

Nikki Dobay: Hello and welcome to GeTtin' SALTy, a state and local tax policy podcast hosted by Greenberg Traurig. My name is Nikki Dobay, shareholder in the Sacramento, California and Portland, Oregon offices.

I am very pleased to have a regular back on the podcast. Joining me today is Jared Walczak. Jared is senior fellow at the Tax Foundation. Jared is also newly the president and founder of the Walczak Policy Consulting Group.

Jared, thank you so [00:00:30] much for being back.

Jared Walczak: Well, Nikki, thank you so much for having me.

Nikki Dobay: And you joined us at the end of last year and we were able to announce your transition into your new role at the Tax Foundation. So before we jump into the topic today, and we have a very kind of narrow topic for the group, so you guys are going to have to wait for this, but Jared, catch us up on how this dual role is going. You have your own consulting firm now and a new really exciting title. I know you're back really [00:01:00] focused on the policy work at Tax Foundation, which we all really appreciate everything you do. So how's that been going?

Jared Walczak: It's been going incredibly well. It's very busy on both fronts. So at the Tax Foundation, I stepped away from the day-to-day management role where I had been a VP. I managed a team, and they're a wonderful team, but I think that my skills are less as a people manager and more as a policy person, or at least that's what really gets me excited. So I was able to step into a role that gets me back much [00:01:30] more working on the policy issues that are really interesting right now. And we're in a time of so many fascinating, new or expanded policy issues that I really wanted to dive into. And it's given me more capacity to focus on that.

And then some of those same issues in my new role where I've taken on clients, whether that's like state-based think tanks, chambers, other organizations, working with them on a lot of these similar policy issues, [00:02:00] white papers, analysis, blog posts, helping them think through research ideas, working directly with their teams, lots of different ways I've approached this. But yeah, it's been a great opportunity to jump directly into a lot of the issues I've worked on for a long time, but with additional groups and additional ways.

Nikki Dobay: Yeah. It seems like you're also kind of joining some of the state specific taxpayer associations as kind of a fellow or in some sort of consulting capacity [00:02:30] on policy issues. And I think that's just going to be a huge resource for all of those organizations. I'm sure we'll be working on some things, lots going on on the West Coast, as you know. So really excited for this transition for you. Thanks for letting folks know what you've been up to.

But now this is an issue we've never talked about on the podcast, and there's been a lot of buzz about it lately. So I'll stop hiding the ball. We're going to be talking about data centers today. And [00:03:00] as I sit back and think about this issue, it's one that's been out there in the state tax policy arena for a long time. Generally, the states were being very favorable with respect to incentives or other types of things to kind of sweeten the deal to get those into those states and having them be developed in their states.

And it seems like there's been a shift, and you tell me if this is kind of sudden or this has been kind of creeping up on [00:03:30] us, but there seems to be kind of a shift in those policies, and we see a lot in the news right now of the states backing away.

And so Jared, what the heck is going on with data centers and how states and policymakers are really thinking about this?

Jared Walczak:

Well, it's a fascinating question, and it's been an unusually political issue where it's very much focused on one industry, where maybe a few years ago there were a lot of states that really wanted to be first movers on [00:04:00] this and wanted to position themselves as dangling something. Not like, let's fix the tax code and make sure that it applies in the proper way to data centers like it would to anything else, but let's structure it like it looks like it's an incentive.

And now when perhaps some of the politics have shifted, where in some areas there's more skepticism around data centers, and you can think that's good, bad, or indifferent, but where there is some political pushback, there's been a lot of reevaluation of the tax [00:04:30] side of things. And I think that's actually quite unfortunate because it's a lot around the way that it was framed initially.

Take, for instance, something like sales tax exemption. Hugely important issue because data centers are very capital intensive. And one of the things they're buying, of course, is servers, chip sets. They are doing this a lot, not just when they're first constructed, but this is something where there's a significant refresh, especially with AI, but really just the growth in the sector, the technological [00:05:00] advancements, and just the burnout on some of these chips themselves, just with the demand on them. They only last a couple of years. So you are replacing your chips every couple of years, and your servers. And these are extremely expensive purchases, and it's a classic business input. Consuming a chip, they are using it to produce something that is sold. If this was traditional manufacturing, that would be exempt in almost every state.

With data centers, states mainly treated them the same way, but instead of saying, " [00:05:30] Well, it's exempt by right because it's clearly a business input," they said, "Hey, we've got a great deal for you. We've got an incentive that will make it exempt." And the thresholds frankly weren't hard. In most states, it was pretty easy for the data centers to qualify for them, so it looked

about the same for their purposes. But now you fast-forward a few years and the policy landscape has changed a bit [inaudible 00:05:50]-

Nikki Dobay: And the revenue landscape.

Jared Walczak: Yeah. And if it were an exemption that was just like manufacturing, everyone would say, "Well, that's just what the sales tax is. It shouldn't be on those inputs." That's pretty classic [00:06:00] manufacturing input. But it's an incentive and it's in the incentives report. And there's a number next to it, and a lot of lawmakers and a lot of people are looking and saying, maybe some air quotes around that, "Why are we giving money? Why are we returning this to them?"

And I think that's the wrong framing. I think it misunderstands [inaudible 00:06:20], but it creates this new conversation that's very different than we'd be having around say the machinery and equipment of a traditional manufacturer. So whether it's Virginia, or [00:06:30] Texas, or Nebraska, or all the other states, you're having this interesting conversation. Should it be in? Should it be out? If it's already out, should it go back in? That's a really different conversation than we have almost in any other industry.

Nikki Dobay: And so Jared, going back to the history, because that's very helpful for setting the stage, is there a reason that we didn't see these just come in to the general business inputs, manufacturing, those types of provisions in and of themselves? [00:07:00] Do you think that was political when it happened or was it just the nature of these are a little different, it was fitting a square peg in a round hole, and so the states kind of just created something new without really thinking about the long-term implications of that?

Jared Walczak: I think mostly they didn't think through the implications. I do believe there were reasons, but I think it's led to an unexpected result.

So you start with the way that states treated manufacturing, machinery and equipment, and typically [00:07:30] it required there to be NAICS codes around manufacturing and data centers don't fit into that. So you'd have to do something around it. It makes sense you'd treat it similarly. These are clearly pretty classic business inputs. This is machinery. It is equipment. It's just a little higher tech and it's producing a digital output. So you'd expect that they would apply this. And if you don't, it's frankly a huge deal because this is such a huge expense. It's really hard to justify putting this sort of expense in a place that's putting [00:08:00] sales tax on that.

So almost every state's recognizing, if we want data centers or really just if we want to have a reasonable neutral tax code, we need to exempt the servers, the chips from the sales tax. And you could just do that through the ordinary exemption. I would argue that's what they should have done. I think lawmakers like the idea of having something to offer to entice, that it's maybe just a little

more attractive to say, "Hey, look, if you come here, create 50 [00:08:30] jobs, whatever it is ..."

Usually they're pretty low thresholds. And they'll often use investment like a billion dollars. And I think that was really popular to say, "Listen, we are going to bring billions of dollars worth of industry," and if you have an exemption, you can't say you brought it in. If you say we have an incentive, you can say, "Look at the billions of dollars of industry that our incentives brought in." So they structured it as incentives, even though frankly it should have just been a pure exemption.

And now unfortunately that means that it's showing [00:09:00] up somewhere on an incentives report and you have lawmakers saying, "This looks costly." And I'm out here saying it's not a cost. This was never supposed to be part of your tax base. If they weren't here, there's nothing that would be paid into it. They're not imposing any cost by having servers here, but that framing, that terminology, that approach has really colored the way that the whole issue's treated.

Nikki Dobay:

And so when did we really start to see [00:09:30] the states start to break on this issue? It seems like there were some rumblings last year. I can't recall hearing too much about this the years prior. And again, that might go back to the states were kind of flush with cash. They weren't really too focused on where they could save a couple dollars here or there. Not that this is just a couple dollars. But when did the states start to pivot in their approaches? Because we all follow the news and it seems like it's [00:10:00] a lot of stories about this.

Jared Walczak:

Yeah. So I think it's a confluence of factors and some of this gets outside of my tax expertise and maybe into a little more reading the teas leaves, and prognostication, and interpretation.

But I think it's a few things. One, it's clearly just that revenues everywhere were skyrocketing for years. And now they're fine. I mean, most states, they're still pretty good, but states are maybe focusing a little more on where there's additional opportunities to raise revenue. And there's a number published out there [00:10:30] and it looks like it's a giveaway, so it feels like something you can call back.

I do think it's also something about our political environment and the degree to which data centers have proven controversial. And I'll show my cards here that that doesn't always track for me personally. You hear things about water usage and as best as I know, not an expert, but as best as I know, it's really, really small, and it's less than farmland and all of that. But you see that as a concern in some communities. People just generally don't like living [00:11:00] next to anything business or industrial. And I don't think it's any different than

manufacturing of any other sort, but you get the local issues around data centers.

And in some communities, it's extremely positive. You see communities that their tax base is so much larger. They have so many more parks, they have so much more investment, and their property taxes are probably lower, and certainly they're getting way more bang for their buck. And this has been amazing, but that doesn't mean you're not going to hear people who say, "I don't like this," for whatever reason, "I don't like this." And [00:11:30] I do think that has influenced the tax conversation, especially since it's structured as an incentive. Going back to the way you think about it, if you have constituents as an elected official who don't like something and ask you, "Why are you incentivizing this?" that becomes a hard question to answer in a way that it wouldn't be if you said-

Nikki Dobay: This is normal.

Jared Walczak: ... "Why does the sales tax just apply in the same way as it applies to everyone else?" which is really what we should be doing here.

Nikki Dobay: Right, right. [00:12:00] Well, so let's talk about that. So now we're in this kind of pivotal point where the states are saying, "This is an incentive and why are we offering it?" And I imagine you're talking with policymakers on this issue. Are they understanding this isn't just an incentive and this is something that should be a part of the sales ... And we'll focus on sales tax. There's other incentives, maybe if we have some time we can talk about. But is that message resonating? Are they hearing [00:12:30] it?

Jared Walczak: I think a lot of lawmakers do understand it when it's presented. Some of them know it already. Some of them, I think it is kind of new that they think of it as somehow different and think that data centers are getting a special deal that others aren't.

And that's not the case. That's just not how it's working. They are getting ordinary treatment after jumping through hoops. And now there's a question of taking it away, whereas other similarly situated businesses would just buy right get it, because the sales tax is not supposed [00:13:00] to be on manufacturing, machinery, and equipment. So there's that. I think some of them do get it. There's still a political environment in which they're operating where it can be very tough.

But the other aspect of this is that data centers are paying a lot of taxes. I mean, obviously when there's profits, there's whatever business profit tax you have, corporate income tax, other taxes that are imposed on this. Real property taxes are quite substantial. In many states, there's also tangible personal property taxes. And I don't love those. I don't think [00:13:30] that that's an ideal form of taxation, but where they're being paid, it's enormous.

Going back to just the scale of the investment and how much of it is going to be your servers and chip sets, and to a lesser extent, your chillers, and your gen sets, and whatever else is in there. It's a lot, I'm pretty sure. It's really valuable capital investment. And whatever your tax system is, you're raising an awful lot of local revenue and at least a decent amount usually of state revenue from this. [00:14:00] In any other system, like just ordinary treatment of the sales tax, it wouldn't be in there. And I don't see anything being missed. I mean, there's always this question like, are we missing something in our sales tax base? Are we missing something in our larger tax base?

And I look at this as an industry that's paying the ordinary taxes, paying very high versions of them because they're capital intensive. And the sales tax treatment that they've generally received in most states is really just getting the ordinary treatment, and sometimes not even that, because some states have restrictions [00:14:30] like certain data centers qualify for it and some don't. And sometimes it's size-based, sometimes it's employment based, and sometimes it's actually what they do. Like if you have a co-location facility where you have multiple clients, it may not be available to you. Why? I mean, it's not really clear. It's not clear why that would be different or worse in some way, but there are these additional hoops. It's already worse treatment. You're starting from that point.

Nikki Dobay: Is there any opportunity to kind of [00:15:00] shift our thinking so that this isn't an incentive and maybe there are some changes made to the manufacturing exemptions or other exemptions in this space to just make sure these capital investments are covered and treated fairly when we think about how the sales tax code is applied?

Jared Walczak: Yeah. I mean, I recognize that there have always been business inputs in [00:15:30] the sales tax. There always will be. I wish there weren't, but there will be. We're not going to solve that. But we've generally had a pretty broad consensus that there are some pretty clear early inputs. Things like machinery and equipment are classic versions of that, that we just don't put in a tax that's about consumption.

So I believe that broadening that to capture something that's clearly in the same category makes sense. Whether that's just add additional NAICS codes, whether that's right data centers [00:16:00] in, I would argue, continue if there's future innovations that create something else that clearly fits this, that's somehow outside of your definitions. Ideally your definition's broadly enough that it can encompass new innovation, but also be willing to update to maintain the proper treatment that you've already probably, at least implicitly acknowledged in almost every state, is proper treatment.

So write this into the exemptions you already have. Treat it the same way you would [00:16:30] any other manufacturing machinery equipment, which in almost every state with a sales tax means you are going to exempt it. Don't call

it an incentive. Don't treat it that way. Don't threaten to change it, or put new standards on it, or take it away any given year. I mean, it's so much about the direction you're looking at it. If you implicitly begin, "This is revenue and we're taking it out of the base," that's very different than when you say, "This has no business being [00:17:00] in a sales tax. That's not what a sales tax is." And therefore, it makes really almost no sense to even calculate it.

What does it matter? It's like saying, well, I mean, we saw the White House accidentally do this a little while back where they talked about how much revenue you could get from broadening sales tax base, and they said, "Put it into income tax reductions." And if you looked at their math, they were doing things like accidentally using the implicit rental value of living in your own home.

And you can do that. You can say that it's clearly [00:17:30] consumption of a form, But it would be really weird to treat that as a sales tax exemption and question every year whether we should change it, because it's not what the sales tax is for, and it would make no sense for the sales tax to be put on it. And I would argue, maybe this isn't quite as mind-boggling, but it's not meant for this either. And it's a kind of confused conversation to begin with the assumption that this is in and then talk about whether it should go out. It's really the other way around.

Nikki Dobay:

Yeah. If these would've [00:18:00] never been addressed, so let's say the states just didn't address them at all. I assume we would've had litigation by this point to have courts look at, is this manufacturing for purposes of these general exemptions? So it's one of those issues where obviously the more that policymakers can think through it and get to the right answer, and I would agree with where you say the right answer is that this is just how sales tax works, this shouldn't be in there at all.

Because [00:18:30] I think what we will be left with if they just start repealing these things is all of these legal questions and people really saying, "Is this manufacturing? Should this just be something that qualifies under the general machinery, and equipment, and manufacturing exemption?" So who knows if we'll get to clarity, the right answers everywhere, but my sense is if there's just kind of this backlash and the incentives [00:19:00] are repealed, we're going to be left in a limbo. But taxpayers aren't going to keep pushing the policy issue. And again, to your point, it's the right policy issue too.

Jared Walczak:

It is. And also with this industry, I mean, I know that there are people who love it and who hate it, and you have people who wouldn't mind if it was gone from their state, but the reality is it's a net plus for jurisdictions. It raises a lot of revenue from other sources. And it does so in [00:19:30] a pretty small footprint. I mean, especially when you think something like the argument is not it creates a ton of direct jobs. My understanding, I'm not an expert on this, but my understanding is that there aren't a ton of people. They're well paid, but there's not a ton of people who work in a data center. It does create a fair

amount of jobs in the community because like I said, there's a lot of things that are being refreshed. It's being constantly updated, all of that. So there's jobs created in the community.

But it's also something where there's a lot of value here. There's a lot of tax. And it's not putting a whole lot of burden, say, on the school system or [00:20:00] on other elements. It's basically a lot of, I don't want to say free revenue, but it's a windfall for jurisdictions. And when you look at Loudoun County, Virginia and just how much revenue they raised for this, or a lot of other jurisdictions across the country, it's clearly been a significant benefit. A lot of jurisdictions have realized this is something they definitely do want.

And if you start taxing it too intensely, it will leave, or at least the new construction will be elsewhere, because [00:20:30] you can't just place one of these absolutely anywhere. There are some factors you need to consider. It needs to be along some sort of tech corridor. You need the fiber connection, the low latency. You actually care about the climate, like the weather, both you don't want extreme weather, but also you've got to chill these things. You've got to keep them cool. So there's a degree to which certain weather I think is better for them. All kinds of factors, land value. Energy costs are a significant factor.

So it can't go literally anywhere, but there are a [00:21:00] lot of places it can go. And if you put sales tax on servers and they are making multi-billion dollar routine investments, not one time, but every few years cycling through a billion dollars or billions of dollars worth of servers, and there's a question of is sales tax on that or not, that really can be a make or break question for where you locate one of these.

Nikki Dobay: What about those states where they don't have sales taxes, [00:21:30] so they are offering other types of incentives? Do you feel like those also have a spotlight or has the conversation really just been centered on the sales tax issue?

Jared Walczak: I think the conversation has been mostly sales tax because it's, I think, wrongly perceived as a handout, that it's an incentive rather than a traditional exemption. There's been, in some places, obviously, discussion around tangible personal property taxes, because this is a lot [00:22:00] of capital. And if it has TPP taxes imposed on it, that's an extremely heavy tax burden. So a lot of states, some just don't have tangible personal property taxes. A fair number, basically almost all investments of TPP get the first 10 years exempt or something like that [inaudible 00:22:22].

But there are going to be some discussions if there's a particular program geared around data centers. But my impression is there's not a lot of that, [00:22:30] that they may be eligible for your standard treatment, whatever that may be, which may be exemption for a number of years. But I would imagine that to the extent that there are some that are just for data centers in this

environment, that will get scrutiny. But mostly in that realm, it's just a question of, do they get the treatment that everyone else does?

And for me, it just goes back to neutrality. It's not treat some industry better. It's try not to treat them worse, try not to single them out. And unfortunately, some of the conversation that's having right now, I think [00:23:00] is singling them out.

Nikki Dobay: Well, and final thought from my end, and then I would welcome your final thoughts, is this is not an industry that's going to go anywhere. I mean, it's based on everything that's going on, we're talking about AI every hour of the day at this point, these are just necessary, and it's necessary to keep everything running. And so I think the states really need to come to terms with [00:23:30] this. And so I hope they're hearing your arguments and that there are sound policy reasons for these things to be exempt.

Jared Walczak: I mean, I think there's no question that this is happening, just industry individuals. AI is obviously a big driver of this, but even before AI, we needed these data centers, but AI expands that.

And I think for a lot of people, AI is still a chat tool. It's an interesting tool [00:24:00] that you ask a few questions to. But for businesses large and small, it is integrated into every process. It is part of the way that you do business. And there's really no stepping back from that. It is just fundamentally part of the business process in this country and really around the world now.

So the question is not, are we going to have expansion of this or are we going to have data centers? It's a question, where are they going to be, like which states are they going to be in? Because that can be different [00:24:30] based on tax policy. And maybe also a question of how much of it's in the US. And that's a question that's relevant for the economics of the US, I suspect.

And I'm really stepping outside of my areas of expertise now, but it also matters to us for reasons beyond pure economics. Like, when you see the power of what some of these tools can do, I like the idea of them being developed in the US, or at least in certain countries, and other countries maybe not getting a ... Depends on the country. I'm not saying like a [00:25:00] chauvinistic, only in the United States, but I wouldn't like to see us give up our edge, would be my very personal non-tax thought.

Nikki Dobay: Yes. And I know I said I gave my final thought, but I guess I'd just kind of add on to that, when we're talking about now US investment versus other foreign investment, now the tax conversation becomes even more important because in those, generally in foreign jurisdictions, there's a VAT where this conversation doesn't even exist. So to the extent [00:25:30] the states want to make themselves competitive with foreign investment and things of that nature, they really need to get the policy right on this.

Jared Walczak: That's absolutely right.

Nikki Dobay: All right. Well, Jared, thank you so much for this conversation and for getting us up to speed on what the heck's been going on out there on this issue.

But before I let you go, surprise non-tax question. So today's question, what is the most interesting job you've [00:26:00] ever had?

So I'll go first. So in college, I worked in a cheese packaging plant. Maybe that's not the most interesting, but it's interesting in the extent that it's the farthest away from probably what I'm doing now. Although I will say it probably did contribute to my staying in college and going to law school. But we just got large chunks of cheese. It got cut up into different type, chunks, slices, [00:26:30] shredding, all sorts of things, and then we packaged it all up.

And so how about you?

Jared Walczak: Fortunately for me, in the truest sense of it, my most interesting job is the job I have now, that I get to do some really interesting tax policy work.

But in sort of the most novel, the sort of different, I would go back to high school. I worked for a summer with this small local company that basically hosted [00:27:00] auto parts sales. And they did them at fair grounds and farm show grounds that weren't in use. So my job was basically to crew the setup. I was a part of this crew that would go and transform the farm show ground into a vending arena for these shows and these sales. And it was me, like, I don't know, 15 or 16 year old me, I think 16. I was driving. 16 year old me. [00:27:30] And then a bunch of 40 and 50 somethings who were very transient, in between jobs, people who actually worked a lot at the fairs, and the carnivals, and all of that.

Often I was roped into things because I was a 16-year old who had a driver's license that hadn't been suspended or revoked, and that was a kind of novel thing. It was a little bit of a different environment for me.

Nikki Dobay: Probably also really made you want to go to college, and [00:28:00] grad school, and all of those things. Yes. Yes.

I remember when I worked there. And the people were all wonderful. I mean, they were amazing, but I really would just go home and tell my parents like, "Yep, this is a really great understanding how the world works, but I would like to be in a different world eventually."

But well, that sounds like a pretty interesting one. I think my father probably shopped at those types of auction trade shows.

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[00:28:30] Well, Jared, thank you so much as always and for indulging me in your odd job story. And thank you to the listeners for checking out the podcast.

Information about Jared and I will be in the show notes. If you have any questions or comments, please leave them there. And I will be back with you in a few weeks on the next GeTtin' SALTy.