

Proposal for the Taxation of Data Centers

Senate Finance Committee Democratic Staff White Paper

The U.S. is in the midst of a data center construction boom which has few historical comparisons, and which was almost unimaginable a few years ago. In the last four years, data center construction in the U.S. has quadrupled, impacting communities and workers across the country. This year, hyperscaler spending is set to be roughly \$700 billion on data centers, with no end in sight.

It is important that the U.S. lead the world in technological innovation, including where data centers are necessary, such as AI, cloud, robotics, and more. But this buildout comes at a cost.

Data centers strain limited local resources. Houses go unbuilt as data center developers scoop up land near major markets. Redevelopment and new manufacturing projects stall as data centers monopolize investment dollars and the time of skilled labor. Data centers are rapidly popping up in already water-stressed regions that will struggle with the new demand and disrupting local communities with persistent noise pollution. Rural communities fear that productive agricultural land will be rezoned to make way for data centers, altering their character and economies. All this while data centers consume huge amounts of power and raise energy prices for families, farms, and small businesses throughout the country.

And much of the data center buildout is to advance new technologies that could lead to substantial workforce upheaval. The U.S. has been caught flat-footed in the past by the labor impact of major technological shifts. This time, we need to be ready.

To address the impacts on communities and the country – higher energy prices, drained resources, and workforce upheaval – we will need new streams of revenue. It is only logical that we look to the companies building and benefitting from these projects to contribute.

In order to raise revenue in a targeted and administrable way, this white paper proposes to focus on the taxation of this data center network. The new revenue will come in two parts:

- 1) Removal of the existing investment incentives in the tax code as they apply to data centers, that are unnecessary for the massive data center buildout going on throughout the country; and
- 2) Creation of a Data Center Public Investment excise tax to provide a consistent revenue stream.

These proposals will not end data center development or put at risk the U.S. maintaining its status as the global leader in AI and other innovative technologies. Rather, they will ensure we have the resources to help the communities and workers most impacted as data center construction continues.

A tax on data centers – particularly one that is borne primarily by new data centers – will fall most heavily on the major hyperscalers that have spent hundreds of billions of dollars in recent

years. This construction is not slowing down, and with the high demands of AI training, inference, memory, and storage, the data center construction boom could last for many years more.

Comments on this white paper are very welcome, and we anticipate releasing discussion draft language in the fall. Comments should be addressed to DataCenterTax@finance.senate.gov, no later than Monday, August 31.

Removal of existing unnecessary benefits

As a first step, we can remove existing, expensive incentives as they apply to data center construction, as the overwhelming demand for data center construction makes these incentives unnecessary and wasteful. Today, data centers do not need any special incentives in the tax code to get built. Massive hyperscalers are already spending money hand-over-fist to build them. Incentives that could easily be removed from data centers on a new-construction, go-forward basis are:

- Opportunity Zones – prohibit opportunity zone funds from investing in new data centers, as they do not create substantial long-term employment or other direct economic benefits in low-income communities;
- 100% bonus depreciation – assets purchased to build and supply a new data center should not be eligible for 100% bonus depreciation;
- REIT inclusion – exclude the rents paid to REITs by new data centers from the tax-favorable REIT regime.

Other investment incentives may also no longer be necessary or appropriate for data centers. These changes and the Data Center Public Investment excise tax should all be considered as additions to, rather than alternatives for, policies like raising the corporate income tax rate and the stock buyback excise tax rate.

Implementation of new Data Center Public Investment excise tax

The new Data Center Public Investment excise tax will generate long-term funding to support workers and communities nationwide. The tax would be a gross receipts tax on data center operators on their data centers in the United States. The tax would apply at a low single-digit rate, and include mechanisms to properly target the tax and prevent avoidance.

With huge shares of investments in data centers coming from hyperscalers and the largest, most-valuable corporations in the world, this tax would primarily be borne by those causing the data center boom and most able to pay.

Determining what is a data center

Generally, a data center is a facility that primarily contains electronic equipment used to process, store, and transmit digital information, and may be free-standing or within a larger structure that uses environmental control equipment to maintain the proper conditions for the operation of electronic equipment.¹ This definition alone would be broad, so carveouts would be developed to focus the tax on data centers as commonly understood, rather than trip-wiring ancillary operations into the tax.

The design will specifically exclude certain types of locations from the excise tax. First, internet infrastructure will be excluded. Second, corporate IT departments would not fall into the tax, as long as they are small, directly owned to serve the business's workforce, and the business does not sell AI services, cloud computing, or comparable technological lines of business. Third, small local data center operators will be excluded from the tax, provided they are not selling their data center services to a hyperscaler.

We will continue to explore how the definition of a data center may be tailored to meet the policy goals.

Addressing pre-existing data centers

Many data centers pre-date the massive data center boom that has led to so much concern by the public and Congress. The current buildout was kicked into high-gear by the end of 2023, so pre-2024 assets would face less impact from the tax.

For all but the largest actors, the share of assets in a data center that represent pre-2024 assets (using unadjusted basis) will be exempted from the tax. For example, if a data center included \$1 million of assets placed in service in 2023, and \$4 million of assets placed in service in 2025, then the tax would be reduced by 20 percent.

How to deal with the many business models of data center infrastructure

Data centers may be owned directly by the largest AI and technology services companies. Some may be owned by massive "neo-cloud" companies and others by independent businesses that build data centers at smaller scales.

The tax will focus on the "data center operator." Generally, this will be the party that is responsible for the operation and maintenance of the data center and its facilities, and has the benefit of being able to sell the services of that data center. In many cases this will be the legal owner of the data center, but where the owner is not also the party operating the data center and/or selling the services of that data center, then the tax liability will fall on the taxpayer operating it.

¹ 42 USC 17112

How to prevent tax avoidance

There are many varied and complex relationships among the builders, owners, operators, and users of data centers. The Data Center Public Investment excise tax needs to be able to address all these arrangements, and structures like vertical integration and complex interrelationships cannot be avenues for tax avoidance.

In a simple case of vertical integration, one company may own and operate the data center, and use the data center's compute power for its own AI service. In that situation, the transactions are strictly internal, and would not be separately stated gross revenue. In other cases, a taxpayer may sell data center services to a company that it also owns a substantial share of. A data center owner could use the data centers for its own business and lease compute power to a direct competitor. A hyperscaler may not own a data center, but instead enter into a contract that guarantees it will lease access to 100 percent of the data centers servers and storage for many years, providing the guarantee before the data center is even built. These and others make accurate gross receipts calculations difficult and subject to avoidance and abuse without rules in place to address them.

To prevent avoidance, certain taxpayers (detailed below) would be subject to a deemed minimum gross receipts system. Similar in concept to a cost-plus transfer pricing system, this deemed minimum gross receipts system will look at the costs of operating a data center to determine a deemed minimum amount of gross receipts for that data center. It will then apply a "greater of" test to the actual gross receipts of the data center and the deemed minimum gross receipts for each year.

The calculation of the deemed minimum gross receipts will include a portion of the cost of the tangible and real assets, annual expenses like rent, wages, and electricity, and a profit markup that reflects the returns in the technology industry.

This deemed minimum gross receipts system will apply to two types of data centers: those owned, operated, or rented by massive data center operators, and those being utilized by major data center payors. For example, a massive data center operator could be any business that has data center assets with an unadjusted basis of more than \$25 billion. For these operators, any data center that they own, lease, or operate would be subject to the deemed minimum gross receipts system. A major data center payor could be any taxpayer that has data center services expenses of at least \$2 billion in a year. In this scenario, any data center that has more than half its services being utilized by the major data center payor would be subject to the deemed minimum gross receipts system. These rules would also apply where the largest players are providing financing, guarantees, or other complex financial arrangements to a data center to avoid technical ownership, but which are tantamount to being in control.

Since the system is a deemed minimum gross receipts regime, a taxpayer's actual gross receipts may move above and below the deemed minimum gross receipts calculations over different years. We may consider a limited tax credit system for taxpayers that pay the Data

Center Public Investment excise tax based on the deemed minimum gross receipts in one year, and then pay the tax based on actual gross receipts in the following year.

Non-U.S. data centers

The treatment of non-U.S. data centers that provide data center services for the U.S. market is an issue that merits further consideration. A system designed to prevent taxpayers from avoiding the excise tax should include an understanding of the U.S.'s lead in advanced data center infrastructure and the extent to which non-tax barriers will independently prevent this avoidance.

Data centers in space

Any services provided to U.S. customers by data centers that are in space will be subject to the tax. If a space data center seeks to avoid the tax by being treated as a non-U.S. asset, a withholding tax would apply to any payments made by U.S. taxpayers to use the data center.

Use of Revenue

The Democratic Staff is seeking comment on use of the revenue from this excise tax. It is the view of the Ranking Member that a priority should be to directly aid those adversely affected by the dramatic changes in our economy expected to be wrought by widespread adoption of AI.