

- SUBJECT:** Apportionment under the margins tax by Internet hosting businesses
- COMMITTEE:** Ways and Means — committee substitute recommended
- VOTE:** 11 ayes — Oliveira, Otto, Bohac, Hartnett, Hilderbran, C. Howard, P. King, Paxton, Peña, Taylor, Villarreal
- 0 nays
- WITNESSES:** For — James LeBas, Rackspace; (*Registered, but did not testify:* Lance Lively, Will Newton, National Federation of Independent Businesses - Texas; Alan Schoenbaum, Rackspace; Chris Shields, Greater San Antonio Chamber of Commerce)
- Against — None
- BACKGROUND:** Under Tax Code, 171.106, a business must apportion its taxable receipts between business conducted in Texas and that conducted outside of the state in order to determine its tax obligation under the margins tax. Under sec. 171.103(a)(2), each service performed in Texas is considered to be taxable as business conducted in Texas, regardless of where the service was sold.
- DIGEST:** CSHB 3927 would amend Tax Code, sec. 171.106, to consider a receipt from Internet hosting services to have been a receipt from business done in Texas, if the customer to whom the service was provided was located in this state. CSHB 3927 only would apply to a taxable business that received more than 75 percent of its total revenue from Internet hosting. This change to the apportionment of receipts would take effect for reports due on or after January 1, 2015.
- On or before December 1 of each year, the comptroller would be required to evaluate the statewide fiscal impact of the implementation of this bill. If the evaluation determined that implementation of this bill would not have a negative fiscal impact to the state, the change to apportionment would take effect for each report originally due on or after January 1 of the year following the year in which the comptroller made that determination. The comptroller's evaluation duties and the effect they had on this bill would expire on December 2, 2013.

CSHB 3927 would define “Internet hosting.” Internet hosting would not include telecommunications services. The bill also would define “computer server” for purposes of the code.

CSHB 3927 would take effect on September 1, 2009, and only would apply to a report originally due on or after the effective date of this act.

**SUPPORTERS
SAY:**

CSHB 3927 would correct a tax bias that makes Texas less competitive as it seeks to secure more high-tech investment and jobs. CSHB 3927 would accomplish this by taxing out-of-state companies and in-state companies in the same way.

A company engages in Internet hosting when it buys or rents a large facility and fills it with servers that are used to host other companies’ websites and other electronic services, such as e-mail. These facilities are commonly called server farms. Under current law, the margins tax apportions the Internet hosting company’s revenue to where its servers are, rather than where its customers are. Internet hosting companies that house their servers in Texas pay tax on 100 percent of its revenue, even if only a tenth of customers are in Texas. This deters companies from locating their server farms, and infrastructure investments and employees, in Texas.

States and countries compete for server farms because they attract highly paid and technically advanced jobs. They are geographically stable because, once established, they are costly to move and create investment in Internet and utility infrastructure.

CSHB 3927 would put Texas law on apportioning Internet hosting services in line with the laws on the sale of goods and Internet service, which base the tax on the location of the customer. CSHB 3927 would make the tax neutral regarding placement of investments, which would put Texas on an equal playing field when it comes to competing with other states and countries for server farms. Some businesses have made specific decisions not to locate their server farms in Texas because of the existing antiquated tax apportionment method. Several states already are basing their apportionment rules for Internet hosting services on customer location rather than server-farm location, including Connecticut, Florida, New York, and Ohio.

Any decrease in state revenue caused by the bill would be offset by increased tax revenue from out-of-state businesses that would be

apportioned on the percentage of their Internet hosting services provided to customers in Texas.

OPPONENTS
SAY:

CSHB 3927 would create a \$2 million loss to the Property Tax Relief Fund beginning in fiscal 2015. This loss to the fund would have to be made up from some other source. The Legislature would either have to shift the tax burden onto other taxpayers or would have to shift general revenue from another program or service. The state cannot afford to cut revenue as it prepares for what is expected to be a tight budget in fiscal 2012-13.

NOTES:

The substitute differs from the bill as filed by changing the definition of "Internet hosting" to mean providing for consideration to an unrelated user access over the Internet to computer servers on which the users process the user's own data and that are owned or leased and managed by the provider, and that are located in a remote, secure data center is owned or leased by the provider. The committee substitute excludes telecommunications services from the definition. The committee substitute removes language defining other similar information technology services over the Internet including: cloud computing, computing as a service; data storage, and hosted e-mail.

The committee substitute would increase the percentage of business activity that taxable business would have to have received from Internet hosting from 50 percent to 75 percent. The committee substitute also added authority for the comptroller to implement the Internet hosting apportionment rule early if the comptroller determined that it would not have a negative fiscal impact on the state.

The companion bill, SB 1315 by Wentworth, was left pending in the Senate Finance Committee on May 11.