HB15-1158

Colorado Legislative Council Staff Fiscal Note

STATE FISCAL IMPACT

Drafting Number:	LLS 15-0096	**Date:**	February 25, 2015
Prime Sponsor(s):	Rep. DelGrosso; Pabon Sen. Holbert	**Bill Status:** **Fiscal Analyst:**	House Business Affairs and Labor Larson Silbaugh (303-866-4720)

BILL TOPIC: SALES & USE TAX REFUND FOR DATA CENTERS

Fiscal Impact Summary*	FY 2015-2016	FY 2016-2017	FY 2021-2022***
State Revenue		**($10.4 million)**	**($18.5 million)**
Revenue Change General Fund		($10.4 million)	($18.5 million)
State Expenditures	**$112,595**	**$356,460**	
General Fund	$106,590	$289,287	
Centrally Appropriated Costs**	$6,005	$67,173	
FTE Position Change	0.5 FTE	5.7 FTE	
TABOR Set-Aside		($10.4 million)	
Appropriation Required: $30,740 - DOR (FY 2015-16), $75,850 - OEDIT (FY 2015-16)			

* *This summary shows changes from current law under the bill for each fiscal year. Parentheses indicate a decrease in funds.*

** *These costs are not included in the bill's appropriation. See the State Expenditures section for more information.*

*** *FY 2021-22 impacts are to show the potential revenue reduction from this policy several years into the future. State agencies will need resources to administer this bill, but those costs are unknown.*

Summary of Legislation

This bill creates a sales and use tax refund for equipment used in qualified data centers. The refund can be claimed for sales and use taxes paid on equipment like computers, cables, switches, climate control, power generation, and back up power. The refund is available for sales and use taxes paid on equipment on or after January 1, 2016. The refund must be claimed between January 1 and April 1 in the year following the year when the sales taxes were paid. The maximum refund is $3 million per year, per taxpayer. In addition to the owner or operator of a data center, tenants making qualified purchases are also eligible to claim a refund.

Data centers must meet certain requirements for the equipment to be eligible for the refund and the Office of Economic Development and International Trade (OEDIT) must certify that those requirements are met. To qualify as a new data center, it must be at least 25,000 square feet and have at least $40 million in investments in a five-year period beginning January 1, 2011. A qualified refurbished data center must include 25,000 square feet and have a $20 million investment in a two-year period, beginning on January 1, 2014. Investments made prior to December 31, 2015 can be used to qualify as a new or refurbished data center, but no sales tax refunds are allowed on these purchases. Once a data center is certified by the OEDIT, it retains its status as a qualified data center for 20 years. Each year, the OEDIT is required to report to the General Assembly the economic benefits of the state sales and use tax exemption on IT equipment used in data centers.

Background

There are two basic types of data centers: enterprise and co-location data centers. Enterprise data centers are owned and operated by an individual company to provide the computing power necessary for their single business. The single company builds and maintains the infrastructure, including the heating and cooling, backup power, and security systems necessary to protect their own computer equipment. In co-location data centers there is an owner or operator that builds and maintains the infrastructure and leases space to individual tenants. For example, staff has identified a data center with 220 tenants that own or lease the physical computer equipment, but the owner or operator owns the building and support infrastructure. The number of taxpayers claiming the refund will vary by the type of data center, but the overall investment is likely to be similar for both types of centers.

State Revenue

The availability of information on data center investments is limited. Based on the assumptions in this fiscal note, this bill will **reduce General Fund revenue by $10.4 million in FY 2016-17.** The refund is available for 20 years once the data has been certified by OEDIT, and new data centers will be built each year. Based on one estimate of data center growth between 2009 and 2014, this bill will reduce General Fund revenue by $18.5 million in FY 2021-22. The actual impact of this bill may be higher or lower depending on how actual data center investment compares to the assumptions in this fiscal note.

Assumptions. In Colorado, 39 co-location data centers were identified through an internet search. The total number of enterprise data centers is unknown. It is difficult to identify which co-location and enterprise data centers would meet the criteria in this bill. For this fiscal note, it is assumed that four would qualify as new data centers and eight would qualify as refurbished data centers in 2016.

Based on information from the data center industry, new data centers are built with the expectation that it will take several years to reach capacity. Over this time, tenants will install new equipment until the facility is full. A report on one large data center states that the facility will have between $500 million and $1 billion in total equipment when it reaches capacity. If it reaches capacity in 10 years, between $50 million and $100 million in new qualifying investments would be made per year. In addition to new tenants, existing tenants will replace a portion of their IT equipment as it ages. Because the information available is for one of the largest data centers in the state, it is assumed that the average qualifying investment for new data centers will be $25 million in 2016.

Refurbished data centers can also qualify for the refund. Because refurbished data centers are already at capacity, the qualifying investments are mainly tenants replacing existing equipment. In general, computer equipment is replaced every three to five years, but not all of the IT equipment are computers. For example there are cables and switches that have a longer useful life than computer servers. Some tenants also have redundant computer equipment that is used to back-up business operations. This redundant equipment may be replaced less often than the primary computers. Because refurbished data centers are full, the average annual investment is less than for new data centers. It is assumed that the average refurbished data center will have $10 million in qualifying investments in 2016.

Co-location data centers try to attract potential tenants by advertising so they are easier to identify than enterprise data centers. It is assumed that co-location data centers will be half of the total qualified data centers in the state and enterprise data centers have the same qualifying investments as co-location data centers. For enterprise data centers, one taxpayer would claim the refund for all qualifying investments at a data center, while tenants of co-location data centers would be eligible for smaller refunds.

Refunds for qualifying investments made in 2016 can be claimed between January 1 and April 1, 2017, the second half of FY 2016-17. This bill will reduce sales tax revenue by $10.4 million in FY 2016-17. Table 1 has a summary of the assumptions.

Once a datacenter is qualified by OEDIT, taxpayers are eligible for the refund for 20 years. Data provided on the value of nonresidential construction by Dodge Data and Analytics suggests that the square footage of data centers expanded by 77.8 percent in the five years between January 1, 2010 and December 31, 2014. Assuming the eligible investments in IT equipment grows at the same rate between 2016 and 2021, this bill will reduce sales tax revenue by $18.5 million in FY 2021-22.

Table 1: Summary of Assumptions for HB 15-1158

	Number	Average Annual Investment	Average Annual Sales and Use Taxes Paid	Total Annual Investment	Total Annual Sales and Use Taxes Paid
Co-location Data Centers					
New Data Center	4	$25,000,000	$725000	$100,000,000	$2,900,000
Refurbished Data Center	8	$10,000,000	$290,000	$80,000,000	$2,320,000
Enterprise Data Centers					
New Data Center	4	$25,000,000	$725000	$100,000,000	$2,900,000
Refurbished Data Center	8	$10,000,000	$290,000	$80,000,000	$2,320,000
Total	**24**			**$360,000,000**	**$10,440,000**

TABOR Impact

This bill reduces state revenue from sales taxes, which will reduce the amount required to be refunded under TABOR. TABOR refunds are paid from the General Fund.

State Expenditures

This bill will increase state expenditures by $112,595 and 0.5 FTE in FY 2015-16, $356,460 and 5.7 FTE in FY 2016-17, and $354,617 and 5.7 FTE in FY 2017-18. Table 2 summarizes these expenditures.

Table 2. Expenditures Under HB 15-1158		
Cost Components	**FY 2015-16**	**FY 2016-17**
Personal Services (DOR)		$203,774
FTE		5.2
Operating Expenses (DOR)		$29,276
Computer Programming (DOR)	$30,740	
Document Handling (DPA)		$15,090
Personal Services (OEDIT)	$25,672	$25,672
FTE	0.5	0.5
Operating Expenses (OEDIT)	$20,178	$15,475
Computer Programming (OEDIT)	$30,000	
Centrally Appropriated Costs*	$6,005	$67,173
TOTAL	**$112,595**	**$356,460**

** Centrally appropriated costs are not included in the bill's appropriation.*

Department of Revenue. The department will process refunds for data centers similar to how they process refund claims for manufacturing machinery and equipment. Each initial review is expected to take a little over eight hours but at least one additional review is expected to be required for 20 percent of refund claims. The DOR expects about 1,000 refund claims per year. The department will need 5.2 FTE in FY 2016-17 and following fiscal years. After the General Fund payday shift, salary and benefits will be $203,774 in FY 2016-17. Standard operating expenses will be $29,276 in FY 2016-17.

The state's tax administration software will be modified to administer the new sales tax refund. This will require 145 hours of testing and development by the computer vendor. This will cost $30,740 in FY 2015-16.

Department of Personnel and Administration. The Department of Personnel and Administration will receive, open, prepare, scan, and shred the state's tax correspondence on behalf of the DOR. It is assumed that each refund claim will have 90 pages of supporting documentation that will need to be entered into the state's tax administration software. This will cost $15,090 in FY 2016-17.

Office of Economic Development and International Trade. The bill requires the OEDIT to certify that a data center meets the requirements for the refund and notify the Department of Revenue and the data center that it has qualified. Prior to finalizing the certification, the OEDIT shall consult with the Economic Development Commission. Starting in November 2017, the Office of Economic Development will provide the General Assembly with estimates of the economic benefits of the sales and use tax exemption. The Office of Economic Development and International Trade will hire an additional 0.5 FTE in FY 2015-16 and following fiscal years to administer the certification process and prepare the report to the General Assembly. This will require $25,672 in salary and benefits in FY 2015-16 and future fiscal years. These FTE require standard operating and capital costs of $5,178 in FY 2015-16 and $475 in FY 2016-17. In addition, OEDIT will need $15,000 per fiscal year for promotion and travel expenses related to the refund.

The Office of Economic Development and International Trade uses a computer program to administer the application process for tax incentives. Setting up this sales tax refund will cost $30,000 in FY 2015-16.

Centrally appropriated costs. Pursuant to a Joint Budget Committee policy, certain costs associated with this bill are addressed through the annual budget process and centrally appropriated in the Long Bill or supplemental appropriations bills, rather than in this bill. The centrally appropriated costs subject to this policy are estimated in the fiscal note for informational purposes and summarized in Table 3.

Table 3. Centrally Appropriated Costs Under HB 15-1158*

Cost Components	**FY 2015-16**	**FY 2016-17**
Employee Insurance (Health, Life, Dental, and Short-term Disability)	$4,015	$45,516
Supplemental Employee Retirement Payments	1,990	21,657
TOTAL	**$6,005**	**$67,173**

**More information is available at: http://colorado.gov/fiscalnotes*

Effective Date

The bill takes effect August 5, 2015, if the General Assembly adjourns on May 6, 2015, as scheduled, and no referendum petition is filed. The refunds will be available for sales and use taxes paid beginning January 1, 2016.

State Appropriations

To implement this bill the Department of Revenue will need a $30,740 General Fund appropriation and the Office of Economic Development and International Trade will need a $75,850 General Fund appropriation and an allocation of 0.5 FTE in FY 2015-16.

State and Local Government Contacts

Revenue
OEDIT
Personnel
Counties
Municipalities
OIT
RTD