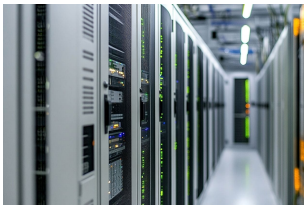

Do AI Data Centers Make a Product? Kentucky Tax Law May Say Yes (Part 3)

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Authors:

Mark F. Sommer

Now that we know what a hyperscale data center is, and also why these types of operators are choosing Kentucky, let's talk a bit more granularly. As in hyperscale data centers supporting artificial intelligence (AI). Do they produce anything? Are they making a product?

In a prior blog post, we referenced Kentucky Attorney General Opinion 25-10, which addressed incentive-related matters concerning a hyperscale data center. In analyzing the type of activity a hyperscale data center undertakes, Kentucky's attorney general specifically referenced "digital information" and the fact that various statutes indicate that the involved digital information is "processed."

Albeit in a rather simplistic manner, the attorney general parsed the words used in the industrial revenue bond incentive financing statute (which requires a commercial product) in the context of a hyperscale data center supporting AI to address whether a "product" is created.

The attorney general opined as follows:

> The second question to consider is whether data may be considered a "commercial product." A "product" is most simply defined as "something produced." Black's Law Dictionary defines "commercial" as "[o]f, relating to, or involving the selling of goods or services for a profit." Therefore, data is a commercial product because it is produced and can be sold for a profit. To be clear, the data processed by the facility need not be produced by the facility to be considered a commercial product; mere processing suffices to meet the definition of KRS 103.200(1)(a).

Thus, Kentucky's attorney general believes that a hyperscale data center produces a "product."

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Kentucky sales and use tax provisions are aligned with the attorney general's position. KRS 139.010(11) provides that "digital property," the sale of which is subject to Kentucky sales and use tax, includes the electronic transfer of the following items: digital audio works, digital books, finished artwork, digital photographs, periodicals, newspapers, magazines, video or electronic games, etc., and any digital code related to such property. And "finished artwork" includes, *inter alia*, drawings, graphs, designs, and illustrative materials.

This concept, that "digital property" is its own type of product separate and apart from others and also not a service, stems from the guidance/requirements of the Streamlined Sales and Use Tax Agreement (SSUTA). SSUTA Section 332 (May 13, 2026) places some conditions on a state's ability to additionally define certain digital property. The effect of this is that, regardless of the payment structure or intended use, Kentucky is prohibited under SSUTA from classifying digital property as a service or general non-specific tangible property. This clearly supports the position that the processing or creation of digital property is its own type of product.

Further, even in the blockchain technological world, Kentucky recognizes that products are being created. In legislation enacted in 2021, specifically House Bill 230, Kentucky's General Assembly, quite unusually, affirmatively recited the legislative intent behind its bill authorizing a sales tax exemption on energy used in connection with cryptocurrency mining facilities. The Recitals to 2021 HB 230 were very clear in expressing the General Assembly's desire to adapt Kentucky's somewhat antiquated tax structure to 21st century advanced manufacturing — there, cryptocurrency mining, and here, data center operations:

WHEREAS, it is necessary to clarify the General Assembly's original intention that Kentucky's tax code must and does recognize that **the continuing development of new and advanced manufacturing and industrial processing technologies** has led to new industrial processes, such as blockchain used for commercial mining of cryptocurrency, **which should and must be taxed in a manner similar to historical forms of manufacturing or industrial processing**,

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in order to continue to encourage the location and expansion of such operations in the Commonwealth, rather than in other states likewise competing for such businesses . . . (emphasis supplied).

Very powerful legislative intent!

So, it seems very clear that hyperscale data centers used in connection with AI operations not only process data and digital information, but they also create a digital product which, by Kentucky statute, is not to be treated as a service — the implication being it is treated as a product. And further, the General Assembly's affirmative and stated intent of treating such new technological developments in a manner no different than historical manufacturing or industrial processing activities involving non-digital tangible personal property is powerful support as well.

All of this is to say that a strong case is made that a data center does not provide a service, that a product is created, and it should be treated in a tax-consistent manner with any other tangible product.

Next up: more details on why hyperscale data centers should be treated as manufacturers or producers involved in the production of a product. Please contact the author if you have questions or comments on this series. You can also visit FBT Gibbons' **Tax Law Defined® Blog** for more insight into the latest developments in federal, state, and local tax planning and tax administration.

Bluegrass, Big Data Series

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- Part 5 — Kentucky's Data Center Tax Incentive: What Hyperscalers Need to Know
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- Part 8 — Kentucky's New Policies on Data Center Incentives Released

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