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April 25, 2024

Assembly Member Jacqui Irwin, Chair
Assembly Member Tri Ta, Vice Chair
Assembly Committee on Revenue and Taxation
California State Legislature

Via Position Letter Portal

Re: COST Opposes A.B. 2829, Creating New Digital Advertising Services Tax

Dear Chair Irwin, Vice Chair Ta, and Members of the Committee:

On behalf of the Council On State Taxation (COST), I am writing to express opposition to A.B. 2829, which would create a new digital advertising services tax. Governor Newsom has been steadfast in his commitment to not create any broad-based tax increases.¹ This bill, however, is in direct contravention with the Governor's stance. Assembly Bill 2829 establishes a new, controversial, and untested gross receipts tax on revenues derived from digital advertising services in California. Such a tax would put California at a competitive disadvantage because this tax is ultimately a tax on business inputs.² On its face, the bill appears to be a targeted tax with the negative impact limited to a few technology companies. Unfortunately, the legislation will force impacted companies to pass through the increased costs from this new tax on to consumers and will place California at a competitive disadvantage with respect to encouraging businesses to maintain or expand operations in California.

Assembly Bill 2829, which largely mirrors Maryland's novel digital advertising gross revenues tax, also violates federal law and several provisions of the U.S. Constitution. If this bill is enacted, it will be embroiled in protracted litigation like Maryland's digital advertising gross revenues tax, which is still ongoing.

These activities are also already sufficiently taxed under the State's corporate income tax regime.³ An additional tax is not warranted.

¹ See Governor Gavin Newsom, "[Proposed Budget Summary, Governor's Message](#)," 2024-25 Governor's Budget, January 10, 2024.

² 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 produce other goods or services that subsequently are sold to households. See Karl A. Frieden and Douglas L. Lindholm, "[State Digital Services Taxes: A Bad Idea Under Any Theory](#)," April 10 2023, p. 89 (discussion of how digital services taxes add to the pyramiding of sales and gross receipts taxes).

³ See Karl A. Frieden and Stephanie T. Do, "[State Adoption of European DSTs: Misguided and Unnecessary](#)," Tax Notes State, May 10, 2021, p. 577.

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 approximately 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 California that would be negatively impacted by this legislation.

Negative Impact to California Businesses and Consumers

The proposed digital advertising services tax is a gross receipts tax on business inputs. The COST Board of Directors has adopted formal policy statements opposing both gross receipts taxes and sales taxes on business inputs. While the position on business inputs primarily concerns the states' sales taxes, its logic also applies to the proposed digital advertising services tax, which is a gross receipts tax on business inputs. 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.⁴

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.⁵

The imposition of the proposed digital advertising services tax is primarily focused on taxing business inputs, not consumer purchases. 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. The proposed digital advertising services tax, on the other hand, is a stealth tax that will affect California 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

⁴ COST, "[Gross Receipts Taxes, Policy Position](#)" (last visited April 17, 2024).

⁵ COST, "[Sales Taxation of Business Inputs, Policy Position](#)" (last visited April 17, 2024).

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 proposal is anything but easy to administer. As an untested and novel tax, companies will have to adopt sophisticated accounting and recordkeeping systems to evaluate transactions on a continuous basis. The bill also delegates authority to the California Department of Tax and Fee Administration (CDTFA) to resolve many fundamental questions on how to comply with and administer the tax, such as the sourcing methodology, which likely renders it impossible to determine when a digital advertising service would be taxable in California. This proposal also does not conform to or harmonize with any prior national or uniform state model, leading to additional complexity for taxpayers and the CDTFA.
- *Fairness.* A fair tax treats similarly situated taxpayers equally. Instead of having a broad base and low tax rate, the proposed digital advertising services tax is imposed in a punitive manner based on those providers exceeding \$100 million in global annual gross revenues, including revenue unrelated to digital advertising services.

Violates Federal Law and the U.S. Constitution

The proposed digital advertising services tax would be immediately embroiled in protracted litigation. Since the proposal would apply to digital advertising but not to non-digital advertising, the law would likely violate the federal Internet Tax Freedom Act (ITFA). ITFA, which was first enacted in 1998 and subsequently extended until made permanent in 2016, preempts state and local governments from levying multiple and discriminatory taxes on electronic commerce.⁶ This proposed tax specifically singles out (discriminates against) digital advertising without similarly applying to traditional forms of advertising. The bill also raises valid threats of constitutional challenges, including whether the tax would violate the First Amendment, Equal Protection Clause, and Commerce Clause.

The legality of such a tax under ITFA and the U.S. Constitution is already mired in litigation challenging Maryland's digital advertising gross revenues tax.⁷ California would face similar controversy and judicial review should this bill be enacted. And California would bear the costs to litigate this proposal without generating the anticipated revenue because the proposal likely violates ITFA and the U.S. Constitution.

Businesses Subject to the Digital Advertising Services Tax Are Already Subject to the State's Corporate Income Tax

⁶ Public Law 114-125, § 922(a).

⁷ See Michael Bologna, "[Apple, Peacock Battle for Top Position in Maryland Ad Tax Fight](#)," Bloomberg Daily Tax Report, February 13, 2024 (discussing the ongoing litigation in state court); Sanjay Talwani, "[Md. Digital Ad Tax Rule Illegally Bars Speech, Chamber Says](#)," Law360, April 10, 2024 (discussing the ongoing litigation in federal court).

Businesses which would be subject to this new tax under A.B. 2829 are already subject to the State's corporate income tax on their net income. California's corporate income tax requires mandatory unitary combined reporting, and it is imposed on the privilege of exercising corporate franchises within the State. This imposition threshold gives the State expansive jurisdiction to impose its corporate income tax without requiring a physical presence in the State. As a result, the same businesses that would be subject to the proposed digital advertising services tax are also subject to the State's corporate income tax. California also imposes a market-based sourcing regime for receipts from services, and apportions such receipts using a single-sales factor formula. Market-based sourcing seeks to tax a receipt based on where the customer receives the benefits from the service rather than the location of the taxpayer. To the extent a business collects digital advertising revenue from California customers, that income is already sourced to California for corporate income tax purposes under the State's market-based sourcing rules. Under the single-sales factor apportionment formula, the physical location of a corporation's business now has minimal effect on how receipts are apportioned to the State. As a result, California's corporate income tax regime sufficiently taxes the same activities that would be subject to the proposed digital advertising tax.

Conclusion

COST continues to agree with the California Taxpayers Association (CalTax), the Association of National Advertisers (ANA), and others who argue that the proposed digital advertising services tax should be rejected. We respectfully oppose A.B. 2829 as it is a direct tax on business inputs that violates several key tax policy principles and violates federal law and the U.S. Constitution. Digital advertising activities are also already subject to California's corporate income tax, which would result in the proposed digital advertising tax serving as a second or "double" tax.

Respectfully,



Stephanie T. Do

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