



Why Data Centers May Qualify for Kentucky's Manufacturing Tax Relief (Part 4)

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Authors:

[Mark F. Sommer](#)

Following up on Part 3 of our series, we address in more detail below why data centers are engaged in manufacturing or industrial processing for purposes of taxation in Kentucky. In our prior post, we examined [whether a product is created](#) through the operations of hyperscale data center; here we address the consequences of this distinction from a state and local tax perspective in Kentucky.

First, sales tax. Under Kentucky sales and use tax law, a manufacturer or industrial processor typically does not incur sales or use tax on purchases of goods and services used in the manufacturing or processing stages. A purchase for resale exemption is generally the way out of sales and use tax on such costs for tangible property used in manufacturing, and similar exemptions may apply in the data center context. A manufacturer or processor can also obtain a material reduction in sales and use tax on energy purchases used in manufacturing or industrial processing. See KRS 139.480(3). With energy, specifically electricity, being such a large input into data center operations, treatment as a manufacturer or industrial processor in Kentucky is a material cost savings, as we saw with [cryptocurrency mining](#) after the legislature enacted House Bill 230.

Additionally, Kentucky allows electing local public-school districts to levy a 3% utility gross receipts license tax for schools on energy purchases. And, consistent with the above, a significant exemption for manufacturers and industrial processors exists. Thus, a collective 9% state and local excise tax on electrical purchases can potentially be mitigated if a data center is treated as a manufacturing or industrial processing operation.

Further, Kentucky's rather antiquated ad valorem tax on tangible personal property can also be mitigated if a data center is treated as a manufacturer or an industrial processor. Specifically, *all local* ad valorem taxes on tangible personal property used in manufacturing

or industrial processing operations are exempted, and a low, \$.15 per \$100 depreciated fair market value applies at the state level. To put this in perspective, a data center *not* treated as a manufacturing or processing facility located in Metro Louisville could face an annual tax burden of \$1.917 per \$100.00, whereas, if treated as a manufacturing or industrial processing facility, the all-in rate would be \$0.15. A factor of nearly 13x, material under any standard.

Case law is spotty over the last 100 years in Kentucky in defining a manufacturing process, but in layman's terms it can be seen as a process beginning with material of little or no market value and ending when that material has been converted into a marketable product for its intended use. In other words, after processing by the involved machinery, equipment or assets, something different, a product that is marketable, results.

Examples of manufacturing or processing demonstrate that what might not be seen as processing at first blush nonetheless qualifies. For instance, a commercial greenhouse has been found to be a processor. And the mixing of raw fertilizer materials into other fertilizers is manufacturing: "When a business operation takes raw materials and combines them to make a viable substance which conforms to the wants and needs of a particular customer the business has, in effect, manufactured something new. Simply because the individual components are not chemically altered does not prevent the process from being labeled 'manufacturing.'"

Based on all, one could conclude that a [hyperscale data center facility](#) should qualify when utilized in the artificial intelligence space, especially when the legislative intent on 21st century [advanced manufacturing discussed in Part 3](#) is considered at face value.

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.

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