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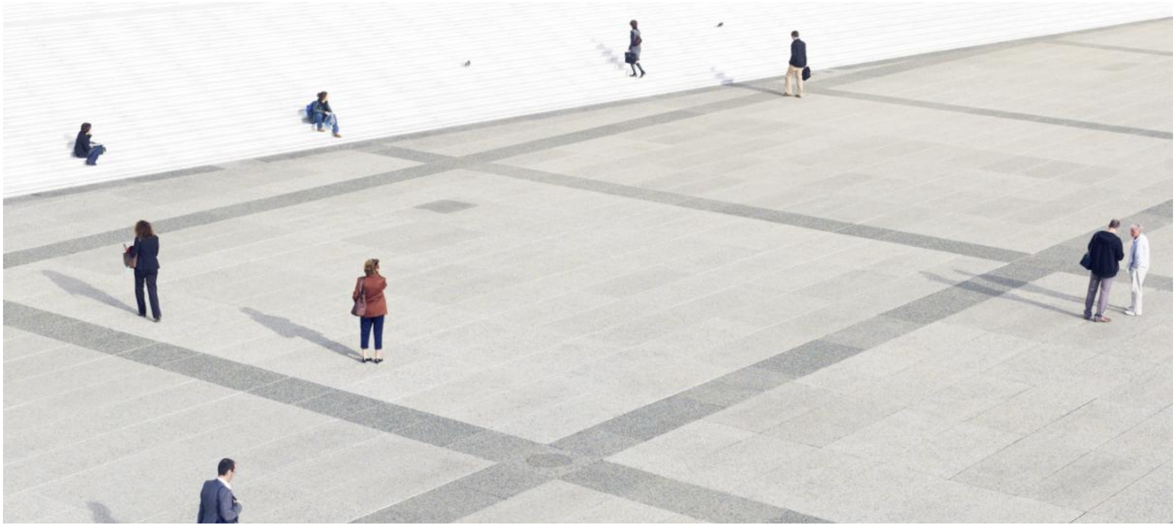
Tax credit trends: Industry and geography



In this issue, our authors explore two different avenues that states may take to offer incentives to businesses. The first involves certain credits and incentives provided to entities engaged in a particular industry; in this case, data center activities. The second concerns New York incentives offered to businesses within targeted geographic regions.

Bob Rischmann discusses state tax credits available to companies expanding or starting data centers. This article surveys various state developments regarding data center state tax incentives, including potential tax benefits and requirements for qualifying as a data center.

James Pomponi examines recent enhancements to the New York Excelsior Job Program. Significant enhancements to the program make it more attractive to businesses and demonstrate New York State's commitment to attracting business and spurring job creation and capital investment in the state. Key changes include decreasing the requirements for creating new jobs, broadening the qualification criteria for targeted industries, revising the requirements for qualifying as a regionally significant project, and allowing partial credits for businesses that realize job commitments at an amount less than originally projected.

We continue to welcome your thoughts and input on any area that may be of interest to you or your company.

Regards,

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How states use tax incentives to attract data centers – A state survey

Millions of state tax dollars are available to data centers as state legislatures across the country battle for their business. Any business seeking to construct, relocate, or maintain a data center should be familiar with the tax benefits offered by states to incentivize locating a data center in their state. While incentives are available based on the legislative guidance summarized below, businesses should also be mindful of opportunities available with most states to negotiate tax abatements when a certain level of capital investment and/or job retention or creation is expected in a locality.

Data centers may have to comply with varying requirements to receive tax benefits including applying to and receiving approval from a state or local tax authority for such benefits, committing to a certain amount of capital investment, agreeing to maintain a certain level of employment, paying employees a particular wage or providing them with heath benefits, locating in a distressed area, and other qualifications.

This article surveys the various state laws and developments occurring over the past four years regarding data center state tax incentives including potential tax benefits and requirements for qualifying as a data center. The following is not intended to detail every aspect of a state's laws, nor intended to summarize every state tax incentive available to data centers. A review and analysis of specific state law is recommended for a more comprehensive understanding of the law's benefits and requirements.

What is a data center?

The meaning of a 'data center' varies from state to state. However, common elements involve a facility that utilizes computer hardware and software to manage digital data. The type of equipment generally included within the meaning of a data center (and, therefore, usually included within a sales tax exemption) includes computers, cooling systems, power infrastructure, and electricity.

While beyond the scope of this article to explore the data center definition in each state, the following examples may prove instructive to provide a general understanding of how states define date centers.

In Minnesota, a data center is a facility used to house *enterprise information technology equipment*, defined as computers and equipment supporting computing, networking, or data storage, including servers and routers. The term includes cooling systems, cooling towers, and other temperature control infrastructure; power infrastructure for transformation, distribution, or management of electricity used for the maintenance and operation of a qualified data center, including exterior dedicated business-owned substations, backup power generation systems, battery systems, and related infrastructure; and racking systems, cabling, and trays that are necessary for the maintenance and operation of the qualified data center.

Nebraska defines a data center to mean computers, supporting equipment, and other organized assembly of hardware or software that is designed to centralize the storage, management, or dissemination of data and information; environmentally controlled structures or facilities or interrelated structures or facilities that provide the infrastructure for housing the equipment, such as raised flooring, electricity supply, communication and data lines; Internet access; cooling, security, and fire suppression; and any building housing the foregoing.

Iowa provides that a data center is a building rehabilitated or constructed to house a group of networked server computers in one physical location in order to centralize the storage, management, and dissemination of data and information pertaining to a particular business, taxonomy, or body of knowledge. The facility of such a data center business typically includes the mechanical and electrical systems, redundant or backup power supplies, redundant data communications connections, environmental controls, and fire suppression systems. Such a facility also includes a restricted access area that uses advanced physical security measures such as video surveillance systems and card-based security or biometric security access systems.

Finally, a Nevada data center is one or more buildings located at one physical location that house a group of networked server computers for the purpose of centralizing the storage, management, and dissemination of data and information pertaining to a particular business and includes the associated telecommunications and storage systems at the location.

State tax incentives for data centers

Arizona

Effective September 1, 2013, H.B. 2009 provides an exemption from its sales tax for purchases of qualified equipment installed in a computer data center. The provision is unique in that it allows an exemption for past and future activity. Existing data centers may qualify if they have created at least $250 million of investment in the prior six years. New data centers may qualify if they create either $25 or $50 million of investment (depending on location) within five years. The exemption generally lasts for 10 years.

Iowa

Passed in 2009, S.F. 478 established significant incentives for qualifying data centers. Effective July 1, 2009, Iowa generally provides a sales and use tax exemption for sales and rentals of computers and equipment necessary to maintain and operate a data center, including cooling systems, cooling towers, and other temperature control infrastructure; power infrastructure for transformation, distribution, or management of electricity; and racking systems, cabling, and trays. A data center's purchase of electricity is also exempt.

Generally, a qualified data center must be at least 5,000 square feet in size and make a minimum Iowa investment of $200 million in its first six years of operation. Data centers with a lower investment may apply for a partial (50%) sales and use tax refund. Iowa rules 701-230.12 and 701-230.13 were adopted in 2010 to provide guidance regarding the specific exempt property, limitations of the exemption, criteria for qualifying data centers, and other elements of the exemption.

Louisiana

In a departure from the typical sales tax benefit offered by other states, applicable for income tax periods beginning after 2012 and franchise tax periods beginning after 2013, H.B. 729 allows for a 20-year single sales factor election program if the activities of a taxpayer at a Louisiana site includes a data center.

Minnesota

Enacted in June 2011, H.F 20 provides a sales and use tax exemption for purchases of enterprise information technology equipment and computer software used in a qualified data center. Electricity used or consumed in the operation of a qualified data center is also exempt. Exempt purchases must be made between June 30, 2012, and July 1, 2042. A qualified data center must be in a facility comprised of one or more buildings that consist of at least 30,000 square feet. Qualified data centers must make an investment of at least $50 million in enterprise information technology equipment and computer software within a 24-month period. Minnesota's Revenue Notice 12-11 provides more details of the exemption.

The exemption was expanded in May 2013 following the enactment of H.F. 677 to include qualified refurbished data centers, decrease the required investment from $50 million to $30 million, and decrease the space requirement from 30,000 square feet to 25,000 square feet.

Mississippi

Effective July 1, 2010, HB 1701 allows a qualified data center to claim a sales and use tax exemption for: (1) sales of component building materials and equipment for initial *construction* of facilitates or *expansion* of facilities in Mississippi and (2) sales and leases of replacement hardware, software, or other necessary technology used to operate a data center. The data center must make a minimum capital investment in Mississippi of $50 million and must create a minimum of 50 new, full-time jobs with a minimum average salary of at least 150% of the average state wage. Taxpayers must file an application with the Mississippi Development Authority prior to construction, acquisition of the buildings, or expansion in the state.

Nebraska

Nebraska's Advantage Act provides various tax incentives (including a total or partial refund of sales and use taxes and a refundable credit against corporate income tax) measured by a taxpayer's investment and wages paid in the state. The Act provides six 'tiers' of investment and wage levels that determine the incentives available to taxpayers in each tier. Over the years, Nebraska has provided guidance for and modified the Act's application to data centers. [Revenue Ruling 29-10-1 (3/9/10); L.B. 918 (signed 4/18/10); Nebraska sales tax exemptions, Department of Revenue (8/14/12); Revenue Ruling 29-12-1 (11/2/11); and LB 1118 (signed 3/7/12)]

L.B. 1080 (signed 4/10/12) creates an exemption independent of the Advantage Act. Effective January 1, 2013, a sales and use tax exemption applies to the purchase of taxable personal property and services by a person operating a Nebraska data center that are assembled, engineered, processed, fabricated, manufactured into, attached to, or incorporated into other tangible personal property for the purpose of subsequent use at a physical location outside of Nebraska.

Nevada

Signed by Nevada's governor on June 13, 2013, A.B. 1 provides that qualified data centers may apply for a sales tax abatement on eligible machinery or equipment. A data center must be located in certain designated incentive zones in Nevada. The data center must also invest a minimum of $100 million in a zone. The duration of the abatement must be between 1 and 15 years.

New York

New York provides a sales and use tax exemption for machinery, equipment, and certain other tangible personal property for use in a data center when such property: (1) will be located or installed in a facility or structure that is an internet data center and (2) is required for and directly related to the provision of internet website services for sale by the operator of the center.

A qualified data center must: (1) operate as a high security environment for the location of servers and similar equipment that hosts Internet Web sites and (2) provide uninterrupted Internet access to customers' Web pages (i.e., 24 hours a day, 7 days a week, 365 days a year) and continuous management of Internet traffic for customers' Web sites. New York Bulletin TB-ST-405 provides more details regarding the exemption. An Internet data center operator should use an exemption certificate when purchasing either property or services exempt from tax.

Ohio

Effective July 1, 2011, H.B. 153 created a partial or complete sales and use tax exemption for purchases of computer data center equipment and on the installation, delivery, and repair of such equipment. An eligible data center must create a capital investment of at least $100 million during three consecutive years and maintain an annual payroll of at least $5 million during the term of the agreement entered into with the Tax Credit Authority.

Effective September 29, 2013, H.B. 59 amends the definition of an eligible computer data center to provide that: (1) one or more taxpayers operating a computer data center business at the project site may qualify; and (2) the total $5 million payroll requirement is replaced with a $1.5 million annual payroll requirement.

South Carolina

On June 7, 2012, South Carolina enacted a sales and use tax exemption for computers, computer equipment, computer hardware, and computer software used within a 'datacenter' (as the term is spelled in the state) that meets certain requirements. The exemption also applies to electricity used by the datacenter and property used for the generation, transformation, transmission, distribution, or management of electricity located and used at the datacenter.

To qualify, a datacenter must generally: (1) invest at least $50 million in real or personal property over a five year period, (2) create and maintain 25 full-time jobs at the facility with an average cash compensation level of 150% of the state or county per capital income for three consecutive years, and (3) be certified by the state's Department of Commerce. An August 25, 2013, Revenue Ruling provides guidance regarding the exemption.

Texas

Effective September 1, 2013, H.B. 1223 generally provides a sales and use tax exemption for certain purchases of tangible personal property "necessary and essential to the operation of a qualified data center." Qualified property includes electricity, electrical systems, cooling systems, emergency generators, hardware or distributed mainframe computers or servers, data storage devices, and software.

Taxpayers must apply to and be certified by the Comptroller to qualify for the exemption. Generally, to qualify a taxpayer must: (1) create at least 20 qualifying jobs and (2) make $200 million of capital improvements over a five-year period. The exemption is available for 10 years if the capital improvement is between $200 million and $250 million. The exemption is available for 15 years if the capital improvement is over $250 million.

The Comptroller adopted an emergency rule and established a web page to provide guidance and resources regarding the new sales tax exemption enacted by H.B. 1223.

Virginia

Effective from July 1, 2010 through June 30, 2020, H.B. 302 and S.B. 130 create a sales and use tax exemption for computer equipment purchased or leased for the processing, storage, retrieval, or communication of data (including routers, connections, and other enabling hardware) in a qualified data center. A qualified data center must: (1) create at least $150 million of new capital investment and (2) result in the creation of at least 50 new jobs that pay at least 150% of the prevailing wage in the locality. The new jobs requirement is reduced to 25 if the data center is located in a locality that has an unemployment rate of at least 150% of the average statewide unemployment rate. Qualified taxpayers must enter into a memorandum of understanding with the Virginia Economic Development Partnership Authority providing the details of the capital investment and new jobs created.

Additionally, a taxpayer that satisfies the above requirements for purchases made between July 1, 2009 and July 1, 2010 is eligible for a grant in the amount equal to the tax paid on such purchases. Tax Commissioner Rulings 10-121 (6/29/10) and 11-183 (10/27/11) provide guidance regarding the exemption's scope and taxpayer qualifications.

Signed on April 6, 2012, H.B. 216 expanded the exemption by extending it to data center operators and tenants of the data center if they collectively meet the exemption requirements.

Washington

As originally enacted, effective April 1, 2010, SB 6789 created a sales and use tax exemption for purchases of eligible service equipment used in an eligible computer data center, including installation labor and services. The exemption also applies to sales of eligible power infrastructure, including labor and services rendered in respect to constructing, installing, repairing, altering, or improving eligible power infrastructure. A taxpayer must be certified by the department and receive an exemption certificate to be presented to sellers.

A qualifying business must increase employment in a data center by at least 35 full-time jobs paying at least 150% of the county's per capita personal income. The business must also provide health insurance for all employees. An eligible computer data center must: (1) be located in a rural county; (2) have at least 20,000 square feet dedicated to housing working servers; and (3) start construction between March 31, 2010, and July 1, 2011. The exemption originally expired on April 1, 2018.

Effective May 1, 2010, SB 6143 provides an alternative to the 35 full-time job requirement. A qualified data center may alternatively increase employment by three full-time jobs for each 20,000 square feet of space newly dedicated to housing working services.

Tax Advisory No. 3163.2011 (3/15/11) clarifies that 'networking equipment and data storage devices' (including routers, switches, hard drives, and other devices used in data storage management) qualify for the exemption if they:

- perform some processing function as part of their specialized communication and storage functions

- are contained within a server chassis (free standing networking equipment and/or data storage devices do not qualify).

Effective April 1, 2012, S.B. 6635 reinstated the exemption, which originally applied to construction that began between March 31, 2010, and July 1, 2011. The new law provides that eligible data centers and qualifying tenants that commence construction between April 1, 2012, and July 1, 2015, may qualify for the exemption on eligible server equipment and power infrastructure. In addition, the exemptions for eligible replacement server equipment placed in new data centers and for qualifying tenants are extended to April 1, 2020.

Wyoming

In 2010, H.B. 67 provided a sales and use exemption for qualifying computer equipment including computers, servers, monitors, keyboards, storage devices and other peripherals, racking systems, cabling and trays that are necessary for the operation of a data processing services center when the aggregate purchase of the qualifying equipment exceeds $2 million in any calendar year. To qualify, the data center must have a capital investment of at least $5 million and certify that it has created, or will create, a certain number of jobs as determined by the Wyoming Business Council.

In 2011, H.B. 117 expanded the exemption to include computer software. The bill also created another category of exemptions, which includes qualifying uninterruptible power supplies, back-up power generators, specialized heating and air conditioning equipment and air quality control equipment used for controlling the computer environment necessary for the operation of a data processing services center when the aggregate purchase of the qualifying equipment exceeds $2 million dollars in any calendar year. To qualify for this 'power' exemption, data centers must make a capital investment of at least $50 million.

Effective July 1, 2013, H.B. 64 expanded the exemption to include co-occupiers of a single data center facility. Prior to H.B. 64, an entity that stores data was eligible for sales and use tax exemptions on certain equipment and other purchases if only one entity occupied the entire data center. H.B. 64 allows equipment and other purchases for a data center with one or more entities occupying the facility to be exempt from sales and use taxes.

The takeaway

States are offering significant tax benefits to attract and maintain data centers within their borders. Given the considerable state activity in this area over the past four years, any company looking to build, relocate, or maintain a data center should explore the numerous tax incentives across the states to assist in its determination regarding the state location that will provide the best benefit for its business.

New York enhances Excelsior Jobs program

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New York State recently adopted several enhancements to its existing Excelsior Jobs Program (Excelsior). Through its approval of Excelsior Emergency Regulations effective July 10, 2013, and New York State Assembly Bill A8104, there have been significant enhancements to the program making it more attractive to businesses and demonstrating New York State's commitment to attracting business and spurring job creation and capital investment in the state.

Several key changes were made as part of the recent legislative developments, including decreasing the requirements for creating new jobs, broadening the qualification criteria for targeted industries, revising the requirements for qualifying as a regionally significant project, and allowing partial credits for businesses that realize job commitments at an amount less than originally projected.

Following are some of the key changes made as part of New York State's 2013 changes to Excelsior:

- A business entity operating predominantly in manufacturing must create at least 10 (previously 25) net new jobs, a business entity operating predominately in agriculture must create at least 5 (previously 10) net new jobs, a business entity operating predominantly as a financial service data center or financial services customer back office operation must create at least 50 (previously 100) net new jobs, a business entity operating predominantly in scientific research and development must create at least 5 (previously 10) net new jobs; a business entity operating predominantly in software development must create at least 5 (previously 10)net new jobs; a business entity creating or expanding back office operations must create at least 50 (previously 150) net new jobs, or a business entity operating predominantly as a distribution center in the state must create at least 75 (previously 150) net new jobs. (NYS Assembly Bill A8104 Part C, Sec.1, Subdivision 3)
- A qualifying Excelsior business entity that does not meet the minimum job requirements of its specific industry may still qualify for Excelsior if it has at least 25 (previously 50) full-time job equivalents, unless such business is a business entity operating predominantly in manufacturing, then it must have at least 10 full-time job equivalents. (NYS Assembly Bill A8104 Part C, Sec. 1, Subdivision 4)
- If, in any given year, a certified Excelsior participant realizes job creation less than the projected amount originally committed to, the Excelsior credit shall be reduced by the proportion of actual job creation to the projected amount, provided that the business meets at least 75% of its original job creation commitment. (NYS Assembly Bill A8104, Part C, Sec. 2, Subdivision 5)
- The definition of 'new media' has been amended to include post-production film projects, and the term 'distribution center' now allows processing and repackaging of goods directly to consumers.

Excelsior provides for 4 refundable tax credits to eligible participants:

- The Excelsior Jobs Tax Credit: A credit of 6.85% of wages per new job to cover a portion of the associated payroll cost.
- The Excelsior Investment Tax Credit: Valued at 2% of qualified investments.
- The Excelsior Research and Development Tax Credit: A credit of 50% of the Federal Research and Development credit up to three percent of research expenditures in New York State.
- The Excelsior Real Property Tax Credit: Available to firms locating in certain distressed areas and to firms in targeted industries that meet higher employment and investment thresholds (Regionally Significant Project).

The Excelsior Jobs Program continues to serve as one of New York State's key economic development tools providing for various tax credit and economic incentive opportunities to eligible businesses expanding in New York State. The State's recent enhancements to the program make it far more attractive to expanding businesses given its reduced qualification requirements and may result in businesses receiving benefits that they did not or would not have qualified for under pre-existing program guidelines.

State developments

While not fully inclusive of all state tax credits and incentives developments, the following provides highlights of some notable items from June 2013 through August 2013.

California

Enterprise zone program terminated

California Governor Jerry Brown signed both Assembly Bill 93 and Senate Bill 90 on July 11, 2013, which make sweeping changes to the California Enterprise Zone credit program.

The new Enterprise Zone credits, exemptions, and incentives generally apply beginning January 1, 2014, and include: (1) a new hiring credit, (2) a new partial sales and use tax exemption for purchases, (3) new 'California Competes' incentives credit program, and (4) generally provides for a ten-year credit carryforward.

Illinois

Enterprise zone changes

Effective August 16, 2013, emergency regulations amend the criteria for designating enterprise zones, amend the scoring method used for enterprise zone applications, and expand the types of companies that qualify as high impact businesses.

Iowa

Increased cap for economic development tax credits

Applicable retroactive to July 1, 2012, H.F. 620 increases the cap amount for economic development tax credits. The annual aggregate tax credit limit is increased from $120 million to $170 million.

Louisiana

Alternative fuel tax

Effective June 10, 2013, S.B. 256 prohibits certain flexible fuel vehicles from qualifying from the alternative fuel tax.

Investment credit and import-export cargo credit

Effective July 1, 2014, S.B. 122 expands the port investor tax credit and the sunset date extended to January 1, 2020. Applicable for tax years beginning on or after January 1, 2014, the bill also expands the import-export cargo tax credit and the sunset date is delayed to January 1, 2020.

Enterprise zone program modified

Effective June 21, 2013, H.B. 571 increased requirements to qualify for Louisiana's enterprise zone program

Nevada

Film credit enacted

Effective January 1, 2014, S.B. 165 enacts a new film tax credit. A taxpayer may receive a credit equal to 15% of cumulative qualified expenditures.

New Jersey

Neighborhood revitalization credit expanded

Applicable to tax years starting on or after January 1, 2012, A.B. 3206 provides that the neighborhood revitalization credit is expanded to apply to a taxpayer's gross income tax liability.

New York

Empire Zone retroactive amendments unconstitutional

The New York Court of Appeals (the highest court in New York) found that retroactive application of Empire Zone Program amendments passed in 2009 violated due process. *James Square Assoc. LP v. Mullen*, N.Y. App. Ct. No. 87 (June 4, 2013).

Pennsylvania

Film production credit amended

Effective July 9, 2013, H.B. 465 amended the film tax credit to provide that production companies must withhold personal income tax on payments to pass-through entities when the entities represent individual talent. The legislation also allows film credits purchased or assigned in 2013 to be carried forward to 2014, and allows credits purchased or assigned in 2014 to be carried forward to 2015.

Mobile telecommunication credit enacted

Effective July 9, 2013, H.B. 465 creates a new credit that encourages investment in mobile telecommunications broadband.

New jobs credit

Effective July 9, 2013, H.B. 465 amended the Job Creation Tax Credit to provide that the Department of Community and Economic Development can award the total credit amount authorized for a multiple-year credit in the first year when a new job is created and the credit is earned.

South Carolina

Investment credits

Effective June 11, 2013, H.B. 3093 provides that taxpayers investing in the rehabilitation of abandoned South Carolina buildings may now claim tax credits.

Port cargo credit expanded

Applicable to tax years beginning on or after January 1, 2014, H.B. 3557 expands the types of businesses that qualify for the port cargo credit.

Let's talk

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