Legislative Analysis

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SALES, USE, AND PERSONAL PROPERTY TAXES: EXEMPTIONS FOR INTERNET DATA CENTERS

Senate Bill 616 as passed by the Senate
Sponsor: Sen. Tonya Schuitmaker

Senate Bill 617 as passed by the Senate
Sponsor: Sen. Peter MacGregor

Senate Bill 618 as passed by the Senate
Sponsor: Sen. Dave Hildenbrand

Senate Committee: Michigan Competitiveness
House Committee: Tax Policy
Complete to 12-8-15

SUMMARY:

The bills would amend various acts to exempt certain personal property associated with the operation of an Internet data center from sales, use, and property taxes. The sales and use tax exemptions would apply from January 1, 2016, to December 31, 2030. The property tax exemption would apply from December 31, 2015, to December 31, 2025.

<u>Senate Bills 616 and 617</u> would provide for a 15-year exemption from the sales tax and the use tax for the sale of Internet data center equipment to, or the storage, use, or consumption of Internet data center equipment sold to, the owner or operator of an Internet data center or a colocated business for use or consumption in the operations of the data center. Senate Bill 616 would amend the General Sales Tax Act (MCL 211.9p). Senate Bill 617 would amend the Use Tax Act (MCL 205.104b, et al.). Further, Senate Bill 616 would require the legislature to annually appropriate sufficient funds from the state's General Fund to the State School Aid Fund to fully compensate for any loss of revenue to the SAF from the sales tax exemption.

<u>Senate Bill 618</u> amends the General Property Tax Act (MCL 211.19 et al.) to provide for a 10-year exemption for eligible Internet data center property, if the local tax collecting unit and the county approved the exemption for a new data center or did not reject the exemption for an existing data center.

Internet Data Centers. An Internet data center is defined in each of the bills as a facility that satisfies all of the following: (1) physically houses networked computer servers assembled for the purpose of centralizing the storage, processing, management, or dissemination of data owned or controlled by the customers of the data center; (2) is specifically designed and constructed to provide a high-security environment for the location of servers and similar equipment; and (3) is owned or operated by an entity whose primary business, or whose parent company's primary business, is that of an Internet data center, and that generates 75% of more of its revenue from the operation and business of an Internet data center.

Data Center Equipment. Senate Bills 616 and 617 would exempt from the sales and use tax data center equipment, which the bills define as high-technology equipment consumed or used physically within an Internet data center, including computers, servers, routers, switches, peripheral computer devices, and their associated tools, racks, shelving, cabling, and wiring. The term also would include any construction materials used to construct the Internet data center, as well as storage batteries, back-up generators, uninterrupted power supply units, and other redundant power supply equipment. The term would not include any equipment owned by a third party that is used to supply the data center's primary power or any third-party communication nodes used to connect an Internet data center to the exogenous Internet environment. "High technology" would mean technology used in the creation, storage, processing, or manipulation of digital data.

Colocated Business. In each of the bills, a colocated business is defined as a person that enters into a contract with the owner or operator of an Internet data center to deploy or use data center equipment physically located within the data center for one or more years. Senate Bill 618 additionally requires the business to physically use or occupy all or part of the qualified data center for a period of one or more years for the purposes of the Internet data center.

Property Tax Exemption. The property tax exemption applies to Internet data center property and can be claimed only a person that owns the eligible data center property and that owns, leases, or otherwise occupies all or part of the qualified data center in which the property is located. This includes, but is not limited to, a colocated business.

Eligible Internet Data Center Property. Senate Bill 618 would define "eligible Internet data center property" as property that is industrial personal property or commercial personal property and is directly used to operate, maintain, or manage the business of an Internet data center or a colocated business.

Local Option for Property Tax Exemption. The property tax exemption only applies if either of the following occurs:

- For a qualified data center <u>in operation before January 1, 2016</u>, the governing bodies of the local tax collecting unit and of the county in which the data center is located fail to adopt resolutions rejecting the exemption prior to April 1 of the first year the data center property could be made subject to tax.

- For a qualified data center <u>beginning operations after December 31, 2015</u>, the governing bodies of the local tax collecting unit and the county adopt resolutions approving the exemption no later than March 31 of the first year that the eligible Internet data center property would be made subject to the collection of taxes without adoption of those resolutions.

FISCAL IMPACT:

The package as a whole would reduce sales tax, use tax, and personal property tax revenue by an indeterminate amount. There are currently about 40 data centers operating in Michigan that would become eligible for the exemptions. Based on information from the Annual Capital Expenditures Survey (U.S. Census Bureau) corresponding to data centers at the national level, the immediate revenue reduction is estimated to fall between $20 million to $30 million on an annual basis, assuming that local units of government do not reject the exemptions for the existing personal property.

However, this estimate does not include revenue losses associated with the colocated businesses that would also qualify for the preferential tax treatment, nor does it account for the possibility that existing businesses could spin off their data collection departments into subsidiaries and colocate as a way to qualify. The extent to which this would result in additional revenue reduction cannot be determined from available information.

In addition, no attempt has been made to estimate any revenue losses that would occur as data centers open or expand in Michigan because the amount of potential new investment and the corresponding time frame cannot be known in advance. However, as a point of reference, exempting $1.0 billion of capital expenditures from the sales/use taxes (assuming 75% of the investment is tangible personal property) would represent foregone revenue of $45.0 million in the year in which the equipment is purchased. Further, if the equipment had a four-year life before needing to be replaced, the foregone personal property tax revenue would total roughly $100.0 million over the four-year life cycle. Thus, exempting a $1.0 billion investment from sales/use and personal property taxes would be expected to result in about $36 million of foregone revenue on an annual basis.

Because SB 616 stipulates that the School Aid Fund (SAF) be held harmless from any sales tax reductions, a reduction in sales tax revenue will only reduce Constitutional revenue sharing, and General Fund/General Purpose (GF/GP) revenue. Reductions in the use tax will affect SAF and GF/GP revenue, and reduced property tax collections will lower SAF revenue (via the 6-mill State Education Tax), local K-12 funding, and revenue to local governments and other taxing authorities (libraries, community colleges, etc.).

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