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Draft legislation proposes new tax rules for data centers

KPMG analysis and observations on Senator Wyden's proposal

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Senator Ron Wyden (D-OR) on October 23, 2026, released draft legislative text for his proposals relating to the taxation of data centers (collectively, the "Proposal"). The provisions of the Proposal warrant consideration because, if enacted, they would represent a significant change in the taxation of users of, and investors in, data centers, and because of the sheer scale of the capital that has been and is expected to be invested in data centers, in part to support the development and use of AI products.

The Proposal also warrants attention because Senator Wyden currently is the Ranking Member of the Senate Finance Committee and, depending on the outcome of this week's midterm elections, may become its chairman come January. In August, Senator Wyden published a white paper previewing the provisions reflected in the draft legislative text of the Proposal (the "White Paper").

In general, following the White Paper, the components of the Proposal fall into two broad categories.

First, the Proposal would enact a new excise tax on the gross receipts of data center operators (the "gross receipts excise tax") and an alternative minimum excise tax on the imputed gross receipts of operators of data centers connected to the largest hyperscalers and consumers of compute-power (the "alternative minimum excise tax"; together with the gross receipts excise tax, the "excise taxes").

The Proposal does not, however, specify a rate for either excise tax. The White Paper had indicated that the rate would be in the "low-single digit[s]."

Second, the Proposal would make certain data center investments ineligible for certain tax incentives and tax-preferred investment structures.

Excise tax and alternative minimum excise tax

Under the Proposal, the gross receipts excise tax would apply to the gross receipts of *data center operators* from the provision of *data center services*. The tax would apply only to gross receipts attributable to data center services provided from *data centers* located in the United States. The tax would apply to tax years beginning after the date of enactment, with temporary grandfather protection for data center assets placed in service prior to 2025.

Several definitions are key.

A *data center operator* is a person providing *data center services* from a *data center*.

A data center is a facility or location located in the United States that houses *data center equipment*.

Data center equipment is electronic equipment that is used to process, store, and transmit digital information, and is housed together in a location that contains environmental control equipment to maintain the proper conditions for the operation of such equipment. This will typically include the server equipment housed in the data center, but not, for instance, cooling and security systems.

Data center services are:

1) Data storage services, cloud services, artificial intelligence training services, inference services, high-volume data processing, any services or activities similar to the foregoing, and such other services as determined by the Treasury secretary to be comparable to any of the foregoing

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2) Any services that "involve the use of" data center equipment located in a data center that has peak electrical demand of 25 or more megawatts
3) Any other service that "involves the use of" data center equipment to process, store, or transmit digital information, if the provision of that service is a "substantial element" of the trade or business of the taxpayer

For purposes of the 25-or-more megawatt determination, data centers that are located on a single property or on contiguous or connected properties are treated as a single data center.

Data center assets are

1) Data center equipment (defined above)
2) Any building or structure used to house data center equipment
3) The land on which the data center is located
4) Any other asset that is used in the operation of the data center and that is located in a building or structure, or on land, that is a data center asset

The Proposal includes several exemptions from the gross receipts excise tax.

First, the gross receipts excise tax would not apply to taxpayers whose gross revenue (not merely their gross revenue from data center-related activities) does not exceed a specified threshold. Even if the taxpayer's gross revenue does not exceed this threshold, however, the exemption would not apply to the taxpayer's gross receipts from a *hyperscale data center*. Hyperscale data centers are discussed below with the description of the alternative minimum excise tax.

Second, data centers whose receipts are subject to the excise taxes would not include data centers substantially all of whose data center equipment (for instance, servers) is used for web hosting services, domain registration, and providing broadband internet access. This exception generally is intended to exempt from the excise taxes the receipts of data centers used to provide "internet infrastructure" services, a concept that had been previewed in the White Paper.

Data centers, as defined for purposes of the excise taxes, also would not include *IT department data centers*. A data center is an IT department data center if it satisfies three criteria. First, no person providing data center services from the data center may be a *hyperscale entity*. We discuss hyperscale entities below. Second, the data center services (by any person or persons) provided from the data center may "not substantially consist of data storage, cloud computing, high-volume data processing, artificial intelligence services, or other such similar services identified [by the Treasury secretary]." Third, either (a) the aggregate deductions allowable to each person providing data center services from the data center are less than 5% of the aggregate amount of all deductions allowable to that person for the tax year; or (b) the unadjusted basis of the data center equipment "with respect to" the data center is less than $25,000,000.

The gross receipts excise tax would also offer limited grandfathering protection to data center assets (including the building itself) placed in service prior to 2025. The tax on the gross receipts of a given data center would be reduced by an amount equal to the tax otherwise due multiplied by a fraction, the numerator of which is the unadjusted basis of the data center assets held by the taxpayer that are "part of the data center" and placed in service prior to 2025, and the denominator of which is the unadjusted basis of all data center assets held by the taxpayer that are part of the data center. In effect, this is intended to reduce temporarily the tax otherwise due, by reference to the portion of the total investment into the data center that was placed in service before 2025. The grandfathering exception expires, however, for tax years beginning after 2029. For tax years beginning after 2029, there would be no reduction in the tax.

The Proposal would also provide for an alternative minimum excise tax, such that a taxpayer subject to both excise taxes would in effect pay the greater amount. Like the gross receipts excise tax, the Alternative

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minimum excise tax would apply to tax years beginning after the date of enactment. No rate is yet specified for the alternative minimum excise tax, but the description of the Proposal released by Senator Wyden states that the rate for both excise taxes would be the same. There generally is no grandfathering protection with respect to the alternative minimum excise tax for investments made or assets placed in service before a certain time.

The alternative minimum excise tax would apply to the imputed gross receipts of data center operators of hyperscale data centers. Imputed gross receipts of a hyperscale data center would be determined by applying a 67% markup on the total costs of data center, including on actual and imputed depreciation. Special rules are provided for determining costs for depreciation. For instance, depreciation is calculated taking into account for all items of data center equipment, such as servers, that are "a part of" the data center, even if that equipment is not owned by the taxpayer; the total depreciation for data center equipment is then allocated to those taxpayers that are data center operators providing data center services from the data center. For data center assets, such as the building, depreciation is only attributed to the taxpayer that owns the asset. Rent paid for use of the data center would be taken into account as part of the taxpayer's costs. Also, the Proposal would prescribe a minimum annual depreciation figure for data center assets whose depreciable lives have ended; there also would be notional depreciation amount for unimproved land, which generally is not depreciable for federal income tax purposes.

Hyperscale data centers fall into four categories

1) Data centers, the majority of whose data center equipment (for instance, servers, but not buildings) is owned, directly or indirectly, by one or more hyperscale entities for more than 270 days during the year
2) Data centers, the majority of whose data center services are utilized by one or more hyperscale entities for more than 270 days during the year
3) Data centers, for which one or more hyperscale entities have the right to utilize the majority of their data center services for more than 270 days during the year
4) Data centers financed (within the meaning of the rules prescribed in the Proposal) by one or more hyperscale entities

Hyperscale entities are persons (a) that own or otherwise use, for a prior period, data center equipment with an unadjusted basis of $10,000,000,000 or more; or (b) that have expenses for data center services for a prior period of $1,000,000,000 or more. Some affiliates' assets and expenses would be aggregated for these purposes. The prior period for measurement is "any preceding taxable year beginning after the second taxable year preceding the date of the enactment"; this generally refers to the year preceding the date of enactment. As an illustration, if the provisions were to be enacted in 2030, the rule would look back to 2029, but not to 2028.

Both excise taxes would be non-deductible.

KPMG observations

Under the Proposal, gross receipts attributable to the provision of data center services from a data center would be subject to the gross receipts excise tax. Unlike the Proposal's provisions relating to REITs and bonus depreciation, which apply only to data centers with a peak electrical demand of 25 or more megawatts, the gross receipts excise tax is not conditioned on a minimum energy-usage threshold. As described above, data center services include any other service that involves the use of data center equipment to process, store, or transmit digital information, that is a substantial element of the trade or business of the taxpayer. This appears to cover a broad category of potential services, especially in light of the relatively narrow exception offered for data centers dedicated to "internet infrastructure" services. Subject to the gross revenue threshold and the IT department data center

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exception, receipts from data center services provided by businesses that do not provide AI-related services therefore could also be subject to the tax.

The White Paper does not specifically address on whose receipts, the gross receipts excise tax could be levied. The Proposal provides that the tax applies to the gross receipts of data center operators; the gross receipts of capital providers, such as owners of data centers leased to hyperscalers, typically would not be subject to the tax because they are generally not data center operators.

The alternative minimum excise tax, like the gross receipts excise tax, is levied on data center operators—or, more specifically, on the gross receipts imputed to that person with respect to a hyperscale data center. The definition of a hyperscale data center does not depend on the types of services provided using equipment housed in that data center. Rather, a data center (as defined) would be a hyperscale data center if it has a significant connection—ownership, use, or financing connections—with major providers or consumers of data center services. The size of a given data center, or the extent of actual or potential energy usage of that data center, is not relevant to this determination. It is worth noting that a person (a data center operator) that is subject to the alternative minimum excise tax need not itself be a hyperscale entity, so long as that person provides data center services from a data center that has a sufficiently significant connection to one or more hyperscale entities. The definition of a hyperscale data center clearly contemplates that the data center can, for instance, be utilized by entities other than hyperscale entities.

The actual and imputed depreciation deductions associated with data center equipment (such as servers) that are part of a data center would, for purposes of calculating the 67% markup, be allocated to a person using the data center to provide data center services in proportion to the portion of all services provided from that data center by that person; the text does not specify how data center services would be quantified for purposes of this ratio. Depending on the circumstances, the resulting allocation may not correspond directly to each taxpayer's investment in data center assets or the profitability of its activities. The Proposal does not require that data center equipment be used to provide data center services in order for depreciation attributable to that equipment to be included in the calculation of the 67% markup.

The Proposal provides for imputed depreciation cost for land, but the text does so only for "any data center asset [that] is unimproved land"; if a data center sits on land, it would presumably no longer be unimproved. By contrast, data center assets include "land on which [a] data center is located."

The grandfathering protection under the gross receipts excise tax would not be available for tax years beginning after 2029, regardless of when the assets constituting the data center were placed in service and regardless of the extent to which direct or indirect ownership of the data center, or its users, has changed. The alternative minimum excise tax, by comparison, includes no grandfathering exception. Along with its imputation of gross receipts by reference to a 67% markup, the Proposal would generally impose a greater tax burden on data centers with significant connections to hyperscale entities than on other data centers. This treatment is consistent with the White Paper's focus on hyperscalers.

Neither excise tax would apply to actual or imputed receipts of data centers located outside the United States. We discuss the Proposal's treatment of orbital data centers below.

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Bonus depreciation

The Proposal would make *large data center assets* placed in service in tax years beginning after the date of enactment ineligible for bonus depreciation.

For these purposes, data center assets have the same meaning as for purposes of the excise taxes, described above. Data center assets would be *large data center assets* if they are used in a data center with peak electrical demand of 25 or more megawatts. Data centers that are located on a single property or on contiguous or connected properties are treated for these purposes as a single data center.

KPMG observations

The delayed effective date of the provision—tax years beginning after the data of enactment—could incentivize accelerating completion of existing data center projects to maximize those assets placed in service before year end. Completion, of even a portion of a data center may permit some data center assets to be eligible for bonus depreciation.

By contrast, taxpayers who have underwritten their investments based on the availability of bonus depreciation could be affected by this provision, particularly where a project cannot be placed in service before the provision becomes effective. Data center construction projects often take several years or more to reach completion. It may be impractical, therefore, to complete the project sufficiently to allow a portion of it to be placed in service. For those projects, the assets may not qualify for bonus depreciation, contrary to the assumptions on which the investment was underwritten or financed. This provision could make it relatively more attractive for data center owners to elect to be treated as real property trades or businesses not subject to the interest-deduction limitations of section 163(j).

The treatment of ostensibly separate data centers located on a single property or contiguous or connected properties as a single data center makes it more likely that data center campuses would reach minimum peak electrical demand of 25 megawatts. The Proposal does not specify the circumstances in which otherwise separate properties would be treated as being “connected” (as opposed to contiguous) and therefore have their electrical demand aggregated.

Qualified opportunity zones

The Proposal would make a business “consisting of the providing data center services” ineligible to be a qualified opportunity zone business within the meaning of Internal Revenue Code (IRC) section 1400Z-2.

The Proposal would also make large data center assets ineligible to be qualified opportunity zone business property within the meaning of IRC section 1400Z-2.

The Proposal would apply to stock, capital or profits interests, or profits acquired in tax years beginning after the date of enactment.

KPMG observation

The Proposal would make data centers meeting the 25-megawatt demand minimum ineligible for the

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benefits of the qualified opportunity zone regime. It is unclear the extent to which investors in data centers have relied upon the tax benefits associated with investments in qualified opportunity zones. The Proposal also may make investments in AI and other companies providing data center services (as defined) ineligible for those tax benefits.

Real estate investment trusts (REITs)

The Proposal would make data centers meeting the 25-megawatt demand minimum to ineligible to generate qualifying income for purposes of the gross income tests applicable to REITs. As a result, amounts paid by tenants of those data centers could not qualify as "rents from real property" under section 856(c) and, as a result, would be nonqualifying income for purposes of both the 75% gross income test and the 95% gross income test. The Proposal would not apply to REITs, at least 80% of whose stock (by vote or value) are classes of stock regularly traded on a national securities exchange.

The Proposal would apply to amounts received by a REIT in tax years beginning after the date of enactment. The Proposal would only apply to amounts received attributable to data centers with a peak electrical demand of 25 or more megawatts and that are acquired after the date of enactment. Data centers that are located on a single property or on contiguous or connected properties are treated for these purposes as a single data center.

KPMG observations

REITs have become an important vehicle for capital investment in data centers. The use of REITs provides, among other things, a tax-efficient entity through which institutional investors can invest without the potential tax disadvantages of investing directly or through an entity treated as a partnership for federal income tax purposes.

The exception for REITs, at least 80% of whose equity is regularly traded on national securities exchanges would be expected to apply to most public REITs trading on U.S. securities exchange or on NASDAQ. Unless a REIT has publicly traded equity or could absorb the revenue generated by the operation of the data center within its "bad income bucket" for each year and/or hold the data center through a taxable REIT subsidiary, the Proposal would effectively make data centers meeting the 25-megawatt minimum threshold that are acquired after the date of enactment ineligible for investment through a REIT. As with the Proposal's provisions relating to bonus depreciation, the REIT provision could impact capital providers (i.e., lessors of data centers) that are not providers of data center services (data center operators, as defined above).

The REIT provision of the Proposal applies only to data centers acquired after the date of enactment, but it does not appear to include an exception for data centers acquired after that date pursuant to a binding contract in place before the date of enactment. The Proposal also does not define the term "acquired" or address, for instance, the extent to which it would apply to projects only partially completed. As a result, if "acquired" is defined to mean projects completed after the date of enactment, non-public REITs that have made significant investments in data center projects might, under the Proposal, be unable to satisfy the gross income tests applicable to REITs once those projects become operational. The underwriting and financing assumptions for these projects often rely upon the absence of entity-level tax that is typically a feature of investment through a REIT. In general, an entity that fails to satisfy the REIT requirements, including one or both gross income tests, becomes taxable as a C corporation.

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On the other hand, the Proposal does not explicitly provide rules that would cause grandfathering protection to expire because of direct or indirect ownership changes in a REIT that owns the grandfathered project; nor does the Proposal provide explicit regulatory authority to do so.

As with the bonus depreciation provision, the treatment of otherwise separate data centers that are located on a single property or contiguous or connected properties as a single data center makes it more likely that data center campuses would reach minimum peak electrical demand of 25 megawatts.

Orbital data centers

The legislative text of the Proposal includes a reserved provision on orbital (i.e., space-based) data centers. The text describes that provision as "in development."

KPMG observation

The White Paper states that receipts generated by space-based data centers would, like terrestrial data centers, be subject to an excise tax. It also states that, if a space-based data center "seeks to avoid the tax by being treated as a non-U.S. asset," a withholding tax would be levied on payments made by U.S. taxpayers "to use the data center."

Research credit

The Proposal would "clarify" that any amount paid for data center equipment cannot be treated as supplies for purposes of the research credit. Although this provision would apply to amounts paid or incurred in tax years after the date of enactment, it also is explicit that its enactment is not intended to create an inference as to whether those amounts would be eligible for the research under current law.

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