HB 1354

Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
Third Reader - Revised

House Bill 1354 (Delegates Charkoudian and Palakovich Carr)
Ways and Means Budget and Taxation

Sales and Use Tax and Personal Property Tax – Services, Aircraft Parts and Equipment, and Data Centers

This bill alters the State sales and use tax by (1) expanding the definition of taxable service to include specified services; (2) exempting the sale of materials, parts, or equipment used to repair, maintain, or upgrade aircraft or the avionics systems of aircraft if installed on specified aircraft; and (3) exempting the sale of qualified data center personal property for use at a qualified data center. The bill also authorizes local governments to reduce or eliminate the percentage of the assessment of any data center personal property used in a qualified data center. **The bill takes effect July 1, 2020.**

Fiscal Summary

State Effect: General fund revenues increase by approximately $25.9 million in FY 2021 and by $29.1 million in FY 2025. General fund revenues decrease by a potentially significant amount beginning in FY 2021 as a result of the sales and use tax exemptions. General fund expenditures increase by approximately $283,500 in FY 2021 and by $66,400 in FY 2025. Future year expenditures reflect annualization and inflation.

($ in millions)	FY 2021	FY 2022	FY 2023	FY 2024	FY 2025
GF Revenue	$25.9	$26.6	$27.4	$28.3	$29.1
GF Expenditure	$0.3	$0.1	$0.1	$0.1	$0.1
Net Effect	$25.6	$26.6	$27.4	$28.2	$29.0

Note:() = decrease; GF = general funds; FF = federal funds; SF = special funds; - = indeterminate increase; (-) = indeterminate decrease

Local Effect: Local personal property tax revenues may decrease by a potentially significant amount to the extent the assessment of qualified data center personal property is reduced or eliminated. Local expenditures are not affected.

Small Business Effect: Potential meaningful.

Analysis

Bill Summary:

Taxation of Services

The bill expands the definition of taxable service to include the following services: (1) a telemarketing bureau or other contact center service; and (2) a lobbying or public relations service.

Aircraft Materials and Parts

The bill exempts from the State sales and use tax the sale of materials, parts, or equipment used to repair, maintain, or upgrade aircraft or the avionics systems of aircraft if installed on an aircraft that has (1) a maximum gross takeoff weight of less than 12,500 pounds or (2) has a maximum gross takeoff weight of 12,500 pounds or more and is primarily used in interstate or foreign commerce. The bill requires the Comptroller to report to the General Assembly by December 31 of each year on (1) the amount of sales and use tax revenue lost from the exemption and (2) any change to the number of aviation technicians employed in the State as a result of the exemption.

Data Centers

The bill provides a sales and use tax exemption for the sale of qualified data center personal property for use at a qualified data center. The buyer must provide the vendor with evidence of eligibility for the exemption issued by the Comptroller. An individual or a corporation is eligible for the exemption if the individual or corporation owns a qualified data center at which the individual or corporation has invested at least $5.0 million in qualified data center personal property and filled at least five qualified positions, within three years after submitting an application for a sales and use tax exemption. The minimum investment in qualified data center personal property only needs to total $2.0 million in a Tier I area.

A data center is defined as a building or group of buildings used to house computer systems, computer storage equipment, and associated infrastructure that businesses or other organizations use to organize, process, store, and disseminate large amounts of data.

A qualified data center includes a data center that is a co-located or hosting data center where equipment, space, and bandwidth are available to lease to multiple customers and an enterprise data center owned and operated by the company it supports.

Qualified data center personal property is personal property purchased or leased to establish or operate a data center. Qualified data center personal property includes

(1) computer equipment or enabling software used for the processing, storage, retrieval, or communication of data, including servers, routers, connections, and other enabling hardware used in the operation of that equipment; (2) heating, ventilation, and air-conditioning and mechanical systems, including chillers, cooling towers, air-handling units, pumps, energy storage or energy efficiency technology, and other capital equipment used in the operation of that equipment; and (3) equipment necessary for the generation, transformation, transmission, distribution, or management of electricity, including exterior substations, generators, transformers, unit substations, uninterruptible power supply systems, batteries, power distribution units, remote power panels, and any other capital equipment necessary for these purposes.

A qualified position is defined as a position that (1) is a full-time position of indefinite duration; (2) pays at least 150% of the State minimum wage; (3) is newly created because a data center begins or expands in a single location in the State; and (4) is filled.

A qualified position does not include a position that is (1) created when an employment function is shifted from an existing data center in the State to another data center of related ownership if the position is not a net new job in the State; (2) created through a change in ownership of a trade or business; (3) created through a consolidation, merger, or restructuring of a business entity if the position is not a net new job in the State; (4) created if an employment function is contractually shifted from an existing business entity in the State to another business entity if the position is not a net new job in the State; or (5) filled for a period of less than 12 months.

A Tier I area is a county with (1) an average rate of unemployment for the most recent 24-month period for which data is available that exceeds 150% of the average rate of unemployment for the State during that period; (2) an average rate of unemployment for the most recent 24-month period for which data is available that exceeds the average rate of unemployment for the State by at least 2 percentage points; or (3) a median household income for the most recent 24-month period for which data is available that is equal to or less than 75% of the median household income for the State during that period. A Tier I county includes a county that no longer meets any of these criteria but has met at least one of the criteria at some time during the preceding 24-month period. A Tier I area also includes an opportunity zone, as defined under § 1400z-1 of the Internal Revenue Code.

To qualify for the sales and use tax exemption, an individual or a corporation must file an application for an exemption certificate with the Department of Commerce. An exemption certificate issued by the Comptroller must be renewed each year and may not be renewed for more than ten consecutive years.

Current Law: The State sales and use tax rate is 6%, except for the sale of alcoholic beverages, which are taxed at a rate of 9%.

Taxation of Services

Taxable services include cellular phone and other mobile telecommunications services; telephone custom calling features; 900-type telephone services; telephone answering services; prepaid telephone calling arrangements; security services; commercial building cleaning; certain commercial cleaning and laundering of textiles for businesses; credit reporting services; pay-per-view television; production of tangible personal property by special order; transportation services for transmission, distribution, or delivery of taxable electricity or natural gas; and consumption of wine not provided by a restaurant, club, or hotel.

Aircraft Materials and Parts

Sales of machinery, equipment, and other tangible personal property used directly and predominantly in a production activity are exempt from the sales and use tax.

Maryland regulations (COMAR 03.06.01.26) specify that the sale or a sale for use of an aircraft, motor vehicle, railroad rolling stock, or vessel that is used principally in interstate or foreign commerce and a sale or a sale for use of a replacement part or other tangible personal property to be used physically in, on, or by it are exempt from the sales and use tax. Under the exemption, a vendor may overcome the presumption of taxability by requiring the buyer to sign a specified form.

Major air carriers are exempt from paying the sales and use tax on materials and parts used to repair their aircraft.

Background: The sales and use tax is the State's second largest source of general fund revenue, accounting for approximately $5.0 billion in fiscal 2020 and 2021, according to the December 2019 revenue forecast. **Exhibit 1** shows the sales and use tax rates in surrounding states and the District of Columbia.

Exhibit 1
Sales and Use Tax Rates in Maryland and Surrounding States

Delaware	0.0%
District of Columbia	6.0%; 10.0% for liquor sold for on-the-premises consumption and restaurant meals; 10.25% for alcoholic beverages for consumption off the premises, tickets to specified sporting events, and specified rental vehicles; and 8.0% for specified soft drinks
Maryland	6.0% 9.0% for alcoholic beverages
Pennsylvania	6.0% plus 1.0% or 2.0% in certain local jurisdictions
Virginia*	5.3%; 2.5% for eligible food items; 2.5% for specified essential personal hygiene items; both rates include 1.0% for local jurisdictions
West Virginia	6.0% plus 0.5% (in one municipality) or 1.0% (in 45 municipalities)

*An additional state tax of 0.7% is imposed in localities in Northern Virginia and the Hampton Roads region, and an additional 1.7% is imposed in localities in the Historic Triangle.

Taxation of Services

A significant contributing factor cited for the erosion of the sales tax base is a shift in the national economy from the consumption of goods, the traditional base of the tax, to the consumption of services. In an August 2019 letter to the Board of Revenue Estimates, the Comptroller's Bureau of Revenue Estimates discussed the changing nature of the State's sales and use tax. The letter noted that household consumption spending is shifting away from goods toward services and digital goods, the vast majority of which are not taxable under the sales and use tax. The letter also noted that since the sales and use tax base is becoming a smaller share of consumption spending, the State collects less sales and use tax per dollar of consumption than in the past.

The extent to which services are taxed varies across the nation. Hawaii, New Mexico, South Dakota, Washington, and West Virginia tax services broadly; in fact, Hawaii, New Mexico, South Dakota, and West Virginia subject all sales of goods and services to tax unless those goods or services are specifically exempt. Meanwhile, in other states, goods and services are not taxable unless specifically included in the tax base.

According to the National Conference of State Legislatures, states have faced several barriers to taxing services. These barriers include (1) administrative challenges in quantifying and tracking the value of services provided and determining where to source the sale of a service; (2) the difficulty in defining the new base (*i.e.*, developing clear definitions of services); and (3) tax pyramiding, where the taxes on business-to-business sales are factored into the final sale price of a product. A number of states, including Louisiana, Massachusetts, Michigan, Nebraska, Pennsylvania, and Utah, have proposed significantly broadening their sales tax bases, including to professional services, but none have been successful. Meanwhile, Connecticut, the District of Columbia, Iowa, Kentucky, and North Carolina have taken incremental steps to broaden the application of their sales and use taxes to additional services.

In Maryland, the State sales and use tax has been imposed broadly on the sale or use of tangible personal property but only narrowly on a few specifically enumerated services. The Maryland General Assembly last considered legislation expanding the sales and use tax base to services in 2012. House Bill 1051 of 2012 would have imposed the sales and use tax on approximately 30 additional types of services. The Department of Legislative Services estimated that revenues could increase by over $600 million under the bill's provisions.

Aircraft Materials and Parts

Exhibit 2 shows the sales and use tax rate for aircraft materials and parts in surrounding states.

Exhibit 2
Sales and Use Tax Rates in Maryland and Surrounding States for Aircraft Parts

Delaware	0.384%
Maryland	6.0%
New York	Exempt
Ohio	Exempt
Pennsylvania	Exempt
Virginia	Exempt
West Virginia	Partial Exemption

Source: Aircraft Owners and Pilots Association

The Maryland airport system consists of 34 public use airports in addition to the Baltimore/Washington International Thurgood Marshall Airport. These public use airports include Martin State Airport, Salisbury-Ocean City Wicomico Regional Airport, and 32 general aviation airports. The Maryland Aviation Administration indicates that these airports are responsible for over 12,500 direct and indirect jobs with $583.0 million in wages and salaries, and $1.1 billion in total economic activity, including $867.0 million from aircraft handling fees and aircraft services.

Salisbury Regional Airport

Salisbury-Ocean City Wicomico Regional Airport (Salisbury Regional Airport) spans 1,081 acres and is the second largest airport in Maryland. The airport provides a variety of services for residents of the Delmarva Peninsula, with direct flights to Charlotte and Philadelphia. The airport supports American Airlines and Piedmont/American Eagle scheduled service, FEDEX cargo service, Maryland State Police helicopter operations, and a wide range of general and business aviation services. Salisbury Regional Airport supports 1,300 direct and indirect jobs in the area and generates approximately $84 million in revenue annually.

Data Centers – Virginia

Virginia provides a state sales tax exemption for computer equipment or enabling software purchased or leased for the processing, storage, retrieval, or communication of data, including but not limited to servers, routers, connections, and other enabling hardware, including chillers and backup generators used or to be used in the operation of a data center in the state. In order to qualify for the exemption, an enterprise or colocation data center must have a new capital investment of at least $150 million and create at least 50 new jobs in a Virginia locality. The minimum new job requirement is reduced to 25 if the data center is located in an enterprise zone or in a locality with an unemployment rate at least 1.5 times the average statewide unemployment rate. New jobs must pay at least 1.5 times the annual average wage in the locality where the data center is located. The exemption expires June 30, 2035.

A July 2019 report by the Virginia Joint Legislative Audit and Review Commission (JLARC) states that Loudoun County has become known as “Data Center Alley” because of its massive concentration of data centers. In addition, an estimated 70% of international Internet traffic flows through Northern Virginia’s telecommunications infrastructure.

The JLARC report also states that there were 159 beneficiaries of the state’s data center sales and use tax exemption and the exemption reduced state revenues by $417 million between fiscal 2010 and 2017. The report indicates that the exemption has resulted in a moderate impact on the state’s economy and that between fiscal 2010 and

2017 private-sector employment increased by 7,665 jobs, Virginia GDP increased by $1.3 billion, and statewide personal income increased by $724.9 million, on average, each year. Overall, the state received $0.72 for every $1.00 spent.

The JLARC report also noted that data center representatives had two main concerns with the job requirements. First, the 50-job requirement is not in line with the capital investment requirement, according to the report. It was reported that data centers continue to become more efficient through automation, which means fewer jobs are necessary. The report indicated that based on an analysis of capital investment and job creation figures from data centers' memorandums of understanding with the state, one job is associated with $6.3 million in capital investment. Therefore, a $150 million investment would be expected to create 24 jobs, on average. According to JLARC, Virginia and Mississippi are the only states that have a 50-job requirement and that most data center sales and use incentives from other states do not have employment creation requirements or they are lower than 50 jobs.

The second concern was that the job creation threshold is a barrier for locating data centers in more distressed areas of the state. The reduced job threshold of 25 jobs for distressed areas and enterprise zones has had very little, if any, impact on encouraging data centers to locate in these areas. JLARC reports that only one data center (Microsoft) using the exemption has located in a distressed locality (Mecklenburg County). As a result, JLARC recommended that the Virginia General Assembly further reduce or remove the minimum job creation requirement in distressed areas or enterprise zones for the data center exemption.

Data Centers – Other States

Twenty eight states, not including those that do not have a state sales and use tax, currently offer some form of tax incentive to data centers operators.

A report for the Illinois Chamber of Commerce Foundation indicates that, in 2017, the data center industry's economic impact on the state was approximately 31,500 jobs, $2.4 billion in labor income, and $7.1 billion in economic output. In 2017, Illinois data centers generated approximately $877.5 million in tax revenue, of which $321.7 million was state and local tax revenue. Illinois does not have a sales and use tax exemption for data center equipment.

Pennsylvania provides a limited sales and use tax refund for data center computer equipment. The refund is capped at $5.0 million per year. In order to qualify for the refund, a data center must have a minimum annual payroll of $1.0 million, within the first four years of certification. Capital investment must be $25.0 million to $50.0 million, depending on the size of the county.

Tier I Counties

The following jurisdictions are Tier 1 counties for purposes of the One Maryland tax credit: Baltimore City and Allegany, Caroline, Dorchester, Garrett, Kent, Somerset, Washington, Wicomico, and Worcester counties.

Personal Property Taxes

In Maryland, there is a tax on business-owned personal property that is imposed and collected by local governments. Personal property generally includes business property including furniture, fixtures, office and industrial equipment, machinery, tools, supplies, inventory, and any other property not classified as real property. To provide for uniform assessments, the State Department of Assessments and Taxation (SDAT) is responsible for assessing all personal property. Each county or municipal government is responsible for issuing the tax bills and collecting the tax. The tax year begins on July 1, and ends on June 30. The personal property tax has been exclusively a local tax since 1984 when the State tax rate on personal property was set at zero.

At the beginning of each calendar year, SDAT notifies business entities on record that a personal property tax return must be filed by April 15. This tax return must include personal property located in Maryland as of January 1, the date of finality. The "date of finality" is the date used to determine ownership, location, value, and liability for tax purposes. Since 2017, all tax returns are now filed electronically. For fiscal 2020, the business personal property tax base is approximately $12.7 billion; for fiscal 2021, the assessable base is estimated to be $12.3 billion.

State Revenues: General fund revenues increase by approximately $25.9 million in fiscal 2021 and by $29.1 million in fiscal 2025 as a result of imposing the sales and use tax on specified services. General fund revenues decrease by a potentially significant amount beginning in fiscal 2021 as a result of the sales and use tax exemptions proposed by the bill. The various provisions of the bill are discussed below.

Taxation of Services

General fund revenues could increase by approximately $25.9 million in fiscal 2021 and by $29.1 million in fiscal 2025 as a result of imposing the sales and use tax on the services specified by the bill.

The estimate is based on product line and NAICS code (North American Industrial Classification System) data from the Economic Census survey conducted by the U.S. Census Bureau in 2012 and adjusted to fiscal 2021 using gross domestic product data for Maryland. The Economic Census data reflects sales by businesses in Maryland with at least one paid employee. It does not include sales by sole proprietors or sales of services that may be purchased by Maryland residents from providers outside of the State that would be subject to the sales tax. The estimate assumes a 6.0% reduction in taxable sales of the services specified by the bill. Future year revenues are expected to increase by approximately 3% annually.

The 6.0% decline in taxable sales reflects sales that would not be subject to Maryland sales tax for two reasons: (1) the sale does not occur because the additional cost dissuades the purchaser; or (2) the sale is diverted to a neighboring state where the service is not subject to a sales tax or the sales tax rate is lower. To the extent that the impact on sales volume varies from what is projected, sales tax revenues would increase or decrease correspondingly.

Exhibit 3 shows the revenue resulting from imposing the sales and use tax on selected services for fiscal 2021.

Exhibit 3
Sales Tax Revenues – Selected Services
($ in Millions)

Services	**FY 2021**
Lobbying or Public Relations Services	$17.0
Telemarketing Services	8.9
Total	**$25.9**

Source: Department of Legislative Services

Aircraft Materials and Parts Exemption

General fund revenues decrease beginning in fiscal 2021. The amount of the decrease depends on the cost of exempt materials and parts used to repair or maintain aircraft and the amount sold each year, neither of which can be reliably estimated.

The Aircraft Owners and Pilots Association identified and surveyed 20 aircraft repair and maintenance facilities in Maryland in 2019 to determine their sales and use tax collections and remittances for aircraft materials and parts over calendar 2015, 2016, and 2017. Of the 10 facilities that responded to the survey, it was determined that each facility remitted approximately $9,000 annually in sales and uses taxes for aircraft materials and parts. If it is assumed the remaining 10 facilities had similar collections as the survey respondents, it is likely that general fund revenues could decrease by between $200,000 and $250,000 annually beginning in fiscal 2021, as a result of the exemption. However, to the extent that the exemption proposed by the bill increases repairs being made in Maryland, general fund revenues will decrease accordingly.

Data Center Exemption

General fund revenues may decrease by a potentially significant amount beginning in fiscal 2021 to the extent qualified data centers meet the investment requirements of the bill. The amount of the revenue decrease depends on the amount and cost of qualified data center personal property that is purchased by qualified data centers, neither of which can be reliably estimated. As a point of reference, qualified data center personal property purchases of $150 million by data center operators would decrease general fund revenues by $9 million, pursuant to the exemption provided by the bill.

The Department of Commerce (Commerce) advises that data center projects can range from small projects to large projects. A small-size project typically locates in an existing building, therefore not requiring new construction. These projects vary in size from 5,000 to 20,000 square feet and create 10 new jobs, on average. A medium-size project is typically undertaken by a data center service provider which leases server space to tenants and are known as *colocation* data centers. It is estimated that these types of projects require new construction of approximately 50,000 square feet of space and may create 25 new jobs, on average. A larger data center project is typically undertaken by large technology companies for their own hosting purposes. These are known as *enterprise* data centers, and are owned and operated by companies such as Google, Facebook, and Amazon Web Services. These large projects usually involve over 100,000 square feet of space and create more than 100 new jobs. Commerce reports that a 2017 study by the U.S. Chamber of Commerce Technology Engagement Center indicated that the average size of a large data center is 165,100 sq. ft. with 157 jobs.

Commerce reports that employment and capital investment will vary among the different types of data centers. Many data centers, such as Amazon Web Services, are often configured as multi-building campuses. In addition, Commerce advises that capital expenditures related to servers is a semi-reoccurring cost because operators generally replace these items on a three- to five-year cycle.

State Expenditures: General fund expenditures increase by $283,500 in fiscal 2021, which accounts for a 90-day start-up delay, and by $66,400 in fiscal 2025. The estimate reflects the cost of the Comptroller’s Office hiring one revenue specialist for taxpayer outreach and assistance, licensing new account holders, tax compliance and enforcement, and auditing new sales and use tax returns. The estimate also reflects a one-time expenditure increase of $215,900 in fiscal 2021 for computer programming changes to the tax reporting and collection system, sales and use tax form updates, and notification costs. It includes salaries, fringe benefits, one-time start-up costs, and ongoing operating expenses.

Positions	1
Salaries and fringe benefits	$62,111
Computer programming changes and notification cost	215,886
Operating expenses	5,525
Total FY 2021 State Expenditures	**$283,522**

Future year expenditures reflect full salaries with annual increases and employee turnover and ongoing operating expenses.

Local Fiscal Effect: Local property tax revenues decrease beginning in fiscal 2021 to the extent local governments reduce or eliminate the personal property tax assessment for qualified data center personal property. The amount of the revenue decrease will vary by jurisdiction and depends on the assessed value of qualified data center personal property that is reduced or eliminated and the local jurisdiction's personal property tax rate. As a point of reference, for every $2.0 million in qualified data personal property that is eliminated, local personal property tax revenues will decrease by approximately $63,400, assuming a weighted average local personal property tax rate of $3.1675.

Small Business Effect: As discussed above, expanding the number of services subject to the sales tax may result in a decline in consumer purchases of these services in the State. To the extent possible, residents may purchase services in neighboring states where these services are not taxed (or are taxed at a lower tax rate) or may choose not to purchase these services at all. The extent to which this may occur cannot be reliably estimated, but a majority of Maryland residents live within a short distance to a neighboring state and therefore could have access to service providers located in other states. While the percentage will vary from service to service, it is likely that many of the service providers in the two service categories listed in Exhibit 3 are small businesses.

Small businesses involved in the repair and maintenance of aircraft may benefit due to more competitive pricing as the State sales and use tax rate for materials and parts will be comparable to the sales and use tax rates in surrounding states.

To the extent that data centers are small businesses, they will not have to pay sales and use taxes on qualified computer technology purchases.

Additional Information

Prior Introductions: None.

Designated Cross File: None.

Information Source(s): Baltimore City; Harford and Talbot counties; Maryland Association of Counties; Maryland Municipal League; Department of Commerce; State Department of Assessments and Taxation; Comptroller's Office; Maryland Department of Transportation; State Ethics Commission; Aircraft Owners and Pilots Association; National Conference of State Legislatures; Department of Legislative Services

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