SB 397

Department of Legislative Services

Maryland General Assembly
2020 Session

FISCAL AND POLICY NOTE
Enrolled - Revised

Senate Bill 397 (Senators Hershey and Peters)
Budget and Taxation Ways and Means

Sales and Use Tax and Personal Property Tax - Exemptions - Data Centers

This 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 only needs to total $2.0 million in a Tier I area. 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 State Department of Assessments and Taxation is authorized to adopt regulations to implement the personal property tax exemption. **The bill takes effect July 1, 2020. The personal property tax exemption applies to taxable years beginning after June 30, 2020.**

Fiscal Summary

State Effect: General fund revenues decrease by a potentially significant amount beginning in FY 2021. General fund expenditures increase by $101,300 in FY 2021.

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

Analysis

Bill Summary: 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 is defined as a data center located in the State in which an individual or a corporation, within three years after submitting an application for the sales and use tax exemption has (1) invested at least $2.0 million in qualified data center personal property and created at least five qualified positions for a data center located within a Tier I area or (2) invested at least $5.0 million in qualified data center personal property and created at least five qualified positions for a data center located in any other area of the State. 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 defined as 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 (Commerce). Each year, Commerce must provide the Comptroller with a list of individuals and corporations that qualify for the sales and use tax exemption. Within 30 days after receiving the list from Commerce, the Comptroller must issue an exemption certificate to each eligible individual and corporation. An exemption certificate issued by the Comptroller must be renewed each year and may not be renewed for more than 10 consecutive years; however, if the individual or corporation invests at least $250 million in qualified data center personal property, the exemption certificate may be renewed for up to 20 consecutive years.

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; and 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.

Virginia Sales Tax Exemption for Computer Equipment Used at a Data Center

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.

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 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.

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: The Comptroller's Office will incur a one-time expenditure increase of $101,300 in fiscal 2021 to notify the approximately 130,000 sales and use tax account holders of the sales tax change and to develop a new exemption form.

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.

Additional Information

Prior Introductions: None.

Designated Cross File: HB 1339 (Delegate Jacobs, *et al.*) - Ways and Means.

Information Source(s): Baltimore City; Harford and Talbot counties; Maryland Association of Counties; Maryland Municipal League; Comptroller's Office; Department of Commerce; Maryland Department of Transportation; State Department of Assessments and Taxation; Department of Legislative Services

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