



TAXING ARTIFICIAL INTELLIGENCE: WHAT SHOULD POLICYMAKERS CONSIDER?

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Concerns about data centers, accumulation of wealth by AI companies, AI's potential displacement of workers, and apprehension about federal tax revenues **have sparked debate about whether and how AI should be taxed.**

Elena Patel and Aparna Mathur **compare five leading proposals**, examining their objectives, revenue potential, administrative feasibility, and policy trade-offs.

Ultimately, other actions like capital income tax reform, a broad-based consumption tax such as a value-added tax (VAT), a carbon tax, or a corporate cash flow tax **could accomplish many of the same goals as an AI tax** and work better with the existing tax code, or at the very least, complement an AI-specific tax.

Artificial Intelligence (AI) could raise productivity across a wide range of occupations and tasks. But it could also replace workers who currently perform some of those tasks. This is critical for the federal budget because the US tax system relies heavily on income earned by workers. Individual income and payroll taxes that fund Social Security and Medicare generate roughly 85 percent of federal tax receipts. A sustained shift in income from workers to businesses could erode federal revenues amid growing demands for public spending to assist displaced workers.

Creating a tax on AI has emerged as a policy solution to this looming challenge, but it's one with significant drawbacks. **A tax aimed squarely at AI is easier to explain to the public than broad capital income tax reform or a new consumption tax. That advantage is real, but it's an advantage in politics rather than economics.**

Why are policymakers considering taxing AI?

- **Erosion of the tax base.** As AI displaces workers, income and payroll tax revenues will fall immediately, while any tax revenue increases from the profits and capital gains would arrive later, if at all. At the same time, demand will rise for public programs that help displaced workers.
- **AI infrastructure imposes costs on people who don't use it.** Data centers use large amounts of electricity and water, and the costs of AI facilities can fall on surrounding communities: Two-thirds of new data centers built since 2022 are in regions already short on water.
- **AI firms may be investing more than is efficient.** If corporate investment into AI is excessive, a tax that raises its cost could reduce it and improve how capital is allocated, increasing overall economic efficiency.

Concerns driving proposals for AI-specific taxes could be addressed through broader tax reform

- Reforming the taxation of **capital income** could address a shift from labor income to capital income regardless of which industries are responsible.
- A **cash-flow tax** could be designed to replace the corporate income tax with one that falls only on supernormal returns across the economy, rather than isolating a single industry.
- A **carbon tax** would price the environmental cost of AI's infrastructure alongside every other source.
- A **value-added tax (VAT)** would raise revenue from a much broader tax base than an AI-specific tax, while generally avoiding taxes on business inputs.

Comparing Five Common AI Tax Proposals



Proposal	Tax Base	Revenue Timing/Stability	Administrability	Key Considerations	Examples
Training Compute Tax	Computing power used to train models	Early, ahead of profits Long-run base uncertain because of improved training efficiency	Hard Self-measured, self-reported	Early revenue, but relies on self-reported data; could slow AI improvements	"What Is a 'Compute Tax' and Why Is the Idea Gaining Traction?" Wall Street Journal
Data Center Electricity Tax	Electricity consumed (per kWh)	Immediate and ongoing	Easy Utility-metered, independently audited	Can be independently verified, but may be poorly targeted	"Proposal for the Taxation of Data Centers." Senate Finance Committee Democratic Staff White
Usage Tax	AI output per unit	Immediate and ongoing Per-unit revenue erodes as models become more efficient	Moderate Providers meter usage for billing, but using a self-defined measure	Well-targeted base, but taxes AI as a business input and cannot distinguish between productive and wasteful uses	H.R.10044 - AI Tax and Work Protection Act, introduced by Rep. Greg Casar (D-TX)
Windfall Profit Tax	Profit exceeding the normal return	Delayed, variable	Hard Under the current corporate tax, the true base varies by investment	Least distorting design, but revenues are delayed until companies become profitable	S.5518 - Make AI Work for Americans Act, introduced by Sen. Mark Kelly (D-AZ)
Automation Tax	Capital invested in automation, or the tasks it performs	Uncertain Tied to the pace of displacement itself	Hardest Base is undefined	Targeted on displacement, but revenue comes after displacement occurs	"Creating a corporate 'robot' tax," proposed by Sen. Ruben Gallego (D-AZ)

Notes: Analysis in this piece may not precisely reflect the details of examples given here. Examples in this table are only included as a reference for the type of proposals discussed.

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