Data Center Software Sales Tax Exemption Modification

Recommendation: The Governor recommends three changes to sales tax.

1. Data center software sales tax exemption modification
2. Local government and non -profit sales tax exemption for construction materials
3. Modification of sales tax provisions in response to the United States Supreme Court decision in *South Dakota v. Wayfair, Inc*

Rationale/Background: Data center software sales tax exemption modification

In the context of Qualified Data Centers and sales tax, there are three types of software:

1) Software that operates data center equipment,

2) Software that manages data, and

3) Software with multiple licenses loaded at the data center and distributed by the enterprise.

Under current law, software that operates data center equipment is exempt. Software that manages data at the data center is also exempt. Software with multiple licenses loaded at the data center and distributed by the enterprise to users outside of the data center is not exempt. The software exemption can be claimed for up to 20 years from the date of the first purchase qualifying for the exemption. This exemption is only available for purchases of this type of software for use in a qualified data center.

This exemption from sales tax was first enacted in 2011. At that time, with refunds being paid beginning after July 1, 2013, it was estimated to cost approximately $24 million in 2014 and approximately $4 million in 2015. The exemption was substantially modified in 2013. Square footage and investment requirements were reduced and the qualification period extended. At this time, the changes to the exemption were estimated to cost approximately $8 million per fiscal year. The most recent Tax Expenditure Report anticipated that the Qualified Data Center exemption would cost $70 million in fiscal year 2018. The 2018 Budget and Economic Forecast published in December indicated that sales tax refund claims were forecasted to be $101 million greater than the prior forecast largely due to qualified data centers.

Proposal: Data center software sales tax exemption modification

The proposal would modify the exemption for software:

- For entities whose first qualifying purchase was 5 or more years prior to July 1, 2019, purchases of software that operates data center equipment and software that manages data at the data center would be exempt, ending with the last purchase made prior to July 1, 2019.
- For entities whose first qualifying purchase was after June 30, 2019, the exemption expands to all software, is limited to 5 years of the first qualifying purchase, and the refund is reduced to 50% of the sales tax paid on the software.
- For entities whose first qualifying purchase was made less than 5 years prior to July 1, 2019, software that operates data center equipment and software that manages data at the data center would be exempt for purchases prior to July 1, 2019; and purchases after June 30, 2019,

and within 5 years of the first qualifying purchase, all software is exempt, and the refund is limited to 50% of the sales tax paid.

Border-to-Border Broadband Development Grant Program

Recommendation: The Governor recommends $35 million in FY2020 and $35 million in FY2021 for the Border-to-Border Broadband Grant Program in Minnesota. The recommendation also allows the Department of Employment and Economic Development (DEED) to reserve up to 3% of grant funds for program administration and broadband mapping.

Rationale/Background: Access to robust broadband is now recognized as a critical factor in the economic and social sustainability of all Minnesota communities. The state has a broadband mapping program which annually gathers current information from all providers about where broadband internet is available and at what speeds. While great progress has been made over the last several years, with 91% of households and businesses having access to a moderate level of service that meets the state's 2022 goals; only 87% of rural homes and businesses have access at this minimum definition. In addition, the state as a whole has only 73.6% of homes and businesses meeting the 2026 broadband goal of access to 100Mbps/20Mbps service.

This recommendation would extend the funding of the Border -to -Border grant program, under Statute 116J.395, at the funding level recommended by the broadband task force. This funding level will facilitate meeting the MN statutory goal of border -to -border access of 25Mbps/3Mbps broadband service by the year 2022 (§237.012) and begin to pave the way for achieving the state's 2026 goal of reaching everyone with a service capable of delivering 100Mbps/20Mbps.

Funding for this program is comprised of a competitive matching -fund grant program designed to act as a catalyst to spur public and private investments in broadband infrastructure in unserved and underserved areas of the state.

Typical grantees include large and small telephone companies, rural cable operators, electric cooperatives, tribal entities, and local governments (in partnership with private providers). Funding at the recommended level, in partnership with private and federal investments, is anticipated to enable the state to effectively reach its 2022 goal of seeing all homes and businesses served at a level that meets the FCC's minimum definition of broadband.

Rural broadband has been a policy priority at both the national and state levels for the last several years. Minnesota is widely recognized as having one of the top broadband programs in the country. By achieving these goals set out in statute, the state puts in place critical infrastructure needed to maintain strong communities. This investment is the 21st century equivalent of extending the road network so that goods could be transported to market or bringing electricity to rural farms so they could modernize their operations and increase efficiencies. It is critical infrastructure needed so that our rural areas can continue to thrive. Ubiquitous high speed broadband internet access provides the platform for full adoption of telehealth applications, smart farming and precision agriculture tools to boost productivity and competitiveness of our agriculture sector, and supports modern education technologies that allow rural schools to deliver education experiences on par with their urban peers.

Along with state broadband mapping information, the broadband task force and Office of Broadband Development use national studies and data from the federal government to track current and future

broadband needs. These sources include the FCC's annual State of Broadband reports, Pew Research studies, the US Census - American Community Survey results and more.

Proposal: This recommendation funds the Border -to -Border Broadband Development Grant Program $70 million for the 2020 – 2021 biennium. This funding commitment will build on several years of public and private investments in broadband infrastructure in unserved and underserved areas of the state and will facilitate meeting the statutory goal of border -to -border access of 25Mbps/3Mbps broadband service by the year 2022 (§237.012) and begin to pave the way for achieving the state's 2026 goal of reaching everyone with a service capable of delivering 100Mbps/20Mbps.

Equity and Inclusion: This program is largely targeted towards communities outside the metro area where broadband infrastructure is not as likely to be in place at a level that is needed to support economic equity in greater Minnesota. This program contains preference consideration for rural unserved communities and those that demonstrate lo w - income indicators such as poverty rate and free/reduced lunch program participation. Tribal areas are specifically called out as eligible to apply for the program and direct outreach to their representatives is conducted when funding becomes available.

Results: This investment would expand broadband access to an estimated 25,221 households, businesses and community institutions. Less easily quantifiable is the positive impacts this program will contribute to extending and leveraging the benefits of ongoing federal Connect America Fund (CAF) II investments; in many areas, Minnesota's resources and tools will help those CAF investments go beyond the lower federal speed requirements to meet or exceed the Minnesota standards.

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Minnesota Innovation Collaborative

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Recommendation: The Governor recommends $4.5 million in FY2020 and $4.5 million in FY2021 to establish the Minnesota Innovation Collaborative (MIC). The MIC will contain a series of initiatives focused on growing Minnesota's innovation economy by accelerating the growth of the state's startup ecosystem and attracting top technology talent to the state. Comprised of a collection of new grant programs, a physical space for education and training, and a new apprenticeship program, the MIC will create a touch -stone for the state to support and enhance visibility and interest in the innovation ecosystem. It will bring together all the key players: founders, venture capitalists, researchers, academia, businesses (including Fortune -500s), and educators in one space. This initiative will be established and created for the next biennium as a pilot program. The intention is to ultimately separate major pieces of the initiative from state government as they grow. Over the biennium, staff will engage businesses, higher education, investors and communities to provide resources to match state investments to sustain and grow the locations and educational services available to entrepreneurs and startups beyond the biennium.

Rationale/Background: In the last decade, America's economy has continued its transition from manufacturing to technology and services. States and cities that create attractive environments for startups, entrepreneurs, and innovative talent are quickly distancing their economies from those who do not. The businesses of the future are the startups of today, and our established businesses need an innovation ecosystem to provide the ideas and talent to continue to be global leaders. Currently, the innovation ecosystem in Minnesota is not well defined nor is there a central organizing body or effort

that coordinates or promotes the ecosystem. The goal of this program is to make the state a top destination for homegrown and outside entrepreneurs to start, build, and grow businesses.

Proposal: The MIC would support a series of new initiatives designed to accelerate the growth of startups. Each initiative is uniquely designed to lower the risk required to fund, start, or grow a venture -backed startup in Minnesota. The MIC will bring all of these initiatives together under a new office that acts as a touchstone for the state to support and will enhance visibility and interest in the innovation ecosystem. The initial office will be located in the Twin Cities within an existing startup co -working space, and will engage stakeholders throughout the state to build programming and eventually a footprint in Greater Minnesota markets.

MIC staff will partner with other organizations to execute programs designed for entrepreneurs and small businesses, work with Fortune 500s and Academia to co -locate their innovation labs in the space, and will run outreach campaigns to ensure all key players in MN's startup ecosystem can take advantage of a series of new programs designed to accelerate their growth. The proposed program would provide leadership, grant funding and forward -thinking approaches to support the innovation ecosystem in Minnesota:

1. **Minnesota Innovation Accelerator Space + Leadership ($1.7 million, FY20 -21 biennium)** The Minnesota Innovation Accelerator will lease space in a private co -working facility and include up to three new positions funded by DEED – a director, high -level professional staff person and an administrative staff person. These positions will be responsible for overall coordination and will serve as a resource for entrepreneurs and businesses. The space would include both a front office for engaging the community, and a classroom for startup training. Key activities of the space will include: o Instruction. Classes and informal sessions on how to start a high-tech innovation business in Minnesota, giving startups an easy pathway to incorporating in the state.

    a. **Promotion.** Activities directed toward entrepreneurs and investors about Minnesota's growing innovation economy.
    b. **Events and Meetings.** Regular events and one -time meetings that bring together key players in the ecosystem and amplify their work along with supporting other organizations events.
    c. **Outreach.** Outreach and education on all innovation activities and related financial programs available at DEED particularly for underserved communities.
    d. **Partnerships.** Interaction and collaboration with the University of Minnesota, Minnesota State schools, private universities, trade organizations and the Mayo Clinic on start -ups and commercialization of technology.
    e. **Advisory Board.** Staff would identify and administer an advisory board to assist with direction, grant programs, evaluations and other partnerships.
    f. **Future of Work Research Initiative.** In conjunction with the University of Minnesota and Minnesota State Colleges and Universities, MIC leadership will work to commission research on the impacts of the fast -evolving economy on Minnesota's labor market. ($500,000, FY20 -21 biennium)

2. **Minnesota Innovation Grants ($5.8 million , FY20 -21 biennium)** DEED will award grants to eligible Minnesota startups involved in developing or producing products or services in Minnesota that will provide quality jobs for Minnesotans for the next generation. The grants will be targeted to the most promising technology businesses in the early stages of development that are generally not yet able to attract adequate private sources of capital, such as commercial bank loans and angel or venture investment funding. Third party evaluations will assist in determining funding levels and recipients. Some of these funds will require matching from non -DEED sources of funding and may be used for the following activities:

   a. **Research and Development Grants.** New innovative ideas require research & development (R&D) to increase their commercial feasibility including proof of concept, IP protection, and prototype design. The most commercially viable projects from eligible businesses could receive a one -time award of up to $50,000 for these activities. ($750,000 in FY 20, $750,000 in FY 21)

   b. **Business Liquidity Grants.** Whether it is space, equipment, staffing contracts or supplier costs there are a variety of business -related non -R&D expenses faced by start -ups. The most commercially viable projects from eligible businesses could receive a one -time award of up to $25,000 for these expenses ($500,000 in FY 20, $500,000 in FY 21)

   c. **Entrepreneur Benefits Packages.** One of the biggest impediments for leaving existing jobs to start a company is the prospect of not having health insurance. Entrepreneurs often need financial assistance to cover costs associated with healthcare, or housing and child -care costs. Eligible entrepreneurs could receive a one -time award of up to $7,500 to help cover these costs. ($1 million in FY20, $1 million in FY21)

      i. **Small Business Innovation Research (SBIR) Match Funding.** This financial support is a match for businesses who are new recipients of SBIR/Small Business Technology Transfer (STTR) phase I and phase II federal awards. The business may use funds to support commercialization activities and related costs associated with the project not covered under the federal grant. Eligible entrepreneurs could receive funding of up to $50,000. ($500,000 in FY 20, $500,000 in FY 21)

   d. **Innovation Vouchers.** This program would provide $5,000 to $25,000 awards to assist small businesses purchase technical assistance and services from qualified public universities, colleges, technical schools and non -profits in Minnesota to advance their technology. This initiative would build on the successful program operated by DEED since 2014. ($150,000 in FY 20 and $150,000 in FY 21)

   Eligible innovative start -ups must work with third -party technology counseling services in Minnesota such as the MIC to develop applications that will be accepted by DEED on a rolling basis. Applications that reflect past or potential investment by outside investors including Fortune 500 -type businesses will be encouraged. Grantees will be required to show proof of investment from the private sector to unlock the assistance and will be provided with ongoing mentoring support from the MIC and other private sector organizations throughout the grant period. DEED staff outside of

MIC would provide administrative support and a 3% administrative fee would cover administrative expenses. Entrepreneurs seeking assistance must demonstrate income in the previous year of less than $150,000.

3. **Entrepreneurship Education Grants ($1.5 million, FY20 -21 biennium)** DEED will issue a Request for Proposals to award competitive grants to organizations throughout the state that can deliver best -in -class educational programming to entrepreneurs and provide outreach on the state's innovation ecosystem. Local match and involvement with the MIC would be required. DEED staff outside of MIC would provide administrative support and a 3% administrative fee would cover administrative expenses. Organizations would be required to provide the following types of services to support and enhance Minnesota's innovation ecosystem.
   a. **Outreach.** Outreach and education on programs available including the Angel Tax Credit program, to support technology business creation particularly in underserved communities. o Mentorship for individual technology based businesses and assistance for entrepreneurs seeking federal grant funding.
   b. **Creation** of consistent programs for technology based entrepreneurs and businesses outside of the 7 - county metro area, in partnership with MNSCU or other local educational partners.
   c. **Promotion.** Activities directed toward entrepreneurs and investors about Minnesota's growing innovation economy.
   d. **Event and Meetings.** Regular events and one -time meetings that bring together key players in their area ecosystem and amplify their work along with supporting other organizations events.

Equity and Inclusion: This proposal seeks to grow Minnesota's innovation economy and provides the kinds of wrap around programming and supports necessary for communities who are less able to become entrepreneurs to grow their businesses. The groups most likely to benefit from this intense programming are low -wealth communities. The MIC is expected to grow Minnesota's economy and will spur increased technological innovation and long -term, high -wage job growth. Outcome measurement strategies are described below.

This program would be re -evaluated after the upcoming biennium to determine whether any changes are needed. Results: In evaluating the results of the MIC, DEED will track the following measures:

•Classes offered and attendees • Events • New partnership development • Grantees served with the new grant programs • Job creation • New businesses established or grown • Research projects undertaken for the Future of Work Research initiative

Angel Tax Credit Program

Recommendation: The Governor recommends $10 million in FY 2020 and $10 million in FY 2021 for the Angel Tax Credit Program.

These funds provide a tax credit to investors or investment funds that put money into early stage companies focused on high technology, a new proprietary technology, or a new proprietary product,

process, or service in specified fields. The program was funded at $15 million in calendar years 2015 and 2016, $10 million in calendar year 2017, and was not funded in 2018 .

Other funds in this program include fees collected for applications and report filing as well as expenditures for Department of Employment and Economic Development (DEED) program staff to certify participating businesses.

Rationale/Background: The Angel Tax Credit program is Minnesota's primary economic development tool for assisting early stage businesses and is part of DEED's commitment to fostering innovation in the state. Minnesota has earned its reputation as one of the best states for business by encouraging the growth and economic competitiveness of businesses of all sizes. As high -tech startups look outside the confines of traditional hubs like Silicon Valley, Minnesota has the opportunity to provide incentives that will encourage job growth and technical expertise here in the state. The Angel Tax Credit program has resulted in over $421 million in private investment in Minnesota startups, leveraged by the state's issuance of $101 million in tax credits to angel investors. The program spurs economic growth and builds on Minnesota's existing ecosystem of high tech, high innovation companies, including the state's clean energy technology companies.

The program is also an important tool for wealth creation in communities across the state. Since its inception, DEED has sought to broaden the base of individuals, communities, and businesses that benefit from the program. DEED believes it is critical that all qualifying businesses in Minnesota have access to the benefits of the program. The policy changes included in this proposal will increase utilization of the program among targeted group businesses, including those owned by people of color, women -owned businesses, veteran -owned businesses, businesses owned by people with disabilities, and/or businesses in Greater Minnesota.

Proposal: The Governor recommends $10 million in FY 2020 and $10 million in FY 20 2 1 for the Angel Tax Credit Program.

The Governor recommends that the Angel Tax Credit program be modified to better serve targeted group businesses. These modifications include:

- Adjust the minimum employee compensation requirement to better serve Greater Minnesota: This proposal revises the minimum employee compensation so rather than applying to every employee of the business, it applies to at least 51% of a business's employees. This requirement has been especially problematic in Greater Minnesota, where wage levels are lower than the metro area. The 2017 requirement was $20.70 per hour or $43,050 per year.
- Lower minimum investment thresholds for investors of targeted business: This proposal reduces the minimum investment for individuals from $10,000 to $7,500 to increase the pool of potential investors in targeted businesses. Targeted businesses typically raise smaller amounts from each investor than non - targeted businesses.
- Reduce disincentives to annual report filing: Modify the late filing penalty to $100 from $500, an amount that has proven to be a substantial disincentive to filing and providing the program with needed information. This proposal also adds authority for the Commissioner of DEED to revoke any credit allocated and certified for investors, funds, and businesses who fail to file.

Equity and Inclusion: This proposal specifically target s businesses owned and managed by minorities, women and businesses located in Greater Minnesota , reserving credits for investments in these business and modifying certain program requirements to better enable them to benefit from the program.

<div align="center">Minnesota IT Services (Cybersecurity)</div>

Recommendation: The Governor recommends a $15 . 412 million General Fund increase in FY 2020, an $8. 734 million increase in FY 2021, and an $ 8 . 234 million increase each fiscal year thereafter to support a robust cybersecurity program at Minnesota IT Services (MNIT) to defend state systems and information. FY 2020 funding will reduce the state's cyber risk by shrinking the number of datacenter s and improving MNIT's cybersecurity program. The recommended ongoing funding allows MNIT to maintain a baseline security posture and capability through a combination of internal staff, licensed tools, and outsourced consultation and services. These investments will prevent more low - sophistication attacks and expedite detection and response to moderate - and higher - sophistication attacks.

This recommendation is equal to a 451% increase to MNIT's General Fund base budget for the FY 2020 -2021 biennium and a 307% increase in the FY 2022 -2023 biennium.

Rationale/Background: Entities in both the public and private sector face unprecedented and continuously advancing cybersecurity challenges. Low -to -moderate sophistication attacks are more effective and profitable than ever , giving rise to significant increase in their frequency. Investments in offensive cyber operations by both criminal organizations and nation states has also led to an increase in the most sophisticated attacks. Further, the pervasiveness of information systems in everything government does increase s the effectiveness, impact, and disruption resulting from such attacks. Studies by lead researchers in the field suggest this trend is unlikely to reverse any time soon.

Government faces the particular challenge of not only attracting the attention of profit -motivated attackers but also politically motivated activists . Minnesota experiences an average of 83 security incidents every month, a quarter of which are email phishing attacks . Some incidents become data breaches which cost the state time, money, and the confidence of citizens. On average, comparably - sized private sector organizations spend greater than 6% of their overall IT budget on cybersecurity, a value that increases year over year. Despite facing the same or, in many cases, greater challenges, Minnesota spends less than 2%.

While some agencies have historically invested in security, most have not, and before certain efficiencies can be realized, those agencies must be brought up to a minimum supportable standard. A first -year investment sets up the state to more effectively leverage longer -term security spend. In recent year s, all agencies have benefited by sharing resources that result in broader availability of deeper expertise . Bringing under -investing agencies up to a minimum baseline will free more resources to improve services for all agencies, regardless of historical spend.

Proposal: MNIT's "Securing the State" proposal will decrease the frequency and impact of security and data breaches by executing two separate but related initiatives:

Reduce the Attack

Surface Bring agency IT into enterprise -grade, physically secure, and robust datacenters.

- Consolidate the physical aspect of information systems, improving the resilience of many IT systems against weather or power interruption
- Simplify the technology by reducing the number of systems and distance over which state systems must communicate to perform basic functions
- Integrate physical security, monitoring tools, and vulnerability management solutions into the enterprise environment

Reinforce and Equip the State's Cybersecurity Team

Staff the security program and equip that staff with tools and consultants that make them more effective.

- Mature agency application security capabilities
- Jumpstart statewide PCI compliance initiative
- Improve detection and blocking of attacks on State employees
- Develop System Security Plans for new systems under development
- Conduct ongoing security risk assessments of existing agency business systems
- Expand security awareness training for the state workforce
- Improve access management capabilities, including expanded oversight of people with powerful system administrator accounts
- Use independent assessors to confirm the adequacy of security controls
- Secure appropriate cyber insurance coverage for the State of Minnesota
- Invest in and deploy advanced cybersecurity tools to detect security anomalies faster and mitigate the risk of distributed denial of service attacks
- Improve situational awareness and response times through around the clock monitoring
- Develop and perform ongoing tests of disaster recovery strategies

This recommendation upgrades the state's existing cybersecurity toolset and adds 14 security professionals to the state's enterprise cybersecurity team. The funding would also allow for the procurement of commercial professional/technical services in the areas of monitoring, vulnerability management, incident response/forensics, risk and compliance, and state employee security training. This funding would also enable the acceleration of existing data center consolidation efforts which improve IT system economy, resiliency, and facilitate security.

This proposal includes what can reasonably be implemented in FY 2020 and FY 2021 , after which further assessment against the evolving threat landscape will be required to determine residual risk and what further investment is warranted. Funding for ongoing performance assessments is part of this recommendation.

Equity and Inclusion: Individuals who utilize government services of any type are disproportionately at risk of their private data being breached in the event of a cyber -attack on Minnesota state government. In addition, individuals who rely on government services would be disproportionately impacted if a cyber -attack were to render government technology systems inoperable. This proposal includes one -time funding to bolster the state's cyber defenses to combat such an attack and includes ongoing funding to help ensure the security of state systems and citizen data held by executive branch state agencies.

Department of Commerce (IT Modernization)—Potential Contract Opportunity

Recommendation: The Governor recommends $416,000 in FY20, FY21, and FY22 to support the Commerce IT System Modernization project. The funds will be used to continue work on the priorities listed in the system modernization plan and roadmap created in 2015. The work is focused on data security, transparency and creating sustainable IT platforms.

Rationale/Background: Commerce has over 40 specialized IT applications used on a regular basis to carry out its mission to protect the public interest, advocate for Minnesota consumers, ensure a strong, competitive and fair marketplace, strengthen the state's economic future and serve as a trusted public resource for consumers and businesses. Many of these applications are in legacy languages, on obsolete hardware, do not meet current security requirements and are on unsupported operating systems/platforms.

The Commerce IT System Modernization project started in 2015 to modernize IT systems to:

- Meet business needs;
- Update systems to align with enterprise standards;
- Improve efficiencies, data quality, security and accessibility;
- Align with Commerce strategic goals

Initial funding through an Odyssey Fund request in 2015 was used to assess Commerce's IT systems, create a modernization plan and begin work on six of the IT recommendations.

Proposal: The Department of Commerce requests $416,000 per year through FY22 for two contracted Java developers. Developers will begin to replace the following systems:

- Access 1997 and 2003 Databases used daily by the Insurance and Enforcement Division s that support the public facing IT applications. Access 1997 and 2003 Databases are no longer supported putting business needs, functionality and service at risk.
- eDockets: Application used to review the official record of utility regulation.
  - 390,695 documents available in FY2018.
  - 12.5 million public views since January 1, 2018.
- eFiling: Application allows users to upload documents as a part of regulatory proceedings.
  - There are 3,711 active users.
  - 17,109 documents efiled in FY2018.
- eAssessment: Updated system will allow utilities to pay the Department assessments online instead of mailing a check.

With these updates, Commerce can better safeguard private and non -public data and serve the public in a timely and cost -effective manner.

This proposal will improve data quality and decrease time spent on manual processes or duplicative data entry. For example, periodically the eFiling system does not retain documents even though the user gets confirmation that all documents were uploaded. In addition, some documents are sent to our service lists manually via paper mailing because there is no method to import the lists and the discovery is managed outside of the current IT system.

This proposal is effective July 1, 2019.

Equity and Inclusion: Many of Commerce's existing systems do not meet accessibility standards. A key component of the Commerce IT System Modernization is to update IT systems to meet accessibility standards and serve all Minnesotans. Many of these applications provide online no -cost public access to utility and stakeholder filings that increase consumer transparency.