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September 11, 2023

The Honorable Susan L. Moran, Senate Chair  
The Honorable Mark Cusack, House Chair  
The Honorable Michael D. Brady, Senate Vice Chair  
The Honorable David Paul Linsky, House Vice Chair  
Massachusetts Joint Committee on Revenue

**Re: COST's Opposition to Digital Advertising Tax Proposals (H. 2787, H. 2821, H. 2828, H. 2930, H. 2966, and S. 1846)**

Dear Chairs Moran and Cusack, Vice Chairs Brady and Linsky, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing in opposition to digital advertising tax proposals: H. 2787, H. 2821, H. 2828, H. 2930, H. 2966, and S. 1846, which would study the feasibility of or establish a new, controversial, and untested gross receipts tax on revenues derived from digital advertising services in the Commonwealth. Such a tax would put Massachusetts at a competitive disadvantage with respect to encouraging businesses to maintain or expand operations in the Commonwealth because this tax is ultimately a tax on business inputs.<sup>1</sup>

Similar taxes at the international level have already garnered strong negative reaction, including threats of retaliation from the U.S. Treasury and punitive tariffs by the U.S. Trade Representative. Indeed, a recent global tax agreement brokered by the OECD/G20 nations includes a requirement that all existing national-level digital services taxes be withdrawn. Moreover, Massachusetts is unlike the countries that have adopted or proposed similar types of taxes because these activities are already sufficiently taxed under the Commonwealth's corporate excise tax regime.<sup>2</sup> An additional tax is not warranted.

The tax could also violate the Permanent Internet Tax Freedom Act and several provisions of the U.S. Constitution.

### 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 over 500 major corporations engaged in interstate

<sup>1</sup> 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 households.

<sup>2</sup> See Karl A. Frieden and Stephanie T. Do, "[State Adoption of European DSTs: Misguided and Unnecessary](#)," Tax Notes State, May 10, 2021, p. 577.

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 Massachusetts that would be negatively impacted by these proposals.

### **COST Opposes Gross Receipts Taxes on Business Inputs**

The COST Board of Directors has adopted a formal policy statement opposing both gross receipts taxes and sales taxes on business inputs. While the position on business inputs primarily concerns states' sales taxes, its logic also applies to a gross receipts tax on digital advertising services. COST's policy positions 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.*<sup>3</sup>

*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.*<sup>4</sup>

The imposition of a gross receipts tax on digital advertising services is focused on taxing business inputs, not consumer purchases. What is different and troubling about digital advertising tax proposals (DATs) is that they represent an atypical base expansion that *exclusively* targets business inputs, including digital advertising and other digital infrastructure receipts. 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 or their sales tax equivalents, this process is turned upside down by adding only business purchases to the gross receipts or sales tax base.<sup>5</sup>

This disproportionate taxation of business inputs 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 Massachusetts businesses and residents in several unseen ways. The tax will impact residents 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

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<sup>3</sup> <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/grossreceiptstaxes.pdf>

<sup>4</sup> <https://www.cost.org/globalassets/cost/state-tax-resources-pdf-pages/cost-policy-positions/sales-taxation-of-business-inputs.pdf>

<sup>5</sup> 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.

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 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 who should be subject to the tax. This tax also does not conform to or harmonize with any existing national or uniform state model, leading to additional complexity for taxpayers and the Department of Revenue.
- *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 Excise Tax**

It is important to note the origins of this proposal. State consideration of a gross receipts tax on digital advertising services is generally designed to replicate the French Digital Services Tax and other national-level digital advertising services taxes, which have been widely condemned by both the U.S. government and businesses operating in global markets. These national-level digital advertising services taxes have been adopted or considered as a temporary fix to a problem that does not exist at the state level in the United States. Under the current international tax system, physical presence standards (*i.e.*, permanent establishment rules), and income producing activity sourcing methodologies largely preclude the taxation of many digital businesses under the corporate income tax.

As a result, these national digital services taxes serve as a temporary stopgap measure until more fundamental reform is implemented by the Organisation for Economic Co-operation and Development's (OECD) Pillar One project to address digital business models. The OECD Pillar One reforms to national corporate income taxes would apply new economic nexus and market-based sourcing rules to at least a portion of the income of the world's largest businesses.<sup>6</sup>

In Massachusetts, digital platform companies that do business in the State are already subject to the Commonwealth's corporate excise tax and there is no rational basis for imposing an additional discriminatory tax solely on digital businesses. The corporate excise tax requires mandatory unitary combined reporting and applies an economic nexus standard if a company's Massachusetts sales exceeds \$500,000 for the taxable year. The economic nexus standard gives the Commonwealth expansive jurisdiction to impose the corporate excise tax without requiring a physical presence in the Commonwealth. As a result, the same businesses that would be subject to a new gross receipts tax are also subject to the corporate excise tax, if they meet the \$500,000 threshold. Massachusetts also imposes a market-based sourcing regime for receipts from services and generally apportions such receipts using an apportionment factor that is heavily weighted toward the market through its double-weighted sales factor. Market-based sourcing seeks to tax income based on where the customer receives the benefits from the service rather than the

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<sup>6</sup> The goal of the OECD's Pillar One is to reach a global agreement to change the allocation of taxing rights on business profits to expand the taxing rights of market/user jurisdictions.

location of the taxpayer. Under the double-weighted sales factor, the physical location of a taxpayer's business now has less impact on how receipts are apportioned to the State. As a result, Massachusetts' corporate excise tax regime sufficiently taxes the same activities that would be subject to a digital advertising tax as proposed in these bills.<sup>7</sup>

### **Digital Advertising Taxes Potentially Violates Federal Law and the Constitution**

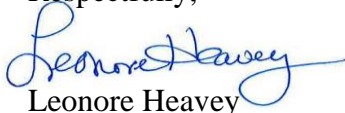
Finally, a digital advertising tax, if enacted, would be immediately embroiled in protracted litigation. Since the new tax would apply to digital advertising but not to non-digital advertising, the law would likely violate the federal Permanent Internet Tax Freedom Act. These bills, depending on how they are drafted, 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, these bills also warrant additional scrutiny for possible violation of the Foreign Commerce Clause. Massachusetts is not allowed to "impair federal uniformity in an area where federal uniformity is essential"<sup>8</sup> or prevent the United States from "speaking with one voice" in regulating foreign commerce.<sup>9</sup> 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.<sup>10</sup> The United States, along with nearly 140 other countries, endorsed the 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 Massachusetts directly runs contrary to the United States' uniform opposition to digital services taxes.

### **Conclusion**

COST respectfully opposes all proposals seeking to establish a DAT. A DAT is really a disguised tax on business inputs that violates several key tax policy principles. These activities are also already subject to Massachusetts' corporate excise tax, and the imposition of the tax would serve as a second or "double" tax on those activities. Lastly, the constitutionality of this tax is in serious doubt, especially given the United States' recent actions to combat digital services taxes.

Respectfully,

  
Leonore Heavey

cc: COST Board of Directors  
Douglas L. Lindholm, COST President & Executive Director

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<sup>7</sup> In the last few years, proponents have raised other justifications for DATs, including a consumption "gap" theory and models based on a severance tax, a regulatory tax, and an excess profits tax. For a critical analysis of these alternative rationales, see generally Frieden and Lindholm, *supra* note 5.

<sup>8</sup> *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 448 (1979).

<sup>9</sup> *Id.* at 451.

<sup>10</sup> <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").