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February 6, 2025

Via Email

Representative Marvin L. Abney, Chair
Representative Scott A. Slater, First Vice Chair
Representative Alex Marszalkowski, Second Vice Chair
House Committee on Finance
Rhode Island General Assembly

Re: COST Opposes Digital Advertising Gross Revenue Tax in H 5076

Dear Chair Abney, Vice Chair Slater, Vice Chair Marszalkowski, and members of the House Committee on Finance:

On behalf of the Council On State Taxation (COST), I am writing in opposition to the provisions in Article 5, Section 17 of H 5076 that would establish a 10% gross receipts tax on revenues derived from digital advertising services in the State. This proposed Digital Advertising Gross Revenue Tax is a new, controversial, and untested tax and will likely face protracted litigation like Maryland's Digital Advertising Tax (DAT). A DAT would put Rhode Island at a competitive disadvantage with respect to businesses seeking to maintain or expand their operations in the State because the tax is ultimately a gross receipts tax on business inputs and those activities are sufficiently taxed under the State's corporate income tax regime.¹

About COST

COST is a nonprofit trade association based in Washington, DC. COST was formed in 1969 as an advisory committee to the Council of State Chambers of Commerce and today has an independent membership of around 500 major corporations engaged in interstate and international business. COST's objective is to preserve and promote the equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. Many COST members have operations in Rhode Island that would be negatively impacted by this proposal.

COST Opposes Gross Receipts Taxes on Business Inputs

The COST Board of Directors has adopted formal policy statements opposing both gross receipts taxes and other taxes on business inputs. While the position on business inputs primarily concerns states' sales taxes, the same logic also applies to a

¹ Business inputs constitute intermediate, not final, goods and services because companies either resell these goods and services or use the materials, products, machinery, and services to market or produce other goods or services that subsequently are sold to the final consumer.

gross receipts tax on digital advertising services. Two COST policy positions covering business inputs are:

*Gross receipts taxes are widely acknowledged to violate the tax policy principles of transparency, fairness, economic neutrality and competitiveness; generally, such taxes should not be imposed on business.*²

*Imposing sales taxes on business inputs violates several tax policy principles and causes significant economic distortions. Taxing business inputs raises production costs and places businesses within a State at a competitive disadvantage to businesses not burdened by such taxes. Taxes on business inputs, including taxes on services purchased by businesses, must be avoided.*³

A gross receipts tax on digital advertising services focuses on taxing business inputs, not consumer purchases. What is troubling about DAT proposals is that they represent an atypical base expansion that *exclusively* targets business inputs, including digital advertising. Historically, the sales taxation of business inputs occurs less overtly, as both business-to-consumer and business-to-business transactions are included in the sales tax base without an exemption for the business inputs. With DATs, this process is turned upside down with the gross receipts tax imposed exclusively on business inputs.⁴

A DAT's inclusion of business inputs in the gross receipts tax base violates several core tenets of sound tax policy—transparency, economic neutrality, effective tax administration, and fairness.

- *Transparency.* A transparent tax, like the sales tax on consumer purchases, is obvious to the taxpayer, and its economic effects are easily understood. A gross receipts tax on digital advertising services, on the other hand, is a stealth tax that will affect Rhode Island businesses and residents in several unseen ways. The tax will impact residents both as purchasers, by imposing hidden taxes and thus making the products they purchase more expensive, and as workers, by depressing investment and thus reducing wages and employment opportunities.
- *Economic Neutrality.* An economically neutral tax does not influence business choices (of location, of operational entity, of suppliers, etc.). This tax will force companies to either pass their increased costs on to consumers or reduce their economic activity in the State to remain competitive with other companies in other states that do not bear the burden of such taxes.
- *Effective Tax Administration.* Effective tax administration is enabled by taxes that can be easily administered by a state and can facilitate voluntary compliance by all businesses. This entails tax base and sourcing rules that are comprehensible to both tax administrators and taxpayers. This tax is anything but easy to administer. For example, Maryland, the only state to have enacted such a tax on digital advertising services, has

² <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/grossreceiptstaxes.pdf>

³ <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf>

⁴ See generally, Karl A. Frieden and Douglas L. Lindholm, "[State Digital Services Taxes: A Bad Idea Under Any Theory](#)," Tax Notes State, April 10, 2023.

delegated authority to the Comptroller to resolve many fundamental questions on how to comply with and administer the tax, such as the sourcing methodology, determining the appropriate tax rate, and which entities should be subject to the tax. This State's proposed DAT also does not conform to or harmonize with any existing national or uniform state model, leading to additional complexity for taxpayers and the Division of Taxation.

- *Fairness.* A fair tax treats similarly situated taxpayers equally. Instead of having a broad base and low tax rate, the gross receipts tax on digital advertising services is imposed in a punitive manner based on the size of the taxpayer's revenues.

Businesses Subject to the Digital Advertising Tax Are Already Subject to the Corporate Income Tax

In Rhode Island, digital platform companies that do business in the State are already subject to the corporate income tax and there is no rational basis for imposing an additional tax solely on digital businesses. The State's corporate income tax requires mandatory unitary combined reporting using the "Finnigan" method for sales factor representation, effectively giving the State expansive jurisdiction to impose the corporate income tax without requiring a physical presence in the State. As a result, the same businesses subject to this proposed gross receipts tax are already subject to the State's corporate income tax. Rhode Island also imposes a market-based sourcing regime for receipts from services and apportions such receipts using a single-sales factor apportionment formula. Market-based sourcing with a single-sales factor apportions income from services based on where the customer receives the benefits from the service rather than the location of the taxpayer. As a result, Rhode Island's corporate income tax regime sufficiently taxes the same activities that would be subject to this proposed DAT.

Digital Advertising Taxes Potentially Violates Federal Law and the Constitution

Finally, a DAT, if enacted, would be immediately embroiled in protracted litigation. Since the new tax would apply to digital advertising but not to non-digital advertising, the law would likely violate the federal Permanent Internet Tax Freedom Act (ITFA). DATs also raise several constitutional issues, including whether the tax would violate the First Amendment and Commerce Clause.

Given the recent progress to revamp the international corporate tax system, this bill also warrants additional scrutiny for possible violation of the Foreign Commerce Clause. Rhode Island is not permitted to "impair federal uniformity in an area where federal uniformity is essential"⁵ or prevent the United States from "speaking with one voice" in regulating foreign commerce.⁶ The United States' opposition to digital services taxes was affirmed by actions of the U.S. Trade Representative that imposed 25% tariffs on imports from several trading partners that adopted digital services taxes.⁷ The United States, along with nearly 140 other countries, endorsed the

⁵ *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979).

⁶ *Id.* at 451.

⁷ <https://ustr.gov/about-us/policy-offices/press-office/press-releases/2021/june/ustr-announces-and-immediately-suspends-tariffs-section-301-digital-services-taxes-investigations> (the tariffs were suspended "to provide additional time to complete the ongoing multilateral negotiations on international taxation at the OECD and in the G20 process").

key principles of the OECD's Pillar One reforms, one of which requires countries to remove all digital services taxes once the new corporate income tax rules are implemented. Adopting a digital advertising tax in Rhode Island directly runs contrary to the United States' opposition to digital services taxes.

Conclusion

COST opposes all proposals seeking to establish a DAT, including the Digital Advertising Gross Revenue Tax provisions in H 5076 because DATs are taxes on business inputs that violate several key tax policy principles. Advertising services are already subject to Rhode Island's corporate income tax, and the imposition of the new tax would serve as a second or "double" tax on those activities. Lastly, federal law (ITFA) and the U.S. Constitution's Commerce Clause place the legality of this tax in serious doubt, especially given the United States' recent actions to combat foreign-based digital services taxes.

Respectfully,

A handwritten signature in blue ink, reading "Leonore Heavey", enclosed in a thin black rectangular border.

Leonore Heavey
Senior Tax Counsel

CC: COST Board of Directors
Patrick J. Reynolds, COST President and Executive Director