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Taxation of Data Centers

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&

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What is a data center?

The Code of Virginia (HB 1699) defines a data center as: “a facility whose primary services are the storage, management, and processing of digital data and is used to house (i) computer and network systems, including associated components such as servers, network equipment and appliances, telecommunications, and data storage systems; (ii) systems for monitoring and managing infrastructure performance; (iii) equipment used for the transformation, transmission, distribution, or management of at least one megawatt of capacity of electrical power and cooling, including substations, uninterruptible power supply systems, all electrical plant equipment, and associated air handlers; (iv) internet-related equipment and services; (v) data communications connections; (vi) environmental controls; (vii) fire protection systems; and (viii) security systems and services.

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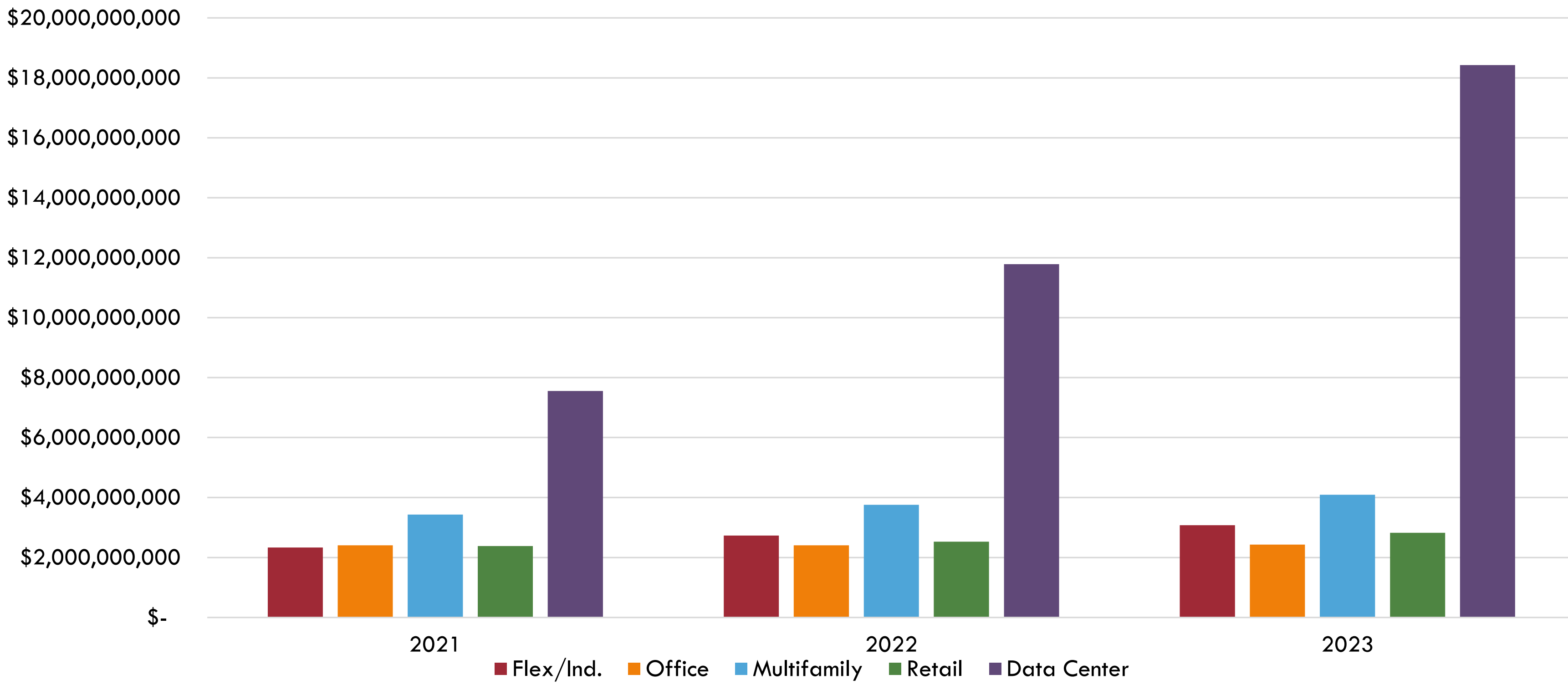
Countywide Taxable Commercial Real Property

	2021 Valuation*		2022 Valuation*		2021 - 2022 Percent Change	2023 Valuation		2022 - 2023 Percent Change
Data Center	$	7,554,480,000	$	11,784,804,880	56.0%	$	18,424,463,180	56.3%
Land	$	1,703,288,110	$	1,921,889,210	12.8%	$	2,168,359,360	12.8%
Multifamily	$	3,430,534,440	$	3,758,489,300	9.6%	$	4,092,642,880	8.9%
Flex - Industrial	$	2,333,560,830	$	2,731,984,510	17.1%	$	3,075,189,620	12.6%
General Commercial	$	2,173,114,740	$	2,337,152,710	7.5%	$	2,478,987,060	6.1%
Hotel	$	198,188,420	$	264,458,330	33.4%	$	344,113,830	30.1%
Office	$	2,406,252,480	$	2,404,377,980	-0.1%	$	2,431,920,630	1.1%
Retail	$	2,382,779,260	$	2,528,129,440	6.1%	$	2,825,723,560	11.8%
Total Taxable	**$**	**22,182,198,280**	**$**	**27,731,286,360**	**14.2%**	**$**	**35,841,400,120**	**29.2%**

*The 2021 & 2022 valuation data may not match the Assessment Summary published at the time as the values in this chart are end of year adjusted values.

Select Countywide Taxable Commercial Real Property



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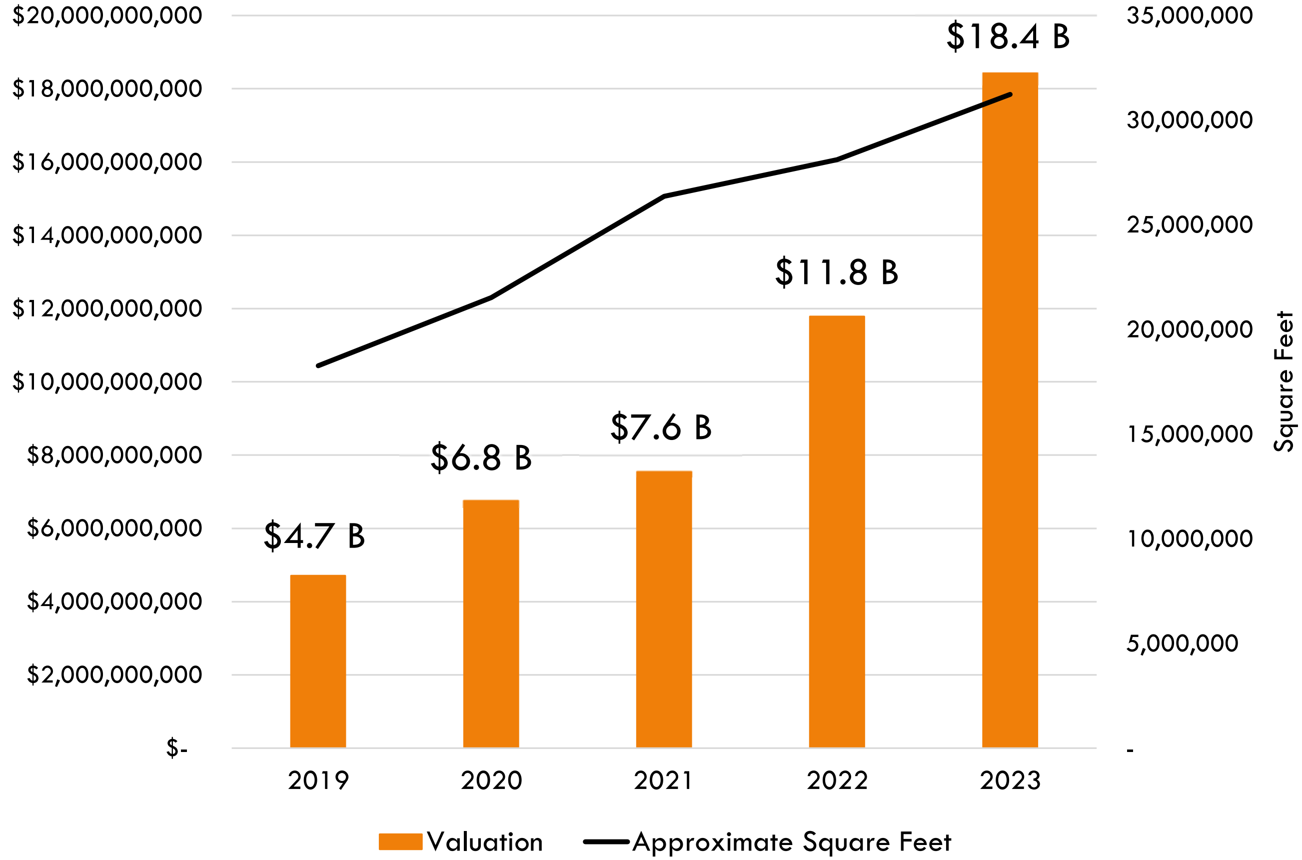
Data Center Taxable Real Property



Features of Data Centers

- Most data centers offer redundancy of operations for their occupants. This would include backup power, such as generators and UPS (uninterrupted power source) batteries to ensure continuity of service, cooling and air management equipment, multiple fiber trunks for data transmission and backup servers and computer equipment.
  - ✓ 100% Up Time
  - ✓ 1.5 times and double redundancy
  - ✓ Full backup of all equipment at another data center location in case primary location fails
- Connectivity to power (most cases at least one megawatt of available power) – located near electrical transfer stations
- Highspeed Fiber/Internet connectivity
- Raised flooring -- vented panels in the floor aid in cooling
- Humidifiers (used to control static)
- HVAC equipment to manage building temperature, with backup systems, to include (water) Chillers and Fan Walls
- Zoned fire suppression equipment

Features of Data Centers cont.

- Building security to monitor both inside and outside for building entry and movement throughout the building.
  - ✓ Keycards, passcodes, biometric scanners
  - ✓ Cameras to include monitors and recording equipment
  - ✓ Gates and fencing
  - ✓ Security guards – at the front gate to the property and at entry to building
  - ✓ Metal detectors
  - ✓ Asset scanners

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Fixtures or BPP?

Items Typically Considered Realty Fixtures	Items Typically Considered Business Personal Property
Raised Flooring	Performance Power Ratio (PPR) – connects to main PDU and acts as breaker unit
Fire Suppressant systems	Cabling/wiring
A/C units internal	Trays for cabling/wiring
Humidifiers (used to control static)	Cages – maybe referred to as "build out"
Chiller units external	Computer Equipment
Fan Wall	Server Racks
Security System	Offices/breakrooms, furniture
Digital Security Controls (DSC)	Point of Presence (POP) - space where service carriers provide internet connections
Dark Fiber (connecting individual buildings owned by the same operator to each other)	Meet Me Room (MMR) - same as Point of Presence
Main Power Distribution Unit (PDU)	
Uninterrupted Power Source (UPS) – also known as the "Battery Back-up"	
Generators	

Enterprise Data Centers

Built and managed by a company for their own use. No unaffiliated occupants. The site should be used exclusively to house data center equipment and support staff but no other company functions.

- Real estate division will value the complete data center, including fixtures.
- The occupant of an enterprise data center will not need a business license as they are not holding themselves out for business at the data center building. Even though an enterprise data center may host information for other people or businesses, that would not make the data center liable for business license tax.
- All enterprise data centers are liable for business personal property tax for their tangible assets at the data center facility. Typical tangible assets for enterprise data centers include:
  - ✓ Cabling and wiring
  - ✓ Trays for cabling and wiring
  - ✓ Computer equipment
  - ✓ Server Racks
  - ✓ Office/ breakroom furniture

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Net Lease Enterprise Data Centers

The location has only one occupant who does not own the building. The occupant is renting the building to use as a data center. There are no unaffiliated occupants. Usually, the occupant will design and complete the final build out in line with their needs, referred to as a “powered shell”.

- Real estate division will value just the building shell for “powered shell” buildings.
- The building owner who is leasing the building is liable for business license tax on the gross rents of the building.
- The occupant will <u>not</u> need a business license as they are not holding themselves out for business at the data center building. Hosting does not qualify as conducting business at the data center location.

Net Lease Enterprise Data Centers cont.

- All items installed by the occupant to "complete the build out" and turn the building shell into a data center for their use, would be business personal property taxable, even though those items would typically be considered realty fixtures. The following items would be <u>in addition to the typical tangible assets for enterprise data centers</u> and would include:
  - ✓ Raised flooring
  - ✓ A/C units
  - ✓ Humidifiers
  - ✓ Chiller units
  - ✓ Fan wall
  - ✓ Security system
  - ✓ Uninterrupted Power Source (UPS) – aka "Battery Back-up"
  - ✓ Generators

Net Lease Retail Data Centers

Building is constructed by one company, then rented to single operator, which then operates the location as a co-location data center. Usually, the occupant will design and complete the final build out in line with their needs, referred to as a “powered shell”.

- Real estate division will value just the building shell for “powered shell” buildings.
- The building owner who is leasing the building is liable for business license tax on the gross rents of the building.
- The data center operator would be liable for business license tax on the gross receipts for services provided at the data center. The data center operator will usually charge occupants on the basis of power usage, with the housing of occupant equipment, connectivity, security, and redundancies treated as included services.
- All items installed by the occupant to “complete the build out” and turn the building shell into a data center for their use, would be business personal property taxable, even though those items would typically be considered realty fixtures.

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Net Lease Retail Data Centers cont.

- Occupants who have contracted with the data center operator for services at the data center would be liable for business personal property tax on all tangible assets located at the facility. Those items would typically include:
  - ✓ Performance Power Ratio (PPR) – connects to main power distribution unit and acts as a breaker unit
  - ✓ Cabling/wiring and trays
  - ✓ Cages – maybe referred to as "build out"
  - ✓ Computer Equipment
  - ✓ Server racks
- Similarly, carriers providing internet connection points in the Point of Presence (POP) rooms or Meet Me Rooms (MMR) would be liable for business personal property tax on all tangible assets located at the facility typically in these spaces, unless they are a qualified telecommunications provider.

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Retail Data Centers

Building is constructed as a purpose-built facility (i.e., constructed to be a retail/co-location data center), the building owner/operator leases space to numerous occupants of varying sizes, often called cages. Each cage has secured access, and some companies offer varied levels of service depending on the occupant needs.

- Real estate division will value the complete data center, including fixtures.
- The data center owner/operator would be liable for business license tax on the gross receipts for services provided at the data center. The data center operator will usually charge occupants on the basis of power usage, with the housing of occupant equipment, connectivity, security, and redundancies treated as included services.

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Retail Data Centers cont.

- Occupants who have contracted with the data center owner/operator for services at the data center would be liable for business personal property tax on all tangible assets located at the facility. Those items would typically include:
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Data Center Terminology

- **Hyperscale** – This is a term originating from the data center industry. It is used to describe data centers that are built with more scalability than a typical data center. We expect to see more tangible business personal property at these facilities as they are equipped with considerably more power than traditional data center facilities.
- **Wholesale** - This is a term originating from the data center industry. It is used to describe data centers that are purpose-built facilities (i.e., constructed to be a retail/co-location data center), but rented to a single occupant.
- **3rd Party Manager "Operator"** – Sometimes a data center owner will contract with a 3rd party manager ("operator"), thereby outsourcing the management of occupant contracts and operations of the facility to a company who performs those duties.
- **White Space** - occupant spaces or client use spaces
- **Gray Space** - support spaces for data center owner/operator uses

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Others "Doing Business" at the Data Center

- 3rd Party Manager "Operators" would be taxable on the gross receipts that they collect for services at the data center.
- Most data centers have security guards outside at the gates and inside the building behind the entrance door. Sometimes the security guards are outsourced to a security company. The security company providing the security guards will be business license tax liable.
- Sometimes data center occupants will "sublet" a portion of their power consumption allotment to another company wishing to co-locate inside a data center facility. The company "subletting" will allow the sub occupant to place their equipment inside their cage at the facility. It can be very challenging identifying and then requesting the information for sub occupants in order to ensure business personal property tax compliance.

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Challenges – Requesting Records

- The data center business sector is very reluctant to provide business information and will claim their nondisclosure agreements they have with those they do business with prevents them from providing the information the COR is requesting.
- A few of the items Loudoun County has requested during our review process include copies of contract agreements, tax returns, occupant lists with contact information and others “doing business” at the data center location.
- Data center occupants in retail/co-location facilities don’t always register and file their tangible business personal property for taxation. The COR will need to request updated data center occupant lists with contact information annually to ensure tax compliance.
- The data center owners who operate their own facilities are incredibly reluctant to provide occupant lists with contact information . However, it can be even more challenging to get occupant lists with contact information from data center operators or 3rd party manager “operators”.

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Challenges – Requesting Records cont.

- Authority to Request Information - Local tax officials are authorized by VA Code §58.1-3109(6) to "require taxpayers or their agents or any person, firm or officer of a company or corporation to furnish information relating to tangible or intangible personal property, income or license taxes of any and all taxpayers; and require such persons to furnish access to books of account or other papers and records for the purpose of verifying that tax returns of such taxpayers and procuring the information necessary to make a complete assessment of any taxpayer's tangible and intangible personal property and license taxes for the current tax year and the three preceding tax years."
- Summons Process – Pursuant to Code of Virginia §58.1-3110
- Loudoun County COR has successfully summoned a large multi data center owner/operator.

Challenges – Company Structure - REIT

- Loudoun County has found that several data center owners and/or operators are structured as Real Estate Investment Trusts (REIT).
- There are 2 different types of REIT subsidiaries, (1) Qualified REIT Subsidiary (QRS) and (2) Taxable REIT Subsidiary (TRS). REITs are federally required to distribute at least 90% of their net income as dividends to their stockholders to maintain their REIT designation.
- A QRS is not taxable, but is one of either 2 entities, either a non-taxable corporation or a disregarded entity to its owner the REIT. A QRS can only legally accept “rents”. In order for rents to qualify, a REIT generally must not manage the property or furnish or render services to the tenants of the property, except through an independent contractor from whom it derives no income or through one of its TRSs.
- A TRS can perform services for occupants without disqualifying the rents received from occupants.
  - ✓ BPOL – State Deduction – Tax Returns from REIT rather than TRS
  - ✓ An independent contractor continually providing services at the data center will probably meet threshold for definite place of business at the data center (30 days or more on a consistent basis).

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Challenges – Company Structure – REIT cont.

- Retail/co-location facilities charge occupants on the basis of power usage, with the housing of occupant equipment, connectivity, security, and redundancies treated as included services. The occupant contract for services at a co-location facility is <u>not</u> a lease as the contract does not create a leasehold interest or tenancy interest in the data center building.
  - ✓ As QRS subsidiaries of REITs can only legally accept “rents”, some REITs believe that they are not taxable on the services provided by their TRS subsidiaries.
  - ✓ Requiring the co-location data center to provide you with copies of their contracted service agreements should help you verify the gross receipts to be claimed for the facility.

Challenges – Company Structure – LLC

- Loudoun County has found that most data center facilities are held in the name of a Limited Liability Company (LLC).
- Rather than buying or selling the real property (i.e., land & building), companies are buying and selling the LLC that holds the real property. When the acquisition of the entity takes place, all of the assets of the entity transfer with the ownership of the entity itself (including FEIN#).
- Since the owner of record for the real property does not change (still in the name of holding LLC), the "buyer" avoids real estate transfer taxes.
- Many of the recent "buyers" are investment companies like Blackstone and Vantage. They are not based in Virginia and know nothing of local BPOL & BPPT liabilities. Many times, the only way to identify the "new owner" is by researching the new mailing address given to Commercial Real Estate for the real property tax assessment bill.
- Often the investment firms will place the entity as a QRS of a REIT and will outsource the management of the data center to either an independent contractor or back to the retail data center company that they acquired the entity from.

Challenges – Rebates

Shortly after the onset of the data center review process that Loudoun County undertook starting in fall 2021, we were faced with a large enterprise data center facility operator claiming "rebates" on their tangible business personal property.

- The "rebates" were listed as negative value assets on the asset list.
- There is no precedent with regards to rebates and the applicability to tangible business personal property. The Code of Virginia and Tax Commissioner rulings do not address whether "rebates" reduce original cost of tangible assets or if they are disallowed.
- Loudoun County requested guidance from the Tax Commissioner regarding rebates in October 2021 and received a response to our guidance request in August 2022. The guidance explains that "rebates" should be allowed to reduce the original cost of the asset if specific criteria are met.

Questions?

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