# Fiscal Note

**BILL #** HB 2584 **TITLE:** data center tax relief; qualification

**SPONSOR:** Stevens **STATUS:** House Engrossed

**PREPARED BY:** Rebecca Perrera

**Description**

The bill expands the transaction privilege tax (TPT) and use tax exemption for data center equipment to include rented or leased equipment and software. Purchased equipment and software is already exempt. The bill also modifies the investment requirements for a computer data center to qualify for tax relief to include the cost of improvements, in addition to the costs of land, buildings, and equipment, which are already included in the qualification requirements. Finally, the bill eliminates the requirement that the owner, operator, or colocation tenant present its certificate of qualification to a retailer in order to receive a TPT exemption.

**Estimated Impact**

The JLBC Staff cannot determine the fiscal impact with any certainty due to the lack of definitive data on leased and owned data center equipment. Under a simplified set of assumptions ,the JLBC Staff estimates the bill would reduce General Fund revenues by $(2.7) million in FY 2017, $(2.9) million in FY 2018, and $(3.0) million in FY 2019.

The Arizona Department of Revenue (DOR) does not have an estimate of the bill's impact.

**Analysis**

Background

Laws 2013, 1st Special Session, Chapter 9 provided tax relief for the owner, operator, or colocation tenants of certain data centers. Specifically, it exempted data center equipment purchases from retail transaction privilege tax and use tax.

In order for a computer data center to qualify for the TPT exemption, they must first apply for certification through the Arizona Commerce Authority (ACA). The certification process requires that a computer data center submit the anticipated investment with the data center to the ACA. In order to qualify for certification, the data center must then meet one of the following criteria:

1) The computer data center must make a minimum investment of $25 million, including land, buildings, modular units, and equipment over the next 5 years if located in a rural area.

2) The computer data center must make a minimum investment of $50 million, including land, buildings, modular units, and equipment over the next 5 years if located in an urban area.

3) The computer data center must make a minimum investment of $250 million including land, buildings, modular units, and equipment over the preceding 6 years prior to September 2013.

If a computer data center meets the above criteria, they may receive the tax incentives mentioned above for a period of up to 10 years. Under certain circumstances, the exemption period can be extended to 20 years.

In addition, in order for a colocation tenant to qualify for the TPT exemption, the colocation tenant must occupy space at a certified data center for at least 2 years and use at least 500 kilowatts per month.

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The bill modifies the investment requirements for a computer data center to qualify for tax relief to include the cost of improvements, in addition to the costs of land, buildings, and equipment, which are already included in the qualification requirements. The JLBC Staff assume that the inclusion of the cost of improvements to qualify for the exemption has no impact on new data centers qualifying for the tax exemptions due to a lack of information about how many additional data centers would qualify under this change.

State Revenue Loss

*New Data Centers*
As part of a fiscal note on the 2013 legislation, the JLBC Staff assumed that data center space would grow an average of 250,000 square feet per year irrespective of the exemption. Jones Lang LaSalle, a commercial real estate services and investment management firm, completed a financial analysis of the 2013 legislation. Their analysis estimates various economic impacts of a prototypical 100,000 square foot data center. The JLBC Staff extrapolated these estimates to apply to data center growth of 250,000 square feet annually. Under these assumptions, the JLBC Staff estimated the annual increase of 250,000 square feet of data center space would require an initial investment of $50 million for equipment with a life span of 3 years.

In terms of the HB 2584 impact, there is a lack of definitive information on the extent to which data center equipment is leased instead of purchased. As a simplifying assumption, this analysis assumes that 25% of new equipment is leased based on discussions with industry representatives. In that circumstance, as each 250,000 square feet of new data center space opens, the annual value of leased equipment would be $12.5 million. This amount represents 25% of the $50 million investment assumption from the 2013 analysis. The JLBC Staff further assumes that an annual lease agreement is equal to the marginal value of the leased equipment distributed evenly across the lease terms. Using a 3-year lease based on the typical useful life of this equipment, the annual lease payment for leased equipment of $12.5 million would be approximately $4.2 million with an annual TPT of $208,300.

Under the state's TPT distribution formula, this $(208,300) loss from exempting these leases would reduce state General Fund revenues by $(153,700) annually, as shown in *Table 1*. Using a 3-year forecast horizon, the reduction would be repeated each year as a new 250,000 square feet of space is built. In year 3, the bill would reduce the General Fund revenues by $(461,100).

*Existing Data Centers*
Existing certified data centers currently pay TPT on leased equipment, which would no longer occur under HB 2584. There are currently 15 certified data centers. The average square footage of these data centers is 280,000 square feet. Using the same methodology as above, the JLBC Staff estimates that the total annual lease payment for existing data centers is $70 million and with an annual TPT of $3.5 million. Under the state's TPT distribution formula, the General Fund's share of this loss of revenues would be $(2.58) million annually as shown in *Table 1.*

**Table 1**

**State Revenue General Fund Impact – Cumulative**
($ in Millions)

| Fiscal Year | Existing Data Centers | 2017 Data Centers | 2018 Data Centers | 2019 Data Centers | Total Impact |
|---|---|---|---|---|---|
| 2017 | (2.58) | (.15) | | | (2.73) |
| 2018 | (2.58) | (.15) | (.15) | | (2.88) |
| 2019 | (2.58) | (.15) | (.15) | (.15) | (3.03) |

**Local Government Impact**

Counties
HB 2584 is estimated to reduce state TPT by $(3.71) million in FY 2017, $(3.92) million in FY 2018, and $(4.13) million in FY 2019. Under the statutory distribution formula for retail sales, counties receive 16.2% of total state TPT collections from such sales. Thus, under the bill, counties would lose state-shared revenue of $(600,900) in FY 2017, $(634,700) in FY 2018, and $(668,400) in FY 2019.

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In addition, the bill would also affect the county excise taxes imposed on retail sales. All 15 counties in the state levy some type of county tax. Although these taxes are collected by the state, they are all distributed to the counties except for the 0.5% transportation excise tax imposed in both Maricopa and Pima Counties. These excise taxes are directly allocated to the Maricopa Association of Governments (MAG) or Pima Association of Governments (PAG) rather than Maricopa or Pima County governments.

Based on the Arizona Department of Revenue's 2015 Annual Report, the statewide average rate for all county excise taxes levied on retail sales is estimated to be 0.31%. Therefore, the bill would reduce total county excise taxes by an estimated $(229,900) in FY 2017, $(242,800) in FY 2018, and $(255,800) in FY 2019. This estimate does not include the excise tax levied to fund the regional transportation systems under MAG and PAG.

In summary, total county revenues, including both state-shared TPT and local excise taxes, would be reduced by $(830,800) in FY 2017, $(877,500) in FY 2018, and $(924,200) in FY 2019.

Cities

Cities currently receive 10.0% of total state TPT collections from retail sales. Thus, under HB 2584 cities would lose state-shared revenue of $(370,800) in FY 2017, $(391,700) in FY 2018, and $(412,500) in FY 2019.

The exemption for leased or rented data center equipment and software under the bill would also apply to municipal TPT. While the city sales tax rate varies by municipality, this analysis assumes an average city sales tax rate of 2.0%. Therefore, the bill would reduce total city sales tax collections by an estimated $(1.48) million in FY 2017, $(1.57) million in FY 2018, and $(1.65) million in FY 2019.

In summary, total city revenues, including both state-shared TPT and municipal TPT, would be reduced by $(1.85) million in FY 2017, $(1.96) million in FY 2018, and $(2.06) million in FY 2019.

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