

LEGISLATIVE BUDGET BOARD  
Austin, Texas

FISCAL NOTE, 83RD LEGISLATIVE REGULAR SESSION

March 18, 2013

**TO:** Honorable Harvey Hilderbran, Chair, House Committee On Ways & Means

**FROM:** Ursula Parks, Director, Legislative Budget Board

**IN RE: HB1223** by Hilderbran (Relating to tax incentives with respect to certain data centers.),  
**As Introduced**

**Estimated Two-year Net Impact to General Revenue Related Funds** for HB1223, As Introduced: a negative impact of (\$50,800,000) through the biennium ending August 31, 2015.

General Revenue-Related Funds, Five-Year Impact:

Fiscal Year	Probable Net Positive/(Negative) Impact to General Revenue Related Funds
2014	\$0
2015	(\$50,800,000)
2016	(\$104,100,000)
2017	(\$147,900,000)
2018	(\$193,500,000)

All Funds, Five-Year Impact:

Fiscal Year	Probable Revenue (Loss) from General Revenue Fund 1	Probable Revenue (Loss) from Cities	Probable Revenue (Loss) from Transit Authorities	Probable Revenue (Loss) from Counties and Special Districts
2014	\$0	\$0	\$0	\$0
2015	(\$50,800,000)	(\$9,400,000)	(\$3,200,000)	(\$1,600,000)
2016	(\$104,100,000)	(\$19,200,000)	(\$6,500,000)	(\$3,300,000)
2017	(\$147,900,000)	(\$27,300,000)	(\$9,300,000)	(\$4,600,000)
2018	(\$193,500,000)	(\$35,700,000)	(\$12,100,000)	(\$6,100,000)

Fiscal Analysis

The bill would amend Chapter 151 of the Tax Code, by adding a new Section 151.4292 to provide for refunds of sales and use tax related to qualifying data centers; and Chapter 313 of the Tax Code, to provide for eligibility of such qualifying data centers for a limitation on appraised value.

The bill would add new Section 151.4292 to provide that a qualifying data center, a qualifying

operator, and a qualifying tenant would be entitled to receive a refund on an annual basis of sales and use taxes paid on the purchase of certain tangible personal property.

A data center would be defined to be a facility: 1) located in this state; 2) composed of a single building or a portion thereof specifically constructed or refurbished and actually used primarily to house servers and related equipment and support staff for the processing, storage, and distribution of data; and 3) that meets other standards related to power supply, fire suppression, and enhanced physical security.

A qualifying data center would be one that: 1) in combination with an operator of the data center or a tenant of the data center, creates at least 20 full-time, permanent jobs that pay at least 120 percent of the county average weekly wage in the county in which the data center is located; and 2) makes or agrees to make a capital investment, on or after September 1, 2013, of at least \$150 million in this state related to improvements to real and tangible personal property installed at the data center over a four-year period after initial construction or refurbishing of the data center facility.

A qualifying operator would be a person who controls access to a qualifying data center, regardless of ownership of the items of tangible personal property at the data center. A qualifying tenant would be a person who contracts with a qualifying operator to place or cause to be placed and to use tangible personal property at a qualifying data center.

A qualifying data center, qualifying operator, and qualifying tenant would be entitled to a refund of taxes paid on tangible personal property that is necessary to manage or operate the data center, including: electricity; an electrical system; a cooling system; an emergency generator; hardware or a distributed mainframe computer or server; a data storage device; network connectivity equipment; a rack, cabinet, and raised floor system; a peripheral component or system; software; a mechanical, electrical, or plumbing system necessary to operate the foregoing property; any other item of equipment or system necessary to operate any of the foregoing, including a fixture; and a component part of any of the foregoing. Excluded from eligibility for refund would be tax paid on office equipment or supplies, equipment or supplies used primarily in sales or distribution activities or in transportation activities, or property for which a refund may be received under Section 151.429 (tax refunds for enterprise projects). The amount of refund of taxes with respect to an eligible item of tangible personal property would be the greater of the amount by which the tax paid exceeds the amount of tax that would have been paid at a rate of one percent, or the amount by which the tax exceeds \$80.

If the capital investment used to qualify a data center is at least \$150 million but less than \$200 million, the qualifying data center, operator, and tenants are eligible for tax refunds on purchases during a period beginning with the date the data center becomes a qualifying data center or the date a tenant becomes a qualifying tenant and before the 10th anniversary of the date of qualification; if the capital investment is \$200 million or more, the refunds are for taxes on purchases beginning on the date of qualification and before the 15th anniversary of the date of qualification.

The refunds are to be administered on an annual basis. The Comptroller is provided rulemaking authority necessary to implement the new Section 151.4292. While this authority includes rules relating to qualification and disqualification for refunds, there is no explicit authority to require repayment to the state of refunds received by qualifying data centers, operators, and tenants in the event the capital investment requirement is not met within the four year period required by new Section 151.4292(d)(2).

Section 313.024(b), Tax Code, is amended to include a data center that is eligible to receive a tax

refund under Section 151.4292 among the entities eligible for a limitation on appraised value for school district property taxation under the Texas Economic Development Act.

## Methodology

Data on the composition of data center infrastructure and electricity costs obtained from industry sources was used to model expected annual expenditures by data centers that would be subject to tax under current law but that would be eligible for refund under the provisions of the bill.

As the definition of data center is not limited to those located in the state after September 1, 2013, and the act of refurbishing a data center is a potentially nominal threshold to meet with respect to qualifying a data center and inaugurating a four-year period of capital investment after September 1, 2013, it is expected that prospective expenditures on tangible personal property in relation to existing data centers would be eligible for the refunds. Additionally, it is expected that at least three new data centers that would, in combination with expenditures by tenants, meet the capital investment requirement would begin construction each year under current law, without the provision of the tax refund incentive proposed in the bill.

As the bill provides for expenditures of data centers, data center operators, and data center tenants to be aggregated for purposes of meeting the capital investment threshold, it is expected that businesses whose data operations entail expenditures insufficient to meet the capital investment threshold for the tax refunds would be induced to migrate into colocation arrangements so that their expenditures, when aggregated with those of other tenants and a data center, would qualify for the refunds. That is, it is expected that ongoing expenditures for data operations that are currently taxable and that would remain taxable under current business arrangements would be diverted into arrangements eligible for the tax refunds.

The term "capital investment" is not defined; it is assumed that expenditures on any items with a useful life in excess of one year, including installation costs, would be claimed as capital investment.

The limitation of tax to \$80 per item would be difficult to administer and significantly reduces the amount of revenue that otherwise would be collected under the one percent rate of tax otherwise provided by the bill.

As the bill allows an exemption for items used in data centers—either new or refurbished structures—it is possible that some data centers built after the effective date of this bill would qualify repeatedly and thus be exempt indefinitely, regardless of Section 151.4292 (f).

Because the refunds are to be administered on an annual basis, there would be no fiscal implications during fiscal 2014.

As Subchapters B and C of Tax Code Chapter 313 expire on December 31, 2014, the broadening of the eligibility criteria for participation in the Chapter 313 program would only affect two future annual “classes” of Chapter 313 projects—those with a first complete year of their qualifying time period in tax year 2014, and those with a first complete year of their qualifying time period in tax year 2015.

It is unknown how many school districts will enter into Chapter 313 agreements with data centers; therefore the fiscal impact cannot be determined at this time. The following example is provided for an estimate of the magnitude of the fiscal impacts. This example assumes an increased participation in the program of two data center projects per future annual class,

resulting in four additional Chapter 313 projects before the program expires.

Because the first two years of tax benefit for a Chapter 313 project flow through an annual tax credit paid beginning in the fourth year of a project, the state fiscal impact for these four projects would begin after three years, starting in tax year 2016, with associated state impact beginning in state fiscal year 2017 and continuing through state fiscal year 2025. The estimated annual school district Maintenance and Operations (M&O) property tax levy losses would be approximately \$3.05 million in fiscal year 2017 and \$6 million in fiscal year 2018 if two data center projects per year become eligible for participation in Texas Economic Development Act before the expiration of Chapter 313, with the annual loss slightly declining from \$6 million in each fiscal year after 2018, falling to zero by 2026.

The state would incur cost under the Foundation School Program (FSP) corresponding to local M&O revenue losses. For FY17, state cost would depend upon whether affected districts receive hold harmless state aid. On average, estimated state cost for FY17 would be equal to approximately 65% of school districts' FY17 local M&O levy loss, or \$1.98 million. Upon expiration of the FSP hold harmless at the end of FY17, state cost to the FSP beginning with FY18 and each year thereafter would be roughly equal to the prior year's local M&O levy loss.

### **Local Government Impact**

There could be a corresponding loss of sales and use tax revenue to local taxing jurisdictions. It is not clear whether the entitlement to refunds includes refunds of local sales and used taxes; this fiscal note includes implications for local governments under the interpretation that they are subject to refund.

School districts entering into Chapter 313 agreements involving data centers would benefit from additional Foundation School Program state aid or reductions in recapture corresponding to losses in local M&O revenue resulting from the limitation on taxable value of affected property. Affected school districts would also be eligible for state reimbursement for amounts remitted in the form of tax credits resulting from taxes paid on affected property during the first two years of the agreement.

**Source Agencies:** 304 Comptroller of Public Accounts, 701 Central Education Agency

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