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BILL ANALYSIS

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Senate Bill 237 (Substitute S-11 as passed by the Senate)
House Bill 4906 (Substitute S-10 as passed by the Senate)
Sponsor: Senator Kevin Hertel (S.B. 237)
Representative Joey Andrews (H.B. 4906)
Senate Committee: Finance, Insurance, and Consumer Protection
House Committee: Tax Policy

Date Completed: 7-24-24

RATIONALE

As digital technologies such as artificial intelligence continue to evolve, tech companies need more data centers to house large networks of servers that store and process the data. According to testimony before the Senate Committee on Finance, Insurance, and Consumer Protection, constructing more data centers in Michigan would benefit local and State economies because of jobs involved in their construction and operation and increase investment in broadband or renewable energy within the communities they are sited; however, siting qualified data centers is competitive because the data centers can be constructed in any location with sufficient electric and water infrastructure availability. Some people believe that Michigan should offer a financial incentive to encourage the construction of enterprise data centers in the State, citing other states' efforts. Accordingly, it has been suggested that qualified entities constructing and operating enterprise data centers in Michigan be offered a use and sales tax exemption.

CONTENT

(COMPANION BILL LINK: S.B. 238 et al.)

Senate Bill 237 (S-11) and House Bill 4906 (S-10) would amend the Use Tax Act and the General Sales Tax Act, respectively, to do the following:

-- **Extend the sunset on a use and sales tax exemption for qualified entities' sale, storage, use, or consumption of data center equipment through December 31, 2050.**
-- **Establish the same use and sales tax exemption for enterprise data centers, which would generally be data centers that met specific requirements related to capital investment and the creation of new jobs in the State, through December 31, 2050.**
-- **Establish the same use and sales tax exemption for an enterprise data center located on a brownfield redevelopment or former electric power plant through December 31, 2065.**
-- **Prescribe the process for an enterprise data center to obtain a certificate from the Michigan Strategic Fund (MSF) certifying that the property met certain conditions within six years.**
-- **Require exempt facilities to report certain information to the MSF.**
-- **Require the MSF to provide the Department of Treasury with a copy of each report concerning purchases for which an exemption was claimed.**
-- **Prohibit the MSF from issuing new certificates for use and sales tax exemptions to qualified enterprise data centers after December 31, 2029.**

Qualified Data Center Exemption

The General Sales Tax Act exempts from sales tax a sale of data center equipment to the owner or operator of a qualified data center or a colocated business for assembly, use, or consumption in the operations of the qualified data center, or a sale of data center equipment to a person engaged in the business of constructing, altering, repairing, or improving real estate for others to the extent the data center equipment is to be affixed to or made a structural part of a qualified data center, through December 31, *2035*. Under the same circumstances, the Use Tax Act exempts from use tax the storage, use, or consumption of data center equipment sold to the owner or operator of a qualified data center or a colocated business or to a person engaged in the business of constructing, altering, repairing, or improving real estate for others. The bills would extend the sunset on these exemptions to December 31, *2050*.

"Colocated business" means a person that has entered into a contract with the owner or operator of a qualified data center to use or deploy data center equipment physically located within the qualified data center for a period of at least one year. The bills would specify that a contract and all its renewals would have to have been in place for a period of at least one year.

Each exemption continues to apply if the numbers gathered by the local economic development corporations are certified and reported to the MSF and subsequently forwarded to the Department of Treasury and demonstrate that the qualified data centers, collectively have, in aggregate, established in the State at least 400 data center industry jobs or data center industry related jobs, or a combination of both since 2016. The bills would specify that "data center industry jobs" and "data center industry related jobs" would not include "qualified new jobs".

"Qualified new job" would mean a full-time job created by the qualified entity or its affiliates at the facility that is in excess of the number of full-time jobs that the applicant and its affiliates maintained in Michigan before issuance of the certificate as determined and verified by the MSF. "Qualified entity" would mean an applicant to whom a certificate is issued for a particular enterprise data center and who complies with certain requirements described below.

Qualified Data Center Brownfield or Former Power Plant Exemption

"Enterprise data center" would mean a facility that the MSF determines meets, or is expected to meet within the time frame set forth in the certificate, all the following requirements:

-- The facility is located in Michigan.
-- The facility is composed of at least one building.
-- The facility is designed and intended for housing, and does house, data center equipment to centralize the storage and processing of data.
-- The aggregate capital investment in the facility made by the qualified entity, and any of its affiliates that will develop, own, and operate the facility, is at least $250.0 million.
-- The qualified entity and any of its affiliates, in the aggregate, create and maintain a minimum of 30 qualified new jobs in Michigan with an annual wage that is equal to 150% or more of the prosperity region median wage through December 31, 2050 or, for a facility that is located on the property included in a brownfield plan under the Brownfield Redevelopment Financing Act or on property that was once an industrial site used primarily as a power plant to generate electricity for sale, through December 31, 2065.
-- Before the start of operations, the facility will use municipal water or, if the facility cannot use municipal water before the start of operations, the facility will develop a plan to convert to using municipal water within five years after the start of operations.

-- Except as otherwise provided, the facility does not receive and, through the applicable date, will not receive any State or local property tax benefit, including property tax benefits available under the General Property Tax Act, the Michigan Renaissance Zone Act, and Public Act 198 of 1974; this would not apply if the governing body of each local unit of government affected by the property tax benefit approved the receipt of the property tax benefit by resolution.

In addition to the requirements above, the facility would have to attain certification under one or more of the following green building standards by the time the facility has been placed in service for three years:

-- BREEAM for New Construction.
-- BREEAM for In-Use.
-- Energy Star.
-- Envision.
-- ISO 50001 – energy management.
-- LEED for Building Design and Construction.
-- LEED for Operations and Maintenance.
-- Green Globes for New Construction.
-- Green Globes for Existing Buildings.
-- UL 3223.

The bills would specify that "enterprise data center" would not include a facility that the MSF determined no longer met, or was no longer expected to meet within the time frame set forth in the certificate, the requirements described above.

As used above, "prosperity region" would mean each of the ten prosperity regions identified by the Department of Technology, Management, and Budget on August 25, 2017. "Prosperity region median wage" would mean the median annual wage for the prosperity region where the facility is located based on the most recent data made available by the Michigan Bureau of Labor Market Information and Strategic Initiatives.

"Aggregate capital investment" would mean capital investment made and maintained in the facility to the extent that investment results in an increase in the total capital investment that the qualified entity and its affiliates, in the aggregate, maintain in Michigan when compared to the total capital investment that the applicant and its affiliates, in the aggregate, maintain in Michigan before issuance of the certificate, as determined and verified by the MSF.

"Applicable date" would mean the date specified as follows:

-- For a facility that is located on the property included in a brownfield plan under the Brownfield Redevelopment Financing Act or on property that was once an industrial site used primarily as a power plant to generate electricity for sale, December 31, 2065.
-- For any facility not described by the previous provision, December 31, 2050.

"Governing body" would mean the body in which the legislative powers for a local unit of government are vested. "Local unit of government" would mean a city, village, township, or county.

"Property tax benefits" would mean any benefits that reduce the property tax burden on the facility for purposes of encouraging economic development, such as property tax exemptions, millage rate or valuation reductions, and property tax capture, other than property tax capture under a brownfield plan that has been approved by the governing board under the Brownfield

Redevelopment Financing Act, and that is in effect at the time of the application for an enterprise data center submitted to the MSF.

Beginning on the bills' effective dates and through December 31, 2050, or, with respect to an enterprise data center subject to a certificate that was located on the property including in a brownfield plan under the Brownfield Redevelopment Financing Act, or on a property that was once an industrial site used primarily as a power plant to generate electricity for sale, through December 31, 2065, the sale (under the sales tax in House Bill 4906 (S-10)), storage, use, or consumption of data center equipment sold (under the use tax in Senate Bill 237 (S-11)) to either of the following would be exempt from the sales and use tax:

-- A qualified entity or its affiliates for assembly, use, or consumption in the operations of an enterprise data center subject to a certificate.
-- A person engaged in the business of constructing, altering, repairing, or improving real estate for others to the extend the data center equipment was affixed or was made a structural part of an enterprise data center subject to a certificate.

"Certificate" would mean the document issued by the MSF to an applicant that certifies or otherwise establishes that the facility developed, owned, and operated by the applicant or an affiliate of the applicant, or to be developed, owned, and operated by the applicant or an affiliate of the applicant, and identified in that document qualifies as an enterprise data center.

Certificate to Qualify for Exemption

To qualify for and claim an exemption described above, the qualified entity would have to have received a certificate for that facility which would have to be in good standing at the time the data center equipment was sold to the purchaser.

With respect to the exemption, a person seeking a certificate for an enterprise data center would have to apply to the MSF on a form and in the manner prescribed by the MSF. The application would have to include an affirmation signed by the applicant stating that it would expect the facility to satisfy the criteria for an enterprise data center and the anticipated time frame for doing so, which could not exceed six years. Within 120 days after receiving a complete and correct application, the MSF or its designees, which could include authorized employees, officers, and agents of the MSF and employees of the Michigan Economic Development Corporation (MEDC), would have to review the application and either issue a certificate to the applicant or provide written reasons for its denial. The certificate would have to specify a time frame for a facility to satisfy each of the criteria for an enterprise data center, which time frame would have to be the lesser of six years or the time frame identified by the applicant of the application. Additionally, the MSF would have to provide the Department of Treasury with a copy of each certificate.

The qualified entity of a facility for which a certificate had been issued would have to report to the MSF purchases for which an exemption was claimed, and employment, tax withholding, capital investment, and other such information required by the MSF to determine whether the facility continued to qualify as an enterprise data center. The MSF would have to provide the Department of Treasury with a copy of each report received from a qualified entity. The report would be subject to audit and would have to be made on an annual basis following issuance of the certificate. The report could not include any remittance for tax and would not constitute a return or otherwise alleviate any obligations. Except for the copy of each report submitted to the Department of Treasury, the MSF could not disclose any information that was not aggregated or any information that could be used to identify a specific person or data center.

Within three years after a facility for which a certificate had been issued was placed in service, the qualified entity of the facility would have to certify to the MSF, in the form and manner prescribed by the MSF, that the facility had attained certification under one or more of the green building standards described under the definition of "enterprise data center".

The MSF would have to revoke a certificate if it determined a facility no longer met the definition of an enterprise data center. If the MSF determined revocation was appropriate, it would have to provide written notice to the qualified entity and the Department of Treasury between 60 and 180 days before revocation, notifying the qualified entity of its preliminary determination to revoke the certificate and providing the qualified entity an opportunity to demonstrate, within the time period specified in the notice, that the facility continued to meet the definition of an enterprise data center. Following the expiration of the period specified in the notice, if the MSF determined that the facility did not meet the definition of an enterprise data center, the MSF would have to revoke the certificate.

If revocation occurred *within 10 years* after issuance of the certificate, the former qualified entity would have to pay to the Department of Treasury an amount equal to the entire amount of the tax exemptions stemming from the certificate that have been received by all persons, plus interest as specified in Section 23(2) of the revenue Act calculated from January 1, of the year the exemption was received until the amount was paid to the Department of Treasury.[1]

If revocation occurred *more than 10 years* after issuance of the certificate, the former qualified entity would have to pay to the Department of Treasury an amount equal to the entire amount of the tax exemptions stemming from the certificate that have been received under by all persons, plus interest as specified in Section 23(2) of the revenue Act, calculated from January 1, of the year the exemption was received until the amount was paid to the Department of Treasury, unless the MSF determined, pursuant to published guidelines, that a lesser amount, but at least 50% of the entire amount of the tax exemptions stemming from the certificate that had been received by all persons was appropriate after evaluating the circumstances. During the time specified in the notice, all persons would have to cease claiming a tax exemption stemming from the certificate. If a certificate were revoked, the MSF would have to notify the Department of Treasury within five days after the revocation.

The bill specifies that the MSF would have the powers necessary to charge and collect reasonable administrative fees to effectuate the purpose of certifications under the bill.

The MSF Board could not issue any new certificates of exemption after December 31, 2029. This sunset would not affect any existing certificates of exemption in effect on December 31, 2029.

<u>Annual Summary Report to Qualify for Exemption</u>

A person engaged in the business of constructing, altering, repairing, or improving real estate for others that had claimed an exemption for a particular facility would have to submit an annual summary report to the qualified entity or former qualified entity to which a certificate for that facility was issued on or before January 1 of each year that provided, at a minimum, information sufficient to identify the person that made the purchases and the purchase price (under the use tax in <u>Senate Bill 237</u>) or sales price (under the sales tax in <u>House Bill 4906</u>) of all items purchased each month of that year. Such a person also would have to maintain

[1] Section 23(2) of the revenue Act requires that a taxpayer that paid less than the required amount of taxes or makes an excessive claim be liable for the deficiency and interest and specifies the calculation formula for such amount.

all invoices, bills of sale, or similar documents for all claimed exempt purchases that indicated the date of purchase, the items purchased, and the purchase price (under the use tax in Senate Bill 237) or sales price (under the sales tax in House Bill 4906) of the property that was identified in the summary report for four years after the date of the purchase. Except for the copy of the report required to be submitted to the Department of Treasury, the MSF could not disclose any information that was not aggregated or any information that could be used to identify a specific person or data center.

Legislative Recommendations to Reduce Environmental Impact

The bill specifies that the Legislature would encourage a person claiming an exemption to take direct steps to adopt practices to mitigate negative environmental impacts resulting from expanded use of data centers, including through all of the following:

-- To the extent possible, procuring or contracting for power from renewable sources.
-- Adopting practices to improve the energy efficiency of existing data centers, including through upgrading and consolidating technology, managing data center airflow, and adjusting and improving heating, ventilation, and air conditioning systems.

In addition to the recommended standards above, the Legislature would also encourage a person to take actions to conserve, reuse, and replace water, including all of the following:

-- Using water efficient fixtures and practices.
-- Treating, infiltrating, and harvesting rainwater.
-- Recycling water before discharging.
-- Partnering with local water utilities to use discharged water for irrigation and other water conservation purposes.
-- Using reclaimed water where possible for data center operations.
-- Supporting water restoration in local watersheds.

MCL 205.94cc (S.B. 237)
205.54ee (H.B. 4906)

PREVIOUS LEGISLATION

(This section does not provide a comprehensive account of previous legislative efforts on this subject matter.)

Senate Bill 237 and House Bill 4906 are similar companion bills to House Bill 4905 and Senate Bill 238, respectively.

BACKGROUND

Generally, Public Acts 251 and 252 of 2015 established sales and use tax exemptions for the sale of data center equipment to the owner or operator of a qualified data center or a co-located business for assembly, use, or consumption in data center operations. These sales and use tax exemptions only applied to co-located data centers, which differ from enterprise data centers. Co-located data centers generally refer to data centers that house shared data from multiple companies. Space in these data centers is "rented out" instead of owned by a company, and the owner of the data center is paid a fee for the period that the data is housed. Enterprise data centers generally refer to data centers owned and operated by a single company and are the most popular way for corporations to house their data.[2]

[2] Smolaks, Max, Uptime Institute, "*The majority of enterprise IT is now off-premises*", February 2024.

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

The presence of data centers yields many economic benefits to the communities in which the centers are sited. Data centers create a business ecosystem around them by supporting jobs for construction workers, contractors, skilled tradesmen, building maintenance workers, local suppliers, and new data center employees. In addition, many data centers want to train their own workforce to use high tech equipment, which could lead to more Michigan residents occupying other internet technology jobs.

In other states, data centers themselves are returning investments in local communities. A recent report from the Progressive Policy Institute claims that the technology sector has shown very high long-term growth in its stock of productive capital; the stock of productive equipment in information and data processing services rose by 720% from 2007 to 2020.[3] According to testimony before the Senate Committee on Finance, Insurance, and Consumer Protection, data centers invest the most capital in the United States. This likely would increase the taxable value of the communities in which data centers were sited, which could alter a community's economic prosperity. Testimony also indicates that three different data centers are considering moving to Michigan communities, potentially providing those communities with over $150.0 million in taxable revenue combined. The job creation and increase in tax revenue could provide Michigan communities tens of millions of dollars for schools and operating costs and so the State should incentivize these centers to build here.

Opposing Argument

Data centers have negative environmental impacts because they consume large amounts of energy and water. Worldwide, it is estimated that data centers consume about 3% of the world's total electric supply and produce 2% of the world's greenhouse gas emissions.[4] This is about as much as the airline industry and is projected to grow.[5] According to testimony submitted to the Senate Committee on Finance, Insurance, and Consumer Protection, in other states, the increased energy demand put on energy infrastructure from data centers has forced financially uneconomic coal and gas plants to return to service. Also, data centers typically use diesel generators for backup generation in the case of a power outage. Supporting the expansion of data centers without sufficient environmental protections and regulations would contradict the actions taken toward decarbonization of Michigan's power sector this Legislative Session.

In addition, data centers consume large amounts of water to cool the racks and cabinets that house servers within data centers. According to testimony submitted to the Senate Committee on Finance, Insurance, and Consumer Protection, large data centers can consume anywhere from 1.0 million to 5.0 million gallons of water per day, or the same amount of water as a town of 10,000 to 50,000 people.[6] While the Great Lakes are at little risk of being drained, data centers that consume water from rivers, lakes, or groundwater sources could damage those bodies of water with significant and sustained use. In particular, if groundwater were used as the water source, the damage to aquifers could jeopardize the supply of drinking water and water used for agriculture for the local region. Encouraging the expansion of data

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[3] Mandel, Michael, *et al.*, "*Investment Heroes 2022: Fighting Inflation with Capital Investment*", July 2022.
[4] Anthesis: Climate Neutral Group, "*Carbon emissions of data usage increasing, but what is yours?*", 2024.
[5] *Id*.
[6] Osaka, Shannon, The Washington Post, "*A new front in the water wars: Your internet use*", April 2023.

centers without implementing water conservation practices and strategic siting could strain Michigan's water resources.

Legislative Analyst: Nathan Leaman

FISCAL IMPACT

The bills would reduce State and local revenue by an unknown amount that would likely be at least $52.5 million through Fiscal Year 2065-66, and likely could exceed $90.0 million, but would depend on when any affected purchases would take place, the number of affected taxpayers, the specific characteristics of the any affected property, and the degree to which the activity would have occurred absent the bills or occurred elsewhere in the State absent the bills. The majority of any revenue reduction would likely lower School Aid Fund (SAF) revenue, although the bills would also reduce General Fund revenue and, through constitutional revenue sharing provisions, local unit revenue. The exact impact on each revenue source would depend on the relative distribution of exempted purchases under the sales tax compared to the use tax.

The bills' revenue impact relates to two primary provisions: 1) extending the existing sales and use tax exemptions for qualified data centers from 2035 until 2050 (and, in some cases, until 2065) and 2) establishing a new sales and use tax exemption for enterprise data centers. Under current law, the existing sales and use tax exemptions for qualified data centers are estimated to reduce State and local unit revenue by approximately $2.5 million per year. The estimated fiscal impact assumes this revenue loss remains constant through the maximum December 31, 2065 exemption date. To the extent that data centers increased in number or activity as a result of the bills, the revenue loss from the legislation would be greater.

Under current law, the enacting sections for Public Act (PA) 251 and 252 of 2015 (the acts that established the existing sales and use tax exemption for qualified data centers), required the State to appropriate from the General Fund to the SAF the amount needed to compensate the SAF for any revenue losses under the provisions. The language of the enacting section requires such compensation be paid for "any loss of revenue…resulting from the enactment of this amendatory act." Although such provisions are not binding and may not compel appropriations, since the enactment of PAs 251 and 252, money has been appropriated from the General Fund to the SAF in accordance with the enacting section; however, it is unclear if any revenue losses attributable to the bills would be required to be compensated from the General Fund, because such losses would not be the result of PAs 251 and 252.

The second provision would exempt purchases related to an enterprise data center. To qualify as an enterprise data center, a facility must provide at least $250.0 million in capital investments. The distribution of any exemption under this section across fiscal years is unknown, but assuming only one firm met the $250.0 million threshold and all $250.0 million in investments were subject to sales and use taxes, the associated revenue reduction would total at least $15.0 million. If more than one firm met the threshold, then the revenue loss under these provisions of the bills would increase by approximately $15.0 million for each additional firm. Like with the existing exemption for qualified data centers, the exemption for enterprise data centers would presumably create an ongoing revenue loss of unknown magnitude. The bills do not contain provisions that would attempt to hold the SAF harmless for any revenue losses attributable to enterprise data facilities.

Approximately 73% of sales tax revenue is distributed to the SAF, while 10% of sales tax revenue is distributed to local units according to constitutional revenue sharing provisions. For purchases covered by the bills, the General Fund receives any remaining sales tax revenue. Under the use tax, the SAF receives one-third of any revenue, with the remaining revenue deposited in the General Fund. The distribution of any revenue loss resulting from the bills would depend on the distribution of purchases exempt from the sales tax as compared to the use tax.

Secondary revenue impacts resulting from the wage requirements required to qualify for the exemption would likely be negligible. Average wages in the sectors affected by the bills exceed the requirements under the bills.

The MSF would experience a minimal fiscal impact to implement the bills with current appropriations likely sufficient to cover additional costs.

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.