COST
COUNCIL ON STATE TAXATION

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May 26, 2026

Via Email

Senator Louis P. DiPalma, Chair
Senator Frank A. Ciccone, III, First Vice Chair
Senator Walter S. Felag Jr., Second Vice Chair
Senate Committee on Finance
Rhode Island General Assembly

Re: COST Opposes Senate Bill 2028 – Tax on Digital Advertising Services

Dear Chair DiPalma, Vice Chairs Ciccone and Felag, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I urge you to oppose Senate Bill 2028 that imposes a "sales" tax on digital advertising services sold in Rhode Island. This bill raises several concerns: the imposition of a tax on digital advertising services that is purchased almost exclusively by businesses as a business input violates several principles of sound tax policy; the tax likely violates the Permanent Internet Tax Freedom Act (ITFA) virtually assuring protracted litigation and uncertain revenues; and the tax will be extremely difficult to administer both for taxpayers and the Division of Taxation.

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 more than 450 major corporations engaged in interstate and international business. COST's mission 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.

Taxes on Business Inputs Violate Sound Tax Policy Principles

The COST Board of Directors has adopted a formal policy position opposing the imposition of sales taxation on business inputs[1]. That policy position provides:

> *Imposing sales taxes on business inputs violates several tax policy principles and*

[1] See https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-ofbusiness-inputs.pdf.

> *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.*

Imposing sales tax on business inputs, including this unique tax on digital advertising services, violates the key tax policy principles of neutrality, equity, simplicity, and transparency, as well as causing economic distortion. This distortion results primarily from tax pyramiding. Pyramiding occurs when a tax is imposed at multiple levels and thereby imposes a hidden effective tax rate that exceeds the retail sales tax rate. The hidden rate creates a lack of transparency for both the consumer and the legislature. Tax pyramiding forces companies to either pass these increased costs on to consumers or reduce their economic activity in the State to remain competitive with other service providers that do not bear the burden of increased taxes. The economic burden of taxes on business inputs inevitably shifts to consumers through higher prices or to labor in the State through lower wages and fewer jobs. To put it simply, although this tax is a direct tax on businesses, the vast majority of the tax will be passed along to Rhode Island citizens through higher prices and/or stagnating wages.

Taxes on Digital Advertising Are Legally Suspect

The proposed tax on digital advertising services in S.B. 2028 raises serious legal concerns and will undoubtedly become embroiled in expensive and protracted litigation, putting at risk any revenue raised by the tax. Rhode Island will find itself in the same position as Maryland and Washington where the collection of digital advertising services taxes has stalled due to ongoing litigation. The imposition of taxes on advertising services that differentiate between digital and non-digital services, like the proposal in S.B. 2028, likely violates ITFA and raises serious Due Process and Commerce Clause concerns under the U.S. Constitution.

The Proposed Tax Is Administratively Burdensome

The COST Board of Directors has adopted a formal policy statement urging states to impose fair, efficient, and customer-focused tax administration. COST's policy position is as follows:

> *Fair, efficient and customer-focused tax administration is critical to the effectiveness of our voluntary system of tax compliance. A burdensome, unfair, or otherwise biased administrative system negatively impacts tax compliance and hinders economic competitiveness.*[2]

The proposed tax in S.B. 2028 is in direct opposition to fair and efficient tax administration, because it is a burdensome tax that will require most taxpayers to initiate extensive system changes to collect and remit the proposed tax within the sales tax system. The service providers implicated in S.B. 2028 do not currently collect and remit tax on these services and will be required to register for a "sales" tax account and expend significant IT resources to accommodate the tax. S.B. 2028 leaves many questions about the administration of the tax unanswered. As just

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[2] See https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/fair-efficient-and-customer-focused-tax-administration---revised-feb-2024---final.pdf

one example, how will the "retailer" know the global revenues of their customer in order to apply the correct rate? The numerous additional administrative issues, such as the many undefined terms that will require taxpayers to guess which transactions and which parties are subject to the tax, are unconscionable, particularly when taxpayers that fail to collect the proper amount of tax will be liable for any taxes they failed to collect.

Conclusion

COST opposes the proposed tax on digital advertising services. S.B. 2028 introduces a novel and legally questionable tax that violates several key principles of sound tax policy. The tax runs afoul of the U.S. Constitution and federal law and will ultimately harm Rhode Island businesses and consumers. For these reasons, we strongly urge this committee not to advance S.B. 2028.

Respectfully,

Leonore F. Heavey

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cc: COST Board of Directors
Patrick J. Reynolds, COST President & Executive Director