F I S C A L   I M P A C T   R E P O R T

ORIGINAL DATE 1/28/21
SPONSOR Padilla **LAST UPDATED** **HB**

SHORT TITLE Gross Receipts Tax Deduction for Data Centers **SB** 26

ANALYST Graeser

REVENUE (dollars in thousands)

Estimated Revenue					Recurring or Nonrecurring	Fund Affected
FY19	**FY20**	**FY21**	**FY22**	**FY23**		
	See Fiscal Impact Section: Fiscal Effects are uncertain as to amount and timing but can potentially exceed a general fund negative impact of $1 million annually.				Recurring	General Fund (Gross Receipts and Compensating Tax)
	See Fiscal Impact Section: Fiscal Effects are uncertain as to amount and timing, but can potentially exceed a negative impact of $4 million annually and increasing each year				Recurring	Local Governments Gross Receipts and Compensating Tax and Property Tax beneficiaries

Parenthesis ( ) indicate revenue decreases

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY21	FY22	FY23	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
	$10.3			$10.3	Nonrecurring	TRD/ITD – staff workload
	$32.0			$32.0	Nonrecurring	TRD/ITD – contract services

Parenthesis ( ) indicate expenditure decreases

- The costs shown in the table can be accepted within the current staff resources.

SOURCES OF INFORMATION
LFC Files
Analysis of HB324 (2018)
Analysis of HB596 (2019) and Analysis of SB352 (2019 Regular Session)

Responses Received From
Taxation and Revenue Department (TRD)

Comments Received on HB-596 (2019) from
Economic Development Department (EDD)
New Mexico Finance Authority (NMFA)

SUMMARY

Synopsis of Bill

Senate Bill 26 creates gross receipts tax and compensating tax deductions for new or largely reconstructed large data centers. The Economic Development Department (EDD) is required to certify the eligibility for a data center nontaxable transaction certificate (NTTC). An eligible data center is a new or largely reconstructed data center for which the taxpayer and one or more other taxpayers expend $25 million in eligible costs. The taxpayer claiming the deduction must separately report the deduction to the Taxation and Revenue Department (TRD). (Note: the taxpayer claiming the deduction is not the data center, but the recipient of a data center NTTC.) TRD is required to report the amount of deduction annually to the Legislature. EDD and TRD are required to protect from public disclosure the proprietary business information contained in an application for a data center deduction certificate of eligibility, although EDD is permitted to disclose the name of a qualified data center associated with a data center certificate of eligibility. If, after EDD certifies a data center and the data center taxpayer begins issuing NTTCs allowing other taxpayers to take deductions, the taxpayer fails to meet the $25 million in eligible cost requirement, the bill provides for full or partial claw back.

The definition of tangible property eligible for the deduction for sale of tangible property to a government entity is significantly more expansive and inclusive regarding the difference between taxable real property construction and deductible tangible personal property, including equipment. Pursuant to the definition of “construction materials” in last year’s HB245, most of the inclusions in the definition section of the bill at section 1, subsection L paragraph (2) subparagraphs (a), (b), (c), (d) and (f)would be considered real property for the purpose of an Industrial Revenue Bond (IRB).

The bill also proposes a property tax abatement for all data centers, including existing data centers currently receiving property tax abatements pursuant to an IRB deal. In lieu of the total property tax abatement for a period of up to 30 years pursuant to approval of an Industrial Revenue Bond IRB, or the declining abatement in last year’s bill, this bill provides for a permanent special method of valuation that is set at 5 percent of initial costs.

The effective date of this bill is July 1, 2021. The property tax special method is applicable to the 2022 property tax year and future fiscal years and applies to all data centers, not just new, large ones that qualify for this deduction.

In all respects except for the dates referenced in the previous paragraph, this bill is identical to HB-596 from the 2019 session.

There is no delayed repeal date but LFC recommends adding one.

FISCAL IMPLICATIONS

TRD describes considerations and methodology of Revenue Impact: Section 1: The gross receipts and compensating tax deduction against the sale or lease of data center equipment applies only to new projects and expansions that are approved by the EDD, invest at least $25 million, and begin on or after July 1, 2021. Because the number, timing, and scale of any projects that might qualify for the proposed deduction is unknown, it is not possible to accurately estimate the cost of the deduction. However, because qualifying projects must spend at least $25 million on eligible costs, the cost of the deduction may be significant.

Section 2: Section 2 of the bill provides a special valuation ratio for data center systems, and property that is part of such systems; such property is to be valued at five percent, (5.00%), of its original cost for property taxation purposes. This valuation method would apply to all data system centers, not just to new projects and expansions, effective with the 2022 property tax year. The proposed special property valuation method could result in the loss of most ad valorem property tax revenue from every private communications network in the state (see the Policy Issues section below). Based on state-assessed valuations of cable, telephone, cellular, internet and other electronic communications, a conservative estimate is a loss of $350 million in taxable property value. Additionally, estimates for known and under-construction data centers were estimated using published numbers for sizes and cost of equipment per square foot, and assuming two years of depreciation. This is an additional loss of tax base of roughly $400 million in property value now and $1.5 billion in property value when planned construction is complete. Property tax yield control rate adjustments mean only a value weighted 40 percent of this revenue loss will be realized, or approximately between $10 and $23 million. Most of this will be realized by counties, but approximately 4.5 percent of it will be experienced by the state general obligation bond debt service fund. Other property tax beneficiaries which will be negatively impacted by the reduction in taxable property values include municipalities, school districts, and other political subdivisions.

Note that currently properties not claimed as depreciable do not fall under ad valorem property taxation at all, per Section 7-36-8(7) NMSA 1978. Taxpayers are unlikely to claim that data center system property is non-depreciable, and therefore not subject to property taxation, because the value of the depreciation is most likely more than that to be saved via avoidance of taxes, especially for the electronic-oriented property targeted in this bill, so it seems unlikely that companies would avoid the taxation at the cost of the depreciation.

LFC staff concur and add more detail copied from HB596 (2019):

The bill might not significantly decrease state or local revenues below the levels already anticipated with current data centers in the state, but the bill could prevent future revenues the state and local governments would otherwise receive. The bill expands the limits of what would be considered tangible personal property exempt from property taxes and deductible under industrial revenue bonds (IRBs) using current statute and determinations by TRD and the Administrative Hearings Office. Even with an IRB, real property construction is still gross receipts taxable. By moving the line as to what is considered real property as opposed to tangible personal property, a taxpayer can reduce gross receipts and compensating tax liability even further than at present.

2018's HB245 redefined construction materials for gross receipts tax purposes to create uniform standard for nonprofits, governments, and IRB recipients alike. HB-489 (and its duplicate SB352) appears to expand the definition of tangible personal property to include certain items that might be considered real property construction and therefore taxable under current interpretations. If that were true, then taxpayers who operate data centers pursuant to IRBs could elect to take advantage of the expanded definitions pursuant to this bill to reduce tax liabilities even further. This might lead to reduced revenue for the general fund and the local government.

Another possibility incumbent on the provisions of this bill is to provide tax advantages for a future or proposed data center to be located in a tax increment development district (TIDD). Projects in TIDDs are not eligible for IRBs. Thus, a data center in a TIDD would not be eligible for any special gross receipts tax or property tax deductions or abatements. This bill creates tax advantages for a data center in a TIDD that are completely comparable with the tax advantages accorded to an IRB-funded project. Although this tax advantage might be material in recruiting a data center to an existing (or future) TIDD, the incremental gross receipts and property tax revenues would not be available to repay the TIDD developer for infrastructure costs. The property tax abatement would continue forever – even after the 30-year property tax abatement for IRB projects expired.

LFC staff prepared the following fiscal estimate of the potential impact of this proposal, assuming one $25 million investment is made each year. The gross receipts and compensating tax impacts are relevant for the construction phase, but the property tax effects are cumulative and enduring.

Cumulative Impact of SB-352 -- Assuming one $25 Data Center Investment per Year ($ thousands)										
Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10	
(755)	(755)	(755)	(755)	(755)	(755)	(755)	(755)	(755)	(755)	Gen Fund Impact
(131)	(131)	(131)	(131)	(131)	(131)	(131)	(131)	(131)	(131)	Small Cities
(87)	(87)	(87)	(87)	(87)	(87)	(87)	(87)	(87)	(87)	Small Counties
(61)	(61)	(61)	(61)	(61)	(61)	(61)	(61)	(61)	(61)	Muni Equivalent
(154)	(154)	(154)	(154)	(154)	(154)	(154)	(154)	(154)	(154)	Muni GRT
(47)	(47)	(47)	(47)	(47)	(47)	(47)	(47)	(47)	(47)	County GRT
(132)	(250)	(355)	(445)	(521)	(584)	(633)	(667)	(688)	(699)	ABQ operating
(217)	(411)	(583)	(731)	(857)	(959)	(1,039)	(1,097)	(1,131)	(1,148)	Bern Co operating
(138)	(262)	(371)	(465)	(545)	(611)	(662)	(698)	(720)	(731)	APS operating
(129)	(245)	(347)	(435)	(510)	(571)	(619)	(653)	(673)	(683)	UNMH
(61)	(115)	(163)	(204)	(239)	(268)	(290)	(306)	(316)	(320)	CNMCC operating
(4)	(8)	(11)	(14)	(17)	(19)	(20)	(21)	(22)	(22)	Other Operating
(100)	(190)	(270)	(338)	(397)	(444)	(481)	(508)	(523)	(531)	ABQ Debt
(26)	(48)	(69)	(86)	(101)	(113)	(122)	(129)	(133)	(135)	Bern Co debt
(91)	(172)	(243)	(305)	(357)	(400)	(434)	(457)	(472)	(479)	APS debt
(27)	(52)	(74)	(92)	(108)	(121)	(131)	(139)	(143)	(145)	State debt
(20)	(38)	(54)	(68)	(80)	(89)	(97)	(102)	(105)	(107)	CNMCC debt
(2,180)	(3,026)	(3,775)	(4,418)	(4,967)	(5,414)	(5,763)	(6,012)	(6,161)	(6,235)	Total Impact

It is useful to note that the gross receipts provisions of this bill only apply to new, large data centers and their equipment, not to recently constructed or partly constructed data center facilities. Some public testimony indicates the provisions of this bill would not be applicable to the first Facebook data center building in Los Lunas but might apply to the second building and associated equipment. The grand opening of the first building was announced on February 1, 2019. This completed building and its associated equipment and any subsequent buildings and equipment are covered by the $30 billion industrial revenue bond approved by Valencia County. However, construction phase gross receipts and compensating taxes are not abated for any property considered real property, as opposed to tangible personal property.

The Facebook deal also includes some payments in lieu of property taxes. It is uncertain whether the provisions of this bill might apply to any subsequent development of the Facebook site. The permanent property tax abatement for all buildings and equipment at the Valencia County site would almost certainly be covered by the provisions of this bill. After 30 years, the payment in lieu of taxes would probably also vanish when the provisions of this bill would supersede the provisions of the IRB deal.

This bill may be counter to the LFC tax policy principles of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

TRD describes some policy implications of the provisions of the bill:

> **Section 1:** The proposed gross receipts and compensating tax deductions will reduce general fund revenue and narrow the tax base. This may lead to a reduction in government services, an increase in taxes in other areas, or both. Furthermore, because the annual cost of the deduction is difficult to predict, adoption of the proposed deduction will increase volatility in revenues.
>
> The tax incentives in this bill may, however, induce data center projects to locate in New Mexico, creating jobs, and additional sources of state and local revenue.
>
> Due to the $25 million investment requirement, smaller data centers would be at a competitive disadvantage to larger projects that meet the threshold. This can be seen as a violation of the taxation principle of equitability.
>
> These new proposed deductions do not include a sunset date. TRD supports sunset dates for policymakers to review the impact of deductions before extending them if a sufficient timeframe is allotted for tax incentives to be measured. Given the potential cost to the state, a sunset date would force an examination of the benefit of this deduction versus the cost.
>
> **Section 2:** This section allows more than just new dedicated data centers to claim the special property valuation method and expands the set of businesses which can use the special valuation method beyond those that can claim the deduction provided by Section 1, by including an expansive definition of “data system plants” as entities entitled to use the method. These two expansions of the valuation method to entities not eligible for the deduction in Section 1 would result in a significant revenue loss, as outlined in the Methodology for Estimated Revenue Impact section above. To limit the financial impact, TRD suggests limiting the valuation methodology to data centers whose construction or development, or reconstruction, redevelopment, or expansion begins on or after July 1, 2021, as in Section 1(L)(1) of the bill, and/or providing for a sunsetting of the special valuation method.

LFC staff largely concur with these points and add some additional information copied from 2019's analysis of HB596.

The property tax provisions of this bill may be a direct result of some confusion at the federal level for this type of business, where the support equipment is necessary to the operation of the business. IRS has one definition of equipment for the purposes of inclusion in a real estate investment trust and a somewhat conflicting definition for depreciation purposes under the modified accelerated cost recovery system (MACRS). A useful law review article is referenced in the footnote on this page.

This bill defines "data center equipment" to include a long list of support equipment that normally would be considered real property and redefines these items as tangible property. The commonly accepted standard of real property is generally determined by the six-factor test set forth in *Whiteco Industries, Inc. v. Commissioner.* Those tests consist of six questions that probe such matters as the nature of affixation, the removability of the asset after fixation and the intent of permanency when installed. The Internal Revenue Code itself does not define "real property," but rather the working definition is found in the regulations, which include two components: (1) the asset must be deemed permanent (either as a structure or a structural component of such structure) and (2) it must not be an accessory to the operation of a business.[1] By these definitions, some, if not most of the list of support equipment may well be necessary to the operation of a data center business.

The bill uses the phrase "colocation tenant," in numerous places and provides that, if the facility is sold, any deductions or abatements transfer to the new owners or colocation tenants. This may lead to an understanding of why this bill has been introduced.

The industrial revenue bond is a mechanism whereby equipment installed in the facility, including computer equipment, servers, cooling equipment, is considered owned by the sponsoring government. Thus, this equipment is eligible for gross receipts and compensating tax deductions for sale of tangible personal property to a government. Similarly, the government ownership of the facility, including the tangible personal property within the facility, creates a property tax exemption for as long as the government property is property tax exempt.

NMFA is concerned with gross receipts tax revenue bond impairment and proposes an amendment:

"Approximately 28 percent of all New Mexico Finance Authority ("NMFA") Public Project Revolving Fund ("PPRF") loans are secured by GRT. Every additional deduction to payment of GRT has the potential to reduce GRT collections in total."

"To the extent that GRT is reduced, potential exists for NMFA PPRF bonds and loans to be impaired. NMFA strongly suggests that every tax law change should include impairment mitigation language, similar to Section 6-21-18, NMSA 1978, should the net result of the tax law change turn out to be a net revenue reduction in revenues pledged to bonds. The proposed bill does not include appropriate impairment mitigation solutions."

PERFORMANCE IMPLICATIONS

1 https://taxlawjournal.columbia.edu/article/tax-matters-vol-4-no-1/defining-real-property-and-its-consequences/

The LFC tax policy of accountability is met with the bill's requirement to report annually to an interim legislative committee regarding the data compiled from the reports from taxpayers taking the deduction and other information to determine whether the deduction is meeting its purpose.

ADMINISTRATIVE IMPLICATIONS

TRD will need to update publications, create a new form for the Nontaxable Transaction Certificate (NTTC), and GenTax and form instructions will need to be updated to include a special code for reporting the new deduction. A report will need to be created to track the information regarding the new deduction.

The Information and Technology Division (ITD) reports staff workload costs of $10.3 thousand and contractual service costs of $32 thousand related to implementation.

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

TECHNICAL ISSUES

TRD is concerned with several technical issues.

The data center deduction is available only to data centers built after July 1, 2019 and where the total cost is at least $25 million. Such data centers will, therefore, have a financial advantage over existing and smaller facilities. Therefore, similar property will be subject to different methods of valuation, which is contrary to Article VIII, Section 1(A) of the New Mexico Constitution.

Section 1(F) (page 3, line 19) notes a decision from EDD will be made on eligibility for the nontaxable transaction certificate (NTTC) necessary to claim this deduction; however, there is not a remedy spelled out for what a taxpayer can do if the EDD determines they are not eligible, and the taxpayer disagrees. Section 7-1-24 NMSA 1978 does outline the path to an administrative protest, but this scenario does not fit into the parameters set forth in Section 7-1-24(A) NMSA 1978.

Section 1specifies that a NTTC must be provided to the seller or lessor. If an NTTC will be required TRD suggests that this also be outlined in Section 7-9-43(C) NMSA 1978. If not, alternative evidence should be allowed per Section 7-9-43 NMSA 1978 to claim this deduction. TRD would suggest adding the following language on page 2, line 2 after nontaxable transaction certificate "or provides alternative evidence pursuant to Section 7-9-43 NMSA 1978."

Section 1(G) on page 4, line 8 is redundant, having been covered in 1-D starting on page 2 line 24. However, TRD does prefer the language used in subsection G.

Section 1(I) starting on page 4 line 18, which prohibits EDD and TRD from sharing certain proprietary information, could be problematic to enforce. Currently, under the Inspections of Public Records Act (IPRA), the only proprietary business information that can be protected are the business plans of public hospitals. Hence, this section may be found to be unenforceable.

Section 1(J):

- starting on page 4, line 25 the bill outlines that EDD may revoke a certificate of eligibility, but the clawback measures in this section will be determined by EDD, which does not have an auditing mechanism. This type of financial determination may be better handled by TRD, which does have an auditing mechanism. Or if this language stays the same, TRD would like to make sure they have the authority to audit or inform the business that they will need to file amended returns and pay the tax due for the deduction that should no longer be claimed.
- starting on page 5, line 12 of the bill calls for a public hearing before EDD in the event eligible costs are not expended to determine how much of a previous deduction to disallow. It is unknown and uncertain whether EDD has the expertise to administer this hearing process or if EDD should be denying the taxpayers ability to claim this deduction. A possible solution is to amend Section 7-1-17 NMSA 1978, such that a non-payer become a delinquent taxpayer. A delinquent taxpayer would then have the right to protest EDD's finding before the Administrative Hearings Office.
- Starting on page 5, line 20 of the bill requires the taxpayer to remit the unallowed deduction to TRD within 180 days. There is no provision to allow TRD to start collection efforts in the case the amount is not paid within 180 days. A possible solution is to allow the TRD to audit and assess the taxpayer. This would allow the taxpayer to provide additional documentation and would also open the taxpayers protest rights under the Tax Administration Act.

Section 1(L)(2) on page 7, line 1 the reference to "intangible consumables" should be deleted. It is unclear how "intangible consumables" are a part of data center equipment and inclusion could lead to confusion. Furthermore, "intangibles" are not defined in the Tax Code, and not subject to GRT, which taxes only tangible personal property (unless the intangible may be considered to be the product of a service).

This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date. TRD concurs with this recommendation.

POSSIBLE AMENDMENTS

NMFA suggests the proposed bill should be amended to include appropriate impairment mitigation solutions consistent with other New Mexico laws. The NMFA recommends looking at the language contained in Section 6-21-18 of the NMFA Act:

"The state does hereby pledge to and agree with the holders of any bonds or notes issued under the New Mexico Finance Authority Act that the state will not limit or alter the rights hereby vesting the authority to fulfill the terms of any agreements made with the holders thereof or in any way impair the rights and remedies of those holders until the bonds or notes together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceedings by or on behalf of those holders, are fully met and discharged. The authority is authorized to include this pledge and agreement of the state in any agreement with the holders of the bonds or notes."

OTHER SUBSTANTIVE ISSUES

The proposed gross receipts and compensating tax deductions for a data center is reminiscent of the exemption for 1-800 or WATS phone service. (7-9C-6 NMSA 1978). This deduction, enacted in 1993, created the call center industry in New Mexico. No one has ever done an economic benefits analysis, but this could be the exemplar for why states enact economic development tax expenditures. When they work, the economic benefits return more revenue to state and local governments than the direct revenue foregone. It could be that this data center deduction could similarly create an entire industry in the state but that is impossible to determine with available data.

This bill pushes the envelope in many ways, as outlined in the Technical Section above. At minimum, the proponents of this bill should explain the specific purposes of the bill. The major change contained in this bill is the long-term property tax abatement and the expansive definition of tangible personal property that includes many items previously considered to be real property.

LG/JC/sb

APPENDIX A

https://www.abqjournal.com/1141783/failed-bill-aimed-to-lure-data-centers-to-state.html
https://phys.org/news/2017-07-facebook-mexico-center.html
Los Lunas agreed to give up property taxes for 30 years in exchange for annual payments starting at $50,000 and topping out at under $500,000, while the state promised billions of dollars in industrial revenue bonds and other economic development funding. State utility regulators also cleared the way for Facebook and Public Service Co. of New Mexico to create a renewable energy tariff, which allows the company to secure solar- and wind-generated electricity to power the data center.

Facebook says the Los Lunas facility will be one of the most advanced, energy-efficient centers in the world. It will have an evaporative cooling system capable of protecting the servers inside from New Mexico's frequent dust storms.

State economic development officials have estimated that New Mexico could gain about $75 million in gross receipts tax revenue over the next decade from construction costs related to the project.

Read more at: https://phys.org/news/2017-07-facebook-mexico-center.html#jCp

APPENDIX B – Analysis of Differences between the provisions of SB-36 (this bill) and provisions of HB-245 (2018)

Relevant provision from HB-245 (2018), defining “construction materials” for gross receipts tax purposes:
… does not include tangible personal property, whether removable or non-removable, that is sold or will be subsequently sold to a 501(c)(3) organization or to the United States, New Mexico or a governmental unit or subdivision, agency, department or instrumentality of the United States or of New Mexico and is or would be classified for depreciation purposes as three-year property, five-year property, seven-year property or ten-year property, including indirect costs related to the asset basis, by Section 168 of the Internal Revenue Code of 1986, as that section may be amended or renumbered."
Relevant definition of three-year, five-year, seven-year or ten-year property. https://www.irs.gov/pub/irs-pdf/p946.pdf
Publication 946 Cat. No. 13081F How To Depreciate Property

1. 3-year property.
   a. Tractor units for over-the-road use.
   b. Any race horse over 2 years old when placed in service. (All race horses placed in service after December 31, 2008, and before January 1, 2018, are deemed to be 3-year property, regardless of age.)
   c. Any other horse (other than a race horse) over 12 years old when placed in service.
   d. Qualified rent-to-own property (defined later).
2. 5-year property.
   a. Automobiles, taxis, buses, and trucks.
   b. Computers and peripheral equipment.
   c. Office machinery (such as typewriters, calculators, and copiers).
   d. Any property used in research and experimentation.
   e. Breeding cattle and dairy cattle.
   f. Appliances, carpets, furniture, etc., used in a residential rental real estate activity.
   g. Certain geothermal, solar, and wind energy property.
   h. Any machinery equipment (other than any grain bin, cotton ginning asset, fence, or other land improvement) used in a farming business and placed in service after December 31, 2017, in tax years ending after December 31, 2017. The original use of the property must begin with you after December 31, 2017.
3. 7-year property.
   a. Office furniture and fixtures (such as desks, files, and safes).
   b. Agricultural machinery and equipment.
   c. Railroad track.
   d. Any property that does not have a class life and has not been designated by law as being in any other class.
   e. Certain motorsports entertainment complex property (defined later) place in service before January 1, 2018.
   f. Any natural gas gathering line placed in service after April 11, 2005. See Natural gas gathering line and electric transmission property, later.
4. 10-year property.
   a. Vessels, barges, tugs, and similar water transportation equipment.
   b. Any single purpose agricultural or horticultural structure.
   c. Any tree or vine bearing fruits or nuts.

d. Qualified small electric meter and qualified smart electric grid system (defined later) placed in service on or after October 3, 2008.