

# 3 Key State and Local Tax Considerations Throughout a Data Center Lifecycle



As the data center industry expands, massive capital investments, multistate operations, and co-location arrangements are becoming commonplace; while they can act as force multipliers for growth, they also create a complex web of state and local tax (SALT) obligations. Whether in the early planning stages of a build, renovating an existing site, or managing properties, data center operators must factor these obligations into their strategic tax planning to support the continued success of their facilities.

This insight explores three critical tax considerations that apply throughout the lifecycle of a data center. Acting on these considerations can help data center operators maintain tax compliance and capture cost efficiencies.



## PART 1

# Understanding Tax Credits and Incentives Across Tax Types

As data center operators expand across state lines, they need to understand the various data center-specific exemptions offered by each state, which can differ significantly. Knowing the credits and incentives available in a given state or locality can help them reduce their total tax burden and make more informed site selection decisions.

### SALES AND USE TAX EXEMPTIONS

Sales and use tax exemptions, particularly for machinery and equipment (M&E), can help operators realize substantial upfront cost savings. Data-center-specific M&E that often fall under those exemptions include servers, power supply, backup generators, HVAC systems, fiber optics, and cabling. M&E exemptions can be particularly relevant for data center operators that are in the site selection phase or are expanding locations and should be factored into the cost analysis of a potential target location.

### PROPERTY TAX ABATEMENTS

Property tax abatements are among the most common incentives offered because data centers require massive capital investments but create relatively few permanent jobs compared to other industries. Many jurisdictions use property tax relief to make themselves more competitive and attract data center projects because data centers signal economic development appeal and can boost infrastructure investment.

### ENERGY AND RENEWABLE INCENTIVES

Data centers consume high levels of energy, so power availability and grid capacity are increasingly driving site selection decisions, and energy efficiency has become key for developers. With local residents, regulators, and investors pressuring data centers to [increase investment in sustainability initiatives](#) and reduce environmental damage, many companies are pursuing dedicated [renewable energy generation](#) to lower their carbon footprints. Not only does renewable energy help address rising operational costs and growing stakeholder demand for green initiatives, but sustainable infrastructure can open the door for data center companies to pursue renewable energy tax credits and incentives.



### BDO'S TAKE

Whether data center operators are choosing their first locations or looking to expand, knowing about, applying for, and potentially capturing all [available credits, incentives, and exemptions](#) can significantly reduce both upfront investment needs and ongoing operational costs.

A third-party advisor with in-depth knowledge of statutory incentives across the country, as well as relationships with state and local economic development officials, can help operators identify, negotiate, and capture valuable incentives that align with business needs.

## PART 2

# The Nuances of Co-Location and Why They Matter

Co-location allows data center operators to house their infrastructure in a shared facility, distributing capital expenditures across multiple entities. But these arrangements come with several key tax triggers that owners and operators must proactively address.

### SALES TAX CONSIDERATIONS IN CO-LOCATION

Sales tax treatment is a major consideration for co-location design. In many co-location facilities, data center owners or landlords provide services to keep servers and other technologies up and running for their tenants. However, landlords often overlook sales tax exemption opportunities and subsequently fail to pass those potential savings on to their tenants. Data center tenants must be active in identifying and claiming applicable exemptions on equipment, servers, and power infrastructure investments to avoid missing valuable tax savings.

### PROPERTY TAX COMPLIANCE RISKS

All entities in a co-location arrangement must maintain a shared understanding of equipment ownership — whether it is owned, leased, or licensed. Leasing and ownership structures can affect tax reporting obligations and compliance.

If ownership is unclear, both the landlord and tenant risk violating tax reporting compliance standards. For example, if both the landlord and tenant report on the same M&E assets, this can lead to double taxation. If neither reports on those assets, this creates a major gap and could potentially lead to tax compliance violations and enforcement penalties.

Leasehold improvements — any physical enhancements or modifications made by a tenant to leased property — often create gray areas because taxation of real property versus personal property varies significantly across jurisdictions. The tax treatment of essential data center technology, such as cabling, fiber, cooling towers, and electrical, can also differ by location. One jurisdiction might classify new cooling units and electrical upgrades as taxable personal property owned by the tenant, requiring the tenant to report and pay annual property tax, while another jurisdiction could treat those same improvements as real property, making them the landlord's responsibility for property tax purposes.



### BDO'S TAKE

To mitigate tax compliance risks and manage compliance costs, data center owners and tenants should collaboratively define ownership, reporting responsibilities, and exemption eligibility upfront. All parties must have access to clear documentation that outlines the details of the co-location arrangement, which will help avoid duplicative taxation or neglected property tax responsibilities.

## PART 3

# Operating Models Determine State Income Tax Burden

Data center companies operating in multiple states can create income tax nexus in jurisdictions where the company owns or leases property, employs personnel, or has other business activities. Once nexus is established, the company must determine how each state computes and apportions income. While many states have moved to a single-sales-factor formula to apportion income to the state, others apply different apportionment methodologies, such as a three-factor formula based on property, payroll, and sales, making a state-by-state analysis more complex.

Because [apportionment rules](#) are not uniform across states, data center operators should proactively evaluate how their receipts, property, and payroll will be treated in each relevant state. That analysis can affect both compliance and planning, including how the business tracks its activities and models its expected state tax footprint and liabilities. Proactively addressing those issues can help reduce surprises, clarify tax obligations, and better position the company to manage its overall state income tax exposure.

### COMPOUNDING THE CHALLENGE: SALES FACTOR CLASSIFICATION AND SOURCING RULES

The state treatment of data center revenue often depends on how the underlying activity is characterized under each state's rules. Depending on the facts and specific state, revenue can be treated as arising from services, the lease of tangible personal property, or the license or use of intangible property. That characterization is important because it can directly affect how receipts are sourced to the state for sales factor apportionment purposes.

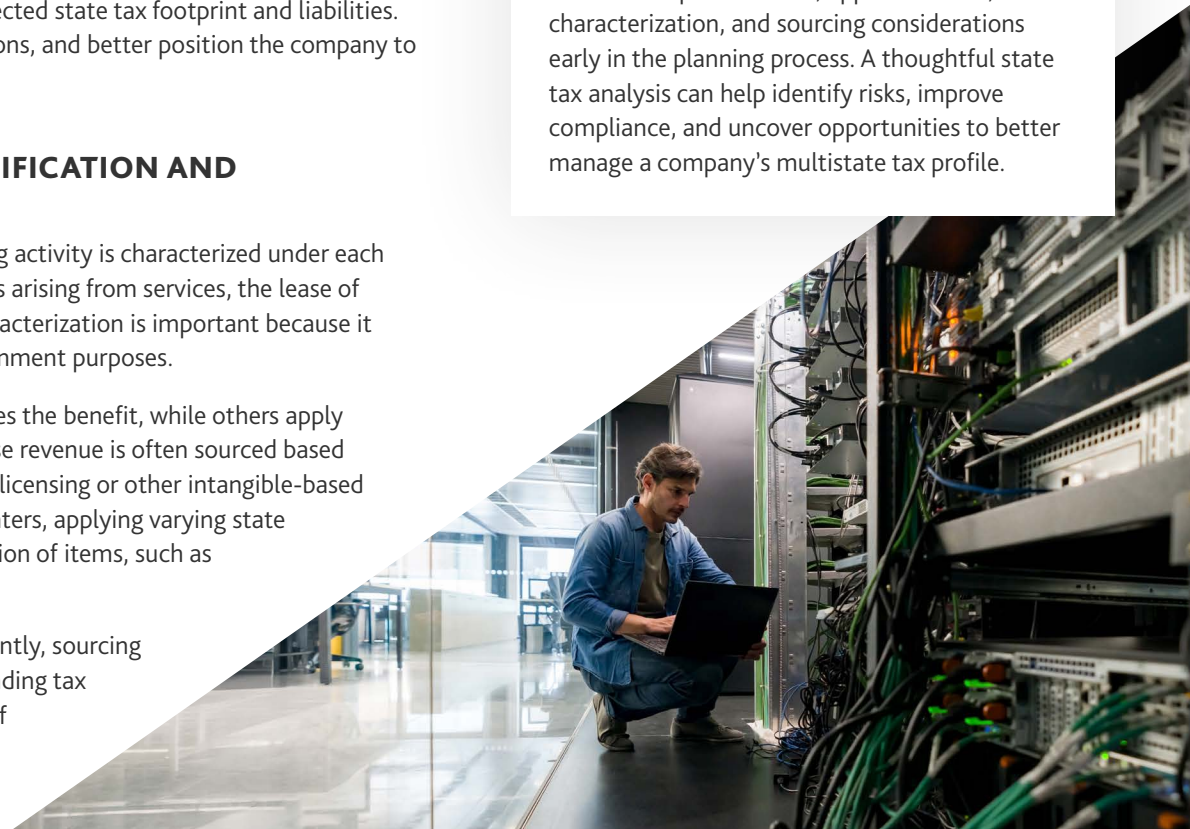
For example, some states source services based on whether the customer receives the benefit, while others apply different approaches, such as where the service was delivered or performed. Lease revenue is often sourced based on the location of the data center property or where it is used and receipts from licensing or other intangible-based arrangements can be sourced where the intangible property is used. For data centers, applying varying state rules is not always clear, particularly when the arrangement involves a combination of items, such as infrastructure, software, access, processing, storage, and support.

Because states have disparate rules and can characterize revenue streams differently, sourcing determination can also vary significantly among locations. As a result, understanding tax obligations can be highly complex. Businesses must carefully assess the nature of any revenue streams and the sourcing methodology applied by each state.



#### BDO'S TAKE

When evaluating new sites or expanding existing ones, or even assessing overall business operations, data center companies should incorporate nexus, apportionment, characterization, and sourcing considerations early in the planning process. A thoughtful state tax analysis can help identify risks, improve compliance, and uncover opportunities to better manage a company's multistate tax profile.





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