DEPARTMENT OF TAXATION
2016 Fiscal Impact Statement

1. **Patron** Robert G. Marshall

2. **Bill Number** HB 121
   House of Origin:
   X **Introduced**
   ____ **Substitute**
   ____ **Engrossed**

   Second House:
   ____ **In Committee**
   ____ **Substitute**
   ____ **Enrolled**

3. **Committee** House Finance

4. **Title** Income Tax; Modify the Method of Apportionment for Certain Data Centers Retail Sales Tax; Exemption for Certain Data Centers

5. **Summary/Purpose:**

This bill would provide an exception to the modified method of apportionment that is required for certain enterprise data center operations. The exception would apply to enterprise data center operations that are:

- First located in Virginia on or after January 1, 2016, on property that is not zoned for industrial use and require use of a 150-kilovolt or greater electrical transmission line, where any part of such line is located above ground within 1.5 miles of the data center; or

- Located in Virginia prior to January 1, 2016, on property that is not zoned for industrial use and require use of a 150-kilovolt or greater electrical transmission line for the first time on or after January 1, 2016, where any part of such line is located above ground within 1.5 miles of the enterprise data center operations.

This provision would be effective for taxable years beginning on or after January 1, 2016.

This bill would also exclude such data center operations from the Retail Sales and Use Tax exemption for purchases of equipment by data centers and their tenants. This provision would be effective January 1, 2016.

6. **Budget amendment necessary:** No.

7. **Fiscal Impact Estimates are:** Preliminary. (See Line 8.)

8. **Fiscal implications:**

<u>Administrative Costs</u>

The Department of Taxation ("the Department") considers implementation of this bill as routine, and does not require additional funding.

Revenue Impact

This bill would have an unknown revenue impact. The modification of the apportionment method for certain enterprise data center operations would have a General Fund revenue impact, to the extent that such taxpayers would pay a different amount of corporate income tax. Because the apportionment method for certain data center operations is not effective until July 1, 2016, no taxpayers have yet utilized this method. Accordingly, the extent to which taxpayers with enterprise data center operations would be impacted by this provision is unknown.

The provision of this bill disallowing the Retail Sales and Use Tax exemption for certain data centers would result in an unknown increase in Retail Sales and Use Tax revenues, to the extent that such data center operations would be subject to the Retail Sales and Use Tax on purchases of their equipment. Based on data from the Virginia Economic Development Partnership Authority regarding planned data center investment, the estimated revenue loss from the Retail Sales and Use Tax exemption for data centers is $49.3 million in Fiscal Year 2015, $51.1 million in Fiscal Year 2016, $52.0 million in Fiscal Year 2017, $53.0 million in Fiscal Year 2018, $54.2 million in Fiscal Year 2019, $55.4 million in Fiscal Year 2020, and $56.6 million in Fiscal Year 2021.

9. Specific agency or political subdivisions affected:

Department of Taxation

10. Technical amendment necessary: No.

11. Other comments:

Virginia Methods of Apportionment

Statutory Method of Apportionment

Virginia generally requires the Virginia taxable income of a multistate corporation to be apportioned to Virginia by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor, plus twice the sales factor, and the denominator of which is four.

The property factor is a fraction that consists of the average value of the corporation’s real and tangible personal property owned or rented and used in Virginia over the like property located everywhere. The payroll factor is a fraction, the numerator being the total amount of compensation paid or accrued within Virginia during the taxable year by a taxpayer, and the denominator being the total compensation paid or accrued everywhere during the taxable year. The sales factor is a fraction, the numerator of which is the total sales of the corporation in Virginia during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year. Sales, other than sales of tangible personal property, are deemed in Virginia if:

- The income-producing activity is performed in Virginia; or

- The income-producing activity is performed both in and outside of Virginia and a greater proportion of the income producing activity is performed in Virginia than in any other state, based on costs of performance.

An "income producing activity" is an act or acts directly engaged in by the taxpayer for the ultimate purpose of producing a sale subject to apportionment. "Cost of performance" is defined as the cost of all activities directly performed by the taxpayer for the ultimate purpose of producing the sale to be apportioned.

Modified Method of Apportionment for Certain Enterprise Data Center Operations

During the 2015 Session, the General Assembly enacted legislation (House Bill 2162 and Senate Bill 1142 (2015 *Acts of Assembly*, Chapters 237 and 92)), which require a taxpayer with an enterprise data center operation to apportion Virginia taxable income using single factor apportionment based on sales if such taxpayer enters into a memorandum of understanding with the Virginia Economic Development Partnership on or after July 1, 2015, to make a new capital investment of at least $150 million in an enterprise data center in Virginia on or after July 1, 2015. The modified method of apportionment applies beginning with the taxable year for which VEDP provides a written certification to such taxpayer that the new capital investment has been completed. The modification is being phased in as follows:

- From July 1, 2016 until July 1, 2017, qualifying corporations would be required to use a quadruple-weighted sales factor; and
- From July 1, 2017, and thereafter, qualifying corporations would be required to use the single sales factor method to apportion Virginia taxable income.

Because this modified method is not effective until July 1, 2016, no taxpayers have yet claimed this method on their Virginia corporate income tax returns.

Modified Method of Apportionment for Manufacturing Companies

During the 2009 Session, the General Assembly enacted legislation (House Bill 2437 (2009 *Acts of Assembly*, Chapter 821)) that allows manufacturing companies to elect whether to apportion Virginia taxable income using the statutory method of apportionment or using a single sales factor method of apportionment. This modification was phased in as follows:

- For taxable years beginning on or after July 1, 2011, but before July 1, 2013, qualifying corporations may elect to use a triple-weighted sales factor;
- For taxable years beginning on or after July 1, 2013, but before July 1, 2014, qualifying corporations may elect to use a quadruple-weighted sales factor; and
- For taxable years beginning on or after July 1, 2014, and thereafter, qualifying corporations may elect to use the single sales factor method to apportion Virginia taxable income.

A manufacturing company that elects to use the modified method of apportionment will be subject to additional taxes if such manufacturing company's average annual number of full-time employees for the first three taxable years that it used the modified method of apportionment is less than 90 percent of its base year employment, or if the average wages of the manufacturing company's full-time employees, as certified by the manufacturing company, is not greater than the lower of the state or local average weekly wage for its industry. "Base year employment" is defined as the average number of full-time employees employed by the manufacturing company in Virginia in the taxable year that ended immediately prior to the first taxable year in which the manufacturing company used the modified method of apportionment for manufacturing companies.

Modified Method of Apportionment for Retail Companies

During the 2012 Session, the General Assembly enacted legislation (House Bill 154 and Senate Bill 49 (2012 *Acts of Assembly*, Chapters 86 and 666)) that requires certain retail companies to apportion Virginia taxable income using a single sales factor method of apportionment. This modification is being phased in as follows:

- For taxable years beginning on or after July 1, 2012, but before July 1, 2014, retail companies must use a triple-weighted sales factor;
- For taxable years beginning on or after July 1, 2014, but before July 1, 2015, retail companies must use a quadruple-weighted sales factor; and

For taxable years beginning on or after July 1, 2015, and thereafter, retail companies must use the single sales factor method to apportion Virginia taxable income.

<u>Retail Sales and Use Tax Exemption for Data Centers</u>

Under current law, beginning July 1, 2010 and ending June 30, 2020, computer equipment purchased or leased by certain data centers for the processing, storage, retrieval or communication of data, including but not limited to servers, routers, connections and other enabling hardware, is exempt from the Retail Sales and Use Tax. Purchased or leased upgrades, additions to, or replacement of the computer equipment in a qualifying facility are equally exempt. The exemption does not apply to separately sold computer software or general building improvements or fixtures.

In order to be eligible for this exemption, the data center must be located in a Virginia locality and must result in new capital investment of at least $150 million on or after January 1, 2009. The data center and its tenants, if applicable, also must create, on or after July 1, 2009, at least 50 new jobs paying at least one and one-half the prevailing average wage in the locality or at least 25 new jobs paying at least one and one-half the prevailing average wage if the locality has an unemployment rate for the preceding year of at least 150 percent of the average statewide unemployment rate or is located in an enterprise zone. The investment must be made in accordance with a memorandum of understanding with the Virginia Economic Development Partnership Authority. The exemption also extends to purchases made by tenants of a data center that meets the requirements of the data center exemption.

In Fiscal Year 2015, 13 data center operators and 63 data center tenants qualified for the Retail Sales and Use Tax exemption.

Proposed Legislation

Method of Apportionment for Certain Enterprise Data Center Operations

This bill would provide an exception to the modified method of apportionment that is required for certain enterprise data center operations. The exception would apply to enterprise data center operations that are:

- First located in Virginia on or after January 1, 2016, on property that is not zoned for industrial use and require use of a 150-kilovolt or greater electrical transmission line, where any part of such line is located above ground within 1.5 miles of the data center; or

- Located in Virginia prior to January 1, 2016, on property that is not zoned for industrial use and require use of a 150-kilovolt or greater electrical transmission line for the first time on or after January 1, 2016, where any part of such line is located above ground within 1.5 miles of the enterprise data center operations.

This provision would be effective for taxable years beginning on or after January 1, 2016.

Retail Sales and Use Tax Exemption for Data Centers

This bill would also exclude such data center operations from the Retail Sales and Use Tax exemption for purchases of equipment by data centers and their tenants.

This provision would be effective January 1, 2016.

Similar Bills

House Bill 120 is identical to this bill.

House Bill 966 would change Virginia's primary method of apportionment from the three-factor double-weighted sales factor method to the single sales factor method, and would make other modifications to Virginia's law regarding apportionment.

House Bill 872 would extend the sunset date of the Retail Sales and Use Tax exemption for purchases of equipment by data centers and their tenants from June 30, 2020 to June 30, 2023.

Senate Bill 64 would remove the sunset date of the Retail Sales and Use Tax exemption for purchases of equipment by data centers and their tenants. The exemption is due to expire June 30, 2020.

cc : Secretary of Finance

Date: 2/1/2016 MTH
HB121F161