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NetChoice
Protecting Free Speech and Free Enterprise Online

Rhode Island HB 5076

TESTIMONY IN OPPOSITION

February 26, 2025

Rhode Island House of Representatives
House Finance Committee

Dear Chairman Abney and members of the House Finance Committee,

On behalf of NetChoice, a trade association working to make the internet safe for free enterprise and free expression, I write in opposition to the digital ad tax contained within HB 5076, the governor's 2026 budget proposal. NetChoice respectfully asks that you oppose this provision as it would:

1. Violate the First Amendment, Supremacy Clause, and Dormant Commerce Clause of the U.S. Constitution
2. Would drive up costs for thousands of small businesses in Rhode Island and make them less competitive
3. Risk undermining the digital goods and services Rhode Islanders love and use everyday

Rhode Island's Digital Ad Tax is Unconstitutional

Maryland enacted the country's first-of-its-kind digital advertising tax in 2021 and it has been in the courts ever since. Like Maryland's ad tax, Rhode Island's proposal to tax the sales of consumer personal data and digital advertising violate the (1) Supremacy Clause and (2) Dormant Commerce Clause. Rhode Island should abandon this ill-fated provision. Barring that, the State should avoid collecting digital taxes until any law has survived constitutional challenge—otherwise the State will have to return all collected taxes, creating a major headache for the government and lawmakers.

I. Rhode Island's Proposed Digital Ad Tax Violates the 1st Amendment

HB 5076's Section 44-72-2(b) of the proposed legislation provides that companies "may not directly pass on the cost of the tax imposed under this section to a customer who purchases the digital advertising services by means of a separate fee, surcharge, or line-item." This restriction constitutes a content-

based speech regulation because it prohibits companies from communicating specific information about the tax burden to their customers.

II. HB 5076 Fails Strict and Intermediate Scrutiny Tests

As a content-based speech restriction, the pass-through prohibition must satisfy strict scrutiny, requiring the state to prove it is "narrowly tailored to serve compelling state interests."[1] The state cannot meet this exacting standard.

The only apparent purpose for the restriction is to obscure the tax's impact on consumers by preventing businesses from separately identifying the cost—an illegitimate government interest that cannot justify speech restrictions. See Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, 425 U.S. 748, 770 (1976) where the court rejected the state's attempts to keep consumers in the dark about commercial information.

Moreover, the prohibition is neither narrowly tailored nor effective at achieving its purported aims. Companies remain free to simply raise their overall prices to account for the tax burden. The speech restriction thus does nothing to prevent tax pass-through while significantly burdening protected expression about tax policy.

Even when the more lenient intermediate scrutiny standard is applied, HB 5076 cannot hold up. Under this test prohibitions on commercial speech must: (1) advance a substantial government interest; (2) directly advance that interest; and (3) be no more expansive than necessary.[2]

The Sixth Circuit's analysis in BellSouth Telecommunications, Inc. v. Farris is instructive. There, the court struck down Kentucky's prohibition on separately stating a tax charge on customer bills, holding that preventing companies from communicating tax charges violated the First Amendment. 542 F.3d 499, 506 (6th Cir. 2008). The court emphasized that "if the government may not ban speech altogether, it also may not ban corporations from saying who bears the blame for an increased price."

Like the Kentucky law, Rhode Island's pass-through prohibition fails each prong of Central Hudson:

First, the state cannot demonstrate any substantial interest in restricting truthful information about tax costs. Courts have consistently rejected governmental attempts to "keep[] the public in ignorance" as a legitimate basis for speech restrictions. See Va. State Bd. of Pharmacy, 425 U.S. at 770.

Second, the prohibition does not directly advance any legitimate state interest since companies can still pass on tax costs through general price increases. The restriction merely limits consumer access to accurate information about the source of price increases.

Third, the blanket prohibition on separate line items is far more extensive than necessary. Less restrictive alternatives, such as disclosure requirements or formatting rules, could address any legitimate state interests without completely prohibiting tax-related speech.

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[1] Reed v. Town of Gilbert, 576 U.S. 155, 163 (2015)

[2] Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n, 447 U.S. 557, 556 (1980)

III. Alternative Avenues to Speech Won't Save the Provision

The state may argue that companies remain free to discuss the tax through other means besides line items. But the Supreme Court has repeatedly held that "the existence of alternative channels of communication" cannot save an otherwise unconstitutional speech restriction. See Consolidated Edison v. Public Service Commission, 447 U.S. 530, 541 n.10 (1980).

Plus, line-item disclosures represent a uniquely effective means of communicating tax costs to consumers. Prohibiting this form of communication therefore significantly burdens companies' ability to convey truthful information about the impact of state tax policy.

In sum, the pass-through prohibition represents an unconstitutional restriction on protected speech that cannot survive First Amendment scrutiny under either strict or intermediate standards of review. Courts have consistently invalidated similar attempts to restrict tax-related communications, and Rhode Island's prohibition suffers from the same constitutional defects.

Rhode Island's Digital Ad Tax Violates the Internet Tax Freedom Act

Rhode Island's proposed Digital Ad Tax represents a clear violation of the Internet Tax Freedom Act (ITFA), which Congress made permanent in 2016. ITFA explicitly prohibits states from imposing "multiple or discriminatory taxes on electronic commerce." 47 U.S.C. § 151 note § 1101(a)(2). The proposed legislation violates ITFA in at least three distinct ways.

I. The Tax Discriminates Against Electronic Commerce

First, the Digital Ad Tax is facially discriminatory under ITFA's definition. A state tax is discriminatory when it "is not generally imposed and legally collectible by such State...on transactions involving similar property, goods, services, or information accomplished through other means." Id. § 1105(2)(A)(i).

The proposed tax applies exclusively to "advertisement services on a digital interface," defined to include "banner advertising, search engine advertising, interstitial advertising, and other comparable advertising services." Yet it completely exempts non-digital advertising through traditional media channels like print, television, radio, and billboards. This disparity in treatment between digital and non-digital advertising is precisely what ITFA aims to prevent.

Courts have struck down similar discriminatory state taxes. In *Performance Marketing Association v. Hamer*, the Illinois Supreme Court invalidated a tax on online performance marketing because it did not apply to print performance marketing. 998 N.E.2d 54, 59-60 (Ill. 2013). The court found this differential treatment was "expressly preempted by the ITFA" since it discriminated against electronic commerce. Id. Rhode Island's Digital Ad Tax suffers from the same fatal defect by targeting only online advertising while leaving traditional advertising untaxed.

II. The Tax Creates the Risk of Multiple Taxation

Second, the Digital Ad Tax violates ITFA's prohibition on "multiple" taxation of electronic commerce. ITFA defines a multiple tax as one imposed by a state "on the same or essentially the same electronic commerce" that is also "subject to a tax imposed by another State..." without a credit for taxes paid. 47 U.S.C. § 151 note § 1105(6)(A).

The legislation's vague sourcing provisions, which merely reference "the ratio of devices in Rhode Island that access advertising to total devices that access advertising," create a significant risk of multiple taxation. With Maryland having enacted a similar digital ad tax and other states considering comparable legislation, many digital advertising transactions could be subject to taxation by multiple states without any credit provisions. This is exactly the type of duplicative taxation that ITFA prohibits.

III. The Tax Falls Within ITFA's Definition of Electronic Commerce

Third, the Digital Ad Tax clearly falls within ITFA's broad definition of taxes on "electronic commerce." ITFA defines electronic commerce to include "any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer, or delivery of property, goods, services, or information, whether or not for consideration." Id. § 1105(3).

The legislation explicitly targets advertising services delivered through "digital interfaces" including websites and applications accessed over the internet. These digital advertising services constitute "transactions conducted over the Internet" involving the "sale" and "delivery" of advertising services. The tax therefore squarely qualifies as a tax on electronic commerce subject to ITFA's restrictions.

Given these multiple violations of ITFA's core provisions, the Digital Ad Tax would likely be preempted and struck down by courts if enacted. The U.S. Supreme Court has repeatedly emphasized that ITFA establishes a clear federal prohibition on discriminatory state taxation of electronic commerce that states cannot circumvent. The Rhode Island legislation's targeted taxation of digital advertising, while exempting traditional advertising, represents exactly the type of discriminatory treatment that Congress aimed to prevent through ITFA.

The Digital Ad Tax Violates the Commerce Clause

The proposed Digital Ad Tax violates several fundamental principles under the dormant Commerce Clause doctrine, which prohibits states from unduly burdening or discriminating against interstate commerce. The Supreme Court has established that state taxes must satisfy four criteria under Complete Auto Transit v. Brady: they must "(1) apply to an activity with a substantial nexus with the taxing State, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the State." 430 U.S. 274, 279 (1977). Rhode Island's proposed tax fails on multiple fronts.

I. Lack of Substantial Nexus

First, the legislation fails to establish the "substantial nexus" with Rhode Island required under *Complete Auto* and refined in *South Dakota v. Wayfair*, 138 S. Ct. 2080 (2018). While *Wayfair* eliminated the physical presence requirement, it still demands that state taxes have a sufficient connection to in-state activity.

The bill's vague sourcing provision, which bases nexus merely on "the ratio of devices in Rhode Island that access advertising to total devices that access advertising," falls short of this constitutional requirement. The provision fails to account for whether advertisers specifically target Rhode Island consumers or derive meaningful economic benefit from the state. This nebulous device-based standard could sweep in advertising activity that has only incidental connection to Rhode Island, violating the substantial nexus requirement.

What's more, by applying the tax based on global annual revenues exceeding $1 billion, the legislation seeks to tax activity occurring wholly outside Rhode Island's borders. As the Supreme Court emphasized in *BMW of North America v. Gore*, states cannot "impose economic sanctions on violators of its laws with the intent of changing ... lawful conduct in other States." 517 U.S. 559, 572 (1996). The bill's reliance on global revenue thresholds represents a similar impermissible attempt at extraterritorial regulation.

II. Unfair Apportionment and Risk of Multiple Taxation

Second, the Digital Ad Tax violates the Commerce Clause's "fair apportionment" requirement by failing to fairly allocate the tax burden between states and creating an unconstitutional risk of multiple taxation. A tax must be both internally and externally consistent to satisfy this requirement. Container Corp. of America v. Franchise Tax Board, 463 U.S. 159, 169 (1983).

The legislation fails the internal consistency test because if every state adopted an identical tax, digital advertising services would be subject to multiple taxation without any credit provisions. The bill's device-based sourcing could allow multiple states to claim tax jurisdiction over the same advertising revenue streams. This risk is not hypothetical—Maryland has already enacted a similar digital ad tax, and other states are considering comparable legislation.

The tax also fails the external consistency test because its apportionment formula bears no "rational relationship between the income attributed to the State and the intrastate values of the enterprise." Id. The device-based ratio provides no assurance that the tax burden will align with actual economic activity in Rhode Island.

III. Discrimination Against Interstate Commerce

Third, the Digital Ad Tax impermissibly discriminates against interstate commerce in both its practical effect and design. By applying only to companies with global annual revenues exceeding $1 billion, the

legislation effectively targets large out-of-state and international companies while exempting local Rhode Island businesses. The Supreme Court has consistently struck down such discriminatory tax schemes that "tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the State." Armco Inc. v. Hardesty, 467 U.S. 638, 642 (1984).

The bill's structure reveals its discriminatory intent. The $1 billion global revenue threshold ensures the tax burden falls disproportionately on out-of-state companies engaged in interstate commerce. But smaller in-state companies providing similar digital advertising services are completely exempt. This sort of economic protectionism is precisely what the dormant Commerce Clause prohibits. See Granholm v. Heald, 544 U.S. 460, 472 (2005).

IV. Lack of Fair Relationship to State Services

Finally, the Digital Ad Tax fails the fourth prong of *Complete Auto* because the tax burden is not "fairly related to the services provided by the State." 430 U.S. at 279. The legislation makes no attempt to connect the tax revenue to any specific state services provided to digital advertisers. Instead, it is designed simply to extract revenue from out-of-state companies based on their participation in interstate commerce.

The Supreme Court has emphasized that state taxes must maintain "a connection to the State's provision of facilities or services." Commonwealth Edison Co. v. Montana, 453 U.S. 609, 626 (1981). Here, the tax rate escalates based purely on global revenues rather than any measure of state services used. This disconnect further demonstrates the tax's constitutional deficiencies.

In sum, the Digital Ad Tax violates multiple core Commerce Clause principles established by decades of Supreme Court precedent. Its vague nexus standards, unfair apportionment, discrimination against interstate commerce, and lack of connection to state services render it highly vulnerable to constitutional challenge.

The Tax Will Hit Consumers and Small Businesses Hardest

Beyond the constitutional questions raised by the digital ad tax provision is the more fundamental one: who has to pay this tax? While it is often marketed as a tax on the largest online advertisers, the reality is that the cost of a digital ad tax is borne by consumers and small businesses. The provision itself makes this clear.

As stated above, HB 5076 maintains that companies "may not directly pass on the cost of the tax imposed under this section to a customer who purchases the digital advertising services by means of a separate fee, surcharge, or line-item." That is to say companies may not *communicate* to their customers the source of increased costs. Businesses then are expected to raise costs on their customers–and suffer the related reputational harm–in silence.

The existence of the particular provision underscores the author's understanding that costs will roll downhill to the little guys. Small businesses that utilize advertising services to compete on a national and global scale will pay this tax. Consumers who want to support their friends, neighbors, and community institutions will pay this tax. No Rhode Islander benefits when prices increase, workers are laid off, and businesses shutter. The internet is a major source of opportunity for thousands of Rhode Islanders. Don't undercut that opportunity with an unconstitutional and ill considered tax.

Again, we respectfully ask for you to oppose the digital ad tax provision of the Governor's proposed budget. As always we offer ourselves as a resource to discuss any of these issues with you in further detail, and we appreciate the opportunity to provide the committee with our thoughts on this important matter.

Sincerely,

Zachary Lilly
Deputy Director of State and Federal Affairs, NetChoice[3]

NetChoice is a trade association that works to protect free expression and promote free enterprise online.

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[3] The views of NetChoice expressed here do not necessarily represent the views of NetChoice members.