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

		ORIGINAL DATE	2/2/19		
SPONSOR	Padilla	**LAST UPDATED**	2/5/19	**HB**	
SHORT TITLE	Data Center Gross Receipts			**SB**	352
				ANALYST	Graeser/Clark

REVENUE (dollars in thousands)

Estimated Revenue					R or NR	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

*Note: these impacts are partly in relation to possible revenues after a recent Administrative Hearing Office decision; a significant portion of this part of the revenue impact might not have been received historically and would not be included in the latest revenue estimate

SOURCES OF INFORMATION
LFC Files
Analysis of HB-324 (2018)

Comments Received from
Economic Development Department (EDD)

SUMMARY

Synopsis of Bill

Senate Bill 352 creates gross receipts tax and compensating tax deductions for new, large data centers. The Economic Development Department (EDD) is required to certify the eligibility for a data center non-taxable transaction certificate (NTTC). An eligible data center is a new 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 & 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 with regard to 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 HB-245, 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 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% of initial costs.

The effective date of this bill is July 1, 2019. The property tax special method is applicable to the 2020 property tax year and future fiscal years and applies to all data centers, not just new, large ones that qualify for this deduction.

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

FISCAL IMPLICATIONS

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.

Last year's HB-245/HFlS redefined construction materials for gross receipts tax purposes to create uniform standard for nonprofits, governments, and IRB recipients alike. SB-352 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 locating in TIDDs are not eligible for IRBs. Thus, a data center locating 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 locating in a TIDD that are completely comparable to 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 have 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 that 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 principle of adequacy, efficiency, and equity. Due to the increasing cost of tax expenditures, revenues may be insufficient to cover growing recurring appropriations.

SIGNIFICANT ISSUES

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 (IRB) 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 located within the facility creates a property tax exemption for as long as the government property is property tax exempt.

PERFORMANCE IMPLICATIONS

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. The confidentiality provisions during the certificate application and approval process are somewhat unusual, but once the certificate has been approved and the taxpayer begins claiming the deductions, there is unusually extensive disclosure.

ADMINISTRATIVE IMPLICATIONS

The provisions of the bill impact moderately on the Economic Development Department, but it is expected that at most one or two $25 million data center investments would be approved annually. TRD would also expend moderate effort in including the claw back provisions in their procedures.

TECHNICAL ISSUES

1. The claw back provision is technically flawed. The data center as a taxpayer never claims a deduction from gross receipts tax. The data center presents a data center non-taxable transaction certificate to, perhaps, many vendors, who then claim the deduction on each vendor's CRS-1 return. This information is protected by 7-1-6.8 NMSA 1978 confidentiality provisions. If, by the end of the five-year period allowed for the data center to fulfill the $25 million investment goal, the goal has been not been achieved, EDD would have no ability to determine the amount of the claw back. The bill provides for a public hearing to determine the portion of the total deductions claimed that should be clawed back, but TRD is not required to provide information on the timing or amount of the deductions that have been claimed by vendors receiving the NTTCs. Although TRD is required to prepare an annual report on the costs and number of vendors claiming deductions and present that report to an

interim legislative committee, TRD is not required to attribute this information to the issuer of the NTTCs, nor share this origin information with EDD.

2. There is no requirement in the bill for data centers to submit expenditure information to EDD, so that agency has no means of verifying that $25 million was actually spent. Since the agreement to spend that money extends from 90 days before the application for a certificate until five years after that date, EDD will have a very difficult task tracking progress toward the investment goal. And by the time EDD could determine that the taxpayer had not made adequate progress, there might be no assets from which to pay claw back amounts. The bill should provide for a quarterly report to EDD detailing taxpayer expenditures, so that EDD can easily track progress toward meeting the $25 million investment goal.
3. Similarly, the bill could include a requirement – discretionary on the part of EDD -- that the taxpayer post a performance bond in the amount of the gross receipts tax deductions claimed from TRD. This might mean several things: (a) the data center taxpayer, in the process of applying for the right to issue data center NTTCs, should be required to establish investment milestones/targets; (b) the data center taxpayer, in addition to reporting to EDD the value of the investments made during a calendar quarter would be required to report the value of purchases made with non-taxable transaction certificates; (c) EDD would be required to determine if the promised investment targets had been met or not, and if not met, whether a public hearing should be held to determine if either the NTTC issuance authority should be revoked or a performance bond in the amount of the deductions or portion of the total deductions should be required.
4. The special method for valuing tangible personal property contained in Section 2 of this bill is in direct conflict with the provisions of 7-36-33 NMSA 1978. This section provides that the value of property not specifically mentioned in section 7-36-22 through 7-36-31 NMSA 1978 shall be valued using a cost approach minus depreciation, with a salvage value not less than 12½ percent of cost. The permanent valuation proposed in this bill for five percent of cost for expansively defined tangible personal property, therefore, violates the general rule that valuation must be current and correct. All of the other special methods listed at 7-36-22 through 7-36-31 NMSA 1978 do not deviate from this general principle.
5. The legislature is not permitted to enact exemptions or abatements of property tax without constitutional authority. Article VIII, Section 3 [Tax-exempt property] provides as follows:

    > The property of the United States, the state and all counties, towns, cities and school districts and other municipal corporations, public libraries, community ditches and all laterals thereof, all church property not used for commercial purposes, all property used for educational or charitable purposes, all cemeteries not used or held for private or corporate profit and all bonds of the state of New Mexico, and of the counties, municipalities and districts thereof shall be exempt from taxation.

    Exemptions of ***personal property*** from ad valorem taxation may be provided by law if approved by a three-fourths majority vote of all the members elected to each house of the legislature (emphasis added).

    In the case law notes, entitled “Authority of legislature” — the legislature is authorized to exempt certain property from taxation and none other. Dillard v. New Mexico State Tax Comm'n, 1948-NMSC-069, 53 N.M. 12, 201 P.2d 345.

    It can certainly be argued that this standalone property tax abatement is unconstitutional if the successor “collocated tenant” has not been granted an IRB. Again the theory of the IRB is that the equipment and building subject to the IRB is owned by the sponsoring

government for the period of time that the IRB is in effect.

The construct used in this bill is to establish a special method of valuation for data center plant that includes an expansive definition of tangible personal property. This may not technically be an exemption from property tax. TRD/PTD and LFC staff advise that the three-fourths majority of both houses requirement of the Constitution may be required.

6. The bill changes the rule as to what is real property and what is tangible personal property. In general, the rule is that if tangible personal property is permanently mounted or affixed to real property, it becomes real property. Section 1, Subsection L of the bill provides "… means purchased or leased, tangible or intangible equipment or software, whether affixed to or incorporated into real property…" This issue was debated and probably litigated years ago when an electronics component manufacturer claimed and was granted approval of a vibration-isolation subfloor and all of the air handling equipment needed for a clean room. Both of these nominally real property installations were held to be tangible property for the purpose of the IRB tangible property deduction. The language of this bill is attempting to push the envelope of the general principle.

7. This bill does not contain a delayed repeal date. LFC recommends adding a delayed repeal date.

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.

Does the bill meet the Legislative Finance Committee tax policy principles?

1. **Adequacy**: Revenue should be adequate to fund needed government services.
2. **Efficiency**: Tax base should be as broad as possible and avoid excess reliance on one tax.
3. **Equity**: Different taxpayers should be treated fairly.
4. **Simplicity**: Collection should be simple and easily understood.
5. **Accountability**: Preferences should be easy to monitor and evaluate

Arguably, this bill violates four of the five criteria, with only the accountability principle enabled.

Does the bill meet the Legislative Finance Committee tax expenditure policy principles?

1. **Vetted**: The proposed new or expanded tax expenditure was vetted through interim legislative committees, such as LFC and the Revenue Stabilization and Tax Policy Committee, to review fiscal, legal, and general policy parameters.
2. **Targeted**: The tax expenditure has a clearly stated purpose, long-term goals, and measurable annual targets designed to mark progress toward the goals.
3. **Transparent**: The tax expenditure requires at least annual reporting by the recipients,

the Taxation and Revenue Department, and other relevant agencies.

4. **Accountable**: The required reporting allows for analysis by members of the public to determine progress toward annual targets and determination of effectiveness and efficiency. The tax expenditure is set to expire unless legislative action is taken to review the tax expenditure and extend the expiration date.
5. **Effective**: The tax expenditure fulfills the stated purpose. If the tax expenditure is designed to alter behavior – for example, economic development incentives intended to increase economic growth – there are indicators the recipients would not have performed the desired actions "but for" the existence of the tax expenditure.
6. **Efficient:** The tax expenditure is the most cost-effective way to achieve the desired results.

This bill pushes the envelope in many different 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. The legislature, in debating this bill, should inquire as to the intent of the bill. It is uncertain why this proposal is necessary

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-352 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.