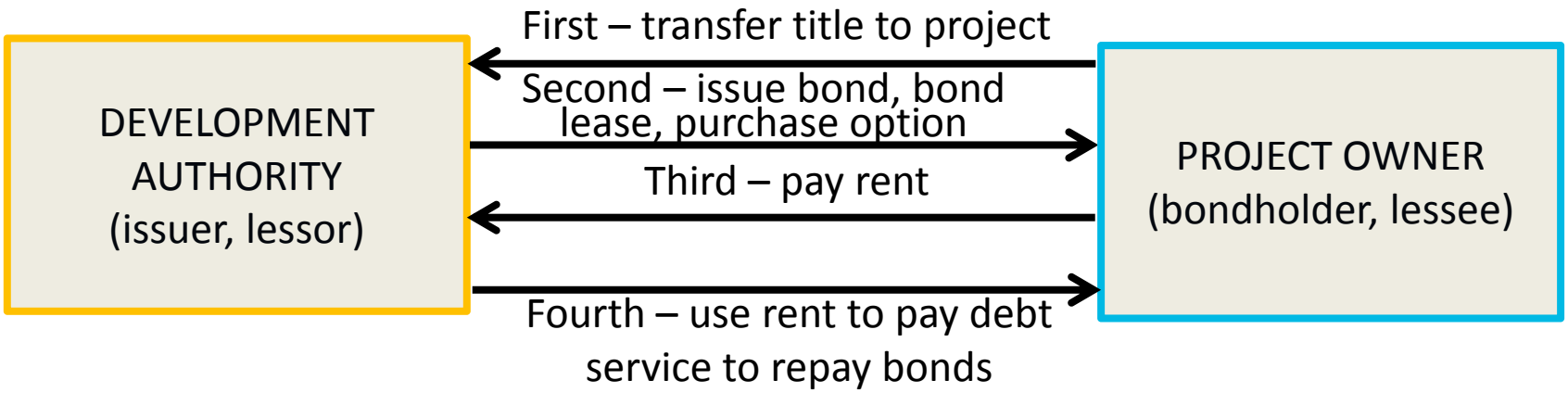
UNDERPINNINGS OF THE TRANSACTION

- TITLEHOLDER (PUBLIC BODY) NEEDS TO BE EXEMPT FROM PAYING PROPERTY TAX OR PROPERTY NEEDS TO BE EXEMPTED
- STILL NEED LEASE TO COMPANY
- LEASE POTENTIALLY TAXABLE

THE TRANSACTION

- BOND-FINANCED SALE-LEASEBACK TRANSACTION
  - "BONDS FOR TITLE"
- EFFECTIVELY, PROJECT OWNER IS "SWAPPING" THE PROJECT TO THE DEVELOPMENT AUTHORITY IN EXCHANGE FOR A BOND, A BOND LEASE, AND A PURCHASE OPTION
  - THESE DOCUMENTS = BENEFICIAL OWNERSHIP OF THE PROJECT BY THE OWNER AFTER THE CLOSING

"BONDS FOR TITLE"



LOCAL OPTIONS

- THE BONDS FOR TITLE STRUCTURE IS A COMMON THREAD IN ANY COUNTY
- HERE'S WHAT CAN VARY FROM COUNTY TO COUNTY-
- THE METHODOLOGY
  - LEASEHOLD VALUATION
  - NONTAXABLE LEASE (USUFRUCT)

LOCAL OPTIONS

- ANOTHER METHODOLOGY
  - EXEMPT PROPERTY
  - IF "CONSTITUTIONAL" DEVELOPMENT AUTHORITY WITH CERTAIN LANGUAGE IN ITS LOCAL CONSTITUTIONAL AMENDMENT
    - STILL NEED TRANSACTION BECAUSE OF "GIFTS AND GRATUITIES" ISSUE, LIMITATION ON POWERS OF DEVELOPMENT AUTHORITIES, ETC.

LOCAL OPTIONS

OTHER LOCAL OPTIONS-

- HAS THE COMMUNITY ADOPTED A POLICY ON INCENTIVES?
- IS A THIRD PARTY COST/BENEFIT STUDY REQUIRED?
- DOES THE DEVELOPMENT AUTHORITY REQUIRE SIGN OFF BY ONE OR MORE LOCAL TAXING AUTHORITIES?

WHAT'S AT STAKE

Depending on the incentives structure, some or all of the following issues will be negotiable-

- The percentage and duration of the abatement
- What property is eligible
- Whether existing investment and/or investment already on the tax digest (not always the same) can be included
- The start date and treatment of any CIP (Construction in Progress)

WHAT'S AT STAKE

Depending on the incentives structure, some or all of the following issues will be negotiable-

- Goals (typically jobs created or retained, and investment to be made)
- Clawbacks
- Post-closing compliance
  - Reporting and auditing
- More
  - project-specific issues

THE COMPANY WILL WANT-

- CONSERVATIVE GOALS
- SAFETY MARGIN
- CURE RIGHTS
- FORCE MAJEURE RIGHTS
- LIMITED ACCOUNTABILITY PERIOD
- LIMIT TIMES ACCOUNTABILITY TESTED
- UNCONDITIONAL/ AUTOMATIC PURCHASE OPTION

FOCUS ON PILOTs

- DEPENDING ON ABATEMENT STRUCTURE USED, PROPERTY MIGHT ACTUALLY NOT BE SUBJECT TO PROPERTY TAX
- IF PROPERTY ISN'T TAXABLE, THEN SOME DOORS OPEN
  - 100% ABATEMENT, OR
  - PAYMENTS IN LIEU OF TAXES (PILOT PAYMENTS)
- CONTRACTUAL PILOT PAYMENTS ARE OUTSIDE NORMAL PROPERTY TAX RULES
- SO, THEY ARE GOVERNED BY CONTRACT (PILOT AGREEMENT)
  - "PILOT RESTRICTION ACT" MIGHT ALSO APPLY

QUESTIONS THE COMPANY MAY ASK-

- WILL IT BE ABLE TO PLEDGE THE PROJECT AS SECURITY FOR A LOAN?
- DO "COMPETITION IN CONSTRUCTION" LAWS APPLY?
- DO "PREVAILING WAGES" LAWS APPLY?
- WILL IT BE ABLE TO SUBLEASE THE PROJECT?
- CAN IT SELL THE PROJECT WITH THE ABATEMENT?

FINANCING LEASE

THE ANSWERS TO MANY QUESTIONS ARE STRAIGHTFORWARD WHEN THE LEASE IS DEEMED A "FINANCING LEASE"

- GEORGIA- In a suit for a sales tax refund, where sale and lease back transaction engaged in by corporations was in substance a security arrangement for a loan, the transaction could not be taxed as a lease. *Footpress Corporation v. Strickland,* 242 Ga. 686, 251 S.E.2d 27 (1978)

FINANCING LEASE

BOOK/ACCOUNTING

"See Financial Accounting Standards Board Statement #13 which discusses the distinctions between direct financing leases, capital leases and operating leases for financial accounting purposes. If any one of the following four criteria discussed in the statement is satisfied then a lease is deemed a transfer of ownership:" SECTAXADV § 19:2

FINANCING LEASE

BOOK/ACCOUNTING

" If any one of the following four criteria discussed in the statement is satisfied then a lease is deemed a transfer of ownership: (1) by the end of the lease term, ownership of the leased property is transferred to the lessee, (2) the lease contains a bargain purchase option, (3) the lease term is substantially (75 percent or more) equal to the estimated useful life of the leased property, or (4) at the inception of the lease, the present value of the minimum lease payments, with certain adjustments, is 90 percent or more of the fair value of the leased property. Leases which are not capital leases under FASB #13 are operating leases and accounted for as true leases." SECTAXADV § 19:2

FINANCING LEASE

TAX

- "Recent leasing cases have applied both the economic substance doctrine and the substance-over-form doctrine, with more emphasis on substance-over-form. Under the substance-over-form doctrine, the key inquiry is whether the lessor obtains the benefits and burdens of ownership. " 41 WGL-RETAX 14
- In a conduit bond transaction, expect the lessee's accountants to place the "benefits and burdens of ownership" on it; i.e., treat the lessee as the "tax owner."

FINANCING LEASE

BANKRUPTCY-

- **In case of bankruptcy of the public body or the Company, the Company is a borrower (and so, is treated as the project owner) and the public body is treated as a lender, if the lease is treated as a financing lease.**
- **"Whether an agreement is a true lease and therefore an executory contract, or a financing lease and therefore a security interest, can be extremely significant".** BKRLM Sec. 6.01

FINANCING LEASE

BANKRUPTCY-

- **"Whether a lease is a "true lease" or a security agreement is determined by a transaction's economic substance rather than its form or the location of title…. If the lease term exceeds the leased property's useful life, or the lessee can defeat the lessor's reversion by exercise of a nominal or low cost option, the lease generally will be considered a security agreement."**

BKLRM Sec. 6.01.

FINANCING LEASE

In Georgia, Development Authorities aren't subject to voluntary or involuntary bankruptcy.

- A Development Authority is a “governmental unit” as defined in 11 U.S.C. § 101(27). 11 U.S.C. § 109 only permits a governmental unit to be a debtor under chapter 9 of the Bankruptcy Code if applicable state law specifically authorizes it to seek such relief. O.C.G.A. § 36-80-5 prohibits a Development Authority from seeking relief under the Bankruptcy Code.
- Involuntary bankruptcy may not be filed against a Development Authority under 11 U.S.C. § 303, because involuntary bankruptcy may only be filed against a “person” as defined in 11 U.S.C. § 101(41) and the Development Authority is a “governmental unit” as defined in 11 U.S.C. § 101(27) and is thus not a “person” as defined in 11 U.S.C. § 101(41).

THINGS TO COME

GASB: Proposed Statement of Governmental Accounting Standards Regarding Tax Abatement Disclosures (the "Proposal")

- Would require governments that are subject to tax abatement agreements to make certain disclosures.
- "We have a specific concern that the Proposal should not be applied to property tax savings resulting in practice when a local authority leases a project to a company. The savings in that case results from the difference in the taxability or valuation of the lease. Calling this "tax abatement" means that, for example, a non-taxable lease by a convention center authority of space for an event would be subject to the Proposal, which surely cannot be your intention. However, the potential for confusion exists, under the current Proposal, and needs to be corrected." Comment on the Proposal by the Georgia Economic Developers Association

THINGS TO COME

Revision of the 2010 proposed FASB Accounting Standards Update, Leases (Topic 840)

- "The new FASB Lease Accounting Standards to be finalized by the end of the summer 2015 will radically transform lease accounting, with far reaching consequences to a company's financial results.
- Under the new rules, operating leases are essentially dead, and virtually all leases will be recognized on a company's balance sheet. Moreover, the traditional method of using the discounted cash flow to analyze lease deals will no longer be sufficient, as two leases with identical cash flows can have very different impacts on the balance sheet and income statement." Source: Atlanta Business Chronicle
- Will not affect current treatment of Bonds for Title

Why is it so difficult to ensure compliance with PILOT Agreements?

- Multiple players involved
- Non-routine in nature
- Lack of understanding
- Lack of communication

What steps can my government take to ensure compliance with PILOT Agreements?

- Document and perform an internal review of the process and procedures surrounding your agreements
- Engage your external auditor to perform agreed upon procedures with respect to your agreements

Procedures and Steps in the Process

1. Obtain a listing of properties in the name of the industrial development authority from the Tax Assessors Office
2. Ask that the list identify properties and their valuations that the tax assessors are billing under various tax abatement agreements or PILOT agreements

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Procedures and Steps in the Process

3. Obtain a listing from the Tax Commissioner's office of the actual tax bills issued for the year for the properties provided by the Tax Assessor
4. Use Industrial Development Authority (IDA) financial statements to compare outstanding revenue bonds (conduit debt) to the list of properties in the name of the IDA

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Procedures and Steps in the Process

5. Obtain copies of tax abatement and PILOT agreements
6. If there is a private revenue bond outstanding but no tax abatement agreement, determine that 100% of the taxes due have been billed to the private entity for the year

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Procedures and Steps in the Process

7. Determine that the amount of property taxes billed to the private entities with a current tax abatement agreement is correct per the agreement
8. Review properties that were on the list at the end of the prior year to see if any of the abatement agreements and/or industrial revenue bonds has expired

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Procedures and Steps in the Process

9. If agreements have expired ensure that the property is no longer in the name of the IDA but has been transferred back to the private entity and included in the current year digest valuation for proper billing of taxes
10. Calculate the dollar amount of property taxes not billed (abatement amount) for the current year as a result of valid abatement agreements

Transparency and Accountability

- Prepare a summary of PILOT Agreements
  - Company name
  - Map Parcel #
  - Expiration date of the agreement
  - Name on Property Card
  - Years and respective amounts to be abated
    - 2015 - 0%, 2016 - 20%, 2017 - 40%, etc.
  - Total unbilled taxes
- Circulate summary report to all players

CONCLUSION

"I am always ready to learn although I do not always like being taught."
Winston Churchill

I HOPE YOU LIKED IT!

QUESTIONS?

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REFERENCES

THIS PRESENTATION AND OTHER REFERENCES CAN BE DOWNLOADED AS FOLLOWS:

- January 2014- "Bonds for Title
- May 2013- P3 – “Public/Private Partnerships Done Right”
- June 2011- "TIFs and TADs in Tough Times“; TIFs and TADs Questions and Answers
- January 2011- "The Incentives ‘Power Curve’- How to Beat It"
- November 2011 - “CSI Incentives- Property Tax Opportunities Uncovered”
- May 2009- "Site Incentives, Tax Credits & Tax Strategies.....Are They the Difference Between Success and Failure“
- July 2008-"Should We Stay or Should We Go? State and Local Incentives: Developing the Decision-Making Process"

at http://danmcrae.info/whitepapers